

Annex 5: Public Finance Management Scoping and Design

Mission

Aide Memoire

12 July 2011

Background

AusAID is committed to supporting the Government of the Islamic Republic of Afghanistan (GIRoA) to strengthen its public financial management (PFM) systems. Improvements in PFM systems will help international efforts to align funding with Afghan priorities, to deliver more aid through Afghan systems and, ultimately, to improve the level of service delivery to the people. A supportive PFM framework is critical to achieving this goal.

Australia has a relatively long history of targeted engagements in PFM in Afghanistan. This support has contributed to improvements in aspects of GIRoA's PFM system. Most recently, a senior AusAID official led a team providing support to the Ministry of Finance in the lead-up to the Kabul conference in July 2010. This work was focused on identifying major constraints to budget execution in the context of national priority programs. Although appreciated by GIRoA, this support has not been systematic. The challenge now is to develop a coherent and prioritised set of actions that are aligned with Afghan priorities.

In July 2010, GIRoA set out its vision in The Public Financial Management Roadmap (PFMR). The PFMR focuses on four key objectives: (i) strengthening the link between budget and key service delivery priorities; (ii) improving budget execution; (iii) increasing accountability and transparency of Government activities; and (iv) increasing the capacity of line ministries to implement budget and deliver services effectively. GIRoA has already made considerable progress in its implementation of the PFMR but success has not been even across all four components and gaps exist in the technical assistance provided to support implementation.

AusAID's Public Finance Management Scoping and Design Mission ('the Mission') was launched to develop a new approach that brings greater coherence to Australia's assistance on PFM in Afghanistan, while being consistent with previous AusAID engagement on PFM. In doing so, the Mission has focused on identifying ways for the Australian Government to add value, avoid duplication, and complement the existing interventions of other donors and GIRoA.

Consultation process

The Mission took place between 27 June and 12 July 2011 in Kabul and Tarin Kowt, Uruzgan. The Mission team included AusAID staff from the Afghanistan program, AusAID's economics section and an external consultant with extensive experience in Afghanistan's PFM sector. The scoping and design process consisted primarily of consultations with GIRoA officials, key donors and development partners working in PFM and key service delivery areas.

At the national level, the mission consulted with deputy ministers, directors general and directors or technical and administrative units within the Ministries of Finance, Education, Public Health, Agriculture and Rural Rehabilitation and Development. In Tarin Kowt the Mission consulted with the Governor's Office, directors and key finance staff of several major line departments, and international implementing partners.

Donors consulted during the Mission included the World Bank, the Asian Development Bank, UNDP, USAID and DFID. Development partners consulted included the Asia Foundation Performance-Based Governor's Fund, the Deloitte implemented Economic Growth and Governance Initiative Project, PKF Technical Capacity Assessment Project, Altai Consulting and the UNDP Making Budget and Aid Work Project representatives.

The agenda discussed in the meetings covered five broad areas: (i) budget preparation and execution process; (ii) expenditure analysis and monitoring; (iii) internal coordination; (iv) capacity of the ministry to implement procedures; and (v) key issues hampering effective budget execution, as perceived by ministry.

Observations and Key Findings

A number of reforms have been implemented since 2001 and the Afghan Government has made impressive recent progress. Despite this progress and the extensive support currently in place, there are gaps and areas that require further assistance.

GIRoA's development budget execution rate was only 41 per cent in 1389 (last fiscal year) and 39 per cent in 1388. Weak budget execution is not only a technical problem; it is also a major political liability and a constraint on sustainable development. At the London Conference in January 2010, donors agreed to increase assistance to Afghanistan through the central budget to 50 per cent over the next two years. It will be difficult for GIRoA to sustain donor commitment to this pledge unless the Government's capacity to spend improves – a point emphasised in AusAID's previous analysis and recommendations in 2010. Furthermore, the long-term legitimacy of GIRoA in the eyes of the Afghan population is closely linked to its ability to convert resources into services for its population.

