

# TABLE OF CONTENTS

|                                                                         |    |
|-------------------------------------------------------------------------|----|
| FOREWORD.....                                                           | 3  |
| LIST OF BOXES, FIGURES AND TABLES.....                                  | 11 |
| LIST OF ABBREVIATIONS.....                                              | 13 |
| EXECUTIVE SUMMARY .....                                                 | 15 |
| INTRODUCTION — REFORMING PUBLIC EXPENDITURE: AN OVERVIEW .....          | 19 |
| A. Definitions, Goals and Objectives .....                              | 19 |
| B. Public Finance in the Command Society .....                          | 26 |
| C. Improving Public Expenditure Management in Transition Countries..... | 28 |
| D. Approaches to Managing Change .....                                  | 31 |
| E. Managing the Reform Process .....                                    | 36 |

## ***PART I***

### **THE BUDGET AND THE INSTITUTIONAL CONTEXT**

|                                                                                  |     |
|----------------------------------------------------------------------------------|-----|
| <i>Chapter 1</i> — THE BUDGET AND ITS COVERAGE .....                             | 41  |
| A. Basic Definitions.....                                                        | 41  |
| B. Nature of Legislative Authorisations.....                                     | 45  |
| C. Coverage of the Budget.....                                                   | 49  |
| D. Other Forms of Government Activity with a Fiscal Impact .....                 | 56  |
| E. Budgetary Documents.....                                                      | 62  |
| <i>Chapter 2</i> — THE LEGAL AND INSTITUTIONAL FRAMEWORK.....                    | 65  |
| A. Distribution of Responsibilities within the Executive.....                    | 65  |
| B. The Role of the Legislature.....                                              | 69  |
| C. Distribution of Responsibilities between Different Levels of Government ..... | 73  |
| D. The Legal Framework .....                                                     | 76  |
| <i>Chapter 3</i> — THE EUROPEAN BUDGET AND THE IMPACT OF EU ACCESSION .....      | 87  |
| A. The European Budget.....                                                      | 87  |
| B. National Budget Policies in the European Union.....                           | 102 |

|                               |     |
|-------------------------------|-----|
| Summary — PART I .....        | 113 |
| A. KEY POINTS .....           | 113 |
| B. DIRECTIONS FOR REFORM..... | 117 |

**PART II**

**ALLOCATION OF RESOURCES**

|                                                                       |     |
|-----------------------------------------------------------------------|-----|
| Chapter 4 — BUDGET CLASSIFICATION, PRESENTATION AND PROGRAMMING ..... | 121 |
| A. Expenditure Classification .....                                   | 121 |
| B. Presentation of Expenditures in the Budget .....                   | 129 |
| C. Programmatic Approaches .....                                      | 131 |
| D. Managerialism.....                                                 | 138 |
| Chapter 5 — POLICY FORMULATION AND BUDGET PREPARATION.....            | 143 |
| A. The Macroeconomic and Policy Context .....                         | 143 |
| B. Preparing the Macroeconomic Framework .....                        | 147 |
| C. Conditions for Sound Budget Preparation .....                      | 157 |
| D. Budget Preparation Process .....                                   | 163 |
| Chapter 6 — MULTI-YEAR BUDGETING AND INVESTMENT PROGRAMMING.....      | 175 |
| A. Multi-year Budgeting.....                                          | 175 |
| B. Other Expenditure Planning and Forecasting Exercises .....         | 185 |
| C. Budgeting and Programming Investment.....                          | 186 |
| Summary — PART II.....                                                | 199 |
| A. KEY POINTS .....                                                   | 199 |
| B. DIRECTIONS FOR REFORM.....                                         | 204 |

