STATUS REPORT

Good Financial Governance in Africa

March 2011

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This publication was compiled by the CABRI Secretariat. It is based on three technical research papers on tax, public financial management and audit practices in Africa, and a fourth background paper on legislative budget oversight. All errors are those of the authors and editors, and the text does not constitute a shared opinion of or representation by the institutions to which the authors are affiliated.

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ACRONYMS AND ABBREVIATIONS

AfDB	African Development Bank
AFROSAI	African Organisation of Supreme Audit Institutions
AFROSAI-A	African Organisation of Supreme Audit Institutions for Arabic-Speaking Countries
AFROSAI-E	African Organisation of Supreme Audit Institutions for English-Speaking Countries
AFROSAI-F (CREFIAF)	African Organisation of Supreme Audit Institutions for French-Speaking Countries *(Conseil Régional de Formation des Institutions Supérieures de Contrôle des Finances Publiques d'Afrique Francophone)*
APRM	African Peer Review Mechanism
ARA	semi-autonomous revenue authority
ATAF	African Tax Administration Forum
CABRI	Collaborative Africa Budget Reform Initiative
CPIA	Country Policy and Institutional Assessment
DAC	Development Assistance Committee
DeMPA	Debt Management and Performance Assessment
DFID	Department for International Development
EITI	Extractive Industries Transparency Initiative
FDI	foreign direct investment
FMIS	financial management information system
GIZ	*Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH*
HIPC	highly indebted poor country
IFMS	integrated financial management system
IMF	International Monetary Fund
INTOSAI	The International Organisation of Supreme Audit Institutions
ISPPIA	International Standards for the Professional Practice of Internal Auditing
ISSAI	International Standards of Supreme Audit Institutions
LTU	large taxpayer unit
MDGs	Millennium Development Goals
MTEF	medium-term expenditure framework
NEPAD	New Partnership for Africa's Development
OBI	Open Budget Initiative
OECD	Organisation for Economic Co-operation and Development
PAC	Public Accounts Committee
PEFA	Public Expenditure and Financial Accountability
PFM	public financial management
PIP	public investment programme
PRSP	poverty reduction strategy paper
SAI	supreme audit institution
UNECA	United Nations Economic Commission for Africa

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The status report is based on three technical research papers on tax, public financial management and audit practices in Africa, and a fourth background paper on legislative budget oversight. The research approach and framework for the project was developed jointly by the networks in March 2010, and the preliminary research findings were discussed and validated at a second workshop in July 2010. The findings presented here are based on primary and secondary research undertaken by the respective research teams, including surveys, literature reviews and analysis of existing cross-country databases and primary country data. Full explanations of the research methodologies and detailed research frameworks pertaining to each research area are presented in the primary research papers, which are available at www.cabri-sbo.org.

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EXECUTIVE SUMMARY

Good public financial governance is a prerequisite for Africa to mobilise its own revenues and grow out of aid. It is intrinsic to development, economic growth and poverty reduction in African states. The responsive, prudent and effective management of the continent's financial resources is what ensures that Africa's citizens can access health, education and basic services, work and live in safe environments and conduct their business knowing that they are protected by the rule of law. Above all, good financial governance is essential for development effectiveness.

African leaders are committed to good governance (including financial governance), as illustrated by the African Union's New Partnership for Africa's Development, the 2003 Abuja Declaration on Democracy, Political, Economic and Corporate Governance and the 2007 African Charter on Democracy, Elections and Governance.

This status report is intended to underpin a Declaration on Good Public Financial Governance for consideration and adoption by African ministers of finance. It is an opportune time for such a declaration. The 2008 financial crisis had its roots in systemic flaws in both private and public practices that lacked transparency and accountability. Moreover, the context of globalisation has brought many opportunities and challenges for African nations.

As a continent, Africa can look back on the first decade of the 21st century as a period during which it achieved progress in terms of the twin guiding values of democracy and development, resulting in improvement in the living conditions of its citizens. Long-term political governance gains can be demonstrated; improved macroeconomic management has contributed to economic growth, poverty reduction and the continent's ability to weather the global economic downturn. African leaders, however, also have to confront the challenges that remain. As much as there are countries that are experiencing a positive cycle of democratisation, good governance, growth and development, there are still many in which the government is not demonstrably open, responsive and accountable. In most countries in Africa, a significant proportion of citizens still live in desperate conditions, with limited access to often inadequate public services, and the full achievement of all the millennium development goals looks increasingly unlikely.

The fine balance between remarkable progress and deep challenges makes it an opportune time to take account of the institutional and political foundations for progress towards good public financial governance in Africa. Unless Africa is focused on strengthening these foundations, in the context of globalisation, the balance can tilt in the wrong direction – away from good governance, effective regulation and equitable growth policies towards rent-seeking, the stifling of the private sector and the further weakening of public policies and institutions.

As networks of public financial governance practitioners ATAF, CABRI and AFROSAI recognise that the institutional foundations of good financial governance coincide significantly with our respective mandates. We, therefore, embarked on this study to recognise progress made, but also to reach a common understanding of financial governance challenges and priorities for consideration by African ministers of finance. This is because successful financial governance reforms – the shared focus of the networks' endeavours – require a commitment by Africa's leaders and bureaucracies to take charge of reforms, in the first place, and to ensure the unvaryingly prudent, accountable and transparent management of Africa's resources.

Our understanding of good public financial governance is informed by this purpose. In order to assess the status of good public financial governance, it would be necessary to understand: (i) what it would look like when it exists; (ii) what would be required in order for it to occur; and (iii) by which outcomes one would know that it is in place. This would allow an informed discussion on what progress has been made towards building good public financial governance and what the reform priorities are.

We, therefore, defined good public financial governance as the legitimate use of power and authority in the management of a country's financial resources with integrity, transparency, accountability, equity and a result orientation to promote development. Good public financial governance, however, requires building effective systems (including traditions and institutions) to mobilise resources and manage financial liabilities and assets, as well as building effective budgeting, budget execution, accounting, reporting and audit systems, and robust oversight institutions. The assumption was that the necessary reforms to build these systems would vary from country to country. Good public financial governance is seen to contribute significantly to effective resource mobilisation, sound fiscal management and the effective and efficient use of resources, and underpins transparent and accountable government.

This definition necessarily places strong emphasis on institution building. This is because we believe that institutions are critical to how we ensure better governance and think about building the foundations of development, democracy and growth in Africa.

Good governance linkages in the public resource management cycle

Over the last two decades, many countries in Africa have put enormous resources into building the institutions and processes that will advance financial governance. Progress is evident. Many countries have successfully reformed their legal frameworks for financial governance, as well as institutions and processes across the public resource management cycle. Tax administration institutions have been reconstituted, fiscal framework processes developed, budget preparation institutions profoundly recast, budget classification dimensions added, systematic performance information collection and procurement laws introduced and audit institutions strengthened. The technical gains from these shifts are evident: there are pockets of the public resource management cycle that are performing better on average – for example, taxpayer management, fiscal forecasting and budget credibility, central budget planning and, in some countries, sector planning practices, internal financial reporting and the timely submission of audit reports to parliament.

However, progress is slow: advances in one area are frustrated all too easily by stasis in another; relapses in the overall governance environment can reverse gains; all too frequently, changes to processes and rules are not followed by changes in behaviour. Experience has shown that effective reform of the financial governance functionality of systems is not a linear path: almost inevitably, better reforms are informed by lessons learnt from the less favourable options pursued in the past, and are sustainable only if they occur within a context of improved vertical and horizontal accountability.

Overall, the study found that financial governance gains are held back by a series of challenges shared across our respective arenas of practice in the public resource management cycle.

Improved public resource management in Africa is blighted by a significant transparency deficit. Without good information on tax and other sources of revenue, expenditure and debt, members of parliament, public auditors and the electorate cannot hold the executive to account,

opening the door for wasteful spending and corrupt practices in the raising of taxes and use of resources. Despite the evidence of better internal availability of information, too many countries still provide scant or no information on fiscal decisions, the state of the public finances and the compliance of actors in the public resource management cycle with laws and regulations.

Across the continent, constitutional accountability relationships are impaired. Our research has highlighted poor performance by African countries in budgetary oversight, due largely to inadequate independence, a lack of resources and procedures in supreme audit institutions (SAIs), deficiencies in parliamentary powers, lack of political will to follow up on the recommendations of SAIs and a lack of co-operation by the executive.

Public financial governance in Africa is plagued by deficient political will to adhere to constitutional frameworks, tax and budget management laws and stated rules and procedures. In each of the areas of the resource management cycle, formal and informal institutions interact. Despite states reforming legal frameworks, establishing and reforming institutional structures and introducing new approaches, rules and procedures, decisions continue to be influenced by well-entrenched informal practices. Arbitrary tax exemption, tax evasion, corrupt tax officials and the illicit outflow of resources are common problems in African tax governance. In budget management, political interference and bypassing of budget planning processes and execution controls undermine the rule of law. The formal procedures of audit and oversight are often delayed interminably or are merely procedural. Overall, the persistence of informal practices in financial governance is entrenched in the incentives faced by key stakeholders from the civil service, the executive and the legislature. The motivation behind informal practices varies: clientelism and manoeuvrings by the privileged to ensure that their interests are protected are often posed as key drivers of informalism.

A political commitment to formalisation of tax, budget and oversight practices will start to provide the necessary countervailing force towards improved financial governance. It should mean the replacement of arbitrariness and accidental privilege by systematic processes and laws of general application. In order to overcome the traditional incentives that drive informalism, African political leaders, in particular finance ministers and senior financial governance bureaucrats, therefore, need to make a strong commitment to enforcing formal rules and imposing consequences for non-compliance.

Technical and managerial capacity shortfalls threaten good financial governance. There is a growing mismatch between the direction of tax, budget and audit reforms in Africa and the availability of skills. The development and use of sophisticated fiscal forecasting models, the development of costed sector plans, the implementation of financial management information systems (FMISs), the shift to a risk-based system of internal audits, and the development of professional audit capacity and full oversight of increasingly sophisticated public finance approaches, among other changes, require highly professional technical and managerial skills. The training, recruitment and retention of skilled personnel in the public finance arena is a priority for good financial governance in Africa. There is also an obligation on governments to ensure that reform choices are informed by their implementation capacity.

Financial governance reform choices are not always country appropriate. Undue donor influence on financial governance reforms affects the ability of African states to establish effective institutions. Donors and their consultants tend to propose what is familiar to themselves, leading to similar institutional approaches to financial governance problems in very different country contexts. Scarce capacity in many ministries of finance has been tied up in implementing donor-designed reform programmes, which often do not take sufficient account of underlying

institutional practices, resulting in ritualistic changes to process or form with little effective improvement in function. Other factors contributing to the poor performance of donor-driven reforms are that local capacity and initiative are suppressed, more costly big-ticket (sometimes premature or inappropriate) projects are prioritised, time frames and reform loads are unrealistic, and reform activities required by different donors overlap or contradict each other.

African governments carry some responsibility; too often, reform proposals and technical advice are accepted uncritically. Therefore, it is urgent that African countries take charge of their own reform requirements, sequencing and approaches.

In view of these challenges, we pose the following core principles for financial governance reforms in Africa:

- *Transparency:* Progress towards good financial governance will be limited unless African governments, in general, effect significant improvements in fiscal and budget transparency. The study confirmed the need for Africa's governments to commit themselves unequivocally to being open about decisions in the public resource management cycle.
- *Accountability:* A commitment by African political leaders and senior public servants to restore and build the functionality of internal and constitutional accountability systems is necessary.
- *Institution building:* African governments need to focus on building transparent, accountable and effective institutions in the public resource management cycle. This means focusing on the progressive formalisation of institutions, eliminating arbitrary privilege, enforcing the intelligent application of laws and procedures and holding actors accountable for informal practices.
- *A result orientation in public financial governance:* The reform of public financial governance systems and, indeed, the raising of resources and budgeting for their expenditure, must be oriented towards a guiding concern with the socio-economic consequences of fiscal decisions, resource mobilisation and the expenditure of public funds.
- *Balancing reforms and capacity growth:* Poor human resource and system capacity can derail any reform initiative. When overly complex institutions are attempted in contexts where professional capacity is scarce, countries run the risk of being worse off because of the reforms. Capacity issues need to be taken into account in reform choices at the same time as African governments need to develop measures to train, recruit and retain the necessary skills for good financial governance.
- *Autonomy in reform choices:* This means that African countries must decide for themselves what their reform priorities are. Ministers of finance have an important leadership role in this regard, to manage donor demands and proposals for reform.

Besides these overarching areas, the study highlighted several technical priorities relevant to our respective mandates within the public resource management cycle.

Priorities for good tax governance

African governments are paying increasing attention to taxation as a key pillar in development effectiveness. The ability of African states to mobilise revenue, fund their development and grow out of aid is a function of good tax governance. The section on tax governance in this report (Section 2) provides an assessment of the status of good tax governance in Africa, including an overview of tax policy and tax administration reform and performance against the history of tax in Africa. It identifies the drivers of change in tax reform in Africa and discusses progress that has been made in restructuring tax administration, improving taxpayer management, expanding tax bases and building a taxpayer culture.

However, it also identifies key challenges in achieving the goals of good tax governance. Despite embarking on extensive tax reforms following the global tax reform agenda, many countries have experienced slow progress, mainly because tax reform is rarely technocratic, but requires a changed mindset and a willingness to reform in many actors and stakeholders. Ensuring that technocratic reforms result in transparent taxation and increased revenues is hampered by the continued use of tax exemptions, by transfer pricing and illicit capital flows to secrecy jurisdictions, corruption in tax administration, constitutional, legal and democratic deficits and poor linkages between taxes paid and the services provided to citizens. These, coupled with weak tax literacy, undermine the growth of a taxpaying culture in Africa. In addition, reform effectiveness is challenged by weak ownership of reforms and poor linkages between reforms.

We have identified the following priorities for improving tax governance.

Addressing tax evasion: In many African countries, where the informal sector is diverse, small and large taxpayers are able to evade tax. This is a big challenge. The informal sector can, however, be brought into the tax net in several practical ways. African countries need to be deliberate about bringing the informal sector into the tax net, while, at the same time, developing fair procedures to ensure tax compliance by all taxpayers, whether in the formal or informal sector.

Stopping illicit capital flows: There should be a concerted effort by the international community and African governments to deal with illicit capital flows from Africa, mainly to tax havens and certain financial institutions. All the opportunities that facilitate the phenomenon of illicit capital flows should be removed and stringent control mechanisms and other incentives put in place through appropriate legislation.

Fighting transfer pricing: Fighting transfer-pricing abuse requires African countries to develop specific legislative measures that are adapted to their legal system and economic context, and to build the administrative expertise needed to enforce them.

Efficient management of the tax system: Efficient management of the tax system enables the public sector to mobilise resources for economic development. It also engenders confidence and trust in public financial management, which is an important component of good governance. Despite efforts to broaden the tax base and reduce tax evasion, many African governments need to take further steps to broaden their tax bases equitably.

Fighting fiscal corruption: Tackling fiscal corruption within tax administrations is a priority in establishing legitimacy. Corruption undermines tax morale and tax revenue. African governments must find solutions to address corruption in tax administration, including steps to prosecute corrupt officials without favour, and measures to reduce the opportunity for corruption.

Ending tax preferences: Revenues foregone by virtue of tax incentives for investment tend to exceed by a wide margin the revenue costs expected before the concession is put in place. In providing an attractive tax system for investors, African governments should aim for transparency, certainty and predictability of tax treatment, and take steps to limit compliance costs (for example, through taxpayer education and streamlined payments), before exempting international investors from all or part of their fiscal obligations.

Instituting measures to build a taxpaying culture: Measures must be instituted to promote a taxpaying culture, including educational campaigns to help taxpayers understand and accept compliance requirements. Such a campaign, however, needs to be supported by measures ensuring that taxpayers perceive the cost of dodging taxes and the risk of getting caught as high. These efforts, in turn, must be balanced by changes in how tax administrations treat complaint taxpayers, namely as clients rather than suspected criminals.

Taxing natural resources: Vast natural resources are already an essential revenue source for many African countries. However, there is evidence that African states receive proportionately less revenue from natural resources into the public revenue pool than do other countries in the world. Shortages of legal and negotiating skills play a major role in driving down natural resource tax revenues, as does corruption. Given the challenges, African countries need to build capacity to (re-)negotiate contracts for taxing extractive industries, while building transparent practices in reporting the flow and use of such revenues.

