Asian Regional Seminar on Public Financial Management

PFM Reforms: The lessons learnt -promises and tears

Session 1: PFM Reform Strategies

IT Driven Reform Process-Successes and Failures

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IMF and other development partner involvement

- The IMF, World Bank and other development partners are involved in several initiatives to modernize the **Policies, Institutional Structures and Systems required to manage public finances in member Countries**

- Automation of Government Financial Management (GFM) Systems is one of the elements of the Reform program

- These systems are also referred to as Financial Management Information Systems (FMIS) or more loosely as Integrated Financial Management Information Systems (IFMIS)

Why?

- Ready availability of **timely and accurate information is critical** to the management of government finances and public funds

- The **large transaction volumes** involved and their **dispersal across multiple sites** around the country requires that the systems be automated.

- Without these systems it may not be possible to obtain the information required for economic management in a timely manner.

Case Studies

- Discuss the implementation of IFMIS systems in three countries with varying initial start off conditions;
- **Russia** (also applicable to other transition economies) e.g. Vietnam;
- **Indonesia and Nepal** (applicable to countries with entrenched legacy systems)
- Discuss whether successful IFMIS development has led PFM reforms or has been carried out in support of policy, institutional and process reforms
- Describe reform design, implementation challenges, capacity and leadership issues.
- Present **lessons learned** and factors that shaped project outcomes
- Point out common pitfalls experienced by IFMIS projects in the region and how to avoid them

Russian Federation Treasury Development Project

Experience also applies broadly to Systems Implementation in other Transition Economies , e.g. Kazakhstan, Vietnam and others

Russia- The Pre-Reform Situation I – What was the problem that needed to be solved?

- In the mid 1990's the **fiscal situation in Russia was under stress**: deficits exceeded targets, weekly cash rationing, accumulation of arrears
- **Spending units had Bank accounts outside the control of the MOF** and the MOF transferred money to these accounts periodically. **Sizable idle balances** could build up in spending unit bank accounts.
- **MOF had no means to exercise control** to ensure that expenditures are in accordance with budget appropriations
- **The Budget framework** including the Budget classification structure also **required additional work**
- **A critical need for more effective budget execution and expenditure management systems** capable of exerting better control over public expenditures

Reform Design is based on problem diagnosis – Two part solution

Part I - Set up policies and institutional structures required for management of government finances

- **Transition economies in general- These were 'green field' sites.** There was a need for building the legal framework and institutional structures ***ab-initio*** to enable the MOF to regain control over the financial resources and ensure that expenditures are in accordance with budget appropriations
- **In countries with entrenched legacy systems,** such as Indonesia, Nepal, Pakistan, the legal and institutional structures for management of Government finances did exist but were in need of repair; Characterized by an erosion of controls **Here Reform involved "plugging the leaks".**

Implementing the solution required - Legal and Institutional Reforms

- **Improvements to the budget management law** which provides the legal basis for Budget Execution

- **Improvements in the budget classification system and CoA to be** consistent with the IMF's GFS

- **Institutional arrangements for banking Government funds and processing payment transactions**
  - A Closure of SU Bank accounts and consolidation in a TSA at the Central Bank
  - Re-engineering payment processes and routing all payment transactions through the Treasury
  - Re-engineering all receipt processes to ensure revenues are directly deposited in the Government account