**PART III**

**MANAGING BUDGET EXECUTION**

|                                                                  |     |
|------------------------------------------------------------------|-----|
| Chapter 7 — THE BUDGET EXECUTION CYCLE .....                     | 209 |
| A. Objectives of Budget Execution.....                           | 209 |
| B. The Expenditure Cycle.....                                    | 211 |
| C. Distribution of Responsibilities .....                        | 215 |
| D. Budget Appropriation Management Rules.....                    | 217 |
| E. Other Issues of Budget Implementation.....                    | 220 |
| Chapter 8 — PAYABLES, PERSONNEL AND PROCUREMENT MANAGEMENT ..... | 223 |
| A. Managing Payables and Arrears .....                           | 223 |
| B. Personnel Budgeting and Expenditure Control.....              | 225 |
| C. Public Procurement .....                                      | 231 |
| D. Contracting-Out .....                                         | 235 |

|                                                                    |     |
|--------------------------------------------------------------------|-----|
| <i>Chapter 9 — THE TREASURY FUNCTION AND CASH MANAGEMENT</i> ..... | 241 |
| A. The Treasury Function .....                                     | 241 |
| B. Cash Management .....                                           | 243 |
| C. Financial Planning and Forecasts .....                          | 248 |
| D. Management of Government Debt .....                             | 251 |
| E. Management of Government Assets .....                           | 255 |
| F. Relationship with the Central Bank .....                        | 255 |
| <i>Chapter 10 — INTERNAL CONTROL AND INTERNAL AUDIT</i> .....      | 259 |
| A. Introduction .....                                              | 259 |
| B. Internal Control .....                                          | 260 |
| C. Internal Audit .....                                            | 267 |
| D. Financial Management of EU Funds in Candidate Countries .....   | 273 |
| <i>Summary — PART III</i> .....                                    | 281 |
| A. KEY POINTS .....                                                | 281 |
| B. DIRECTIONS FOR REFORM .....                                     | 286 |

## ***PART IV***

### **ACCOUNTING, REPORTING, AND AUDITING**

|                                                                    |     |
|--------------------------------------------------------------------|-----|
| <i>Chapter 11 — ACCOUNTING</i> .....                               | 291 |
| A. Accounting Frameworks .....                                     | 291 |
| B. Accrual Accounting .....                                        | 297 |
| C. Reforming an Accounting System .....                            | 302 |
| D. Special Issues .....                                            | 307 |
| <i>Chapter 12 — FINANCIAL REPORTING</i> .....                      | 317 |
| A. General Principles .....                                        | 317 |
| B. Main Reports .....                                              | 319 |
| <i>Chapter 13 — FINANCIAL MANAGEMENT INFORMATION SYSTEMS</i> ..... | 327 |
| A. An Integrated Approach .....                                    | 327 |
| B. Financial Management Systems .....                              | 330 |
| C. Budget Execution and Accounting .....                           | 334 |
| D. Technical Aspects .....                                         | 337 |
| <i>Chapter 14 — EXTERNAL AUDIT</i> .....                           | 341 |
| A. Prerequisites for Effective Auditing .....                      | 342 |
| B. Types of Audit .....                                            | 348 |
| C. Reporting Audit Results .....                                   | 355 |
| D. Acting on Audit Results .....                                   | 356 |
| E. Audit Limitations .....                                         | 357 |
| <i>Chapter 15 — PERFORMANCE MEASUREMENT AND EVALUATION</i> .....   | 359 |
| A. Performance Measurement .....                                   | 359 |
| B. Programme Evaluation .....                                      | 369 |