Understanding the political nature of taxation: While the technical aspects of tax reform are crucial, an understanding of the sustainability of reforms is not possible without understanding how reforms become legitimate. Because taxation affects incentives and distribution simultaneously, tax reform requires a degree of social consensus that the policy is in the collective interest, and/or a state with the ability to coerce those who challenge its allocations. While the technocratic approach to tax reform and institutional development is required, it is insufficient because it ignores the political nature of taxation.

In summary, most African countries face difficulties with their tax policies and tax administration. At the same time, they need to improve revenue mobilisation to finance their ambitious economic development programmes. It is not only the revenue target that is an important issue (since over-ambitious targets undermine good tax and budget governance), but also how taxes are enforced. If revenue targets are reached, but tax collection is effected by harsh, inequitable, illegitimate and coercive methods, this is not good tax governance. Deficiencies in the tax collection system – evasion, corruption, abuse and misapplication of provisions for tax exemption, political interference and the low capacity of tax administrations – are at the root of these failures. In short, the predictability of resource mobilisation is a sine qua non for good tax governance as well as good public financial governance.

Priorities for good governance in budget preparation, execution and reporting

Building sound budget management, execution and reporting systems will shore up the ability of governments to collect taxes to fund development. Good governance in budget preparation, execution and reporting is indispensable to systematic improvements in public infrastructure and service delivery. The section in this report on good financial governance in public financial management (PFM) (Section 3) details the basic institutions required to ensure prudent, transparent and accountable management of public resources in the budget preparation,

execution and reporting phases of the budget process. For each of these phases, it highlights the important technical gains that have been made, including increased budget credibility, strengthened central budget planning practices, improved sector capacity and involvement in budget preparation, greater depth in our perspectives on the budget through improved classification systems, the introduction of systematic performance information and procurement reforms, the strengthened internal flow of financial information, commitment to accounting standards and moves towards integrated financial management systems (IFMS).

However, in the budget arena, our research also highlighted that enforcing transparency and accountability, instituting technical improvements in tandem with capacity development and taking ownership of budget reforms to ensure that they are country-appropriate, realistic and well-sequenced are crucial overarching steps towards the establishment of effective budget management functions.

The following are specific challenges in budget preparation, execution and reporting.

Strengthening fiscal frameworks to enhance predictability and affordability: Many African countries need to improve revenue forecasting practices, address the high use of opaque extra-budgetary mechanisms and use pre-budget statements more effectively to strengthen their fiscal frameworks.

Improving the quality of spending through better budget preparation: In order to achieve effectiveness, efficiency and value for money in budget expenditure, African countries need to integrate their capital and recurrent budgets, elevate their medium-term budget practices to actualise the intent behind relevant reforms, develop the critical capacity at sector and line ministry level for strategic planning and budgeting, and use performance information more effectively.

Prioritising functional budget-execution practices: There is a critical need to prioritise downstream budget reforms, including the operationalisation of single treasury account mechanisms, improved cash planning and commitment practices, strengthened commitment controls and more robust payroll controls. Building effective risk-based internal audit systems will ensure ongoing improvements in budget-execution practices.

Strengthening accounting practices: In order to improve the quantity, quality and timeliness of internal fiscal information, countries need to regularise bank and other reconciliations, provide more support for the implementation of consistent accounting standards, regularise bank and other reconciliations and strengthen reporting practices.

Operationalising procurement reforms: The slow improvement in procurement systems is a welcome development ensuring integrity and value for money in the use of public resources, but the improvements in countries' formal frameworks must be followed by changed procurement practices.

Developing strategic, appropriate and owned integrated financial management solutions: While IFMSs purport to be turnkey solutions to downstream budget-execution weaknesses, African countries have to approach their implementation strategically, ensuring that the technical solutions are sustainable, that the underlying incentives are improved for enhanced business processes in budget execution and transactional record-keeping, and that their management is local and shored up by the necessary technical capacity.

Strengthening political engagement and eliminating political interference: As on the revenue side, political leadership rather than political interference is crucial to good financial governance in budget preparation and execution. A key priority, therefore, is to strengthen transparent, systematic and accountable political engagement with budgets and the PFM system by political actors. This should be supported by the political will and commitment of finance ministers to enforce formal system rules and demand accountability.

Integrating aid in budget processes: A key priority for good financial governance in Africa is the integration of aid in budget processes, the reflection of aid on budget and ensuring that country oversight institutions are engaged on aid options and choices. This is particularly relevant to high-aid-receiving countries. African countries must look at the strategic integration of their aid management and public financial management practices to ensure overall resource effectiveness. This includes making strategic choices about including aid on budget to optimise country benefit and development effectiveness from aid while minimising country risk.

Priorities for good governance of financial assets and liabilities

The management of financial liabilities arising out of public sector operations in Africa is a necessary pillar of good financial governance. The section in this report on good governance of financial assets and liabilities in Africa (Section 4) provides an overview of debt and public enterprise management practices in Africa. Overall, the findings urge African governments to move from *ad hoc* management systems to active risk-based debt management systems where long-term costs are minimised (subject to an acceptable level of risk), as well as from opaque to transparent management of public enterprises.

The following policies with regard to debt management are recommended.

Improve the structure of debt to reduce vulnerability to shocks: African countries should develop the technical capacity to continuously structure their debt to achieve optimal trade-offs between risk and cost.

Build sound debt-management practices: It is important that African countries prioritise the development of sound policies and practices for debt management. This includes: less fragmentation of responsibility and clear definition of who has the power to issue debt; control and management of risks associated with state guarantees and contingent liabilities; co-ordination with macroeconomic and fiscal policy; and accurate debt recording and reporting.

Manage public financial investment in public enterprises transparently: African countries should prioritise the transparent management of financial transfers to public enterprises, as well as the regular monitoring of and consolidated reporting on the health of enterprises owned by government.

Priorities for good financial governance through external audit

Effectively functioning financial governance mechanisms assume the integrity and political will of government to serve citizens and to hold public officials accountable. Accountability requires that actions and decisions taken by public officials need to be subject to oversight. Effective accountability achieved through oversight is an essential ingredient in achieving the objectives of government in providing services to citizens. This involves both the political justification of decisions and actions, and the managerial accountability for implementing the agreed tasks.

Neither of these will be functional unless African states significantly strengthen Supreme Audit Institutions (SAIs) and parliaments.

The section in this report on good financial governance through external audit (Section 5) presents key enabling factors and institutional requirements for an effective audit function, drawing on the international standards established by the International Organisation of Supreme Audit Institutions (INTOSAI). All African countries have organisations responsible for audit functions as member of INTOSAI.

Two types of external audit system are prevalent in Africa, echoing administrative differences between groups of African countries in both the tax and budget arenas. In the Westminster system, SAIs are represented by the auditor-general, who audits the financial statements of government entities, which are then laid before an oversight committee in parliament. The recommendations of this committee for follow-up on the audit findings complete the public resource management cycle in these countries (usually countries with an Anglophone administrative legacy). SAIs in a judicial system form part of the judiciary and are referred to as 'courts of account' or, in some countries, as 'chambers of account'. The work of these bodies generally includes the assessment of the work of public accountants as far as the adequate processing and legality of financial transactions are concerned. Public accountants in judicial systems are placed in each government entity and are personally responsible for the proper expenditure of funds and for drawing up annual financial statements and reports. Courts of accounts can either 'discharge' the public accountant from further liability or impose a penalty or sanction on the public accountant. Countries with a Francophone or Lusophone legacy usually fall into this group. For some of the judicial system countries, the inspector-general of state represents the country in INTOSAI. Inspector-generals of state report either to the president or the country's prime minister.

SAIs in Africa have made substantial progress in recent years towards becoming autonomous professional organisations, as envisaged by INTOSAI. Many examples of good practice have been identified that can be shared and used as a basis for learning. At the same time, there is a definite need to further emphasise some of the essential prerequisites identified internationally. Even though there are differences between African countries in terms of how SAIs are constituted, the challenges faced by SAIs appear to be similar: they concern weak audit practices, lack of financial, managerial and administrative independence, weak financial reporting frameworks in government, insufficient freedom to report, late reporting, inaccessible reports, poor capacity, weak communication and stakeholder management, and still weak frameworks in respect of SAI accountability and ethics. The external audit function is also undermined by poor follow-up on recommendations.

The priorities for improving the functioning of SAIs in the interest of good financial governance are as follows.

Financial reporting framework: Adequate financial reporting frameworks, including clear reporting timelines for government entities, should be provided for and enforced.

Co-ordination of functions: More effective co-ordination should be provided for to improve the functions and relationships between the SAI and other institutions contributing towards accountability.

Accountability: Clear reporting mechanisms should be set up for SAIs, in order to hold them accountable for the effective discharge of their functions.

Legal, financial and managerial independence of SAIs: The government should promote the independent establishment and functioning of the SAI. Independence includes legal, financial, managerial and administrative independence. It means that SAIs should be able to appoint staff, select and conduct audits, and issue reports without undue influence from the executive.

Follow-up of mechanisms: Effective mechanisms should be put in place to enable the regular follow-up of recommendations by the SAI, and by parliament and its oversight committees. This requires that SAIs should have the freedom to follow up on previously reported issues.

Reporting: The SAIs' reports should be public documents, disseminated on a timely basis and in their original format (with additional summaries and interpretations, where necessary).

Communication and stakeholder management: The SAI should foster the awareness of the public and key stakeholders regarding the role and function of SAIs and audit report issues.

Capacity of the SAIs and adherence to INTOSAI standards: SAIs should have formalised mechanisms providing for the continuous training of staff. SAIs should strive towards implementation of applicable INTOSAI standards – in line with their mandate and national legislation – and measure their own performance and auditing practice against these standards. Practical audit manuals, functioning quality-control systems providing for ongoing evaluation of the audit work and better utilisation of existing IT tools should complement this process.

Good financial governance through strengthened oversight

The quality of financial governance in Africa is undermined by weak legislative participation in the budget preparation and oversight process. The section of this report on good financial governance through legislative oversight (Section 6) provides an extensive discussion on the importance of legislatures playing a robust role in approving executive budget proposals and in overseeing budget implementation and outturns. It highlights the key challenges confronting African legislatures in fulfilling their oversight mandates, including lack of independence, formal and informal executive prerogatives in respect of the allocation and use of public resources that weaken legislatures' power of the purse, and ineffective institutional processes and capacity.

Weak oversight allows informal systems to persist and affects fiscal discipline, budget credibility and the quality of spending and service delivery. To a significant degree, this is not necessarily on account of weak formal powers, but rather is because of institutional factors and entrenched, weak oversight practices. A priority for good financial governance in Africa is to build sound legislative institutions, processes and capacity for budget oversight.

PART A: INTRODUCTION

Good financial governance is critical for development, economic growth and poverty reduction in African states. The responsive, prudent and effective management of the continent's financial resources is what ensures that Africa's citizens can access health, education and basic services, work and live in safe environments and conduct their business knowing that they are protected by the rule of law. African leaders are committed to good governance, including financial governance, as illustrated by the African Union's New Partnership for Africa's Development, the 2003 Abuja Declaration on Democracy, Political, Economic and Corporate Governance and the 2007 African Charter on Democracy, Elections and Governance.

This status report is intended to underpin a Declaration on Good Public Financial Governance for consideration and adoption by African ministers of finance. It is an opportune time for such a declaration. The post-mortem of the 2008 financial crisis revealed systemic flaws in both private and public practices that carried on unabated due to a lack of transparency and accountability. Moreover, the context of globalisation has brought many opportunities and challenges for African nations, not least of which is the need to build robust institutions that will ensure an equitable distribution of the benefits of integration with the world economy.

As a continent, Africa can look back on the first decade of the 21st century as a period during which it achieved progress in terms of the twin guiding values of democracy and development, resulting in improvement in the living conditions of its citizens. African leaders, however, have to confront the challenges that remain.

Political governance gains over the decade can be demonstrated, with long-term political stabilisation gaining momentum across the continent and notable overall progress in political governance in some countries. Democratic consolidation is evident, with a shift in attitude towards democratic change of government, the end of violent conflict, and the subsequent relative political stability in Angola, Liberia, Côte d'Ivoire, the Democratic Republic of the Congo, Mozambique and Sierra Leone (UNECA 2009; AfDB & OECD 2010). Improved macroeconomic management has contributed to economic growth and poverty reduction. Between 2001 and 2009, all African states (except for Zimbabwe) showed positive annual real growth, with Equatorial Guinea, Angola, Sierra Leone, Chad, Nigeria, Ethiopia, Mozambique, Uganda, Sudan, Tanzania, Rwanda, Cape Verde, São Tomé et Principe, Mali and Ghana all achieving growth of 6% and more (Africa Economic Outlook 2010). Average GDP per capita grew by 3% for the third consecutive year in 2007, with only one country showing negative growth in this period. Even in 2009, Africa's GDP expanded by 2.5%, despite a global economic crisis that led to a contraction in all other major regions of the world (AfDB & OECD 2010). Over the past two decades, many African countries have reformed and rewritten their constitutions to manage better the power of the executive and improve transparency and accountability in all institutions. These changes are backed by changes in policy and an increasingly vibrant and vigilant civil society and improved capacity in the media, which, in combination, have proved effective in bolstering good governance. As a whole, between 2005 and 2010, Africa demonstrated gains in the quality of governance measured across the political, economic, corporate, democratic and human rights arenas (see UNECA 2009).

At the same time, however, Africa faces significant challenges in consolidating these gains in many countries and replicating them in others. As much as there are countries that are experiencing a positive cycle of democratisation, good governance, growth and development, there are still many in which he government is not demonstrably open, responsive and

accountable. In most countries in Africa, a significant proportion of citizens still live in desperate conditions, with limited access to inadequate public services, and the full achievement of all the millennium development goals looks increasingly unlikely (AfDB & OECD 2010). In Africa, poverty and poor governance coincide: in 2004, 83% of African nations were both poorer and had worse governance than the world average (Kaufmann & Kraay 2005).

So far, only two African nations (Seychelles and Mauritius) count amongst the 83 high and very high human development countries on the United Nations Human Development Index (HDI), while the remainder fall in the middle and low human development group. In fact, 23 out of the 25 low human development countries are African states (UNDP 2009). Moreover, in the 2009 update of the World Governance Indicators across the six indicators of voice and accountability, political stability (no violence), government effectiveness, regulatory quality, rule of law and corruption, 24 of the 50 lowest ranking countries were in Africa, while only 1 of the top 50 was African (Kaufmann, Kraay & Mastruzzi 2009).

The fine balance between remarkable progress and deep challenges makes it an opportune time to take account of the institutional and political foundations for progress towards good public financial governance in Africa. Unless Africa is focused on strengthening these foundations, in the context of globalisation, the balance can tilt in the wrong direction – away from good governance, effective regulation and equitable growth policies towards rent-seeking, the stifling of the private sector and the further weakening of public policies and institutions.

This status report is concerned with the technical and institutional requirements of good public financial governance. It highlights where African countries have succeeded in managing the public finances in ways that are transparent and accountable, optimising available resources to fund essential public services for the citizens of today and tomorrow. However, it also highlights the important challenges that need to be overcome to consolidate, extend and sustain progress. The report is concerned, in particular, with institution-building, with drawing out the links between institutions, their effectiveness, what goes into creating them and the ways in which they affect long-term social and economic outcomes.

The report is the joint product of research and deliberation by the three networks representing the public servants at the heart of financial governance – tax administrators, public auditors and senior budget and planning officials. While it is within the power of these officials to instigate reforms, it is only with the support of finance ministers that the reforms can be made game changing. Therefore, the recommendations are aimed especially at African ministers of finance, who have a particular leadership role to play in ensuring that necessary reforms are backed by the political will to see their meaningful implementation.

Africa has a complex governance environment. In addition to the challenges created by an injurious colonial government legacy, formative systems of electoral politics and persistent conflict in some parts of the region, development assistance has a significant impact on governance in Africa. Altogether, 51 out of the 53 countries in Africa are listed as aid recipients on the OECD DAC (Organisation for Economic Co-operation and Development, Development Assistance Committee) database; between them, they received 41% of total direct Official Development Assistance (ODA) flows between 2004 and 2009, totalling US$117 billion in constant prices (OECD DAC 2010). This carries particular governance challenges, particularly because public expenditure and accountability systems become fragmented, with citizens and local institutions largely absent from the discourse on the use of aid resources. Aid dependency, parallel financial management systems, poor aid sustainability and opaque aid are usually viewed under the aid effectiveness banner. However, given the porosity of the boundaries

between aid and own resource management, these are as much matters development and governance effectiveness.

