

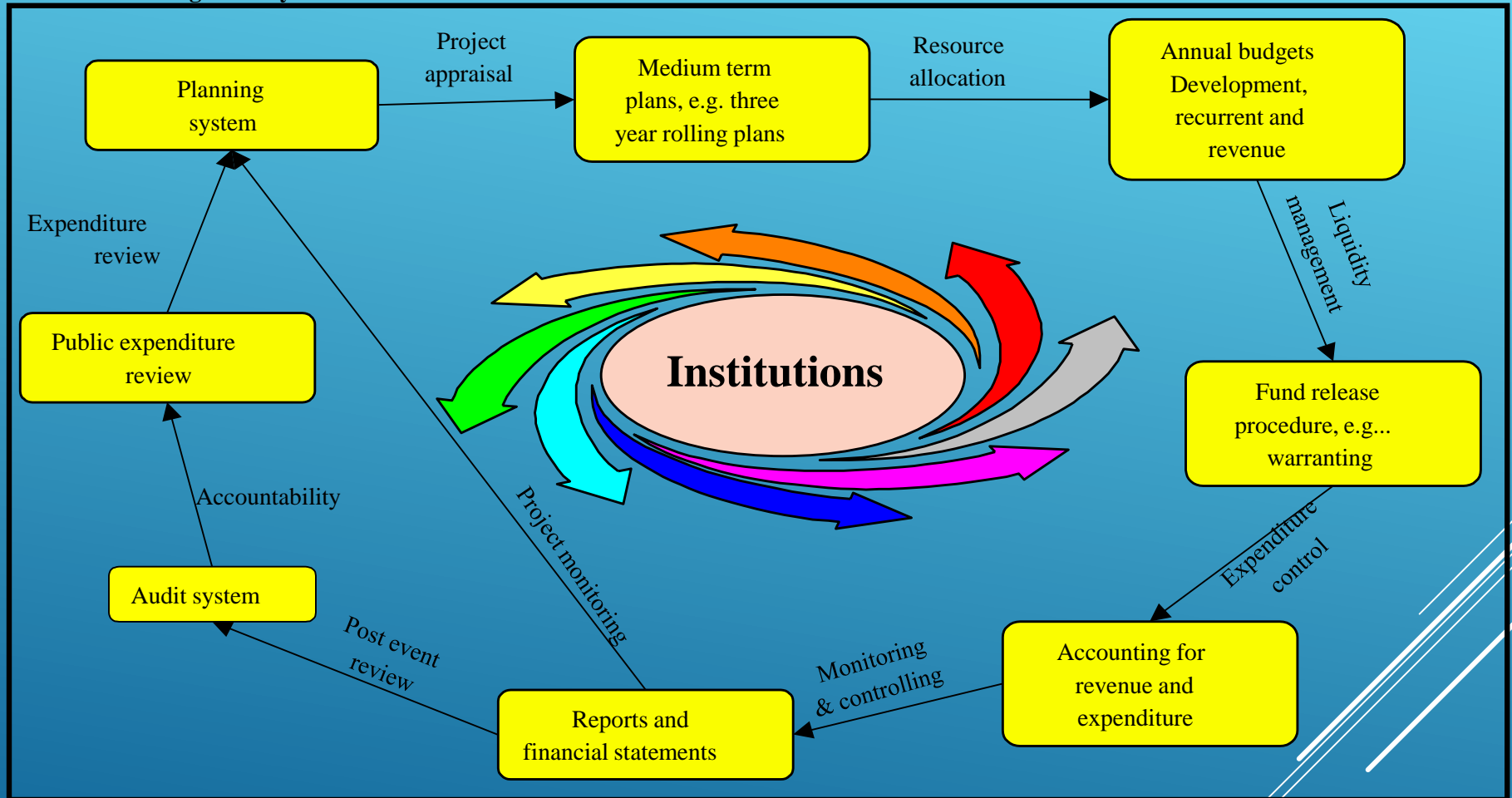
APPLIED FINANCE

Lecture 3



EXPENDITURE MANAGEMENT CYCLE

Financial management system boundaries



Source: Adapted from Integrated Financial Management, Michael Parry, International Management Consultants Limited. Training Workshop on Government Budgeting in Developing Countries. THE UNITED NATIONS. December 1997.

