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Malawi: Report on the Observance of Standards and Codes—Fiscal Transparency Module—Update

This update to the Report on the Observance of Standards and Codes on Fiscal Transparency Module for Malawi was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on February 12, 2007. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of the Malawi or the Executive Board of the IMF.

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MALAWI

Report on the Observance of Standards and Codes
Fiscal Transparency Module: An Update

February 9, 2007

I. Introduction

1. This document updates the original fiscal ROSC for Malawi, which was issued in August 2002.[1] That document reported that despite improvements in fiscal transparency in certain areas (such as the budget classification system and the introduction of a medium term expenditure framework), these developments were not applied consistently across the different areas of fiscal management and insufficient attention was given to data quality. The report thus concluded that further work were required to broaden and deepen the level of fiscal transparency and provided a number of specific recommendations for improvement.

2. This update reviews developments in each of the areas for improvement identified by the 2002 report, assesses to what extent the earlier recommendations have been met and briefly discusses where further improvements are warranted. It is based on material provided by the authorities during the 2006 Article IV mission to Malawi (October 24–November 7, 2006). *Unless indicated differently below, the recommendations made in the 2002 ROSC remain relevant.*

II. Developments Since Original ROSC

3. The original ROSC highlighted a number of concerns and listed several areas for improvement, each of which will be discussed separately below.

4. **The legislative framework for fiscal transparency has been substantially revised and improved**. Given the revision in 2003 of the former Public Finance and Audit Act (implemented through three separate legislations: The Public Procurement Act, The Public Audit Act and the Public Finance Management Act), Malawi now meets good international practice in this area. The *Public Finance Management Act* (PFMA) forms the regulatory framework for public financial management (PFM). It specifies the responsibilities and requirements of government, including reporting on fiscal policy and budgetary issues and the responsibilities of the Minister of Finance, together with the powers he may delegate to senior officials. The Act also defines the responsibilities of the Secretary to the Treasury as

[1] The fiscal ROSC is available as country report No. 02/177 at http://www.imf.org/external/pubs.

well as those of the Controlling Officers, who are appointed by the President to be the Head of a Ministry or Department and are responsible for the collection, receipt and disbursement of public money. Importantly, paragraph 38 of the PFMA was amended in August 2006 so as to limit the discretionary powers of the Minister for Finance to grant tax concessions in situations of natural disaster or calamity.

The Public Procurement Act established the office of the Director of Public Procurement, who is responsible for regulating and monitoring public procurement arrangements throughout Malawi. It also enables the setting up of internal procurement committees, as well as specialized public procurement units within each Ministry, Department or Agency (MDA). The Act describes the rules for and methods of public procurement, which are to be applied, as well as setting out the main principles and procedures for the different types of procurement available to the MDA's. Finally, it identifies the tenderer's right to request a review, as well as the need to undertake an audit of procurement activities and the production of an annual report by the Director to the Minister of Finance.

5. **Fiscal information to Parliament is now more elaborate**. Guided by the requirements of the PFMA, the Ministry of Finance—besides the standard budget documentation—now reports to Parliament on the mid year fiscal performance through the mid year Fiscal Update and Economic Report (available by April 11th at the latest, i.e. with a three months lag). In accordance with paragraph 14 of the PFMA the Ministry of Finance also produces and publishes an annual Economic and Fiscal Policy Statement, which informs the public and the Parliament about fiscal policy priorities over the short- to medium term. This publication is submitted to Parliament on April 11th each year, two months before the budget estimates are presented. The audited annual fiscal accounts, however, are still provided to Parliament and the public with long delays, apparently primarily due to capacity constraints in the office of the Auditor General (paragraph 83 of the PFMA stipulates that these reports are made available to the Secretary to the Treasury no later than six months from the end of the financial year to which they relate, but this timeline is rarely met).