Key points from Ministry of Finance consultations

The Ministry of Finance (MoF) emphasised the priorities set out in the PFM roadmap. The general message from MoF was that Australia could derive the greatest return on its investment by building line ministry capacity for budget execution. In particular, MoF officials pointed to the need to develop capacity in project formulation and design, project management, procurement, financial planning and expenditure controls.

MoF has recently issued instructions to line ministries to form Budget Committees to support budget execution. MoF officials advised that supporting and strengthening the operation of these committees would present the best entry-point for assistance to line ministries.

MoF also noted another potential area for intervention to improve budget execution would be to support the Provincial Budgeting Unit in the ministry. Options proposed included supporting the roll-out of the nascent provincial budgeting pilot, or, given Australia's leadership of the Uruzgan PRT, supplementing the resources of the Provincial Budgeting Unit in Kandahar (which has responsibility for strengthening PFM capacity in Uruzgan).

Key points from line ministry consultations

Line ministries provided mixed responses to questions around their capacity and need for support on financial management. The Ministry of Public Health expressed a requirement for technical support in its financial management. The Ministries of Education, Agriculture and Rural Rehabilitation and Development outlined the strengths of their financial management systems and the efforts they have made to address budget execution issues. However, all ministries, with the exception of MRRD, suggested additional support is needed in the area of project design and program costing, as well as strengthening execution analysis and

monitoring. Most ministries complained about the lack of communication with the Ministry of Finance and provision of guidelines and support in the implementation of reforms.

Key points from donor consultations

Donors provided an overview of their current activities and the challenges faced by GIRoA in PFM. Donors generally agreed that improving budget execution remains a critical challenge. There is a clearly defined division of responsibilities between the major donors in the sector, but most conceded that the budget execution area requires additional support and Australian assistance would be welcome. Building line ministry capacity to develop and execute budgets was identified as a need, and donors supported the MoF's plans to establish Budget Committees in each line ministry to address budget execution issues.

The World Bank suggested Australia should use the ARTF funding mechanism to support the next phase of the Public Financial Management Reform Program (PFMRP II), approved by the World Bank's Board on June 27. According to the Bank, this program still has funding gaps. The program will focus on the treasury, audit and procurement functions within the MoF, as well as procurement functions in line ministries. The World Bank described their proposed approach to procurement support to line ministries under PFMRP II. In particular, they discussed a shift from the approach under PFMRP I where procurement controllers were the main form of assistance in line ministries, to a combination of controllers and facilitators. The hope is that this shift will assist line ministries to deal with procurement processes more effectively and improve budget execution. Slow procurement processes were consistently identified as a barrier to execution by line ministries.

Overall mission assessment

Consistent with the findings of AusAID's earlier PFM assistance mission in July 2010, the Mission team confirmed several causes for low execution across the government budget. It is clear from discussions with MoF, line ministries and others that the most common causes include:

- poor security
- the timing of the fiscal year and delayed approval of the national budget
- highly centralised budget planning process
- poor project preparation and planning
- cumbersome procurement rules and procedures
- lengthy and bureaucratic administrative procedures, and
- lack of communication of the new procedures by the MoF.

Clearly the poor implementation and execution of the development budget is a major issue for Afghanistan. It is widely acknowledged that line ministry capacity is a major constraint to improved execution of the budget. Given line ministries are responsible for spending the budget and delivering services, strengthening their budget execution capacity is fundamental to the long term sustainable development of Afghanistan.

Project design and planning process is one of the weakest links in the ministries. The ministries lack methodology and templates for project development and accurate activity costing. Costing is mostly done using arbitrary percentage increase to the previous year's

figures, rather than informed analysis of the activities and actual market prices. Poor project plans translate into poor implementation and financial plans. As a result, the ministries cannot start implementing activities until very late in the year. The poor planning problem is compounded by a lack of knowledge of the procurement rules and procedures, further delaying implementation.