Despite confronting such similar challenges, the nations of Africa are not homogenous. The 53 countries on the continent represent different levels of income, poverty and growth, different language and cultural traditions, different constitutional configurations and different administrative heritages. Some countries have access to significant natural resource revenues, while others have very little. Some aspects of this diversity occur not only across countries but, in many cases, within countries. The fact that good financial governance challenges can be context-specific (even country-specific) made this a demanding study to undertake. However, there is a need to find the common thread of issues requiring solution across the continent. We believe that the issues presented here constitute a core of institutional and technical challenges that can be addressed or facilitated by African finance ministers, individually and as a group. Of course, there are individual countries that have succeeded in overcoming many of these hurdles. They are noted where relevant, presenting examples of good practice within their contexts.

Progress in respect of good public financial governance and how it is achieved seems to be affected particularly by levels of income and growth, political stability, the constitutional configuration of the state and the type of administration. Across the tax, public financial management (PFM), audit and oversight fields of research, the means of achieving good governance – in other words, the institutions in place, the assignment of roles and responsibilities and the accountability relationships between them – can be categorised as adhering to one of two sets of administrative institutions.

On the one hand is the group of countries (including Tanzania, South Africa, Kenya, Namibia, Ghana, Uganda and Malawi) in which decentralised public expenditure management is combined with the increasing use of autonomous quasi-independent revenue administration agencies, medium-term, programme-based approaches to expenditure planning, auditor-generals' offices and a strong role for parliamentary public accounts committees in completing the public resource management cycle. This combination of elements is found commonly in Anglophone countries. Where countries also have a Westminster inheritance, their constitutions dictate parliamentary systems of checks and balances (where the executive is formed by the majority party in parliament) or, at the very least, hybrid parliamentary/presidential systems.

On the other hand are countries like Mali, Cameroon, Mozambique, Burkina Faso and Benin, which combine centralised public expenditure management with revenue-collection agencies that are embedded in ministries of finance, slow integration of medium-term, programme-based approaches, the use of courts of accounts and a more limited role for parliaments at the end of the expenditure cycle. Presidential systems, where presidents are elected separately from parliament, are more common in these countries. Countries that follow these systems – coupled often with highly detailed administrative laws controlling the budget process – usually are Francophone or Lusophone.

This report does not propose that any one set of arrangements is better than the other in itself. Instead, it endeavours to identify specific challenges to achieving the desired outcomes that apply to one environment rather than the other. It also acknowledges that as common budget reforms spread, more hybrids emerge, leading to greater commonality in the challenges faced. In general, this report endeavours to identify a common status of financial governance in Africa, while being conscious of context. It seeks to recognise the progress made in establishing systems and practices conducive to good public financial governance, while considering the critical challenges that remain.

PART B: THE STATUS OF GOOD PUBLIC FINANCIAL GOVERNANCE IN AFRICA

What do we mean by good public financial governance? Good financial governance is a necessary element of good governance overall. Some sources (NEPAD 2002; APRM 2005; AfDB 2008; OECD 2010; IMF 2007; UNESCAP 2006) define good governance in terms of the characteristics that would typify the management of a government exercising good governance – it would be participatory, consensus-oriented, transparent, accountable, effective and efficient, equitable, operating within the rule of law and without corruption. Others emphasise the place of institutions in good governance (AfDB 2008; Kaufmann et al. 2009; NEPAD 2002), the arenas within which it occurs, for example the political, economic or corporate fields of governance (UNECA 2009; Kaufmann & Kraay 2007), and/or focus definitions on the way in which power or authority is used in the management of a country's social and economic resources for development (World Bank 2007; World Bank 1992). Still others describe good governance in terms of its outcomes, for example voice and accountability, human rights, political stability and absence of violence, effective government and so forth (Kaufmann et al. 2009; UNECA 2009; NEPAD 2002).[1]

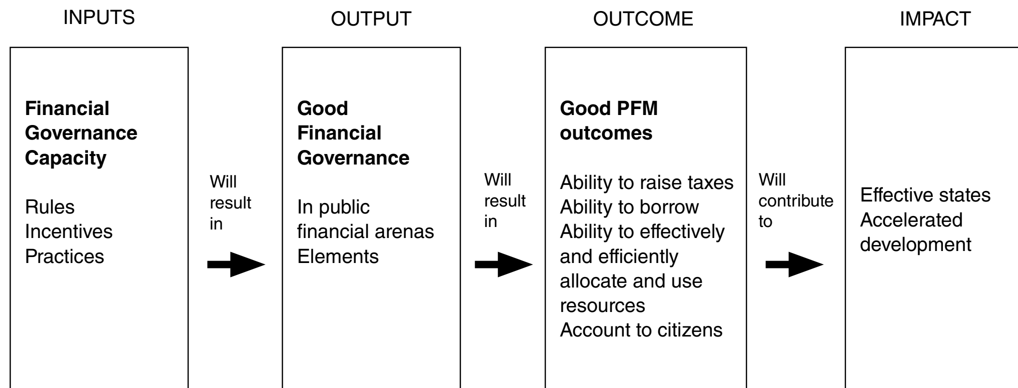
We drew on the complementarities of these perspectives on good governance to define the scope of our enquiry. The argument was that in order to assess the status of good public financial governance it would be necessary to understand: (i) what it would look like when it exists: (ii) what would be necessary in order for it to occur; and (iii) by which outcomes one would know that it is in place. This would allow an informed discussion on what progress has been made towards building good public financial governance and what the reform priorities are. Are they at the level of necessary institutions, or should they address external factors that prevent good public financial governance from resulting in desired outcomes?

We, therefore, defined good public financial governance as the legitimate use of power and authority in the management of a country's financial resources with integrity, transparency, accountability, equity and a result orientation to promote development. Good public financial governance, however, requires the building of effective systems (including traditions and institutions) to mobilise resources and manage financial liabilities and assets, as well as the building of effective budgeting, budget execution, accounting, reporting and audit systems and robust oversight institutions. The assumption was that the necessary reforms to build these systems would vary from country to country. Good public financial governance was also seen to contribute significantly towards effective resource mobilisation, sound fiscal management, and the effective and efficient use of resources, and to underpin transparent and accountable government.

Thus, for the purposes of the status report, good public financial governance is described as a value chain where strong institutions (systems, rules, processes and traditions) result in good governance of public financial resources, contributing to the desired outcomes. The value chain is represented diagrammatically in Figure 1.

1 In this regard, Kaufmann and Kraay (2007) note that although it is difficult to draw a bright line between governance and ultimate development outcomes, it is necessary to maintain a distinction so that governance can be measured separately from its results.

Figure 1: Good public financial governance



The sections below apply the definition to an investigation of public resource management practices and institutions in the key public finance arenas of tax revenue, PFM, debt management, external audit and parliamentary oversight. Across these arenas, common institutional aspects emerged against which states can demonstrate progress. At the same time, there are common obstacles to progress; these turned out to be either impediments that are common across countries or enabling factors that are not in place. These common areas of progress and concern are highlighted in Section 1.

Our definition of good public financial governance necessarily placed strong emphasis on institution building. This is because we believe that institutions are critical to how we ensure better governance and think about building the foundations of development, democracy and growth in Africa.

SECTION 1
GOOD PUBLIC FINANCIAL GOVERNANCE: INSTITUTIONAL LINKAGES

Good public financial governance has its roots in the quality of the institutions performing the tax, PFM, audit and oversight functions of government. While these institutions are linked in the budget process, they operate separately for practical reasons and/or reasons of principle. Nevertheless, our research returned commonalities between countries that cut across these arenas in the management of public resources.

Common areas of progress

Initiatives to reform key institutions

Many countries across Africa have recognised the need to address institutional weaknesses and have embarked on the reform of legal frameworks, institutions and processes across the public resource management cycle. Tax administration institutions have been reconstituted to ensure the more efficient and equitable collection of taxes in Morocco, Tunisia, South Africa, Cameroon, Ghana, Uganda, Zambia, Kenya, Malawi, Rwanda, Tanzania, Zimbabwe, Sierra Leone, Ethiopia, Mozambique, Lesotho, The Gambia and Mauritius, to name a few (ATAF 2010). Public expenditure management reforms are widespread, with very few countries not having undertaken any improvements. Common successful reforms have occurred by way of technical changes – the introduction of modernised legal frameworks, the modernisation of classification systems, the constitution of new structures in the budget preparation process, such as sector committees, and the introduction of new procurement laws (CABRI 2010). Many countries, through their membership of the African Organisation of Supreme Audit Institutions (AFROSAI), are also strengthening their audit institutions (AFROSAI 2010; UNECA 2009).

Modernisation of fiscal policies

Many countries have shifted fiscal policies, with lower budget deficits and greater mobilisation of resources becoming more of a norm in the last decade (UNECA 2009). Owing to this fiscal prudence and generally better macroeconomic fundamentals in the years prior to the global financial crisis of 2008, and to earlier debt relief, many countries were able to continue their major public spending programmes after the crisis, contrary to the pro-cyclical responses to previous exogenous economic shocks (AfDB & OECD 2010).

Key technical gains

The result of these processes is that key technical gains have been made: more countries are now able to return more credible budgets; better information is available on taxpayers within revenue administrations and on expenditure; and more supreme audit institutions (SAIs) are receiving financial statements earlier for processing. At the same time, there are pockets of the public resource management cycle that are performing better on average – for example, taxpayer management, fiscal forecasting systems, sector planning practices and the timely submission of audit reports to parliaments in relevant countries (AFROSAI 2010; CABRI 2010; ATAF 2010).

Advances in public resource management

Some countries have shown major progress across the public resource management cycle. Mauritius, South Africa, Morocco, Burkina Faso, Cape Verde and Ethiopia all scored on average above 2.5 on Public Expenditure and Financial Accountability (PEFA) assessments.[2] Botswana, Madagascar, Uganda, Ghana, Mozambique, Rwanda, Kenya, Sierra Leone, Mali, Zambia and Lesotho scored above 2.0 but below 2.5 on average. A PEFA equivalent score of 2.0 may be considered a halfway mark in effective institution building. These lists illustrate how progress has been achieved, notwithstanding administrative type.

Altogether, 22 out of 53 African countries represented in the World Governance Indicators improved their scores for government effectiveness between 1998 and 2008.[3] This includes Mauritius, Botswana and Ghana, which scored above 0.0 (scores vary between -2.5 and 2.5). Other countries with positive scores (but which have slid back since 1998) are South Africa, Namibia, Tunisia and Seychelles. Rwanda made one of the largest gains in the index between 1998 and 2008, improving its score by 0.9 points, although it still scores below 0.0. In the African Development Bank (AfDB) Country Policy and Institutional Assessments for 2009, 47 out of 53 countries scored more than 3.0 out of a possible 6.0 for economic management. Of these, Algeria, Tunisia, Botswana and South Africa scored 5.0 or higher. These statistics point to good and often improved financial governance performance by very different African states, with countries like South Africa, Mauritius, Tunisia and Botswana coming out on top in one or more of the common cross-country databases.

Challenges across areas

Despite these gains, the research undertaken by the three networks points to the persistence of deep challenges. Although some of the common challenges across areas are endogenous to the technical institutions that comprise the public resource management cycle, some concern the political, administrative and human resource environment within which the institutions operate.

Significant transparency deficit

Transparency is a crucial value in the management of public resources. The availability of reliable, regular, comprehensive, useful and accessible information on resource decisions is a prerequisite for the accountable management of public funds. Both internal and external transparency is required. Without good information on tax and other sources of revenue, expenditure and debt, members of parliament, public auditors and the electorate cannot hold the executive to account. Lack of transparency can lead to wasteful spending and corrupt practices in the raising of taxes and use of resources.

Yet, in all but three of the 33 African states rated in the World Bank's Country Policy and Institutional Assessment (CPIA) in 2008, the score on the transparency, accountability and

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2 The PEFA assessment framework was developed between 2003 and 2005 as a joint undertaking of the World Bank, the European Commission, the UK's Department for International Development (DFID), the Swiss State Secretariat for Economic Affairs, the Royal Norwegian Ministry of Foreign Affairs, the French Ministry of Foreign Affairs and the IMF. It uses 28 indicators grouped in three areas: credibility of the budget, comprehensiveness and transparency, and budget cycle. This report uses the PEFA data to assess the status of PFM systems and outcomes at various points. The report applies the convention established in De Renzio (2008) to convert PEFA's ordinal scores to cardinal scores for analysis, so that an A scores 4.0, a B 3.0, a C 2.0 and a D 1.0, with scores of B+, C+ and D+ converted to 3.5, 2.5 and 1.5 respectively.

3 The World Governance Indicators are compiled by Daniel Kaufmann, Aart Kraay and Massimo Mastruzzi, respectively of the World Bank Development Research Group, the Brookings Institute and the World Bank Institute. The indicators are based on 352 different underlying variables measuring perceptions of a wide range of governance issues. The variables are drawn from 32 separate data sources constructed by 30 different organisations worldwide (Kaufmann & Kraay 2007).

corruption indicator lagged behind the score on the quality of budget and financial management indicator by 0.5 or more points. This deficit is also reflected in the findings of the input papers in the tax, PFM, debt management and audit areas, where the performance of most African countries against assessments of public transparency was very poor. For example, African states performed poorly on the Open Budget Index:[4] of the 27 African countries surveyed for the 2010 index, 18 published no, scant or minimal budget information. Of the remaining nine countries, eight were found to publish only some information, while South Africa was assessed at the highest score worldwide, at 92 out of a possible 100 points. However, there is evidence that the internal availability of information has improved significantly in African countries (CABRI 2010), indicating that it is not necessarily technical factors, but rather issues of practice and political will that allow for the persistence of opaque government in Africa.

Given the centrality of transparency to good public financial governance, rapid improvement in the availability of public information is a priority for reform. African governments can improve budget transparency relatively quickly by publishing for public scrutiny all of the budget information they already produce.

Impaired accountability relationships

The Africa Governance Report II (UNECA 2009) highlights the ‘somewhat negative’ performance of African countries in budgetary oversight, which is due largely to a lack of resources and procedures in SAIs, deficiencies in parliamentary powers and oversight institutions, and a lack of co-operation by the executive. This echoes findings in the audit and oversight sections of this report, which emphasise that the obstacles to improved oversight are about unsupportive legal frameworks (for example, lack of independence of the SAIs and weak parliamentary powers), weak institutions and disproportionately strong executives.

A major challenge to good governance in Africa is to constrain the executive’s power, while not diluting its ability to fulfil its constitutional obligations and electoral mandate. The tendency of the executive to monopolise and abuse discretionary power and authority has been observed since independence. Consequently, various constitutional and governance reforms, such as enshrining the concepts of separation of powers and checks and balances, have been undertaken to restrain the executive. Nevertheless, the propensity of the executive to dominate the other institutions of government remains.

The capacity of the legislature to perform its functions efficiently and effectively is a major concern in many African countries. Legislatures often lack the independence to perform their constitutional functions, because they depend on the executive for their human and material resources and funding (UNECA 2003; 2009).

The high inflows of aid (CABRI 2010), coupled with the negative connotations of tax in Africa, tax exemptions, tax evasion and tax illiteracy (ATAF 2010), mean that the key relationship between taxpaying citizens and a responsive state is insufficiently developed. Taxation not only finances the government, but is also a very visible component of the social contract underlying the modern state. With tax on internal bases stagnant at about 12% of GDP over the last decade

4 The International Budget Partnership, part of the Washington-based Centre on Budget and Policy Priorities, publishes the results of its Open Budget Survey in an Index format as part of the Open Budget Initiative. The 2008 survey provides extensive data and rankings on the level of transparency of the budget process in 85 developed and developing countries (the 2010 survey on 94), based on peer-reviewed surveys conducted by local civil society partners. The questions reflect on the quantity and quality of publicly available budget information in eight key documents associated with the following four stages of the budget process: formulation, approval, execution and evaluation/audit. Twenty-four African countries were surveyed for the 2008 index, including countries with widely divergent socio-economic statuses, from all regions of Africa and from Francophone, Lusophone, Anglophone and Arabic countries. For the 2010 survey, 27 countries were involved. This report uses data from the survey to look at budget practices and transparency across African countries in several respects.

or so, the technical improvements in resource management have not been complemented by an increasing number of taxpayer-citizens that are collectively engaged in politics, making claims on the government for reciprocity, accountability and functioning oversight institutions.

Overall, accountable management of public resources is blighted by ineffective accountability institutions, which are 'undermined through subversion, underfunding and political patronage', while the demand for accountability from civil society is not strong enough (Rakner et al. 2004).

A reform priority for Africa, therefore, needs to be a political commitment to the full funding and restoration of oversight institutions, more openness and responsiveness to citizens in the budget process and the building of broader tax bases to address weak accountability systems.