THREE OBJECTIVES OF PUBLIC EXPENDITURE MANAGEMENT SYSTEMS

- ▶ Macroeconomic discipline and stability
 - ▶ Avoid public finance crises
 - ▶ Support economic growth and stability
- ▶ Strategic allocation of resources
 - ▶ Match government policy with programs, objectives
- ▶ Technical efficiency
 - ▶ Getting the most from spending

BASIC PRINCIPLES OF PEM

▶ Comprehensiveness

- ▶ include all revenue and expenditure, all agencies

▶ Accuracy

- ▶ record actual transactions and flows

▶ Annuality

- ▶ cover a defined period of time (e.g. one year budget, multi-year forecasts)

▶ Authoritativeness

- ▶ only spend as authorized by law

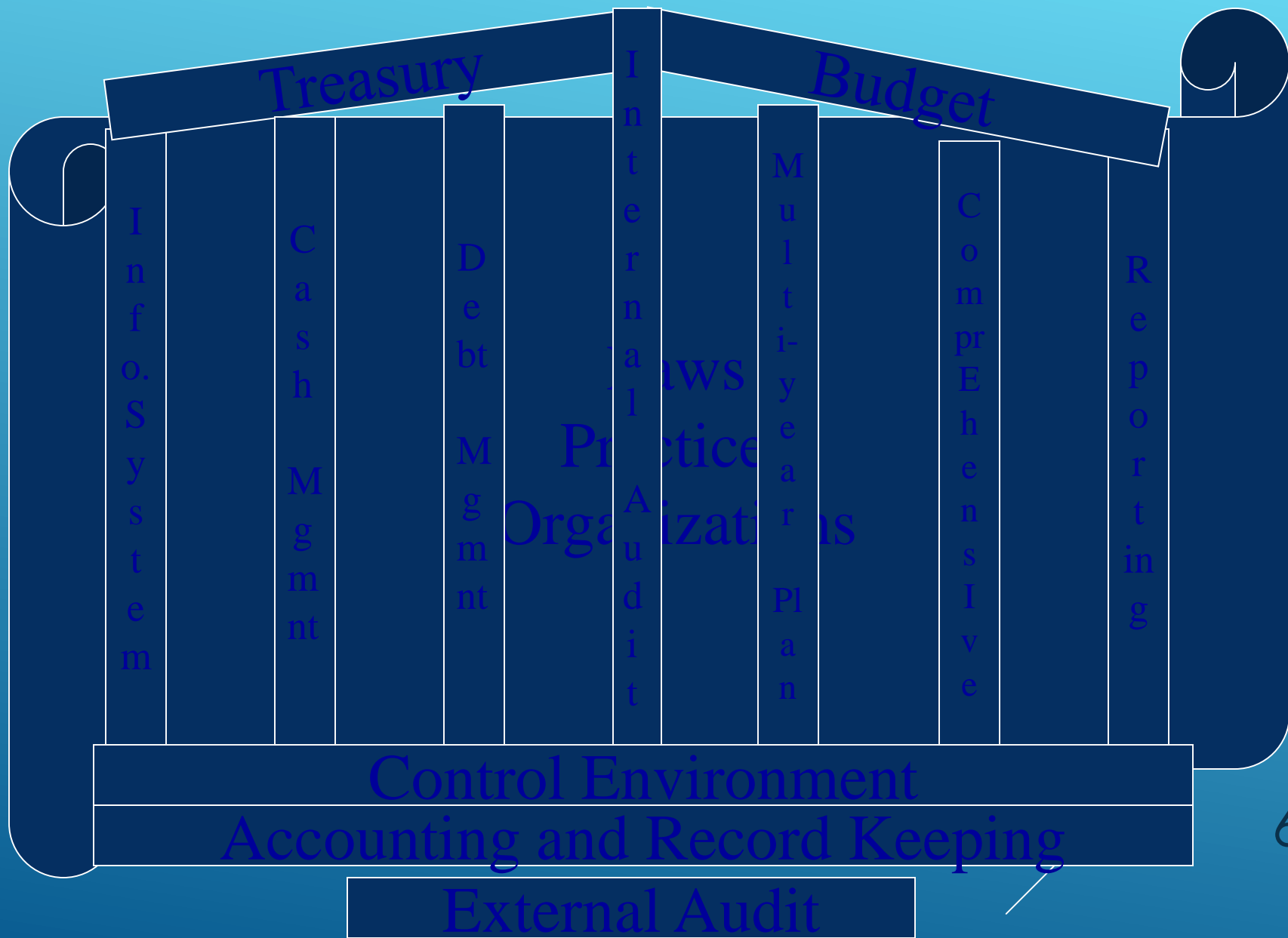
▶ Transparency

- ▶ information on spending is public, timely, understandable

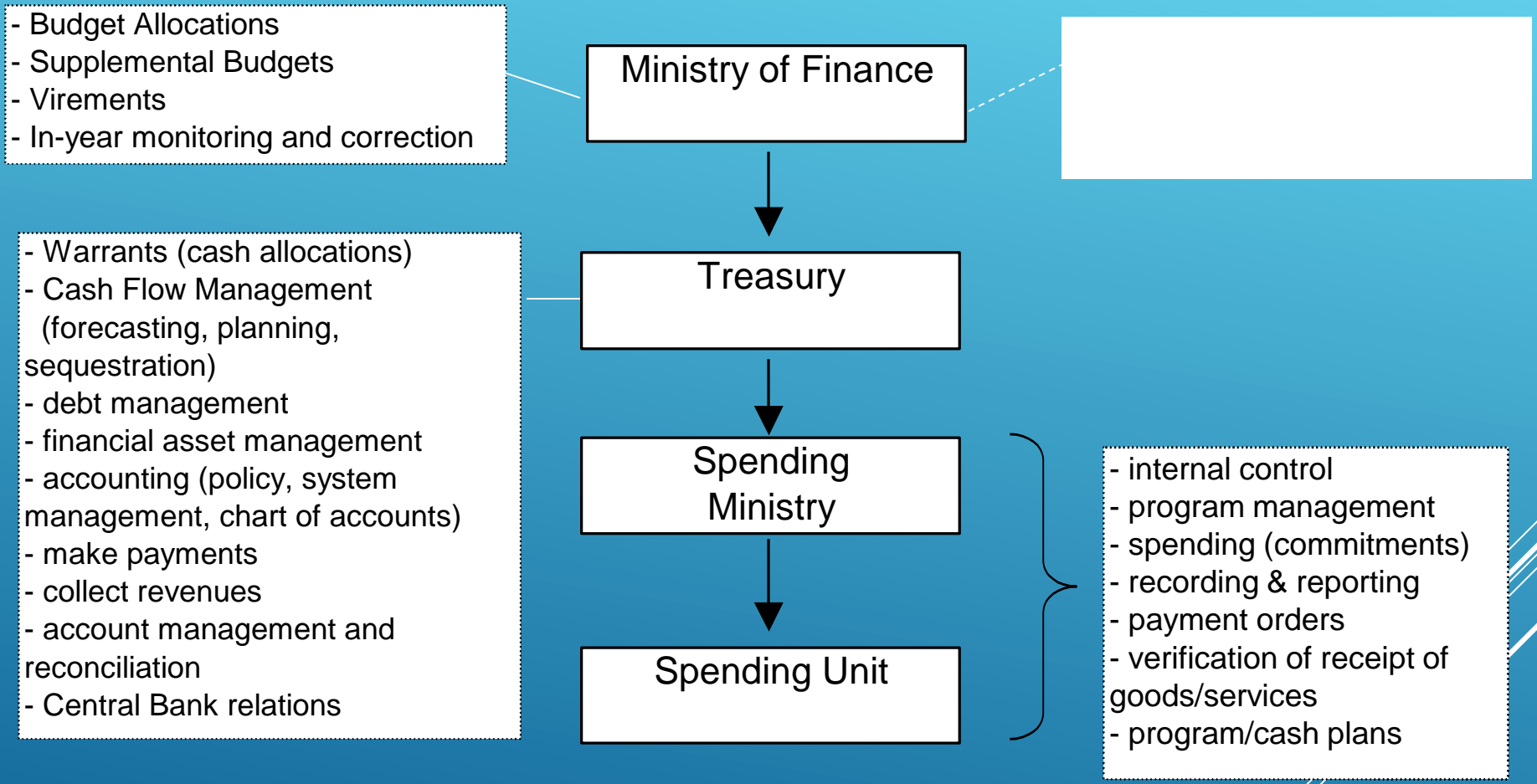
WHAT ARE GOOD PRACTICES?