|                                                                                                                                 |     |
|---------------------------------------------------------------------------------------------------------------------------------|-----|
| <i>Summary</i> — PART IV .....                                                                                                  | 383 |
| A. KEY POINTS .....                                                                                                             | 383 |
| B. DIRECTIONS FOR REFORM.....                                                                                                   | 387 |
| <br><i>Annex I.</i> — QUESTIONNAIRE ON PUBLIC EXPENDITURE MANAGEMENT SYSTEMS.....                                               | 389 |
| A. Introduction .....                                                                                                           | 389 |
| B. The Questionnaire .....                                                                                                      | 390 |
| <br><i>Annex II.</i> — ESTABLISHMENT OF A NATIONAL FUND SYSTEM.....                                                             | 413 |
| A. System for Managing EU Funds (National Fund System) .....                                                                    | 414 |
| B. Budget Execution, Payment and Accounting .....                                                                               | 416 |
| C. Financial Control and Audit .....                                                                                            | 418 |
| D. Procurement under the Phare DIS Rules.....                                                                                   | 418 |
| E. Monitoring and Evaluation .....                                                                                              | 418 |
| F. Management of the Phare, SAPARD and ISPA Funds .....                                                                         | 419 |
| G. The Budget Process, Programming of EU Funds and Co-Financing.....                                                            | 420 |
| H. Irregularities, Fraud and the Recovery of Unjustified Expenditures .....                                                     | 420 |
| <br><i>Annex III.</i> — EUROPEAN UNION REGULATIONS CONCERNING FISCAL<br>SURVEILLANCE, BUDGET, FINANCIAL CONTROL AND AUDIT ..... | 423 |
| <br><i>Annex IV.</i> — IMF CODE OF GOOD PRACTICES ON FISCAL TRANSPARENCY .....                                                  | 431 |
| A. Clarity of Roles and Responsibilities.....                                                                                   | 431 |
| B. Public Availability of Information.....                                                                                      | 432 |
| C. Open Budget Preparation, Execution and Reporting .....                                                                       | 432 |
| D. Independent Assurances of Integrity .....                                                                                    | 433 |
| <br>GLOSSARY .....                                                                                                              | 437 |
| <br>BIBLIOGRAPHY .....                                                                                                          | 475 |
| <br>SELECTED WORLDWIDE WEB SITES .....                                                                                          | 491 |
| <br>INDEX.....                                                                                                                  | 493 |

## LIST OF BOXES, FIGURES AND TABLES

### *Boxes*

|                  |                                                                             |     |
|------------------|-----------------------------------------------------------------------------|-----|
| <i>Box 0.1.</i>  | Main Requirements for Fiscal Transparency.....                              | 23  |
| <i>Box 0.2.</i>  | Ten Basic Principles of Budgetary Reform.....                               | 26  |
| <i>Box 1.1.</i>  | Examples of User Charging in OECD Countries.....                            | 54  |
| <i>Box 1.2.</i>  | Tax Expenditures in France.....                                             | 61  |
| <i>Box 2.1.</i>  | Organisation of the Federal Ministry of Finance in Germany .....            | 66  |
| <i>Box 2.2.</i>  | The Budget Approval Process in Sweden.....                                  | 71  |
| <i>Box 4.1.</i>  | COFOG: Breakdown by Division and Group .....                                | 123 |
| <i>Box 4.2.</i>  | Budget Outlays Classified by Responsibility .....                           | 130 |
| <i>Box 4.3.</i>  | An Example of a Programme Profile.....                                      | 135 |
| <i>Box 5.1.</i>  | The UK Code for Fiscal Stability.....                                       | 148 |
| <i>Box 6.1.</i>  | Examples of Multi-Year Budgeting from the 1970s and Early 1980s.....        | 176 |
| <i>Box 6.2.</i>  | Medium-Term Budgeting in the United Kingdom .....                           | 178 |
| <i>Box 6.3.</i>  | Rolling Forward Multi-Year Budget Estimates.....                            | 179 |
| <i>Box 8.1.</i>  | The European Commission's Interpretation of Concession Contracts.....       | 236 |
| <i>Box 8.2.</i>  | Contracting-Out Gone Wrong: Two Examples .....                              | 238 |
| <i>Box 9.1.</i>  | Incentives for Good Cash Management in Sweden .....                         | 248 |
| <i>Box 10.1.</i> | Key UK Control Arrangements and Responsibilities .....                      | 260 |
| <i>Box 10.2.</i> | Financial Control Checklist.....                                            | 261 |
| <i>Box 10.3.</i> | Public Internal Financial Control Systems.....                              | 262 |
| <i>Box 10.4.</i> | Key Elements of Effective Systems of Financial Control .....                | 263 |
| <i>Box 10.5.</i> | Financial Control Environment.....                                          | 264 |
| <i>Box 10.6.</i> | What Does the Internal Auditor Look For?.....                               | 269 |
| <i>Box 10.7.</i> | Audit Trail .....                                                           | 271 |
| <i>Box 10.8.</i> | National Fund — Definitions.....                                            | 274 |
| <i>Box 11.1.</i> | An Example of a Comparison of Accounting Bases.....                         | 293 |
| <i>Box 11.2.</i> | Comparison Between Full Costs and Cash Payments.....                        | 311 |
| <i>Box 11.3.</i> | An Example of Activity-Based Costing.....                                   | 312 |
| <i>Box 13.1.</i> | Examples of Budget Execution and Accounting Systems .....                   | 325 |
| <i>Box 14.1.</i> | Recommendations for the Establishment and Proper Functioning of an SAI..... | 343 |
| <i>Box 14.2.</i> | Training of Auditors: Sweden .....                                          | 347 |
| <i>Box 14.3.</i> | Denmark: Management by Performance-Based Contracts .....                    | 352 |
| <i>Box 14.4.</i> | France: Highway Construction Policy.....                                    | 353 |
| <i>Box 14.5.</i> | Sweden: Schemes to Reduce Unemployment .....                                | 354 |
| <i>Box 14.6.</i> | United Kingdom: Procurement of Equipment from Research Grants .....         | 354 |
| <i>Box 15.1.</i> | Performance Indicators in the UK Health Sector.....                         | 367 |
| <i>Box 15.2.</i> | Example of a Logical Framework Approach to Evaluation .....                 | 371 |
| <i>Box 15.3.</i> | An Example of an Evaluation Report Structure.....                           | 379 |
| <i>Box 15.4.</i> | Institutional Arrangements for Evaluation.....                              | 381 |