Political will, informal institutions and the implementation gap

The literature on democracy in Africa lists a number of critical challenges, including monetisation of politics, political intimidation, vote manipulation, neo-patrimonialism, ethno-regional voting patterns, strong deference to leadership and expectations of personal favours in return for loyalty, pressure on politicians to reward benefactors after elections and abuse of incumbency by governments. Perceived manipulation of democratic mechanisms has reduced the electorate's trust in the political level.

Within financial governance systems, these factors are reflected in the interplay between economic interests and political or institutional power. Budget reforms can be blocked by economically and politically powerful groups that benefit from the status quo.

In particular, public financial governance in Africa is plagued by the lack of political will to adhere to constitutional frameworks, tax and budget management laws and stated rules and procedures. In each of the areas of the resource management cycle, formal and informal institutions interact. Despite states reforming legal frameworks, establishing and reforming institutional structures and introducing new approaches, rules and procedures, decisions continue to be influenced by well-entrenched informal practices.

Tax exemptions, tax evasion and the illicit outflow of resources are common problems in African tax governance. In many countries, the wealthy often escape fair tax assessment or avoid paying taxes altogether through bribery of tax officials and various forms of patronage. By the same token, in many countries, officials are notorious for using delays, the threat of high tax assessments or the promise of low assessments to extort funds from individuals and businesses, undermining trust in the government. In many countries, tax bases are eroded by the excessive granting of tax preferences and by an endemic culture of non-compliance with tax laws and the difficulty of bringing large informal sectors into the tax net.

In budgeting, centralising budget formulation procedures are often bypassed with budget requests granted through the budgeting back door, opened by interpersonal and political power relationships. Because funds are limited, budget execution is most vulnerable to informal interests and practices. When cash is scarce, poor budget discipline, slippages and expenditures on activities closer to the centre of power in government are common experiences in Africa. The introduction of cash budgeting, in particular, has spawned informality in budget execution by undermining the rule of law (Bouley, Fournel & Leruth 2002). In accounting, the operationalisation of international accounting standards commonly lags behind their formal adoption. In procurement, the translation of new legislation into changed practices has proven to be especially difficult, as has transparency in procurement practices.

The formal procedures of audit and oversight are thwarted by delays in finalising public accounts, and are undermined by poor or merely procedural compliance by the executive. Legislators also can face clientelist demands from constituents for the provision of private goods, such as school fees or start-up funding for private enterprises, based on the conceptualisation of a member of parliament as the 'head' of the community family, as evidenced in Ghana (Lindberg 2010). This can occupy the majority of an MP's time and capacity.

Overall, the persistence of informal practices in financial governance is entrenched in the incentives that key stakeholders from the civil service, the executive and the legislature face. The motivations behind informal practices differ: clientelism and manoeuvrings by the privileged to ensure that their interests are protected are often posed as key drivers of informalism. This is not exclusive to the state. Schick (1999) has long written about the futility of pursuing new public management, formal contractual relationships within the state when interaction between individuals and institutions in society, in general, is governed by informal and personalised agreements. Hyden (2005), however, notes that the motivation is not necessarily personal; it can be public, with informal systems allowing overly cumbersome controls to be bypassed to achieve policy objectives.

Informal practices are perpetuated by the lack of merit-based recruitment in the public service. Although many African countries have enacted legislation to regulate and protect the principles of merit and integrity in their recruitment systems, often it is not applied. The weaknesses of the civil service system stem partly from how the African state developed after independence, under the control of strong political leaders and their supportive elites. The post-colonial African state did not conform to the classical Weberian ideal of a bureaucracy separated from the personal interests and pursuits of those managing it. Instead, the African notion of patrimony has characterised the post-colonial period of state consolidation and nation building. In many countries today, recruitment and career prospects in the public service continue to be greatly influenced by ethnic, cultural and social realities, rather than by the principles of objectivity, equity and transparency (ECA 2009).

Reform experience in Africa has also proven that the areas of the budget process that are most prone to informal patterns of behaviour are also the most difficult to get traction in for the purpose of restructuring and improvement.

Political commitment to the formalisation of tax, budget and oversight practices is a necessary step towards improved financial governance. The formalisation of decision-making, over time, contributes to steady improvements in the quality of public resource allocation; it entails the replacement of arbitrariness and accidental privilege with systematic processes and laws of general application. In order to overcome the traditional incentives that drive informalism, African political leaders, in particular finance ministers, need to make a strong commitment to enforcing formal rules and consequences for non-compliance. Experience in Uganda, South Africa, Mauritius, Botswana and other countries shows that where reforms and formal approaches are backed by this type of political will, significant progress can be made in relatively short periods of time.

Without real political commitment to a formal, accountable state, it is likely that practice will continue to dictate opportunities, entitlements and outcomes. Finance ministers have an obligation to ensure adherence to formal laws, rules and regulations within the public resource cycle. Their authority is crucial in catalysing change in African states. A good starting point to apply political will for reform would be a concerted effort to close the gaps between new PFM legislation, its translation into lower-order instruments and its implementation. Such action, accompanied by enforcement at the micro level of new rules and procedures, will restore the rule of law in financial governance.

Capacity

The discussion above speaks of the crucial importance of political leadership in establishing sound public financial governance processes. Another enabling factor is the capacity to undertake reforms and manage new systems. The need to recruit, train and retain scarce professional policy, economic, financial, accounting, auditing and general managerial skills is well demonstrated in the discussions in Sections 3 to 6 below. These skills are essential to the building of effective financial governance institutions.

Yet, the human resource capacity of African states is often dangerously low, reflecting poor professional skill levels in society in general. The United Nations Economic Commission for Africa (UNECA) estimates that between 1960 and 1989, some 127 000 highly qualified African professionals left the continent. According to the International Organisation for Migration (IOM), Africa has been losing 20 000 professionals each year since 1990. This trend has sparked claims that the continent is dying a slow death from brain drain, and belated recognition by the United Nations that emigration of African professionals to the West is one of the greatest obstacles to Africa's development (Tebeje 2005). This is particularly true in financial governance, where the required skills sets are also in high demand outside of Africa.

There is, thus, a growing mismatch between the direction of tax, budget and audit reforms in Africa and the availability of skills. The emergence and use of sophisticated fiscal forecasting models, the development of costed sector plans, the implementation of financial management information systems (FMISs), the shift to a risk-based system of internal audits, the development of professional audit capacity and full oversight of increasingly sophisticated public finance approaches, among other changes, require high professional skills. Yet, in most countries these skills are scarce. In Sierra Leone, for example, there are only 91 qualified accountants in society at large, rendering the modernisation of internal auditing, accounting and external auditing practice within the state very difficult (Andrews 2010).

Therefore, African countries have a two-fold obligation. On the one hand, the training, recruitment and retention of skilled personnel in the public finance arena are priorities for good public financial governance. On the other hand, there is also an obligation on governments to ensure that new systems are not unduly complex and that cost-effective skills are available to operate them. If the proposed institutions are unduly complex, they are unlikely to be implemented effectively. The institutional origins of fraud and corruption are frequently to be found in failed attempts to implement inappropriately complex management and control systems.

Donor influence and reform sequencing

A decisive impact of strong leadership on financial governance reform is appropriate control of donor influence on systems, and the selection of reform priorities and approaches that are country-appropriate. Hyden (2005), Allan (2009), Schiavo-Campo (2009) and Andrews (2010), among others, have outlined the negative impacts of undue donor influence on reforms in financial governance. These include: high dependency on donors and their consultants, coupled with the suppression of local capacity and initiative; projects that may not be timely or appropriate for the country concerned; costly 'big ticket' programmes that take up reform space without sufficient local ownership; unrealistic assessments of the capacity required and of time frames for reform; and unmanageable reform loads, sometimes with contradictory or overlapping reform activities required by different donors.

Donors and their consultants tend to propose what is familiar to themselves, leading to similar institutional approaches to financial governance problems in very different country contexts. Scarce capacity in many ministries of finance has been tied up in implementing donor-designed reform programmes that often do not take sufficient account of underlying institutional practices, resulting in ritualistic change to process or form with little effective improvement of function.

Frequently, common reform agendas are driven by the North. All too often, reforms are sequenced in line with donor requirements and agendas, using diagnostic tools that are designed for donor fiduciary purposes. For example, the poverty reduction strategy paper (PRSP) movement, driven initially by the highly indebted poor countries (HIPC) process, followed by the Millennium Development Goals (MDGs), the Paris Declaration and the Accra Agenda for Action, has contributed to the development of performance criteria, indicators and programme-performance budgeting reforms to measure the impact of donor spending. These projects – too often not linked to the budget itself – have led to the accumulation by the authorities of vast databases of redundant and unused information, which Peter Kohnert (in Allen 2009) calls 'data cemeteries'. The opportunity cost of reforms that have little effective impact on financial governance is significant.

An underlying problem with donor approaches to reforms is the myopic disengagement of technical change from the politics of resource management and institutional politics. The long-standing ban on many donor agencies engaging in the political arena means that donor-driven reforms take insufficient account of political-economy factors within and between institutions, particularly when reform programmes are designed by external consultants with limited exposure to country conditions. The result, yet again, is ritualistic change to institutional form in financial governance, with little effective change in the functionality of institutions.

African governments carry some responsibility: too often, reform proposals and technical advice are accepted uncritically, particularly when these initiatives are based on practices exported from developed countries with insufficient regard as to whether the institutional base on which they are being transplanted is appropriate and adequate (Allen 2009; Schick 1999).

African countries, therefore, must urgently take charge of their own reform requirements, sequencing and approaches. A familiar refrain in developing country financial governance reforms is 'basics first'. This report contains several proposals regarding how countries can determine what constitutes the 'basics' in their particular circumstances. These include: ensuring a graduated, balanced approach between upstream and downstream, and centralised and decentralised reforms to ensure that progress is achieved across the financial governance system; ensuring that technical reforms within the executive are backed by a strengthening of oversight institutions and transparency; broadening and deepening tax bases to ensure that citizens are engaged with the state; sequencing reforms so that changes in laws, rules and procedures are followed by the systematic formalisation of practices in the public resource management cycle; ensuring that the sophistication of new systems is matched by the professional capacity in the country to operate them successfully; taking account of just how slow and difficult change in financial governance is likely to be; and focusing scarce reform capacity and space on fewer initiatives.

Core principles for financial governance reforms in Africa

The sections below set out area-specific priorities for good public financial governance reforms in Africa. They echo, to some degree, the cross-cutting issues highlighted above, but also address particular technical weaknesses in area-specific institutions. Here, based on the discussion above, we formulate what we see as the core priorities and principles for financial governance reforms in Africa, which concern the important enabling factors (or addressing of obstacles) for the priorities listed in the individual sections below.

In steering the development of public resource management going forward, African ministers of finance should focus on:

- *Transparency:* Progress towards good financial governance will be limited unless African governments, in general, effect significant improvements in fiscal and budget transparency. Our study has confirmed the need for Africa's governments to commit themselves unequivocally to being open about decisions in the public resource management cycle.
- *Accountability:* A commitment by African political leaders and senior public servants to restoring and building the functionality of internal and constitutional accountability systems is necessary.
- *A results-orientation:* The reform of public financial governance systems and, indeed, the raising of resources and budgeting for their expenditure must be oriented towards a guiding concern with the socio-economic consequences of fiscal decisions, resource mobilisation and the expenditure of public funds. Tax administration, policy and budget processes should be oriented to facilitating the optimal use of resources for growth, equitable socio-economic development and the alleviation of poverty.
- *Institution-building:* African governments need to focus on building transparent, accountable and effective institutions in the public resource management cycle. This means focusing on the progressive formalisation of institutions, eliminating arbitrary privilege, enforcing the intelligent application of laws and procedures, and holding actors accountable for informal practices.
- *Balancing reforms and capacity growth:* Poor human resource and system capacity can derail any reform initiative. When overly complex institutions are attempted in contexts where professional capacity is scarce, countries run the risk of being worse off because of the reforms. Capacity issues need to be taken into account in reform choices at the same time as African governments need to develop measures to train, recruit and retain the skills necessary for good financial governance.
- *Autonomy in reform choices:* African countries must decide for themselves what their reform priorities are. In this regard, ministers of finance have an important leadership role to play in managing donor demands and proposals for reform.

Overall, the political will and authority of finance ministers is crucial to drive through the reform priorities listed in this report.

SECTION 2
GOOD TAX GOVERNANCE IN AFRICA

Introduction

Good tax governance and more effective tax systems are central for sustainable development, because they can: (i) mobilise the domestic tax base as a key mechanism for developing countries to escape aid or single-resource dependency; (ii) reinforce the government's legitimacy by promoting its accountability to taxpaying citizens, and displaying effective state administration and good public financial management; and (iii) achieve a fairer distribution of the costs and benefits of globalisation.

Our focus here is on taxation, because it is regarded as a critical facet of the state-building agenda. Good tax governance is an essential ingredient of good financial governance. At the heart of both are not only the mobilisation and judicious use of resources to promote development, but also measures and strategies aimed at promoting accountability, transparency and trust. Increased domestic revenue generation will lead to improved development outcomes only if the revenue is translated into productive public expenditure.

Good tax governance is defined as the capacity of the state to mobilise resources efficiently, effectively, transparently, accountably and equitably to enable the state to implement its policies and programmes to promote development. Some of the features of good tax governance that are entailed in tax reform are providing adequate revenue, shifting towards more appropriate revenue sources, creating more effective and efficient tax administrations and encouraging effective state-society engagement around taxes (Fjeldstad & Moore 2009). Taxation is at the heart of fiscal governance and, thus, is central to the vitality and survival of modern states.

The process of tax collection is regarded as one of the most powerful lenses through which to view good financial governance, because of its ability to determine the distribution of power and the legitimacy of the state. The collection of tax not only requires substantial coercive power but, more importantly, requires a state to be legitimate, since tax collection is easier and the administrative costs are lower when there is a high level of voluntary compliance (Levi 1988). Taxation can lead to the expansion of responsiveness and accountability by providing incentives for citizens and the government to enter into a fiscal contract. In such a bargain, citizens accept and comply with taxation in exchange for the provision of effective services, the rule of law and accountability by the government.

However, good tax governance has been hampered by deficiencies in the tax collection systems in Africa, extensive tax evasion, corruption, abuse and misapplication of provisions for tax exemptions, and political interference in the day-to-day operation of tax-collection agencies with low capacity (UNECA 2009).

Consequently, there is a debate in many African countries on how to develop appropriate methods, procedures, norms and institutions that will promote and enhance good tax governance. In spite of the difficult circumstances, African tax administrations recognise the challenges of establishing good tax governance practices and are making concerted efforts to tackle many of these by embarking on programmes and approaches to improve their revenue collection and tax systems. This is as a result of both a renewed interest in tax matters (discussed below) and a recognition of the importance of domestic resource mobilisation.

The research for this report tracked these efforts and examined some of the key dimensions of good tax governance in Africa, namely the governance framework of rules and institutions, the drivers of tax reform, incentives and practices, the capacity of the state for improved revenue mobilisation and how challenges are addressed by African countries.

Overview of tax in Africa

The history of taxation in Africa begins with colonial rule. Virtually all African states lived under one form of colonial administration or another before they achieved independence, and the imposition of taxation was one of colonialism's defining features. There were three main forms of taxes during the colonial period – the poll (or head) tax, income tax and customs duties.

The poll tax, introduced by the British in the 19th and early 20th century, acquired notoriety for a number of reasons. It was conceived originally as a means of financing public services for the people, but this objective was never realised because the colonial government reneged on its promises of providing public services. Instead, it was seen as oppressive, inequitable, regressive, coercive, discriminatory and arbitrary, which caused resentment, disaffection and widespread rioting among the local communities. Consequently, the incidence of tax evasion, tax avoidance and non-compliance that characterises the attitude of citizens in most African countries today can be traced back to the negative image of taxation during the colonial period. It is this negative image of taxation that has influenced the reluctance of most post-colonial governments and leaders in Africa to talk about taxation. According to Therkildsen (2001), while issues of taxation are central to economic and political debates in the North, it is rather the reverse in Africa.