Within line ministries, internal control procedures are another common source of slow budget execution. An example that was raised in consultations with several ministries was the number of signatures required to clear documents such as purchase orders. Often, these processes appear to be internal requirements rather than official procedures specified in the regulations. There could be a number of reasons such processes remain, including minimising the chances of being accused of corruption. In other cases, traditional or historical systems and processes may be followed, rather than the current rules and regulations. Whatever the reason, these types of processes can add significant time to budget execution.

Another important weakness observed in most ministries consulted is lack of ex post analysis of expenditures, identification of issues affecting spending and recommendations for removing obstacles. The communication of the issues between Finance Departments responsible for monitoring of budget execution, and Program Departments responsible for budget implementing is rudimentary or non-existent in most ministries.

The MoF has recently initiated greater monitoring of budget execution in line ministries, through the institution of Budget Committees. These committees (once established) will comprise representatives of financial and planning departments as well as key implementing departments in the line ministry. The MoF is in the process of issuing instructions to all ministries requesting that Budget Committees be formed. It is worth noting that MoF has previously attempted to introduce so-called Budget Implementation Teams in line ministries. These had similar terms of reference to the Budget Committees, however with few exceptions have largely not been implemented as planned. It is clear that in order for Budget Committees to produce required results in terms of improved budget execution, their work will need to be extensively supported by the Budget Execution Directorate in MoF.

Key Recommendations

One of the principal barriers to higher budget execution is the limited capacity of line ministries. Donor assistance has tended to concentrate in the MoF, which is well supported by a range of assistance programs. The mission recommends that assistance for key central line ministries be considered, focusing on support for:

- project planning and design
- developing annual implementation plans (including procurement and financial plans)
- streamlining administrative and financial procedures, and
- strengthening budget execution analysis and monitoring functions to identify issues and facilitate increased execution.

This assistance should be linked with support to the MoF, Budget Execution Department to improve communication with the line ministries and to facilitate budget implementation processes.

This approach is consistent with the recommendations of the previous AusAID PFM mission to establish Implementation Facilitation Teams and provide high-level support to ministries to implement the National Priority Programs (NPPs). The focus is somewhat broader, covering

the systematic budget execution issues in the selected line ministries, rather than focusing narrowly on the implementation of the selected NPPs. However, the line ministry support will clearly need to have a particular focus on key NPPs and improving execution in these, given NPPs generally account for a large proportion of the development budget in line ministries.

Next Steps

The Aide Memoire will be finalised upon completion of the mission with comments and input provided by the MoF on 12 July. Throughout July and August 2011, AusAID program management in Canberra and Kabul will consider the Aide Memoire's recommendations (including initial feedback from the MoF) and develop a draft Project Design Document. By end-August the draft Project Design Document will be circulated among GIROA counterparts and a round of further consultation with MoF and line ministries will be conducted in early to mid September. A peer review of the Project Design Document will be conducted in Canberra in October and procurement and contracting will follow. This timeline will allow commencement of the Project by February 2012, subject to approval by GIROA and AusAID management.

Acknowledgments

The team would like to thank all of the officials of the Afghan Government for their generous contribution of time, thoughts and ideas. In particular: HE Deputy Minister Mastoor (MoF), HE Deputy Minister Hayat (MoPH), HE Deputy Minister Kunduzi (Agriculture), Director General Jalali (Budget, MoF), Director General Aqa (Treasury, MoF), Director General Qarizada (Internal Audit, MoF), Director General Safi (Finance, MoE), Director General Arian (Policy & Planning, MoE), Director General Zamir (Programs, MoAIL), Director General Naeem (Policy & Planning, MoPH), Director Shams (Finance, MRRD), Director Jalil (Aid Management, MoF), Director Haleemi (Budget Policy, MoF).

We would also like to thank donor representatives and implementing partners from USAID, DFID, the World Bank, UNDP and ADB as well as AusAID staff in Kabul and Tarin Kowt for their kind assistance and efforts to ensure a successful Mission.