Part II - Set up systems to support these policies

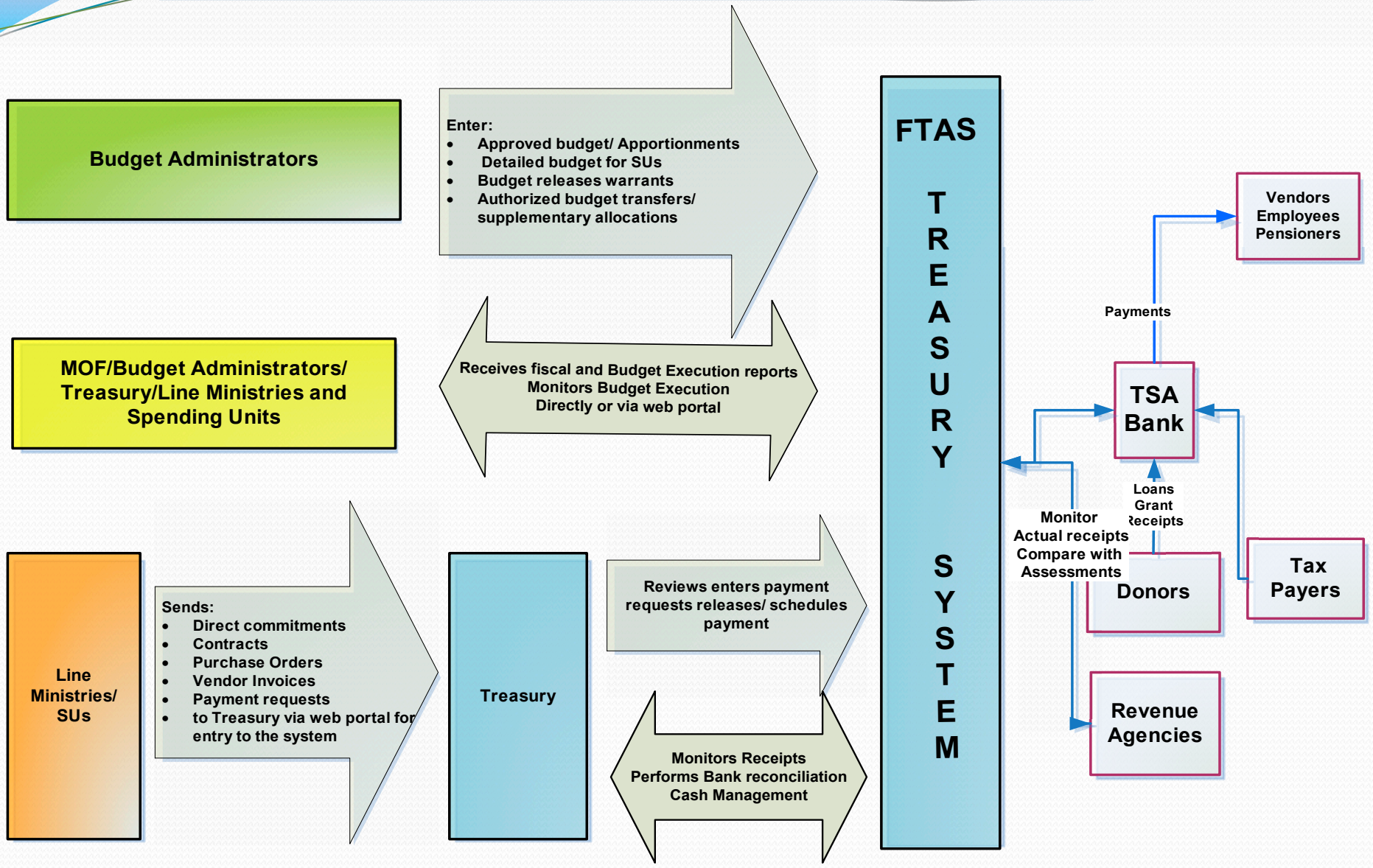
Systems should enable:

- **Better fiscal control**
  - By ensuring that expenditures are in accordance with budget appropriations, commitments and cash allocations
  - Close monitoring of outstanding bills, cash in Government bank accounts, arrears and fiscal deficits
- **Better cash management**
  - By bringing all government accounts under the control of Treasury and consolidation in a **Treasury Single Account (TSA)**
  - By reducing **idle balances** in Government Accounts and improved planning for cash
- **Timely and accurate reporting for Economic management** and for **preparation of statutory financial statements**
- Improved quality of **baseline data for budget preparation**

Russia: Systems Functionality - The Systems Support Core Budget Execution/Treasury Functionality

- Budget Execution
  - Budget Management
  - Commitment Management
  - Payment Management- Processing all government expenditures
  - Receipts Management - Recording revenues and other receipts
  - Bank Reconciliation
- Accounting (posting all transactions as they occur)
- Cash Management
- Fiscal Reporting

Russia- Treasury Systems: Core Functional Processes and Information Flows



A. Hashim, April 2012

Russia Treasury Project – Scale Size

- **Active Users** : 25,000 to 30,000
- System implemented across 83 provinces spread across 11 time zones. **The total number of treasury offices** is approximately **2,500**.
- About **300, 000 federal govt. spending units** are serviced by the system.
- **Regional and local governments also use it to process approved payment requests** to ensure that these payments are made through similar TSAs established for their respective areas.
- The **total number of transactions processed through the system is 30- 40 million a month**
- Approx **30,000** staff **trained** in the use of the system.