Prior to reforms, independent African states retained the institutional blueprints of extractive capacity developed by the various colonial powers. The key institutions for collecting income tax were the Income Tax Department or Department of Inland Revenue, while the Department of Customs and Excise collected customs and excise duties. The Department of Income Tax was organised according to 'type of tax' collected (income tax, corporate tax, etc.), rather than along functional lines like assessment, collection and monitoring. The two departments suffered from: (i) an inability to attract professionally qualified staff; (ii) inefficiency brought about by soft budget constraints; (iii) a culture of corruption; and (iv) a lack of motivated staff. These difficulties were manifest in the low levels of voluntary tax compliance and revenue collected. The colonial government did not regard taxation as a form of social contract between it and citizens. Taxes were imposed on the people from above without any form of consultation. Hence, issues of accountability, transparency and responsiveness were not addressed.

Further, as a result of general decline in the motivation and performance of civil servants in the governments of Africa during the 1970s and 1980s, collection of and accounting for government revenue deteriorated to very low levels (below 10% of GDP in many countries). Poor tax governance was reflected in poor governance of expenditure and public service delivery.

Renewed interest in taxation

Renewed interest in tax issues, a result of the proliferation of tax reforms and new legislation introduced by African governments, has been identified as a general trend. This engagement is not only the result of an increasing awareness of the nexus between taxation, state building and accountability, but is also due to the drivers of tax reform. These include: (i) the international tax family made up of the International Monetary Fund, the World Bank, bilateral development

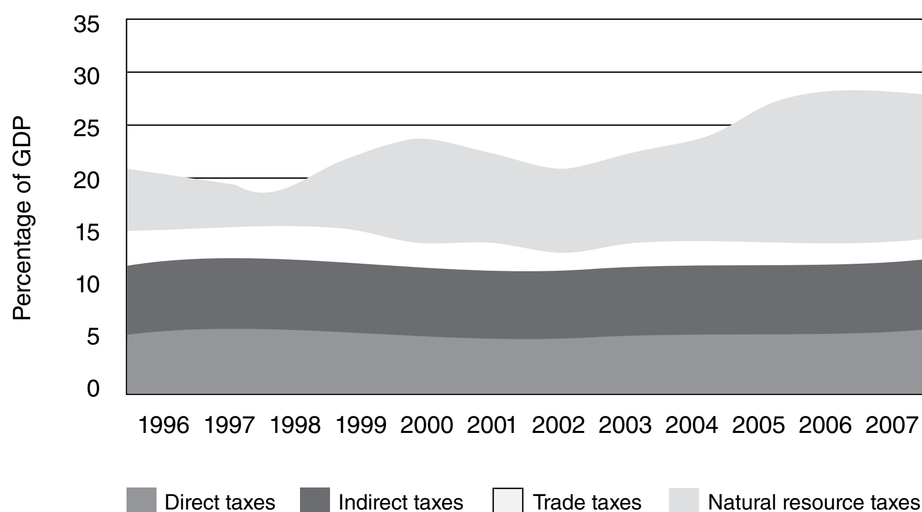
agencies, international tax consultants and NGOs; (ii) the African tax family consisting of, for instance, the African Tax Administration Forum (ATAF) and the African Development Bank (AfDB); (iii) international conventions, accords and declarations; and (iv) the World Taxpayers Association, which has branches in four African countries. These drivers have been complemented by several pieces of tax legislation passed by African countries. This renewed interest in tax issues is likely to be sustained because of the realisation by African governments that fiscal self-reliance entails improved tax systems, which require a culture of trust between the state and citizens, and enhanced government accountability and transparency.

Tax bases and tax structure

Tax policies in Africa generally involve four major tax bases: (i) direct taxes on individuals and companies; (ii) indirect taxes on goods and services; (iii) trade taxes (in particular, customs duties); and (iv) natural-resource taxes. Figure 2 shows trends in the utilisation of the tax bases over time. On aggregate, direct, indirect and trade taxes have declined slightly, while natural-resource taxes have fluctuated but increased as a percentage of GDP. Not all countries, however, have a natural-resource tax base.

Other forms of taxation, including property tax, land tax, user charges (e.g. toll roads and levies on university education) and environmental levies, have largely not been explored in most African countries because of their highly sensitive and political nature.

Figure 2: Tax types as a percentage of GDP, 1996–2007



Source: AFDB & OECD (2010)

Gupta and Tareq (2008) calculate that overall government income from domestic sources in sub-Saharan Africa rose from an average of less than 15% in 1980 to a little more than 18% in 2005. However, as illustrated above, the greater part of this increase comes from higher income from natural resources, and not by virtue of the tax system. Domestic revenue from sources not related to natural resources has risen by less than 1% of GDP in the last 25 years. In developing countries with abundant natural resources, too, state income from sources other than natural resources has remained relatively constant (Keen & Mansour 2008).

These numbers show that there are considerable weaknesses in the fiscal base of low-income countries in Africa. According to the (International Monetary Fund (IMF), tax revenue equivalent to 15% of GDP is a ‘reasonable’ minimum level for low-income countries to secure the financing of basic government tasks such as law and order, health and education (IMF 2005). Many countries do not reach this level. A study by Fox and Gurley (2005) found that as many as 44 of the 168 countries included in the study had tax revenues lower than 15% of GDP in the 1990s. Eighteen of these countries are in sub-Saharan Africa. Income from natural resources and aid might well compensate for deficient tax income, and might ensure that important development goals are reached, but financing state spending through such sources is unpredictable and contributes little to developing the institutional capacity of the state (Bulíř & Hamann 2007; Moore 2004).

Direct taxes

Direct taxes consist of taxes levied on the income of individuals and on corporate profits. During the last decade, direct taxation as a share of GDP experienced a small increase throughout Africa, mostly in middle-income countries like Botswana, Morocco, South Africa and Tunisia. Overall, however, it seems that the trend in direct taxation has been flat.

Personal income tax is one of the oldest taxes in African countries. Most African countries are slowly lowering their overall personal income tax rates in an attempt to broaden their tax base, still applying a progressive rate (from 0% to 35%). Others have a long path of reform ahead. The scope of using personal income tax to redistribute resources towards the poor is limited in Africa. Firstly, the tax base is typically non-comprehensive due to the large untaxed informal sector and non-compliance by employers in registering employees and remitting taxes. Secondly, there are problems in properly administering the tax. Capital income, earned predominantly by relatively wealthy individuals, either faces low effective rates or escapes taxation altogether. Personal income tax lacks equitability.

Corporate income tax revenues, as a percentage of GDP, have been stable across the continent during the last decade. While the implicit tax base has increased due to a rise in the share of corporate profits in national income, corporate income tax rates have been reduced (now slightly over 30%, on average) and African countries have granted many tax exemptions to corporations, with the consequence that actual corporate income tax revenues have remained flat as a share of GDP. Many problems are associated with corporate income taxes, such as the taxing of interest and capital gains, the existence of multiple tax rates and presumptive tax schemes, and the variable presence and quality of anti-avoidance and anti-abuse legislation across the continent. Perhaps the most significant problem, however, is the prevalence of generous tax incentives such as tax holidays.

Indirect taxes

Indirect taxation refers to taxes on consumption, collected on behalf of a government. These include value-added tax (VAT), sales taxes and excise duties. Many African governments, often advised by the IMF, have expanded indirect taxes since independence by replacing sales taxes with VAT. During the last decade, indirect taxation as a share of GDP has decreased marginally in Africa.

Typical rates of VAT in Africa are between 15% and 20%, which is high by international standards for developing countries. Most countries apply a credit-invoice type of VAT. Essential pre-conditions for effective VAT are sufficient administrative capacity and a limited cash-based economy. Unfortunately, this is not the case in most African countries.

One major problem with VAT in Africa is the numerous exemptions granted by governments. For a variety of reasons, VAT exemptions in Africa are often considered to be regressive. Yet, the introduction of VAT, together with better tax administration, has improved the efficiency of the entire tax system in some countries.

Trade taxes

Trade taxes refer to taxes levied at the border. Generally, these are import tariffs and export duties, although export duties have been abolished in most African countries. When countries are weighted by the size of their economy, trade tax revenues have declined by a third as a share of GDP (see Figure 1). The decline has taken place in upper-middle-income and lower-middle-income countries, while trade tax revenue in low-income countries has remained stable as a share of GDP.

Customs duties, otherwise known as import and export duties, constitute the oldest form of modern taxation in most African countries. Import duties are the highest yielding indirect or expenditure tax in most African countries. However, in most countries, the main problems are under-declaration of goods, tardiness in the clearing of goods, due to cumbersome procedures, and corruption on the part of customs officials.

Excise duties are an ad valorem tax on the output of manufactured goods. However, as an *ad valorem* tax, excise duties (in the absence of controlled prices) are hard to administer, as they should be levied on retail prices, or the impact on prices is unclear when it is levied on ex-factory prices.

Natural-resource taxes

Natural resource taxes include mainly revenues from upstream exploration-to-processing activities in oil, gas and mining. They comprise principally royalties and corporate income taxes on resource extraction activities. On average, resource-related tax revenues nearly tripled in Africa as a share of national income between the late 1990s and 2007 (see Figure 1). Since then, they have retreated slightly to around 15% of GDP on average. Libya and Angola, however, recently recorded resource-related tax revenues of 66% and 39% of GDP respectively (AfDB 2010). In some countries, revenues from renewable natural resources are also substantial, for instance from fisheries in Namibia and forestry in Cameroon.

A key trend has been efforts to promote the welfare-enhancing benefits of the extractive industries in natural-resource-rich African countries through the signing of international good governance and anti-corruption initiatives such as the Kimberley Process, the ‘Publish What You Pay’ campaign, and the Extractive Industries Transparency Initiative (EITI).

Conclusion

There is agreement that revenue mobilisation needs to be increased through a shift towards more appropriate revenue sources. This calls for deepening or diversifying the tax base in a number of ways. Firstly, the existing tax base is eroded by the excessive granting of tax preferences, including tax exemptions, in most African countries. Accordingly, tax administrations should review the excessive tax preferences granted, especially to multinational corporations. Secondly, extractive activities are taxed inefficiently. Tax administrations and governments, therefore, should enforce the EITI and renegotiate some of the lease agreements in the sector. Thirdly, tax administrations are unable to bring the informal sector into the tax net. Fourthly, tax administrations have not been

able to tax land, property or the more inclusive concept of (net) wealth, which can raise additional revenue. However, the basic infrastructure to administer these taxes properly is often lacking in Africa. Without a cadastre, such taxes cannot be levied in a comprehensive way (Volkerink 2009).

Tax administration in Africa

There are two main types of tax administration in Africa: (i) semi-autonomous revenue authorities (ARAs), located mainly in Anglophone countries; and (ii) the central government tax administration, which is located within the finance ministry and is found largely in Francophone and Arabic-speaking countries.

Autonomous revenue authorities

In terms of institutional design, ARAs were created in 'environments characterized by large-scale corruption and politicisation of the taxation process' (Fjeldstad & Moore 2008: 250). Consequently, over the past few decades, ARAs have become a popular organisational reform to improve revenue collection in developing countries. In Africa, the ARA model is established in 15 countries, most of which are Anglophone, but with a few exceptions, including Lusophone Mozambique.

There is now some accumulated evidence to suggest that the ARA reforms, at least in the initial years, are associated with increased revenues, reduced corruption and improved taxpayer compliance (Fjeldstad 2003; Taliercio 2003). It is less clear that such arrangements are sustainable. The strong technical approach to tax policy abstracts from politics. The reasons why such reforms were politically feasible in the first place are not addressed and there is no accepted definition of autonomy. Since tax policy, which is the domain of finance ministries, cannot practically be divorced from tax collection, which is the domain of the newly created ARAs, it is not ultimately possible for the latter to function in purely autonomous ways. In effect, autonomy can never be complete where there are interdependencies among agencies and, thus, it is always a contested notion (Fjeldstad & Moore 2008; Pritchard 2010; John 2010). Besides, 'managerial autonomy' is only part of the explanation for the enhanced performance of ARAs: rather, more nuts-and-bolts reforms related to organisational restructuring appear to be an important part of the story. Also, pressure to meet unrealistic revenue targets has led to the use of a combination of a tighter squeeze on registered taxpayers and coercion, which sometimes has contributed to undermining the reputation and credibility of the single ARA in the eyes of the public (Fjeldstad 2003; Fjeldstad 2006; Von Soest 2006).

Central government tax administration within the finance ministry

The majority of African countries still have their tax administrations located within the ministry of finance. This type of tax administration is found mainly in the Francophone and Arabic-speaking countries. Great strides can be made in reforming tax administration while keeping it within the ministry of finance, as evidenced by the experience in Morocco and Tunisia.

Local government tax systems

A discussion of tax governance in Africa would not be complete without some attention to local government tax systems. While central government taxes affect only relatively few people directly (perhaps less than 5% of the total population), local government taxation affects many more (perhaps 30%). To the extent that state-citizen relations are influenced by taxation, local government taxation is central to a better understanding of state-citizen relations (Fjeldstad & Therkildsen 2008).

Despite recent and major central government tax reforms, local government tax systems have remained largely unchanged in many African countries. To a large extent, local government authorities still rely on central government transfers to finance their operations and service delivery. Generally, local tax systems in Africa are distortive and costly to administer, and exacerbate inequity. Further, there is often little or no co-ordination with respect to taxation between various levels of government. This has partly to do with lack of capacity at all levels. At the local government level, the serious shortage of qualified staff in the treasury and planning departments is particularly critical. Africa's local tax collections are also hampered by shortfalls in the numbers and competency of revenue collection personnel, and the difficulty of assuring that all revenues collected reach government quarters (Saito 2008; Bardhan & Mookherjee 2006; Cammack et al. 2006).

Even at the ministerial level, there are only a few tax experts. In some countries, this has led to double-taxation of the same revenue base, as well as inconsistencies between local and central government tax policies. Local governments in Africa are hampered by arbitrary and delayed decisions by local government ministries on what levies individual localities might raise, and at what levels they might be taxed. Furthermore, approvals for requests for taxes or rates are frequently delayed well beyond the time they were due for collection, as well as being arbitrarily changed. Thus, local governments in many countries cannot budget revenues properly, and often must delay collections or make subsequent refunds.

Some African countries, including Kenya, Tanzania and Uganda, have pursued extensive local government tax reforms in recent years. These reforms have focused on simplification and rationalisation of the local tax system, and abolishment of so-called nuisance taxes, such as the poll tax and bicycle taxes. Some local government authorities are experimenting with alternative ways of collecting local taxes (for instance, tender-based outsourcing of revenue collection to private companies or market organisations). The experience with private tax collection so far, however, is mixed.

Tax governance arrangements in Africa

Institutional reforms of tax administrations, be they ARAs or the embedded agency model located within the ministry of finance or the treasury, have resulted in new ways of organising and working, a shift in the organisational culture of tax officials towards more appropriate revenue sources, and improved public awareness of tax rules and procedures.

Organisation of revenue authorities

Traditionally, revenue authorities are organised by product (relating to the type of tax administered), function (such as processing tax returns) or by client (relating to different types of taxpayer). In recent years, African countries have tended to move away from product-based structures built upon different types of taxes to those based on function, although often with elements of a client-based market segmentation approach. This includes, for example, the introduction of large taxpayer units (LTUs) focusing on large companies, which often are responsible for a disproportionate amount of revenue collection, or the introduction of industry-based organisational structures. In this way, they have been able to secure the advantages of improved accountability and control, enhanced compliance, better administrative efficiency, reduced corruption and more customised taxpayer service.

In addition, they often have introduced unique personal identification numbers (PINs) for each individual taxpaying unit. They have moved from a system organised around different taxes to one organised around localities and/or industries, such that individual taxpayers have to deal with fewer tax officers. They have established separate offices and procedures for different categories of taxpayer, typically starting with the creation of LTUs, focusing on big companies. Gradually, they are physically separating the 'back office' functions of assessing tax liabilities and auditing and cross-checking records from the 'front office' function of collecting money, to reduce the scope for direct extortion and bribery (Fjeldstad & Moore 2008).

Ethics and Integrity

The creation of a professional service with a strong organisational culture that reinforces honesty and professionalism is an important goal of good tax governance and one that has been facilitated by the creation of ARAs. Certainly, the creation of ARAs in 15 countries in Africa has established a sense of belonging to a service. The conditions of service in most of them are better than most organisations in the public sector. In addition, most of the staff were recruited at the same time, after a major restructuring of the tax and customs administrations and, therefore, have been able to develop an esprit de corps. The paradox, however, is that tax officials complain of high risks in tax collection and monitoring, particularly when dealing with low-income businesses and people, while at the same time they are tempted by the income that they collect. Furthermore, they are under constant pressure from the ministry of finance to meet targets. It is this answerability and responsibility to the executive branch of government (i.e. the president) that has tended to undermine the autonomy of the ARAs in Africa and, consequently, their organisational culture. It is, however, debatable whether tax administrations have been any more successful in promoting high ethical standards and integrity among tax officials. Studies have shown that many tax departments suffer from extensive corruption. Indeed, revenue agencies in Africa, in particular customs administrations, are perceived by citizens and business people as the most corrupt public institutions (Le 2007).