6. **Improvements have also been made to the budget preparation process**. Following the PFMA, the Ministry of Finance has issued new treasury and desk instructions which imply more transparency from the time budget requests are formulated by the MDAs to the time the consolidated estimates are presented to Parliament (e.g., by issuing a detailed budget calendar and providing guidelines to MDAs in terms of budget formats and spreadsheets). The Minister for Finance has also engaged more actively in dialogue with private sector participants and other stakeholders on the direction of fiscal policy ahead of the budget presentations over the past two years. However, these changes notwithstanding, the budget preparation process is suffering from several shortcomings, both technically and in terms of policy formulation. Efforts are currently being undertaken to improve budget classification and the chart of accounts to *Government Finance Statistics* (GFS) standards, to simplify budget documentation and—in due course—apply the budget planning module of the

Integrated Financial Management Information System (IFMIS, see below). Authorities are also seeking to develop better tools for simulation of fiscal policy changes.

7. **The quality of fiscal data is improving with the implementation of an integrated financial management information system (IFMIS), but coverage is incomplete.** Only funding data for the central government operations are consistently available on a reliable, monthly basis.[2] However, with the successful introduction of the IFMIS (beginning in Fall 2005 on a pilot basis and evolving steadily through 2006 to cover most central government operations) significant improvements can be expected in this area over the coming years.[3] IFMIS records funding, commitment and payments for each MDA, thus ensuring that expenditures are within budgetary limits.[4] Standard monthly reporting tools on these fiscal data are being developed and are expected to be deployed within the current fiscal year. The data quality will be further enhanced once the transformation to GFS2001 standards for central government has been achieved (currently targeted for FY2007/08). However, shortcomings in the quality of data is expected to remain for some time, in particular, in the area of local governments (district assemblies, town assemblies and municipalities), subvented organizations and foreign financed development expenditures, which are not yet covered by IFMIS.

8. **Critical weaknesses in fiscal data quality remain.** There are continuous problems with payroll data which, despite efforts over the past year (including the implementation of a new human resource management system), have not yet been fully resolved. These relate to the capturing of the correct establishment as well as movements in and out of the civil service, promotions and relocations. The management of the payroll is also hampered by the lack of an interface with IFMIS. Furthermore, there is virtually no capacity for internal or external audit of the IFMIS, implying that the system is prone to errors (which are likely to occur regularly as a substantial part of the data is entered manually). Finally, there is a fiscal data quality issue related to arrears. The auditor general prepared an audited stock of accumulated arrears by June 2004, but no audited accounts of arrears have been produced since and even the June 2004 exercise has been subject to criticism for not properly

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[2] The funding reporting has improved since 2004, though, e.g., by the elimination of the special treasury funds in 2004.

[3] A 2006 FAD technical assistance mission to review the IFMIS implementation concluded that, although there are some caveats, "the IFMIS is currently working effectively as a budget expenditure control system" (Olden, Ramachandran and Maclean, "Republic of Malawi: Assessment of Integrated Financial Management Information System Implementation," October 2006). Expenditure control was also enhanced by the replacement in 2005 of individual private bank accounts for each MDA with a centralized payment system.

[4] The coverage of the IFMIS is not yet complete, however. A number of general government units still need to be included in the IFMIS system before it offers a comprehensive set of accounts, including local government, development expenditures, debt-related transactions and subvented organizations.

measuring the arrears (e.g., by not taking into account interest accumulation). If the government decides to go ahead with securitization of some of the larger arrears, as is currently being considered, there will need to be another round of verification before the arrears can be securitized.

9. Malawi does not have an elaborate privatization program. In Spring 2006, the telecommunications company, MTL, was sold to foreign investors at a price of about US$31 million, representing the largest privatization ever in Malawi. But no other state owned enterprises are currently being considered for privatization, largely due to an alleged lack of investor interest. The Privatization Act of 1996 stipulates the legal framework for privatizations, including audit and reporting requirements and procedures as well as regulations for the use of privatization proceeds. These regulations seem to broadly meet good international standards, although it is noted that the Privatization Commission (the autonomous government body responsible for privatizations) is obliged to formally report to the Minister on its activities only once a year (within six months after the end of the fiscal year). No formal account of the MTL transaction has been released as of January 2007 and information to the public has been sparse.