- ▶ Attaining and Maintaining Good Basic Institutions
 - ▶ Basic public finance institutions must work well for good policy and program outcomes
 - ▶ Too often countries reach for advanced OECD reforms, neglecting basic institutions
- ▶ Dedication to continuous system examination, learning and improvement
 - ▶ institutional development is long term

WHAT ARE THE BASIC INSTITUTIONS?



CORE PROCESSES



Financial Management is Everyone's Responsibility
And Service Delivery is also MoF's Responsibility

OBJECTIVES OF BUDGET EXECUTION

- ▶ Manage Spending and Revenues to budget
 - ▶ support choices of elected officials
 - ▶ allow budget to be planning and steering tool
 - ▶ promote macrofiscal discipline
 - ▶ Reduce opportunities for corruption
- ▶ Enable program implementation (service delivery)
 - ▶ Assure resources flow to programs
 - ▶ allow budget to be aid to operational efficiency through spending unit advance planning, efficient administration
 - ▶ enable program managers to achieve objective

CORE TREASURY FUNCTIONS

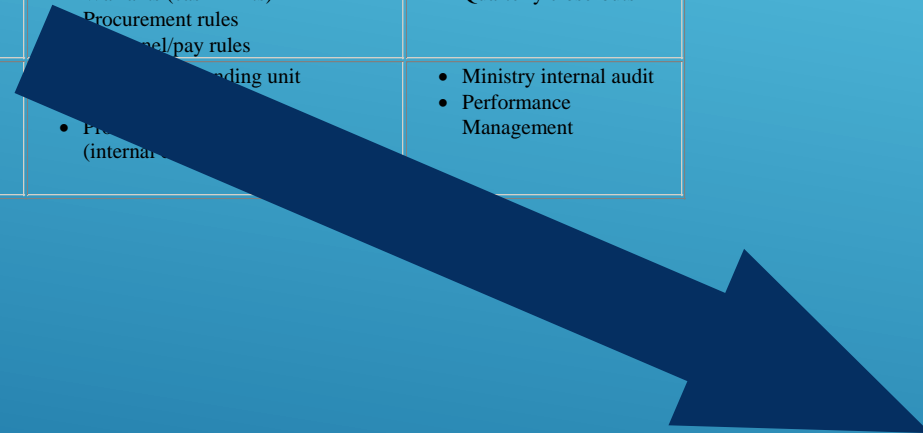
- ▶ Cash management (flow and stock)
- ▶ Financial asset management
- ▶ Debt management, servicing;
 - ▶ Guarantee and contingent liability management
- ▶ Accounting (policy, chart of accounts, general ledger) and reporting
- ▶ Revenue collection, forecasting
- ▶ Account management (payment, collection, reconciliation)
- ▶ Central Bank relations