Shifting the attitude of tax administrations towards taxpayers

Most of the tax administrations in Africa have embraced the practice of 'customer service' and 'user friendliness' (Fjeldstad & Moore 2008). Specifically, they have opened 'customer-friendly' 'one-stop shops' and have simplified procedures that formerly were cumbersome and bureaucratic. In addition, a few have made on-line filing of returns and revenue collection possible, have provided extensive information for taxpayers in printed and digital form and also have tried to explain themes to the taxpayers. In spite of this new 'user-friendliness', which Fjeldstad and Moore (2008) regard as 'mainly window dressing', taxpayers continue to experience extortion, bribery and obstruction rather than willing, responsive service.

Increasing public awareness of tax rules and procedures

Increasing public awareness of the benefits of tax, tax rules and tax procedures is an important driver of substantial improvements in tax performance in some countries in Africa. The methods used are: (i) improving taxpayers' knowledge and awareness of their rights and obligations; (ii) reducing tax compliance costs; and (iii) adopting a customer orientation. These interventions contribute towards creating a sense of tax consciousness and improved tax compliance among the public, even though progress may be slow. In addition, the success of the outreach programmes is reflected not only in improved revenue generation, but also in improved public perceptions of the tax agencies. The tax compliance environment has also been supported by

some governments, such as those in South Africa, Morocco, Rwanda, Mozambique, Ghana, Kenya, Cameroon and Ethiopia, which are openly talking about taxation to their constituents and linking it to development (Pritchard 2010).

It is instructive to note that building trust also depends on efforts to provide better services and education to taxpayers. By increasing awareness and the perceived legitimacy of the tax system, such measures have the potential to improve compliance immediately, while laying the foundation for a more effective tax bargain. According to Pritchard (2010), the importance of tax services in achieving tax compliance is a regular feature of tax reform programmes. Unfortunately, the absence of documented successes suggests that efforts to improve taxpayer services have yet to consistently alter the often antagonistic relationship between tax administrations and taxpayers in Africa. Taxpayers still complain regularly about high compliance costs, lack of clarity about tax regulations and procedures, seemingly arbitrary behaviour by tax officials and a lack of transparency.

Challenges of tax governance in Africa

The discussion above identifies key trends in tax governance in Africa. They relate to the increased interest in taxation, efforts to reform the tax structure to broaden the tax base and to simplify tax codes, efforts to reform tax administration through engineering greater autonomy, improving general capacity, changing how tax administration agencies are organised, upgrading and expanding information technology and improving taxpayer services. It is also noted that the trend of tax revenues on the African continent is far from positive in spite of the reforms, which points to key challenges in engendering good tax governance.

The implementation gap

It is evident that all African countries have implemented tax reforms following the global tax reform agenda. Although there have been some initial successes, most have been slow in bearing fruit, largely because of implementation difficulties. Tax reforms have stalled mainly because of what is referred to as the complexity of joint action. The reforms depend on many actors and stakeholders with differing perspectives, and there are numerous possibilities for disagreement and delays that sharply inhibit their successful implementation.

Tax exemptions

Tax exemptions and tax holidays in various African countries are intended to attract foreign direct investment (FDI). However, uncertainty over the tax treatment of FDI has increased the perception of risk and has discouraged the long-term capital investments that governments typically are eager to attract. Administrative discretion in granting tax incentives has undermined transparency, and has created a perception that tax administrations are open to influence and persuasion. Consequently, tax systems have been seen in most African countries as unfair or open to negotiation, which risks eroding quasi-voluntary compliance with the system. In providing an attractive tax system for investors, African governments should aim for transparency and certainty of tax treatment, and take steps to limit compliance costs, before exempting international investors from all or part of their fiscal obligations (AfDB 2010).

Transfer pricing and illicit capital flows to secrecy jurisdictions

Illicit capital flows from Africa – mainly to tax havens and Western financial institutions – are enormous. Total illicit flows from Africa over the period 1970–2008 represent an estimated US$1.8 trillion. The proceeds of commercial tax evasion, mainly through trade mispricing, are by far the largest component.

Transfer pricing (the determination of a price for transactions between associated enterprises) is a challenge that has adversely affected resource mobilisation. Most extractive industry companies operate internationally and have extensive dealings with affiliated companies, thereby increasing the opportunities for transfer pricing and, thus, the lowering of tax liability. This further complicates the task of tax administrations and creates a challenge that requires specific skills to deal with. The tax laws in most African countries have legal provisions to address the issue but, evidently, that is not enough. The tax administration needs better training on how to recognise the transfer-pricing opportunities, especially in mining operations, and stronger capacity to detect and respond to this problem. The issue of transfer pricing is sophisticated and complex in nature and it has the potential to seriously erode the tax base (AfDB 2010). International collaboration and treaties are required to make inroads against the problem.

Lack of taxpaying culture

The taxpaying culture in most African countries is very weak. Some of the reasons for this attitude are the colonial legacy of taxation being seen as coercive and extractive, the inability of taxpayers to see the relationship between benefits in the form of services provided by the state and taxes paid, and inadequate public education programmes by tax administrations. In other words, there has been a 'general lack of concern for the historical evidence about the connection between taxation and state-building, notably the need to construct taxation systems that engage citizens in politics in a positive way, and contribute to the legitimacy of the state' (Fjeldstad & Moore 2008: 259).

Tax illiteracy

In most African countries, the majority of citizens live in rural areas and belong largely to the informal sector. This has affected tax literacy, as both urban and rural people are not able to comprehend the technical issues involved in tax administration and reform. Tax administrations have undertaken vigorous taxpayer education interventions, but they seem limited because most have concentrated on the urban centres, where the elites live. Similarly, some elites are tax illiterate because they are not interested in tax issues. They regard taxation as a form of coercion and one that will erode their privileges. They, therefore, turn a deaf ear to the taxpayer education campaigns of tax administrations.

Poor linkage between taxes paid and services provided to citizens

This involves asking the question of why people should pay taxes. People pay taxes because they see it as a fiscal contract between themselves and the state. For taxpayers, paying taxes to the state is a *quid pro quo* (that is, they expect services to be provided in return). It is basically 'revenue for services'. Unfortunately, however, in most African states, the provision of public services is unreliable and, where they have been provided, are regarded as not of good quality. The weak link between taxes paid and services provided to citizens has eroded the legitimacy of some governments.

Lack of reform ownership and linkages

The policy interventions and the global tax agenda are set by the international financial institutions – the IMF, the World Bank, regional development banks and aid agencies. However, the most important driver has been the IMF. Tax reforms are not 'home-grown' and contextualised. This has resulted in lack of ownership and has contributed partially to the slow progress made on the tax administration reform front. There often is a weak link between tax reforms and other public sector reforms. Stronger links are necessary to ensure the holistic approach that is needed for co-ordination, information sharing and good practice. In addition, tax reforms have not succeeded as expected because they were not contextualised within country-specific realities, including history, culture, politics, economy, sociology, ideology and values.

Constitutional, legal and democratic deficits

Despite progress towards democratic consolidation in Africa, it could be argued that some tax reform challenges probably are due to remaining democratic weaknesses. Democratic weaknesses involve constitutional and legal practices. The literature on democracy in Africa lists a number of critical challenges, including monetisation of politics (as in the United States of America), political intimidation, vote manipulation, neo-patrimonialism, ethno-regional voting patterns, strong deference to leadership and expectations of personal favours in return for loyalty, pressure on politicians to reward benefactors after elections and abuse of incumbency by governments (AfDB 2005; 2009).

Corruption

Corruption at all levels in Africa has affected revenue mobilisation. As indicated above, studies show that tax agencies are among the most corrupt public institutions in Africa (Le 2007; Fjeldstad 2003; Von Soest 2006; Moore & Rakner 2002; Joshi & Ayee 2009). It is estimated that corruption causes African governments to lose up to 50% of their tax revenue, which in most cases exceeds a country's foreign debt (AfDB 2006). In spite of success stories and measures to reduce tax fraud in African countries, they are still safe havens for tax evasion. In many countries, the wealthy often escape fair tax assessment or avoid paying taxes altogether through bribery of tax officials and various forms of patronage. By the same token, in many countries, officials are notorious for using delays, the threat of high tax assessments or the promise of low assessments to extort funds from individuals and businesses. Indeed, within the public sector, the tax departments and the customs agencies are considered to be the most lucrative (a euphemism for inclined to corruption) for public servants (UNECA 2009).

Different tax regimes in the sub-regional groups in Africa

Africa has 14 sub-regional groupings that have been formed to promote regional integration, particularly in trade, fiscal and monetary policy. These sub-regional groupings also have different tax regimes that do not allow for a harmonised tax system on the continent. In some cases, there are major differences in the tax systems of countries within the same sub-region. For instance, the tax systems of Cameroon and Nigeria are quite different, and the same can be said for Morocco and Egypt.

Priorities for improving tax governance

Our research has highlighted the following key priorities for improving tax governance in Africa.

Addressing tax evasion

In many African countries where the informal sector is diverse, small and large taxpayers are able to evade tax. This is a big challenge. However, the informal sector can be brought into the tax net in several practical ways. For example, Algeria is using a presumptive tax for the mainly informal entrepreneurs. Similarly, Zambia has introduced a flat rate 'base tax' for rural areas, along with a 'presumptive taxation' of 3% on group income for urban areas. Additionally, a 'peddlers license' has been issued for street sellers. It is instructive to note that micro-enterprises could be taxed through a 'synthetic fixed tax': the micro-enterprises would have to pay a fixed tax, based on business activity and a few other easy-to-measure parameters (e.g. location and equipment). Thus, micro-enterprises would be subject to a simple tax scheme based on an assumed profit.

Stopping illicit capital flows

There should be a concerted effort by the international community and African governments to deal with illicit capital flows from Africa, mainly to tax havens and certain financial institutions. Companies engaged in commercial tax evasion, mainly through trade mispricing, should not only be blacklisted, but also prosecuted. Likewise, citizens of African countries who collude with these companies, sometimes acting as fronts, should be sanctioned to serve as a deterrent. All the opportunities that facilitate the phenomenon of illicit capital flows should be removed, and stringent legislative control mechanisms and other incentives put in place.

Fighting transfer pricing

Fighting transfer-pricing abuse requires African countries to develop specific legislative measures that are adapted to their legal system and economic context, and to build the administrative expertise needed to enforce them. African governments must carefully consider the extent of the resources they should devote to addressing transfer pricing. With the existing administrative capacity constraints, and considerable amounts of tax revenue at stake, what is needed is a pragmatic approach, tailor-made to suit the administrative and institutional means available in the specific country.

Efficient management of the tax system

Efficient management of the tax system enables the public sector to mobilise resources for economic development. It also engenders confidence and trust in public financial management, which is an important component of good governance. Despite efforts to broaden the tax base and reduce tax evasion, many African governments need to take further steps to achieve satisfactory results.

The tax system in many African countries is largely inequitable. It is often perceived by citizens to be unfair, difficult to understand and not reflecting taxpayers' capacity to pay. The inability of tax authorities to tax wealthy individuals and large firms is often due to their use of offshore financial centres that facilitate tax evasion and hide the illegal proceeds in non-traceable accounts. The existence of secrecy jurisdictions has serious consequences for both the revenue productivity and the equity of the tax systems in Africa. Tax governance and, indeed, public financial governance will be enhanced by improved equity in tax enforcement and administration.

Fighting fiscal corruption

Tackling fiscal corruption within tax administrations is a priority in establishing legitimacy. Corruption undermines tax morale and tax revenues. An appropriately paid tax official is less likely to take bribes. African governments must find solutions, which could include a pay scale for tax administrators that differs from that applicable to regular civil servants. It has been pointed out, however, that excessive use of bonuses and revenue targets can lead to decreased quality and can cause frustration. Furthermore, reducing tax compliance costs helps with private sector development and lowers the amount of the bribe a taxpayer might be willing to pay to avoid declaring and paying tax. Similarly, opportunities for bribery can be reduced by minimising the number of times a taxpayer needs to interact with tax officers, and by introducing transparent tax codes.

Ending tax preferences

In general, it is better to focus on the actual impediments to investment and aim to address these directly, rather than through tax preferences. In providing an attractive tax system for investors, African governments should aim for transparency, certainty and predictability of tax treatment, and take steps to limit compliance costs (for example, through taxpayer education and streamlined payments), before exempting international investors from all or part of their fiscal obligations.

Revenues foregone by the granting of tax incentives for investment tend to exceed by a wide margin the revenue costs expected before the concession was put in place. In particular, countries frequently underestimate the tax-planning skills of multinational companies, through the use of which they often manage to extend the coverage of their initial tax relief to non-targeted activities and profits. Increased reliance on additional taxes and the need for tax-base protection measures place further strains on the tax system. At the same time, competition amongst countries to attract mobile investment creates pressure for the continued use of targeted tax incentives. Given this scenario, some degree of co-operation amongst countries is required to prevent a counterproductive race to the bottom in effective tax rates on profit. Arguably, with some form of regional collaboration, the priority of policy-makers should be to limit the most damaging tax preferences, such as tax holidays and export incentives. A monitoring framework and computerised system for the exchange of information would be necessary to implement such a combined response.

Improving revenue mobilisation

Most African countries face difficulties with their tax policies and tax administration. At the same time, they need to improve revenue mobilisation in order to finance their ambitious economic development programmes and to meet the objectives of the MDGs. From a governance perspective, it is not only the revenue target, but also how taxes are enforced, that is an important issue. If revenue targets are reached, but tax collection is effected by harsh, illegitimate and coercive methods, this is not good tax governance. Some revenue authorities in Africa have argued that the revenue targets they receive from the finance ministry often are unrealistically high, given the current tax structure. Therefore, to reach the targets, they 'go hunting in the zoo', which implies that those companies that are most easily accessible and less politically connected are exposed for harsh enforcement and quasi-legitimate tax audits. Deficiencies in the tax collection system – evasion, corruption, abuse and misapplication of provisions for tax exemption, political interference and the low capacity of tax administrations – are at the root of these failures. In short, the predictability of resource mobilisation is a ***sine qua non for good tax governance and good public financial governance.***

Measures towards building a taxpaying culture

Measures must be instituted to promote a taxpaying culture. These include the following: (i) governments should remove the perception of firms and individuals that paying taxes brings them little in return by providing quality services and infrastructure to the public and private sector; (ii) the cost of dodging taxes and the risk of getting caught must be perceived as high by taxpayers, and penalties must be applied when evasion is detected; (iii) tax administrations should treat taxpayers as clients rather than as 'suspected criminals'; and (iv) well-defined and well-executed educational campaigns by tax administrations, using the media and new technology, can help in ensuring that taxpayers understand and accept the compliance requirements (in South Africa and Zambia, for example, taxpayer education campaigns have contributed towards public awareness and have increased voluntary compliance).

Taxing natural resources

Vast natural resources are already an essential revenue source for many African countries. However, there is evidence that African countries receive proportionately less revenue from natural resources than do many other countries in the world. Generally speaking, there is more than corruption involved. Governments argue that they cannot make all details of the extractive industries public and that they have limited influence on the companies involved. Countries also compete for the scarce managerial and technical skills needed for resource extraction. Yet, shortages of legal and negotiation skills play a major role in driving down natural resource tax revenues. Given the challenges, the international financial institutions should assist African countries in building the capacity to (re-)negotiate contracts for taxing extractive industries.

Understanding the political nature of taxation

While the technical aspects of tax reform are crucial, an understanding of the sustainability of reforms is not possible without understanding how reforms become legitimate. Because taxation affects incentives and distribution simultaneously, tax reform requires a degree of social consensus that the policy is in the collective interest, and/or it requires a state with the ability to coerce those who challenge its allocations. While the technocratic approach to tax reforms and institutional development is required, it is insufficient since it ignores the political nature of taxation.

SECTION 3
GOOD GOVERNANCE IN BUDGET PREPARATION, EXECUTION AND REPORTING

Introduction

The management of the budget, from preparation through to financial and performance reporting, is an important PFM objective. PFM refers to the procedures, established by law or regulation, for the management of public monies through the budget process, which includes formulation, execution, reporting and analysis (Potter & Diamond 1999; Lienert & Fainboim 2010).

