BACKGROUND AND SUMMARY OF AN INTEGRATED PFM MODEL

A basic integrated model

PFM reform goals countries typically identify are multi-faceted and difficult to achieve. Their achievement depends on active and engaged reforms throughout the PFM process. In this light, recent initiatives in the donor community emphasize the importance of looking at public financial management (PFM) systems in an integrated fashion, and pursuing reforms in this manner. The most recent of these is the June 2005 document, “Financial Management Performance Measurement Framework” produced by the multi-donor Public Expenditure and Financial Accountability Secretariat (PEFA). Following the line of this and other products, it is argued that a good PFM reform plan shows how interventions in all related PFM processes interact to achieve final goals, within one comprehensive, integrated system.

Figure 1 provides a stylized presentation of the processes within this system, and the minimal connection points required for effective functionality. The figure provides a basis for an Integrated Financial Management System (‘business processes’ behind Public Financial Management Information Systems, PFMS).

Figure 1. The various processes within a PFM system

Figure 1 shows that there are a number of processes in a PFM system. Reform effectiveness in this system derives from implementing appropriate initiatives in all six processes (reflected in the complete boxes) and establishing connections between reforms in the various process areas (reflected in the solid arrows, which show how one connection facilitates another, leading to a closed, consistent system of processes). If reforms in all six areas work effectively, but the initiatives are at odds with each other or follow different time-frames, there is no guarantee that the PFM system will generate improved outcomes.

The key process areas in the PFM system, and the importance of their connection, can be briefly understood when each is described.

**Strategic budgeting**

An initial strategic stage precedes the actual preparation of budget proposals. The strategic stage is commonly focused on producing MTEFs, and comprises four elements, shown in Figure 2:

1. **Identifying (and formalizing) medium-term national expenditure priorities:** Strategic national budgets must be focused by clear national priorities.
2. *Identifying (and formalizing) the medium-term resource framework* (and resource envelopes for all years in the medium-term): Clarity about resource availability is a basic starting requirement for strategic budgeting.

3. *Deciding on (and formalizing) medium-term expenditure ceilings (including the current year ceilings):* Strategic and disciplined budget preparation is contingent on having clear boundaries (limits) in which budgeters know they need to fit their requests.

4. *Developing medium-term strategic expenditure plans in budget users:* Strategic budgets require effective prioritization in budget users, which only comes from planning.

Figure 2. The 2 elements of a strategic stage in budget formulation

1. High-level policy direction
2. Medium-term resource envelope (fiscal framework)
3. Medium-term budget ceilings proposed
4. Government agrees on ceilings

Medium-term macro fiscal and expenditure framework adopted, medium term budget policy document

4. Budget users’ plans

The strategic stage produces specific products (before budget preparation begins), which are usually released by Cabinet and submitted to the President or Parliament (depending on the Government system)—making them official and binding:

1. *A medium-term budget policy document for all of Government* (showing the medium-term resource framework, a statement of expenditure policies, major strategic priorities of budget users, and budget ceilings for the medium-term).

2. *Medium-term strategic expenditure plans for budget users.*

These products, particularly the medium-term policy document, lead directly into the preparation stage, where budget proposals and drafts are prepared.

**Budget preparation**

This stage comprises 3 elements:


2. *Developing policy-based, purpose-oriented multi-year budget proposals and Appraising and negotiating budget proposals* (emphasizing annual appropriations within a medium-term context for budget users, and in accordance with clear criteria, as set out in the budget policy document).

3. *Preparing the draft policy-based, purpose-oriented multi-year budget* (emphasizing annual appropriations) and defending budget in Parliament.

The budget preparation stage produces the budget document, which should show:

- The agreed multi-year resource framework (with underlying economic policies and assumptions, and with details reconciling allocations in the current year and new forward estimates with allocations and forward estimates from previous years);
- Revenue policies and revenue breakdown (for medium-term and emphasizing current year);
Expenditure policy priorities, and expenditure allocations;

Expenditure allocation breakdowns by purpose of expenditure (detailed function and/or program), with some basic economic classification as well (preferably within programs);

Performance information for all purpose areas (function/program), showing past performance and targets for the future;

Details of all capital projects undergoing (with details of progress) or newly initiated.

Beyond budget formulation, ‘better practice’ governments focus their systems on budget execution—knowing that even a strong strategic and preparation stage does not guarantee strong outcomes unless execution is also strengthened.

Implementing policy-based, purpose-oriented, transparent budgets requires strong and connected budget execution and fiscal accountability processes and mechanisms. Budget systems need to be connected (as in Figure 1) to yield effective results. Results are threatened by breaks in the system (through weak internal processes or broken connections between processes) or inconsistencies in the system (when different processes introduce different rules or incentives).

The budget execution section includes 4 core process areas (3,4,5 and 6 in Figure 1):

**Core resource management processes**

These incorporate cash and debt management (which also includes revenue management concerns), procurement management processes, personnel management processes, and capital management processes, which yield reliable input access for efficient and effective implementation of budget program. It is impossible to manage a strategic budget without disciplined resource management and reliable resource access. The issue of information systems, relevant throughout the public financial management system, is most commonly raised in this ‘box’.

**Internal controls, internal audit and monitoring mechanisms**

These mechanisms generate the information managers and those observing budget users need to ‘manage’ and ensure efficient and effective implementation of the budget program: These are the processes managers depend on to get the information they need to manage strategically.

**Accounting and reporting processes**

These processes ensure that budget users are recording their activities and reporting on them, showing not only the inputs consumed (by economic item) but also the allocations going to specific purpose areas (functions/programs) and results: Poor accounting and reporting undermines incentives for effective budget implementation and undermines transparency and accountability. ‘Input only’ accounting and monitoring is inconsistent with strategic budgeting.

**External audit (and other accountability) processes**

These processes ensure accountability for implementing the budget program, examining both conformance to the legal aspects of the program and performance in the program: Without these processes there is no accountability; with conformance only audits, the focus of strategic budgeting is not reinforced.

**Additional areas of concentration**

Apart from these core areas, there is increasing emphasis on two more processes within the financial management system. The first is donor management, which is being recognized as important because of the influence of donor funds on financial flows in many governments. The second is disaster management, which is increasingly being seen as a PFM issue because of the
need to plan and budget for disasters, and ensure that disbursement and control systems facilitate response to disasters.

**The vertical dimensions of an integrated financial management system**

It should be noted that the model in Figure 1 emphasizes horizontal aspects of PFM integration—across processes in government. There are also vertical dimensions that should be noted. These dimensions relate to the fact that PFM issues can be raised in central entities in national governments (like Ministries of Finance (MoF)) as well as in implementing agencies in national governments (Ministries, Departments and Agencies (MDAs) and even non-commercial organizations (NCOs)). PFM issues also matter in deconcentrated and decentralized governments, including regional and local governments.

**Thinking about Armenia’s PFM system**

The model here is a simple one, with little detail. It is useful simply to get a basic idea of how inter-connected a PFM system should be. It is similarly useful to get a starting perspective on the degree of integration in Armenia’s PFM system—and in reforms to this system. Four basic questions, which can only be answered when many different perspectives are considered, are:

1. How strong are the individual ‘processes’ in the PFM system?
2. How ‘connected’ are the individual processes?
3. In which ‘processes’ are reforms being pursued, who is doing these reforms, and how advanced are they?
4. How ‘connected’ are reforms in the individual processes?

Each of these questions can be addressed with reference to Figure 1 (answers shown graphically are easy to compare).

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