10. **Fiscal transparency of local government remains weak**. The assemblies and municipalities are currently outside of the IFMIS and, moreover, use a different chart of accounts than the central government.[5] Monthly funding data are available for each assembly, but no proper expenditure and revenue accounts are produced, and end-year account are only produced with major delays. In this context, the consolidation of local government budget execution data with those of central government to produce general government reports is crucial for improving the transparency and accountability of government operations. This consolidation cannot be expected to take place until the IFMIS is rolled out to cover the entire general government (which in current plans is projected for FY2007/08, a relatively tight timeline that might not be achievable).

11. **The financial positions of state owned enterprises (SOE's) are still uncertain**. The SOE's are governed by the PFMA and the general legislation for private enterprises. They are required to report their financial statements to the Ministry of Finance on a quarterly basis and the Ministry compiles an annual account of their financial statements (which is published as part of the Annual Economic Report). These accounts are not audited by external auditors, however, and are not subject to GAAP requirements (Generally Accepted Accounting Practice). Consolidated accounts for the SOE's are expected to be prepared starting FY2007/08 (but will only be published after the end of that fiscal year). The SOE's do not, in principle, undertake quasi-fiscal activities, although it is difficult to assess to what extent electricity tariffs are meeting cost recovery standards or whether the borrowing of

[5] Local government in Malawi consists of 26 district assemblies, 7 town assemblies, and 4 municipalities.

ADMARC does entail quasi-fiscal operations. Specific and tangible fiscal initiatives, such as the rural electrification project undertaken by ESCOM, Malawi's state-owned electricity company, are financed directly from the central government's budget.

12. **The RBM is generally not involved in quasi fiscal activities**. The two exceptions are the support for Malawi's stock exchange and for the electronic interbank payment system, MALSWITCH (which is registered as a private company). In both cases, the RBM has provided initial capital and some (modest) operational and funding support in order to bolster domestic capital markets. The plan is to withdraw fully from both activities once they are self-sustained, but no explicit time limit has been set on RBM's involvement. No new quasi-fiscal activities are planned.

13. **Tax legislation remains partly outdated and fragmented**. However, some improvements have been made, in particular, the 2006 updating of customs codes and procedures. Increased emphasis is also put on consultations with the private sector (on policy and administration), customer service and information dissemination activities. However, the private sector continues to complain about slow and non-transparent administration of VAT refunds.

III. Staff Commentary

14. **There is no doubt that Malawi has achieved significant progress in fiscal transparency over the past 2-3 years**.[6] The PFMA and the IFMIS are two milestones in this respect (although the full benefits of the IFMIS are yet to be seen as coverage expands and reporting improves), but other legislative changes and changes to practices and procedures also point in this direction. These improvements have contributed to the much improved overall budget execution over the past two fiscal years, where expenditures—in sharp contrast to previous experiences—have been kept largely within budgets (except for the scaled up spending on food security measures during the 2006 food crises).

15. **However, much remains to be done**, in particular, with respect to establishing proper, consolidated accounts for general government (based on GFS2001) and incorporating the SOE's into a proper PFM framework. In a broader context, the government should also revisit the medium term expenditure framework (MTEF), which—as of now—is not based on substantial projections and fiscal policy priorities, but are merely mechanical extrapolations of current budget numbers. This is particularly important as the MTEF needs to adequately reflect the objectives and priorities of the Malawi Growth and Development Strategy (MGDS). The government has recently prepared a comprehensive action plan for

[6] See also "Public Financial Management Assessment—Government of Malawi," June 2006, prepared by the Public Expenditure Financial Accountability Framework (the PEFA program).

public financial and economic management. This constitutes an important step toward meeting these challenges—but it is only a first step: the true test will be implementation of the action plan over the next few years.