Good public financial governance is achieved when these procedures result in responsive public services through public spending that is affordable, transparent and accountable, and which funds governments' priorities without wastage or corruption. Africa has made slow but significant progress over the last few decades in building systems to deliver on good financial governance, as is detailed in the paragraphs below. This has been bolstered by overall improvements in democracy.

Yet, PFM systems in Africa still face common challenges in achieving the objectives of good financial governance. In the decades since independence many countries have battled with crippling debt burdens, low credibility of their enacted budges, poor links between their policy priorities and what public resources actually fund, and the high cost of wastage and corruption. The result has been the deterioration and even collapse of public services and infrastructure.

PFM systems in Africa function in the context of aid. Most countries in Africa receive official development assistance (ODA) and other aid flows from various development partners. Some aid is delivered in cash and is managed through country systems. Other aid is delivered off-budget and is received in the form of goods and services by African governments. Some aid takes the form of concessionary loans, and other aid, that of grants. Although aid traditionally flowed for investment projects, today aid pays for public goods and services of all kinds in African countries, from big public infrastructure items to everyday public health and education services.

In whichever form or type, aid flows in Africa create complexities in budget management with which industrialised nations do not have to cope.

- Firstly, the determination of available resources, and their allocation and use cannot occur in isolation from aid flows and the conditions (however formulated) that attach to their use. This is a challenge for most countries, where a systematic interface between aid and PFM systems is not yet well developed. Much aid falls outside of the loop of PFM, resulting in duplication, wastage and unsustainable aid-funded activities. Aid is also unpredictable.
- Secondly, PFM systems have been affected directly by donor advice, conditions and required aid-delivery arrangements. Over the last few decades, African budgeting systems have had to accommodate public investment programmes (PIPs), poverty reduction strategy papers (PRSPs), arrangements for the flow of HIPC funds and the MDGs, as well as various ways of delivering aid resources, such as budget support, sector-wide approaches and pooled funding arrangements. Furthermore, it is difficult to determine whether governments themselves would have embarked on various budget reform approaches, such as medium-

term expenditure frameworks (MTEFs), programme budgeting and the introduction of integrated financial management systems (IFMSs) in the absence of donor pressure to do so. As is elaborated in this section, African countries too often are faced with reform advice and pressure that pays insufficient consideration to the prerequisites that need to be in place, or necessary accompanying reforms, or reform sequencing or, importantly, the differences between countries that affect reforms.

This project, however, is not concerned with the success or failure of any one of these instruments or sets of arrangements in Africa. The primary concerns are: whether underlying budget preparation, execution and reporting systems are functional, deliver the objectives of good financial governance highlighted above and incorporate aid flows effectively; and the reform priorities to get them to this position. The assumption is that countries need sound and functioning technical procedures for budget formulation, execution, reporting and analysis, coupled with functional arrangements for political decision-making, transparency and accountability in budgeting, notwithstanding specific approaches they might follow to achieve such basic building blocks.

More specifically, the assessment in this section is concerned with the status of, and priorities for, establishing the following budget preparation, execution and reporting functions in Africa:

- a comprehensive, clear and implemented legal framework for PFM, so that all spending has a basis in law;
- budget preparation functions, including
  - setting affordable, credible and comprehensive macro-fiscal frameworks, using credible forecasts and realistic targets,
  - using transparent, integrated and specific budget structures and classifications, linked to charts of accounts for *ex post* reporting and accountability,
  - allocating available funds on the basis of accurate past spending information and credible sector expenditure plans to ensure budget effectiveness and efficiency,
  - deciding budget limits and allocating funds on the basis of a disciplined, predictable, legitimate and contestable budget process to ensure that strategic priorities are funded and value for money can be demonstrated, and
  - providing comprehensive, clear, useful and timely information in the budget documentation to parliament and the public on projected revenues, spending and debt, the allocation of available resources to objectives and the expected outcomes of spending;
- budget-execution functions, including
  - predictable, transparent and accountable systems to plan for and management cash,
  - functioning internal controls on payroll and non-payroll expenditure to ensure budget discipline and the rule of law,
  - functioning procurement systems, anchored in a clear legal framework, to ensure that goods and services are procured cost-effectively, competitively, fairly, timely and transparently, and
  - internal audit systems that assist executives in identifying weak areas in budget control systems;
- accounting and reporting systems that follow generally accepted accounting practices to produce reliable financial information in a timely manner;
- transparency to parliament and the public during and after the spending year on the status of the public finances and budget implementation; and

- robust arrangements for integrating aid in budget processes and reflecting it in budget documents and reports.

The systems and their required functionality set out above are viewed as the PFM basics for delivering on the requirements of good governance of financial flows. However, our research also acknowledged that countries that achieve a functional medium-term budgeting perspective in their macro-fiscal framework, budget structure and budget process, and constructively use non-financial performance information to inform their budget choices, are better placed to deliver budgets that are affordable, stable and use resources effectively and efficiently. The research, therefore, also looked at what progress has been made in this regard and what the obstacles are to achieving this functionality in public budgeting in Africa.

This report does not pre-suppose a model PFM system that applies equally to all countries in Africa. It is based on the premise that PFM systems need to be suitable for each country's constitutional, legal, political, administrative and cultural context. At the same time, however, the report proceeds from the understanding that there are required PFM functions and established principles that all systems need to operationalise, notwithstanding their context, in order to achieve good governance of the public finances. The research, therefore, looks at the progress that has been achieved on average against these functions and principles, while noting specific outliers.

The research has shown that there may be enabling and disabling factors attached to different country contexts that are important to highlight up front. Andrews (2008) observes commonalities among the contextual variables for each distinct PFM performance category using PEFA scores. His findings suggest that several factors, working in combination, are likely to facilitate PFM reform in a country and consequently to boost PFM performance. These factors are: (i) a high economic growth rate; (ii) social and political stability; (iii) a 'fiscal state' reliant on domestic tax revenues; (iv) sustained government policy commitments; and (v) non-Francophone heritage. However, these alone do not explain the emergence of the PFM reform space necessary for performance-enhancing reforms. That may have more to do with the intrinsic features of the reform process and its management than with the country context (Hedger & De Renzio 2010). The evidence on administrative heritage is also ambiguous, except that Francophone countries tend to score lower against the PEFA indicators for downstream external accountability dimensions (Andrews 2010). This may also be related to the selection of indicators for PEFA itself. A comparative study by Lienert (2003) suggests that Francophone budget execution and government accounting systems have some potential advantages, but these have not led to typically stronger PFM performance in practice.

The concern here is with factors that are internal to systems for the preparation and execution of budgets. However, achieving good financial governance in budget preparation and execution is also dependent on good tax governance, the sound management of debt and functioning audit and oversight institutions. These factors are discussed in Sections 2, 4, 5 and 6.

PFM reform achievements

African governments have put in place various mechanisms to improve on budget discipline and link their budgets to the priorities identified in national and sector plans over the last two decades. There is hardly a country in Africa that has not embarked on some effort to improve or reform its PFM systems. Our research findings show that good progress has been made towards sound practice in respect of specific PFM functions and systems in many countries.

Better legal frameworks

The existence of a comprehensive legal framework for budget preparation is important in managing the budget process, assigning responsibilities and providing all fiscal decisions and activities with a base in law. Earlier assessments of both Francophone and Anglophone systems found legal frameworks to be lacking in terms of coverage and implementation. Over the last decade, however, several countries have introduced changes to the legal framework for budgeting and PFM, modernising systems, ensuring better coverage of fiscal institutions and reducing some of the distance between country groups (Lienert 2008; CABRI/OECD 2008). The 2008 CABRI-OECD survey of budget practices shows, for example, that most key fiscal functions were covered by the legal framework in all of the 25 countries that participated in the survey. Modern PFM laws in Africa place emphasis on the performance of the budget and on stability, transparency and accountability.

More credible fiscal frameworks

An important underlying objective of PFM systems is budget credibility. If the rules and institutions of the PFM system cannot succeed in delivering expenditure (and revenue) outcomes that are close to the planned outcomes approved by the legislature, the rule of law is undermined and the foundations of good financial governance are weakened. A credible fiscal framework is necessary for medium-term stability and debt sustainability, and underpins affordable policy commitments by the government. Fiscal frameworks are effective in the budget process if they are based on realistic forecasts and include all claims on public resources.

Fiscal framework development in African countries is supported strongly by the widespread use of fiscal rules. The existence of and adherence to fiscal rules means that the budget is defined by macroeconomic constraints that enhance the budget as a tool for macroeconomic stability. Most African countries have fiscal rules that range from expenditure and revenue to budget balance and debt (CABRI/OECD 2008).

In the face of weak revenue bases and limited options for borrowing, many African finance ministries have faced strong political pressure in the past to prepare optimistic fiscal frameworks in order to accommodate higher spending. The research, however, shows that the provision of realistic forecasts of available resources has improved in some countries, overcoming these long-standing challenges. On average, though, African countries forecast aggregate expenditure better than revenue and expenditure composition. PEFA assessment scores show that aggregate expenditure forecasting performance in Africa is better than in PEFA-assessed countries elsewhere in the world (CABRI 2010).

Modernised budget classification systems

How the budget is classified is crucial in determining the quality of the budget process. In modern budgeting systems, good practice dictates that an integrated budget be presented in the most important classifications (usually administrative, combined with economic, functional and/or programmatic), that the classification be embedded in the chart of accounts to ensure that all transactions can be reported in accordance with any of the classifications used (Jacobs, Hélis & Bouley 2009; PEFA 2005) and that classification adheres to established international standards. African countries show significant progress in classification reforms. For example, by 2005 already, all 12 countries assessed by UNECA against budget transparency standards had shown improvements (ECA 2005). Dabla-Norris et al. (2010) found that 15 out of 35 African countries already were using all three classification dimensions. Many countries have also made

progress in integrating development and recurrent budgets (65% of PEFA-assessed countries had achieved some form of integration), aiding functional budget planning.

Improved budget processes

The political leadership, degree of centralisation and strength of the ministry of finance, discipline and timeliness, and degree of participation in and transparency of the budget process are key determinants of the budget underpinning fiscal discipline and allocative and operational efficiency (Allen 2009; PEFA 2005; Holmes & Evans 2003; Wilhelm and Krause 2007; De Renzio 2007). Many African countries have reformed their budget processes successfully in recent years along these lines. Altogether, 75% of PEFA-assessed countries follow timetables (some with minor deviations) (CABRI 2010). Budget processes are also functionally centralised in many countries, with clear assignment of responsibilities, use of numerical fiscal rules and targets, and top-down spending ceilings (CABRI 2010).

Better mechanisms for sector planning in selected countries

Engaging sectors, line ministries and budget agencies in the strategic management of resources, and clearly distinguishing between resource allocations that belong at the centre (allocating envelopes to sectors, ministries and agencies) and resource allocations that rightly belong at lower levels (allocating between uses of funds within an envelope to Cabinet-approved strategies, programmes and projects), is crucial for allocative and operational efficiency. Selected countries in Africa have made significant progress in establishing mechanisms that get this balance right. Countries like Uganda, Kenya, Ghana, South Africa and Rwanda use sector working groups to make or inform trade-offs in more co-operative and participative budget processes. These initiatives point to a growing understanding in Africa of linking priorities to spending better, an area of reform that requires the building of an African knowledge base on what works and where the pitfalls are. While there are still significant challenges in developing credible sector plans, African countries on average outscore their international counterparts in PEFA assessments, indicating that there has been faster progress in Africa in developing sector-level capacity to link plans and budgets.

Widespread efforts to make available non-financial performance information

Input-based budgeting can be enhanced significantly if it systematically links the inputs to information on results achieved. The most basic form of performance-based budgeting is when decision-makers consider information on results in the budget process. Many countries in Africa report the use of performance information. The CABRI/OECD Budget Survey found that 15 countries use performance targets, 12 use performance measures, 19 undertake evaluations of some kind, and 3 use benchmarking to manage performance. Only one country in the survey (Swaziland) does not generate performance information at all (CABRI 2010).

Active reforms of procurement systems in selected countries

Functioning procurement systems mean that goods and services are procured cost-effectively, competitively, fairly and in a timely fashion, and that opportunities for corruption are minimised. Many African countries have made progress with reforming the public procurement system, implementing the reforms outlined in procurement assessment exercises, and changing legal frameworks. For example, Benin, Cameroon, Senegal, Uganda, Mali, Kenya and Ghana have all passed new procurement laws and have made spending agencies accountable for open, competitive and transparent procurement under the oversight of new public procurement

boards. Some have created appeals and complaints mechanisms, promoted procurement planning and initiated capacity-building at all levels in public procurement (CABRI 2010).

Progress towards risk-based internal system audits

In recent years (in line with the professional standards for internal auditing), countries have been under pressure to move closer to independent systems auditing, which comprises a critical review of internal control systems with recommendations for improvement of the systems. The professional standards for internal auditing – International Standards for the Professional Practice of Internal Auditing (ISPPIA), issued in 1992 by the Institute for Internal Auditors – speak to the need for appropriate structures, sufficient breadth of mandate, access to information and power to report, and the use of professional audit methods, including risk-assessment techniques. While the introduction of risk-based internal audit functions is a slow process, given the high institutional and skill requirements, PEFA-assessed African countries are making relatively quicker progress in establishing risk-based internal audit functions than are their counterparts elsewhere (CABRI 2010).

Progress towards the use of standards in public sector accounting

The use of consistent standards and/or international standards in public sector accounting is important for transparency. It ensures that stakeholders can interpret the government's financial statements correctly. Evidence suggests that most African countries have made some progress in the use of standards. Very few African countries scored at the lowest level in PEFA assessments on the use of standards in public sector accounting – only 5% compared to 21% of assessed countries in the rest of the world (CABRI 2010).

In-year reporting has improved

The regular flow of information during the spending year on actual spending is crucial to addressing emerging problems in a timely manner, as a check on disciplined budget implementation and to ensure functional internal accountability systems. Significant progress has been made in improving reporting practices in Africa. In respect of internal reports, the PEFA framework is aimed at measuring the ability to: (i) base planning on timely and regular information on actual budget performance, available to both the ministry of finance and Cabinet; (ii) monitor budget implementation performance in order to identify the need for remedial action early; and (iii) assist spending agencies in managing their affairs. Of the countries assessed against these dimensions, only Lesotho, Mali and Côte d'Ivoire fell below the 50% mark. Morocco fared the best against this indicator, followed by Burkina Faso, South Africa, Mauritius, Uganda and Botswana (CABRI 2010).

PFM challenges to achieving good public financial governance

Despite these gains, key PFM challenges face African countries on the road to a sustained culture of good public financial governance. This is to be expected. It is increasingly understood that building effective, transparent and accountable PFM systems is a long-term undertaking. Even when gains can be demonstrated, countries need to be vigilant to leverage them and ensure that backsliding does not occur. In general, the reality is that progress against the objectives of reforms is slow to materialise and difficult to sustain (Allen 2009; Dorotinsky & Floyd 2004; Obidegwu 2005; Schiavo-Campo 2009; Le Houerou & Taliercio 2002).

The challenges identified by the research fall into two groups: (i) specific weak system points in the PFM value chain; and (ii) factors that weaken or threaten the whole PFM system.

Specific challenges

Weak links in upstream budget systems

On average, African countries have made better progress in strengthening upstream budget systems than in improving downstream budget systems. However, the following key areas require attention.

A focus on improving revenue forecasting is required. While African countries have made progress in budget credibility in respect of aggregate expenditure outturns, revenue forecasting performance lags. A third of PEFA-assessed African countries scored at the lowest possible level for aggregate revenue outturn, while only 9% scored at that level for expenditure outturns (CABRI 2010). Having realistic revenue forecasts is a prerequisite for effective budget planning and execution. African governments should commit to improving revenue forecasting performance in countries where revenue outturn consistently deviates from budgeted revenue.

The incentives for credible forecasts in African countries must be strengthened. The CABRI/OECD survey highlights that mechanisms to support affordable fiscal frameworks are not well developed. For example, in 24 out of the 26 countries surveyed, the forecasts were done internally by the finance ministry, and in only eight of the 24 were independent reviews conducted. Generally, the legislature and the public are provided with very little information on forecasting models, on the assumptions used or on risk. Strengthening of the incentives for credible forecasts can be achieved by ensuring the independence of the forecasts from the central budget authority and/or by putting in place independent country-based review mechanisms. The budget documentation should make public the forecasts and underlying assumptions.

High use of non-transparent extra-budgetary mechanisms must be addressed. In combination, the PEFA, Open Budget Initiative (OBI) and CABRI/OECD survey results point to high use of extra-budgetary mechanisms, combined with low legislative oversight and transparency in respect of them (CABRI 2010). Assessing the merits of the use of these mechanisms in the first place, and ensuring transparency in them, should be a reform priority going forward. They undermine the key good financial governance principle of comprehensiveness in budgeting.