CONTINGENT LIABILITIES

- ▶ Government acts as a guarantor of debt repayment in the event that the borrower cannot make repayment, or of payment under certain conditions
 - ▶ Loan, pension benefit, bank deposit, agricultural price
- ▶ Contingent debt must be managed with the same detail as direct debt.
- ▶ As with direct debt these contingent debts must be inventoried and monitored in a central location
- ▶ Active identification, monitoring, management of risk important

EXPENDITURE CONTROL APPROACHES

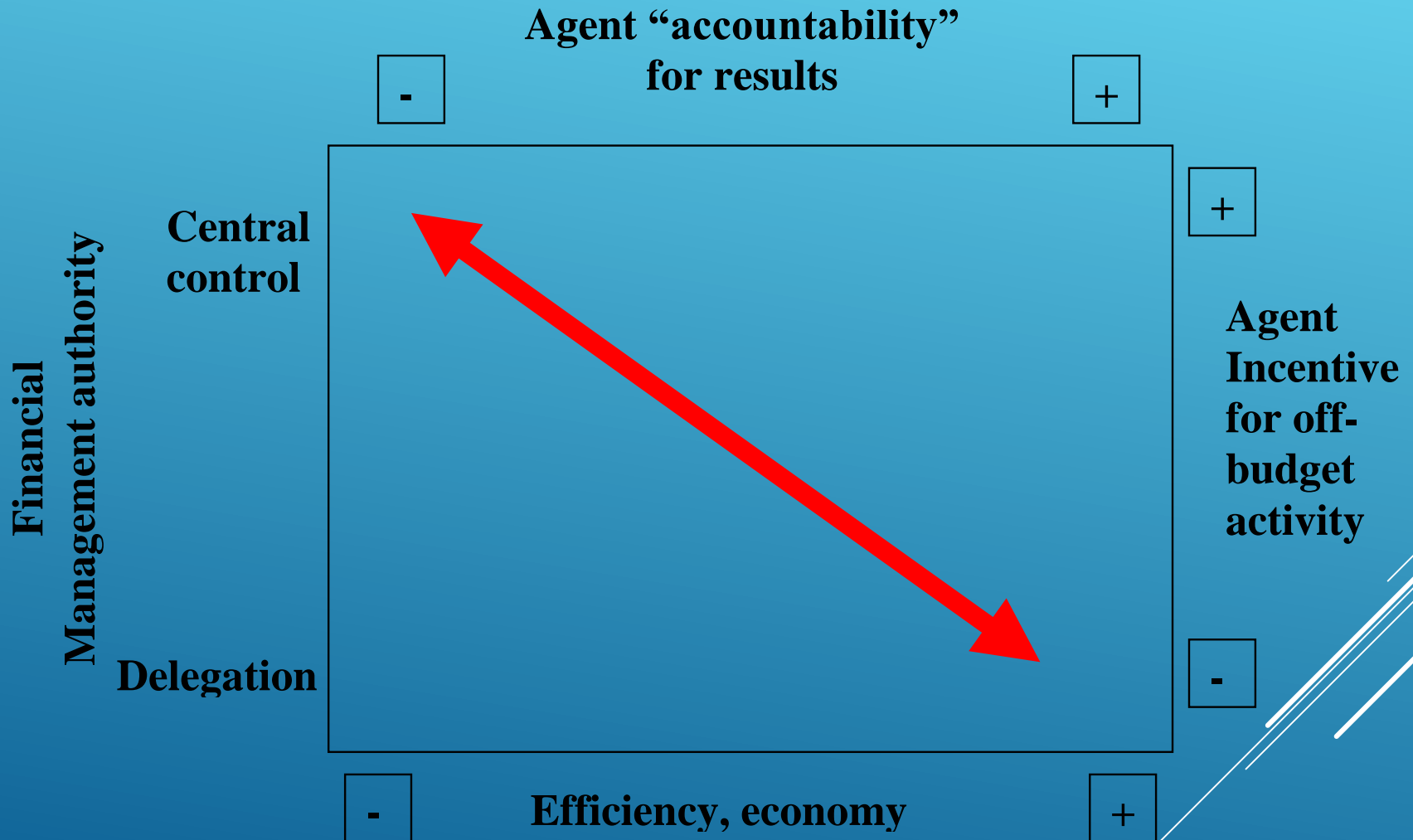
	<u>Ex Ante</u> (to commitment)	<u>Ex Poste</u>
<u>External</u> (to spending unit)	<ul style="list-style-type: none"> • Centralized commitment control (transaction approval) • Allocations (commitment limits) • Warrants (cash limits) • Procurement rules • Personnel/pay rules 	<ul style="list-style-type: none"> • Central internal audit, external audit • Regular reporting • Quarterly close-outs
<u>Internal</u> (to spending unit)	<ul style="list-style-type: none"> • Procurement rules (internal) 	<ul style="list-style-type: none"> • Ministry internal audit • Performance Management