Russia - Lessons learned

Hierarchy of Requirements

- **Political will to implement sound PFM policies and procedures and support within government for reform measures**
- **Realistic Budget Formulation**
- **Institutional arrangements to implement fiscal control**
  - ✓ Control of Treasury over all Government Financial Resources - Consolidation of Bank Accounts in a TSA;
  - ✓ Routing of Transactions through a Treasury office/ out-posted Treasury staff
- **HR Capacity within implementing agencies**
- **Appropriate Technology to support systems**
  - Application Software which can support functional processes
  - Technology Platform to implement Software (H/W, Networking, Middleware)

Notes on Hierarchy

- **Emphasis on policy reform is paramount.**

- **Technical aspects figure lower down in his hierarchy**-Even though very significant investments (> US $ 500m) were required in technology and upgrades to the Infra-structure (US $200m)

- If work on systems implementation is started up without a diagnosis of the problems and any required adjustments to the **policy architecture**, then these systems **would at best lead to improvements at the margin and may not provide value to PFM**

- **Could be counter productive –** E.g if a system is implemented to only disburse funds quickly to Spending unit accounts with no control on transaction processing, it may well increase the speed of the hemorrhage on financial resources. (As in some countries in the region)

Strong Government and MOF Commitment is Critical

- **Can be achieved better if projects are framed as public expenditure management (PEM) systems reform initiatives**
- High on the agenda of most politicians and governments
  - **Accounting systems reform has a more specialized and limited focus.**
- **Linkages can be established between project requirements and policy based lending** to ensure that project milestones are met.

Some Key Implementation Pointers

- Budget Department, Treasury, and Line Ministries **should use the same system to process their transactions and should share databases**
- Budget Preparation and Budget Execution should use the same chart of Accounts.
- **Transactions should be captured in real time** as they occur.
- **Financial controls should be applied in ex-ante mode** to all transactions processed by the system. (e.g. funds availability checking on budgeted expenditures prior to committing funds or making payment).

Comprehensiveness of transaction processing

The scope of the system should include:

- **Budget Funds-** Including transactions related to: Goods and services, Payroll, Pensions, Debt, Subsidies, Fiscal transfers,
- **EBFs**, **Donor Funds** and **Technical revenues**
- No expenditure transaction should be processed outside the system.
- The IFMIS databases should be treated as the primary source for financial reporting within Government- There should be no second set of books.

Without comprehensive Transaction processing basic project objectives will not be realized

If scope is limited to budget funds, the basic objective of fiscal control and good cash management may not be fully realized. Since:

- EBFs and Internally generated funds/ Technical revenues may constitute a major chunk of resources and are lodged in bank accounts outside the TSA.
- Transactions for these funds are processed outside the system

A $50 million modern system could be used to control 40% or less of the of the total government resources. (e.g. some Countries in Africa)

Coverage of the TSA

- **All budget resources, extra budgetary funds, and Technical revenues or internally generated funds.**

- If the latter categories are left out of the TSA and banked separately in private Banks:
  - The amount of financial resources outside the TSA can become large and can constitute a significant portion of the Government's total borrowing requirements;
  - Banks where these resources are lodged use them to buy the T- bills and other instruments.
  - Government in effect has to pay interest on the T-bills which have been purchased from its own resources.
  - **(e.g. China, Cambodia)**

Commitment Management is Essential for Budgetary control

- Satisfactory Budgetary control **cannot** be exercised by ONLY checking for budget availability at the payment stage of an expenditure transaction.