**Figures**

|                                                                                          |     |
|------------------------------------------------------------------------------------------|-----|
| <i>Figure 0.1.</i> Basic Objectives of PEM and Budget Management .....                   | 20  |
| <i>Figure 1.1.</i> Types of Appropriation... and Commitment Appropriation .....          | 47  |
| <i>Figure 2.1.</i> Main Elements of an Organic Budget Law .....                          | 78  |
| <i>Figure 4.1.</i> Illustrative Relationships Between Expenditure Classifications.....   | 128 |
| <i>Figure 5.1.</i> Government Operations Table: Definitions of the Fiscal Balances ..... | 151 |
| <i>Figure 5.2.</i> Relationships Between Main Macroeconomic Accounts.....                | 153 |
| <i>Figure 5.3.</i> Budget Preparation Process.....                                       | 162 |
| <i>Figure 6.1.</i> Medium-Term Budget Framework .....                                    | 181 |
| <i>Figure 6.2.</i> Preparing Multi-Year Expenditure Estimates.....                       | 184 |
| <i>Figure 7.1.</i> Implementation of Budgetary Expenditure .....                         | 213 |
| <i>Figure 9.1.</i> Main Functions of the Treasury .....                                  | 242 |
| <i>Figure 9.2.</i> Illustrative Treasury Organisational Structure .....                  | 242 |
| <i>Figure 9.3.</i> Three Treasury Payment Systems .....                                  | 245 |
| <i>Figure 10.1.</i> Example of an Audit Trail for EU Funds .....                         | 272 |
| <i>Figure 11.1.</i> Cash and Accrual Accounting Options .....                            | 295 |
| <i>Figure 11.2.</i> Chart of Accounts and Financial Reports .....                        | 296 |
| <i>Figure 12.1.</i> GFS Analytical Framework .....                                       | 323 |
| <i>Figure 13.1.</i> Financial Management Information Systems.....                        | 329 |
| <i>Figure 15.1.</i> Programme Logic, Performance Measurement and Evaluation.....         | 373 |

**Tables**

|                                                                                                 |     |
|-------------------------------------------------------------------------------------------------|-----|
| <i>Table 1.1.</i> Measures to Manage the Fiscal Risks of Individual Government Programmes ..... | 57  |
| <i>Table 3.1.</i> Financial Perspective 2000 — 2006.....                                        | 89  |
| <i>Table 3.2.</i> EU Budget Revenues, 1999 and 2000.....                                        | 91  |
| <i>Table 3.3.</i> EU Budget 2000: Breakdown of Expenditure by Subsection .....                  | 92  |
| <i>Table 4.1.</i> Functional and Economic Classification of Expenses/Expenditures.....          | 124 |
| <i>Table 5.4.</i> Possible Timetable for Budget Implementation .....                            | 170 |
| <i>Table 11.1.</i> Accounting Basis Applied for Budget Approved by Legislature .....            | 308 |
| <i>Table 11.2.</i> Plans to Move Budget to Accrual Basis .....                                  | 309 |