CENTRAL CONTROL VERSUS MANAGERIAL FLEXIBILITY

- ▶ Tensions between needs of center to
 - ▶ Control cash flow
 - ▶ Control policy
- ▶ And agency need to manage programs
 - ▶ Larger, less detailed allocations
 - ▶ Longer time horizon
 - ▶ Greater transfer authority/flexible application of resources

GENERAL TENSIONS



TO MANAGE WELL REQUIRES:

- ▶ Monitoring/managing
 - ▶ Cash balances
 - ▶ Cash flow
 - ▶ Inflow
 - ▶ outflow
 - ▶ Commitments
 - ▶ Arrears
 - ▶ Contingent liabilities
 - ▶ New legislation/mandates
 - ▶ Off-budget activity
 - ▶ Understanding future impact of current decisions

WHAT IS AN FMIS?

- ▶ Financial management system:
 - ▶ Information system that tracks financial events and summarizes information
 - ▶ supports adequate management reporting, policy decisions, fiduciary responsibilities, and preparation of auditable financial statements
 - ▶ Should be designed with good relationships between software, hardware, personnel, procedures, controls and data
- ▶ Generally, FMIS refers to automating financial operations

WHAT ARE CORE AND NON-CORE FMIS SYSTEMS?

- ▶ Core systems
 - ▶ General ledger, accounts payable and receivable. May include financial reporting, fund management and cost management.
- ▶ Non-core systems
 - ▶ HR/payroll, budget formulation, revenue (tax & customs), procurement, inventory, property management, performance, management information

WHAT IS “INTEGRATED” FMIS?

- ▶ Can refer to core and non-core integration
- ▶ But, generally, four characteristics*
 - ▶ Standard data classification for recording events
 - ▶ Common processes for similar transactions
 - ▶ Internal controls over data entry, transaction processing, and reporting applied consistently
 - ▶ Design that eliminates unnecessary duplication of transaction entry

WHAT CONSTITUTES A GOOD FMIS SYSTEM?

- ▶ Ability to*
 - ▶ Collect accurate, timely, complete, reliable, consistent information
 - ▶ Provide adequate management reporting
 - ▶ Support government-wide and agency policy decisions
 - ▶ Support budget preparation and execution
 - ▶ Facilitate financial statement preparation
 - ▶ Provide information for central agency budgeting, analysis and government-wide reporting
 - ▶ Provide complete audit trail to facilitate audits

*from Core Financial System Requirement. JFMIP-SR-02-01. Joint Financial Management Improvement Program. Washington, D.C., November 2001.

ESSENTIALS OF GOOD FINANCIAL EXECUTION

- ▶ Timely, accurate in-year reporting
 - ▶ Internal controls, audit
 - ▶ External audit
- ▶ Sufficient detail to identify sources of overspending
- ▶ Sufficiently regular reporting to allow timely management intervention
- ▶ Comprehensive system
- ▶ Accountability framework, control environment