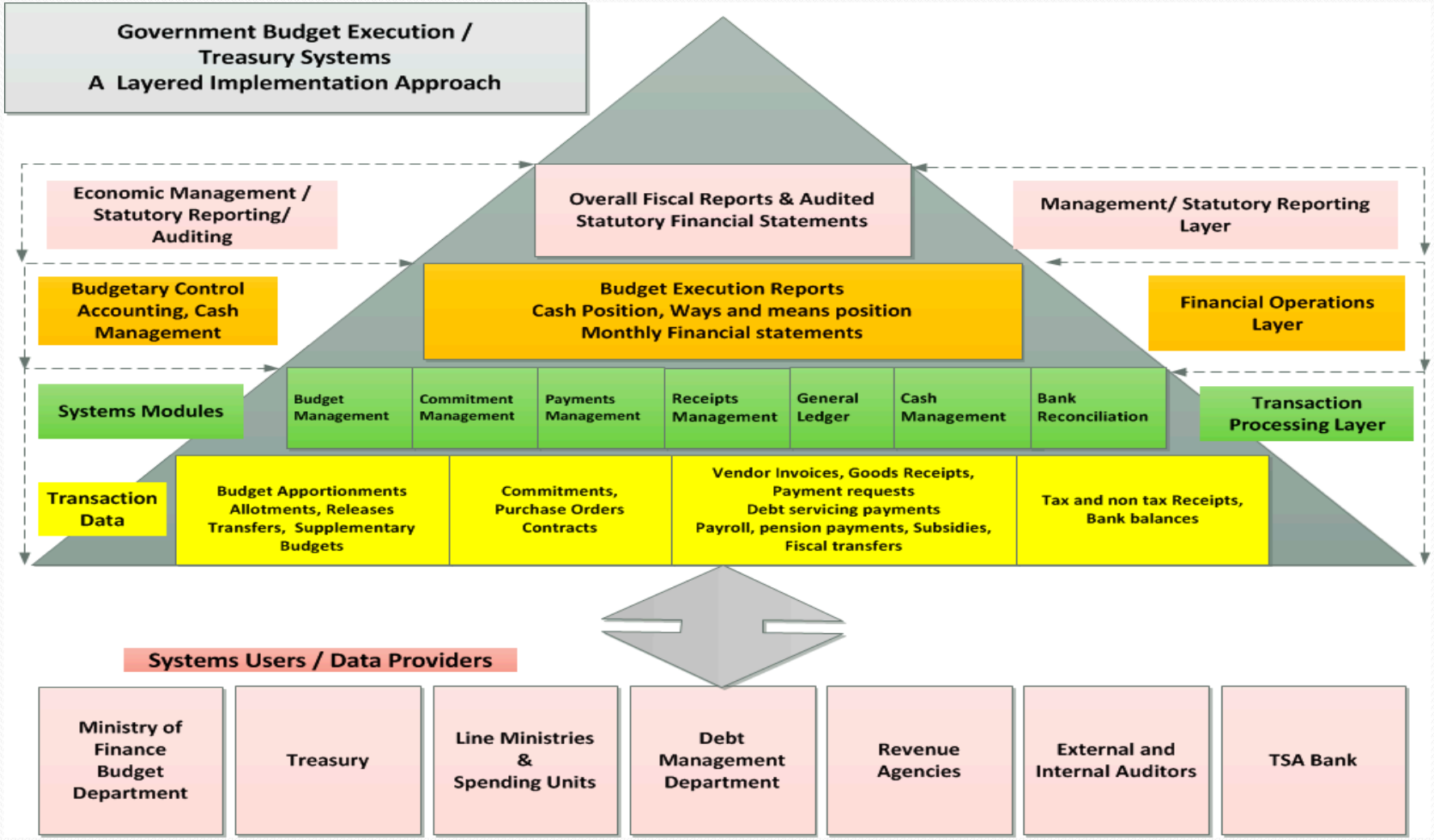
- Too late to be effective since the goods and services have already been received and the government has a legal obligation to pay the vendor

Complexity of Charts of accounts

- **The complete COA / BCS will need to be coded on every transaction and this is cumbersome and can lead to allocation errors.**
- **A balance needs to be struck between the level of detail required on the transaction and the quality of the data entry that is possible** in a given circumstance.
- **An overly complex COA could also increase transaction processing times on the server** especially when the number of active users is also large. (e.g. Vietnam)

IFMIS a layered Implementation approach

- **IFMIS implementation can be viewed as a set of layers**
- The basic transaction data and the systems modules that are used to process this data, constitute **the transaction processing layer.**
- On top of this layer there is a **financial operations layer** that enables production of budget execution reports, determination of the cash position in Government bank accounts, the ways and means position and production of monthly financial statements.
- Finally, on top of the financial operations layer is the **management and statutory reporting layer** which enables production of overall fiscal reports, audited financial statements and statutory financial reports.


Government Budget Execution / Treasury Systems
A Layered Implementation Approach
Economic Management / Statutory Reporting/ Auditing
Overall Fiscal Reports & Audited Statutory Financial Statements
Management/ Statutory Reporting Layer
Budgetary Control Accounting, Cash Management
Budget Execution Reports
Cash Position, Ways and means position
Monthly Financial statements
Financial Operations Layer
Systems Modules
Budget Management
Commitment Management
Payments Management
Receipts Management
General Ledger
Cash Management
Bank Reconciliation
Transaction Processing Layer
Transaction Data
Budget Apportionments Allotments, Releases Transfers, Supplementary Budgets
Commitments, Purchase Orders Contracts
Vendor Invoices, Goods Receipts, Payment requests
Debt servicing payments
Payroll, pension payments, Subsidies, Fiscal transfers
Tax and non tax Receipts, Bank balances
Systems Users / Data Providers
Ministry of Finance Budget Department
Treasury
Line Ministries & Spending Units
Debt Management Department
Revenue Agencies
External and Internal Auditors
TSA Bank

Sequencing I

- First set up the **transaction processing layer** of the systems. This is the most difficult and time consuming.
- It is necessary to have this layer in place to get good and **credible information** to be used for financial operations and for management reporting. Other layers would be built on top of this layer.
- **In Russia** the Government has **now** developed a reporting and monitoring system that provides information on **Key Performance Indicators (KPIs)** to enable the MoF and all budget participants monitor and control the budget execution process.

Sequencing II

- **First Implement** modules to cater to **Core Budget Execution Processes, payments and receipts transactions**, across government before going on to other non-core elements, like fixed assets management, HR management. **(Core Treasury Systems - Still missing in some countries in the region)**
- **First implement MOF/Treasury Centric System then De-Centralize to spending Units** - An attempt should be made to first capture payment / receipt transactions at Treasury offices then de-centralize to Spending units – if necessary/possible. **(Lesson for countries in the region)**
- To start with, budget preparation can be done outside the system or by another system, and the final approved budget can then be loaded in the system and used to control expenditure - However, all subsequent in year budget transactions, like budget releases, transfers etc. should then be done in the Treasury system. **(Lesson for some countries in the region)**

Project Sponsorship and Management

- **Project Sponsor** – Needs to be a high level Government official such as, the Minister of Finance/Permanent Secretary/Controller General of Accounts.
- **Steering committee** **to coordinate views of** all major stake holders- MOF, Treasury, Budget, Central Bank, Line Ministries, Revenue collection agencies.
- **Project manager** - **needs to be a senior official from the FUNCTIONAL SIDE** with stature within bureaucracy and adequate financial and administrative powers to cater to day to day operational administrative and financial requirements - **FMIS projects are NOT IT projects**
- **Selection of a Core team/ working group** - staff with in-depth knowledge of their functional areas
- **Setting up a Project Secretariat** – staff /consultants with experience in contract management and implementing large systems

End User training

- Large numbers of staff will need to be trained
- Most Governments have training institutions which have been used successfully to impart training.
- **Most staff will need to know only specific features of the system** and training, at least in the initial tranche can be limited to these features.
- Set up a help desk , **Hand holding clinics,**
- Train a group of power users thoroughly who can be used subsequently as trainers or technical resource persons for other staff.
- Even in situations where staff have had little or no previous exposure to computer based systems, operational end user staff have readily transitioned to the use of these systems. E.g. Pakistan

Change Management

- **Staff in the implementing agencies need to recognize the inevitability of change. The MOF management has a major role to play here.**
  - For example - Ensure that the only way a payment will be processed is through the system, etc.
- **Convince staff that that their jobs will change but not be eliminated. They will be trained in the operation and use of a more modern system.**
- Staff used to doing their tasks in a given way are reluctant to change. This resistance can be overcome by good **training and hand holding during the transition phase.**

Indonesia-GFMRAP

Case Emphasis:

Importance of institutional reforms prior to system implementation;

Ex-ante transaction entry;

The importance of picking up the transaction at the start of the expenditure cycle.

Implementing the changes to the institutional arrangements **before systems implementation**

- In the nineties two major Bank financed projects attempted to set up systems which would improve the accounting capabilities of the Government.
- However, no attempt to change the policy/ legal framework and the institutional arrangements for budget execution that were the cause of the problems .
- Concentrated on accounting systems reform under existing arrangements.
- **The project was that it recognized that *the problem that needed to be tackled was primarily an expenditure management problem which needed institutional reforms and only secondarily an accounting problem.* *This is an important lesson from the Indonesia project.***

The stage in the budget execution cycle at which the transaction is picked up by the system

- ***A second important difference*** was that the previous projects envisaged picking up the transaction **in ex post mode** after the payment had been made by the payment offices - KPKNs.
- These attempts were not successful since once the payment is made there is no fool proof way in which one can guarantee that all transactions are picked up by the system
- ***EX- ANTE transaction pick up is a key requirement of IFMIS systems and this is a major lesson for such projects.***
- In the new project, the budget administrators, the treasury offices are connected to the system and all stages of the TRANSACTION are SUPPOSED TO BE PICKED UP EX- ANTE MODE (before payment is made) BY THE SYSTEM (at the PO STAGE (with a resulting commitment) followed by the Invoice and the goods report and the payment).

Nepal

Case Emphasis: The criticality of placing primary emphasis on Institutional and policy reforms

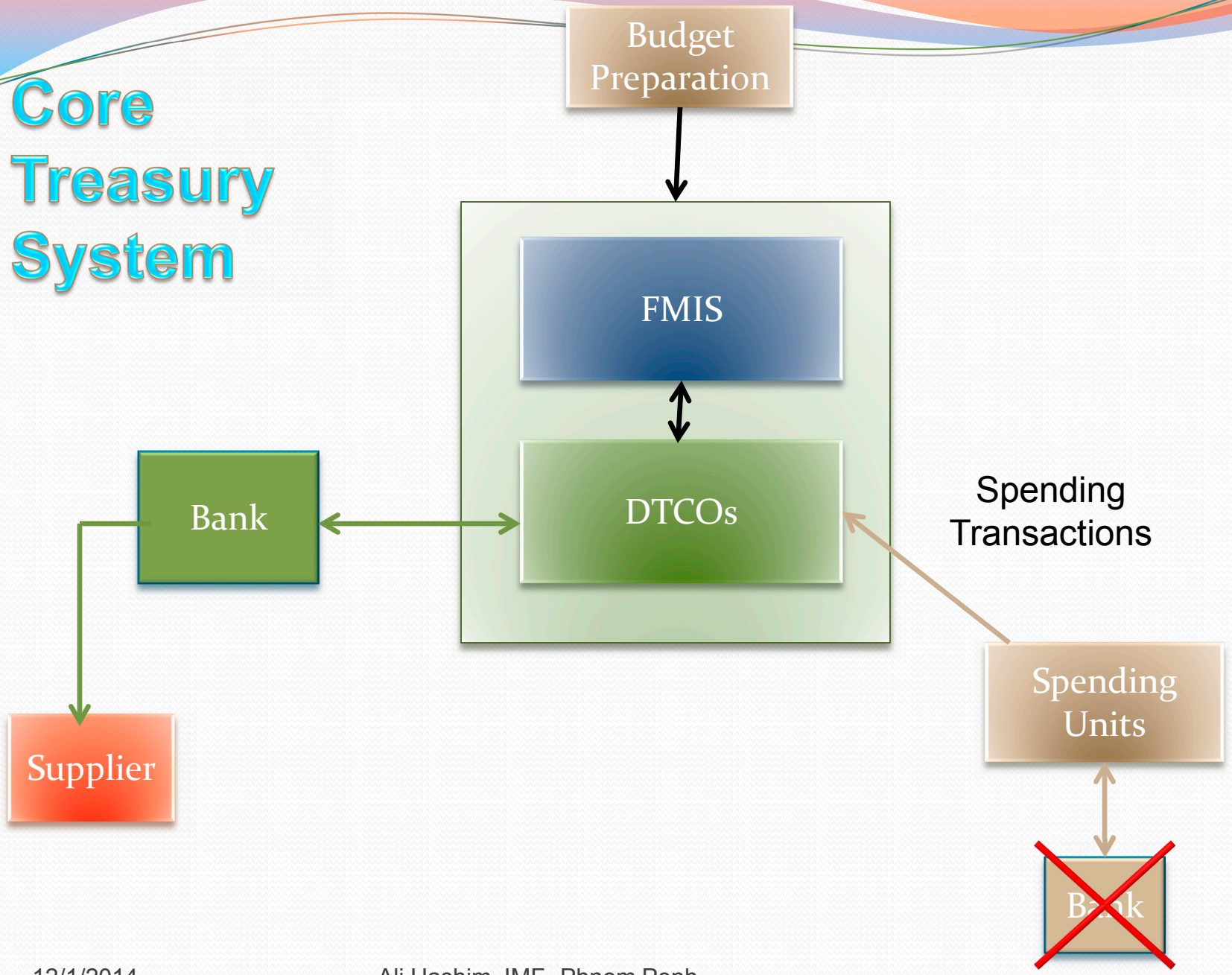
Nepal: Pre Reform situation

- **The Government operated a decentralized payment and revenue remittance operation. With all the attendant problems.**
- The 3500 spending units directly processed government payments and recorded receipts against their own bank accounts (approximately 14000). Tax authorities maintained their accounts and received and recorded revenue.
- These banking arrangements fragmented treasury balances and **generated significant idle balances.**
- **The FCGO/75 -DTCOs did not have adequate control over the budget execution process or** over government cash flows and balances
- MOF did not have data to prepare accurate and up to date fiscal reports.
- Serious instances of embezzlement and financial irregularities often surfaced during ex-post audit.

IMF Recommendations

- Payment and revenue recording need to be controlled by the DTCO.
- **The basic role of the DTCO would change from that of ex-post consolidation of expenditure/ receipt transactions to that of ex- ante control.**
- All SU accounts need to be closed and brought under the control of the DTCO;
- The SU to bring their payment requests to the DTCO who will perform budgetary checks and issue payment instructions.
- The Bank to prepare a list of payments/ receipts made by / in favor of the DTCO.

Core Treasury System



Lessons learned

- A specific lesson that can be learned from the Nepal case is that it shows the criticality of placing emphasis on the institutional and policy reform.
- ***Once the policy framework is put in place then it is possible to achieve very significant outcomes with quite limited technological investments.***
- *Thus e.g the total costs of the system in Nepal is only of the order of $5-7 million.*
- *On the other hand if attention is not given to the policy side then very large investments would lead to very limited outcomes. (some countries in the region)*

Continuing Vulnerabilities

- **Critical need for setting up a stable and fully staffed technical organization within the Government for the sustainability of the IFMIS.**
- These systems are a mission critical government system on which the government depends for its day today financial transaction processing. *Any disruption in systems operations can lead to significant disruptions in a Government's financial operations.*
- In Nepal as in other countries in South Asia e.g. Pakistan, there is essentially no career path for technical IT staff in Government positions unlike the business areas which are staffed from personnel who are recruited on a national basis into recognized cadre structures.

Concluding remarks

- **An IFMIS type system is not a panacea to all of Government's financial problems.**
  - These problems are often **a result of the prevailing state of governance and the political economy** which constrains corrective action even after the issues have been clearly identified.
- **Setting up PFM information systems is a necessary pre-requisite, even essential, for improving budget management, but is not sufficient.**

Continued

- **Resolution of governance, political economy and institutional issues require strong Government commitment and will to reform**

- **Technical inputs** such as an IFMIS system **only provides government with a set of tools** to manage its financial resources. **The outcomes will ultimately depend on whether and how well the tool is used.**

Thank you