Systematic political involvement in the budget process must be strengthened. Political involvement is important in ensuring legitimacy and discipline in the budget process. Yet, only approximately 50% of countries assessed using the PEFA framework had well-developed early political involvement in the budget process, and in less than half of the countries participating in the OECD/CABRI survey were budget disputes resolved by Cabinet or a committee of Cabinet. Almost two out of three African countries did not involve Cabinet in early budget ceiling decisions. Coupled with weak legislative engagement with the budget, this means that political oversight of the budget is weak overall, undermining the legitimacy of budgetary decisions and opening the door for deviation from the approved budget through political interference during the fiscal year. A priority for good financial governance in Africa, therefore, is to enhance the timely and consistent involvement of the political leadership in budget preparation.

Central rules for medium-term planning must be strengthened to be effective budgeting instruments. Many African countries provide no information on forward expenditure projections in the budget presentation in parliament, despite having introduced MTEF reforms. MTEFs are

used mainly for internal purposes alone and, even then, only at the ministry level. Only two countries based their forward estimates on a combination of macroeconomic assumptions and the cost of current and new policies (CABRI/OECD 2008). In other words, resource-constrained medium-term expenditure planning in Africa is still weakly developed, opaque and unaccountable.

Classification reforms must be broadened to include all countries in the region. The Dabla-Norris et al. index (2010) shows that a third of the 35 African countries assessed still used only one dimension of budget classification. This undermines the ability of the government to allocate funds to priorities, and of parliament and the public to assess the quality of expenditure.

Capital and recurrent budgets must be integrated better. Despite some countries having made progress, the continuing separation of capital and recurrent budgets in many others (11 out of 26 countries in the CABRI/OECD survey still had separate budgets) affects budget credibility and allocative and operational efficiency. Even if countries choose to have separate legal instruments for approving investment and recurrent spending, concrete steps towards institutional, managerial and documentation integration must be taken.

Capacity at the sector and line ministry level for strategic planning and medium-term budgeting should be developed. The quality of the budget process is as much dependent on good quality bottom-up processes as it is on macro-fiscal and top-down capacity. The development of costed, resource-constrained sector strategies is critical to the quality of bottom-up processes. While there have been gains in some countries, the sector capacity of many African countries lags behind the development of central budget mechanisms, compromising the quality of processes overall (CABRI 2010). Enhanced capacity at the sector and line ministry level for policy-making, strategic planning and medium-term budgeting is essential.

Performance information should be used more effectively. While many African countries report the collection of non-financial performance information associated with budgets, the effective use of this information for budgeting purposes is not developed strongly (CABRI/OECD 2008). The collection of information without it being used effectively and consistently often results in poor information quality. Countries should be more systematic about the use of performance information in the budget. It is a crucial step towards systematically ensuring operational efficiency and value for money in public spending.

The use of pre-budget statements will increase predictability, stability and transparency. Pre-budget statements play an important role in that they focus the debate on macro-fiscal issues and strategic trade-offs in the budget. They also serve to firm up the budget framework and high-level budget ceilings, thereby assisting in building disciplined budgeting processes. However, very few African countries make use of pre-budget statements on fiscal decisions (OBI 2008).

Downstream weaknesses

The research showed that African countries on average have weak budget-execution systems, with weak internal controls, weak cash management and slow implementation of accounting and FMIS reforms. This is a crucial general finding in terms of our concern with good public financial governance, and is discussed further below. Here we focus on specific weak systems in the budget-execution, accounting and reporting cycle.

On average, African countries do not manage cash optimally. The use of cash rationing to counter revenue shortfalls against the enacted budget is widespread in Africa, and is damaging to the rule of law in budgeting and the capacity of governments to achieve consistent service delivery. A first step is to improve revenue forecasting; on the budget-execution side, the negative impact of cash budgeting can also be countered through better cash management by the government, including adequate cash-flow forecasting and the effective and efficient use of cash balances. Many African governments have committed to using single treasury account arrangements that will allow for the efficient use of cash balances, but implementation lags significantly (CABRI 2010). The challenges of running effective banking arrangements that allow for regular consolidation of balances are many and diverse. Failure to implement such arrangements, however, carries a high cost – the proliferation of bank accounts and failure to consolidate bank balances regularly contributes to the accumulation of arrears, increased borrowing costs and poor oversight of spending. The implementation of single treasury account mechanisms, in order to manage cash transparently, should be a priority for governments in Africa.

Cash planning and commitment practices must be improved. Functional systems of cash forecasting, predictable funding of spending agencies and transparent adjustments of voted allocations are the backbone of efficient budget execution and are a necessary precondition for sound budget preparation. Yet, many countries in Africa have not implemented robust and transparent systems to manage unpredictability and resource shortfalls in budget execution without disrupting budget execution (CABRI 2010). Opaque, arbitrary and discretionary cash rationing is not conducive to good financial governance. A priority reform for African countries, therefore, should be the implementation of transparent, predictable and effective systems of cash planning and commitment.

Commitment controls are weak. Commitment controls are a key part of internal controls supporting budget credibility and efficient budget implementation. Many African countries do not control commitments effectively, with the result that arrears accumulate and/or budget credibility is damaged. Altogether, 65% of PEFA-assessed African countries scored a C or a D, meaning that they have incomplete control systems or that controls are routinely violated. The reasons for this are many, and not all of them are technical – the abandonment of planned activities for activities that are not authorised, lack of timely information on commitments already made and poor incentives for commitment control on account of unpredictable cash flows. The institution of effective and functioning commitment control in line with approved funds is a priority for reform in Africa.

Payroll controls must be developed. Payroll controls have a direct effect on a government's ability to account for the significant proportion of expenditure that is committed to personnel cost. In many countries, integration of personnel records with payrolls, and the updating of both records and payrolls, lags significantly, as evidenced by African countries' performance on the PEFA assessments (CABRI 2010). Few countries have fully fledged and well-developed systems. The development of robust payroll systems is a priority for good financial governance in Africa.

Procurement systems must be strengthened. It is acknowledged above that some countries have made significant improvements to their procurement systems. However, the research has also shown that many African countries remain at risk of poor financial governance in procurement and outcomes, with competitive processes not managed well (CABRI 2010). On the whole, attention to procurement reforms, in terms of transparency, institutions, management, and accountability and control, is a crucial priority for good financial governance in Africa.

Capacity for effective system-based internal audit is weak. The correlation between expenditure composition outturn and the strength of internal audit systems in Africa is statistically significant. Most countries have undeveloped systems of internal audit and, where progress has been made, executive agencies pay scant attention to the recommendations arising from internal audits. A priority for Africa is the development of improved systems of internal audit and a professional cadre of internal auditors, particularly as more countries are adopting reforms that de-concentrate expenditure management responsibilities. However, this will be effective only if underpinned by the political will to address the lack of responsiveness of government institutions to internal audit recommendations.

Support and capacity for the adoption of generally accepted accounting standards is inadequate. The initiative of the majority of African countries to adopt international accounting standards is acknowledged above. The adoption and implementation of generally accepted accounting standards is important for financial control, transparency and accountability. Yet, the research has shown that weak support by senior management for these processes and weak professional capacity in the public sector constrain their implementation in practice (CABRI 2010). The training of accountants and IT specialists, and compliance with existing standards or the adoption of transparent standards (if not the international standards), should be priorities for reform.

Reconciliations are not performed regularly enough. Reconciling balances and bank reconciliations are important checks on the quality of financial management and on budget execution. The research shows that bank reconciliations occur more regularly on average, but that the reconciliation and clearance of suspense accounts and advances lags behind, with many countries undertaking only an (often late) annual reconciliation (CABRI 2010). This potentially can leave significant resources out of the reporting net, with a negative impact on budget management and governance. Improved practices in this regard should be a reform focus in many countries. Timely reconciliation of balances is an important check in financial management. Overall, African countries fare poorly in assessments. Strengthening accounting systems and oversight of accounting practices is a key priority for good financial governance in Africa.

Management of FMIS reforms needs to be strengthened. While the automation of financial management systems is an important support for downstream reforms in budget execution, accounting and reporting, governments need to ensure that reforms are appropriate to their requirements, cost-effective and can be sustained. Political and bureaucratic commitment to implementing and sustaining information technology solutions is crucial.

Macro challenges

The budget-preparation and budget-execution arenas in African public resource management systems face a series of core challenges that hinder progress towards systemic and sustained good public financial governance. These challenges are not primarily about technical budget issues, even if they contain technical aspects. They are political and/or about the incentives for behaviour in public decision-making. The challenges noted here are interdependent and often mutually reinforcing.

Budget transparency

Overall, fiscal and budget transparency is weak and must be addressed as a priority. There is significant scope for countries to improve the availability, coverage and usefulness of *ex ante* budget information to the legislature and the public through the budget.

At the fiscal framework level, parliament and the public do not have the proactive access to the assumptions and models underlying fiscal frameworks, contingent liabilities and extra-budgetary flows that would support accountable budgeting.

Many countries in Africa provide very little or no information to legislatures and the public explaining budget allocations. Even fewer countries report against the information that is provided *ex ante*. Yet, the OECD/CABRI survey indicated that most countries do use performance information, measures and targets in their budget processes. The quality of these data and their use in the budget process would be strengthened if made public. Countries can sequence building their capacity to improve the budget documentation in this regard, starting with a narrative on strategic choices overall, by sector and by spending agency.

Despite many African countries having modernised their internal classification systems to provide multidimensional information on the budget process, relatively few carry this through to providing multi-dimensional information on the budget to parliament and the public. This should be addressed as a priority.

Openness to the public and parliament on progress with implementation of the budget and public accounts is a key requirement of good financial governance. Despite many countries having improved the internal availability of in-year reports, few publish these. Long-term commitment to fiscal transparency, coupled with the identification of immediate means to improve transparency, should be a priority for African governments.

The implementation gap

The research shows that PFM systems – and, therefore, good financial governance – face a gap between new formal system rules and whether or how well they are implemented in practice. This manifests at the high level, where the finding is that the modernisation of public finance legislation is often not followed by the translation of new laws into lower-order instruments like regulations, or by the necessary operational changes to structures, procedures and practices. This highlights an important issue for good financial governance in Africa: countries should not develop laws and rules for PFM that are unlikely to be followed. If new rules are introduced, they should come with a clear strategy for their implementation and a strong commitment to enforce them.

It also manifests at a lower level, where the creation of processes are not matched by changes in behaviour. Andrews (2010) identifies systematic differences in the way that governments meet the different kinds of challenges in PFM systems, key amongst which is that practice lags behind the creation of processes and laws. This theme reflects the institutional differentiation between de jure and de facto institutions, the former being less demanding to adopt and change than the latter. This is apparent in a comparison of the more *de jure* budget preparation dimension in PFM systems and the more de facto dimension in the PEFA assessment framework. Whereas the mean score for the sample of 31 African countries for de jure reforms was 2.33, the mean for de facto reforms was 1.9, with almost double the number of countries scoring Ds in the latter than in the former dimension.

This differential with regard to progress against different PFM aspects is replicated along the upstream/downstream and centralised/decentralised axes. In other words, across countries on average the data point to less progress in terms of downstream PFM systems, less progress in terms of *de facto* mechanisms and less progress for PFM processes that involve decentralised rather than centralised actors (Dabla-Norris et al. 2010; Andrews 2010). While each of these findings points to a good financial governance priority in its own right (the need to pay attention to implementation, to downstream processes and to processes in line ministries), a common

factor underlies the findings – informal systems in budget management and approaches to undertaking PFM reforms.

Informality in budget execution systems

That African countries on average do not translate new legal frameworks and processes into practice is symptomatic of the long-standing tolerance of informality – or the bypassing of formal rules – in budget management in Africa. It is not, for example, that commitment controls are not in place; it is that they are bypassed and that there are no consequences for bypassing them. Hyden (2005) sees the prevalence of informal practices, which have the effect of rendering formal institutional arrangements less effective, as the biggest governance challenge facing most African countries. These informal measures are often rational from an individual perspective, but they undermine objectives at the collective level. They also contradict reform efforts and often serve as the basis for resisting them. PFM reforms in African countries have not transcended these relationships successfully, partly because the reforms proposed may not be the right ones for the affected country at the time, and partly also because they occur on the platform of a long-standing tolerance of informality in public systems.

Approaches to undertaking PFM reforms

The progress differentials also reflect PFM reform practices. Finance ministries are usually the centre of PFM reform processes. It is, therefore, understandable that PFM performance is better for aspects of the system that are more under the control of these ministries, such as upstream processes and de jure mechanisms. Downstream and de facto processes often involve decentralised actors who may not buy into reforms and/or who may have been excluded from the processes that bring about the change in mindset required to change practices. The findings of the research point towards the need to shift the focus of reform from upstream to downstream processes, and from *de jure* to *de facto* PFM mechanisms. Very significantly, however, they also point to the need to draw decentralised actors into reform debates and processes much more deliberately, in order to engender change across the full spectrum of budget preparation and execution institutions.

A second point in respect of PFM reforms concerns the important role finance ministers play in co-ordinating and driving PFM reforms: without their active leadership, it is unlikely that formal systems changes (through new laws and different processes) will become operational. The significant implementation gap in PFM systems that the research points to highlights that the budget reforms are not driven or owned sufficiently by finance.

Allen (2009) points out that frequently reform initiatives are funded significantly by donors. This can lead to a dependency on donors and their consultants to design and drive reforms, which inhibits the development of local capacity and channels finance into projects that may not be appropriate or timely for the country, but are either what the donor knows or thinks is the right thing to do. For certain reforms, it is also important that African officials themselves go through the process of developing and undertaking the reforms themselves, in order to make the correct hard choices, trade-offs and compromises.

Sequencing of reforms

Overall, the sequencing of reforms is not driven sufficiently by country context or need. It is questionable, for example, whether focusing scarce resources and thin capacity for reform on the implementation of a programme performance budget in a country that does not have basic cash-management and planning systems in place is the right choice. In the long run, the faster progress in upstream reform as against downstream processes will threaten countries' ability to sustain the upstream improvements and to achieve good public financial governance.

It is important for good financial governance in Africa that countries are more resistant to donor-driven PFM system reforms, rely more on local commitment, knowledge and capacity, and present realistic timelines for reform processes.

Management of donor funds
The integration of aid on budget and transparency with regard to aid flows (from all sources) are crucial for mutual accountability for aid and partner-country ownership and sustainability of aid. These principles are well formulated in the international aid effectiveness discourse, but adherence to them in the interests of countries is also critical for good financial governance in Africa. The 2007 CABRI study on aid on budget and the PEFA assessments point towards significant challenges to bringing aid on budget, key of which is the frequency, quality and timeliness of information flows on aid. The predictability of aid is also important for sound macro-fiscal and budget management in African partner countries. For good financial governance, therefore, it is a priority to increase international pressure for improved aid information practices, to bring together aid and public financial management processes at country level, and to enhance African country ownership and management of aid towards development effectiveness.

Capacity to sustain quality public financial management
Skills shortages in terms of economists, accountants and auditors are well documented, and affect the capacity of states to design, implement and maintain PFM reforms and to operate PFM processes. Across the budget cycle, processes require scarce technical skills. For example, establishing a professional systems-based internal audit system requires significant numbers of individuals with the requisite audit and financial qualifications, experience and skills; developing automated FMISs requires information technology, accounting and process-engineering skills; building macroeconomic models and undertaking debt, macroeconomic and fiscal analysis and forecasting requires experienced economists. Yet, these skills are rare in African countries.

Besides technical skills, African countries require informed, enabled and strong middle-management capacity to translate and drive the implementation of macro reform strategies and capacitated, strong senior officials to guide the design of reforms and manage donor relationships. A key priority for good financial governance going forward, therefore, has to be the development and implementation of strategies to train, recruit and retain the specialised technical and managerial skills required in the budget and budget reform processes.

Priorities for good financial governance in PFM

Address fiscal transparency shortfalls

A key priority for good public financial governance in Africa is to make available to legislatures and the public useful, comprehensive, reliable, timely and accessible information on fiscal and budget decisions and the state of the public finances. An immediate commitment should be to improve the annual budget documentation and to publish the information that already exists. In addition, African countries should all prioritise transparency to the legislature and the public, and establish what information is important to publish but not yet available, prioritise its reliable production and make systematic progress towards full fiscal and budget transparency.

Ownership and sequencing of reforms

Finance ministries should take ownership of reform choices and processes. Key to this is ensuring that the basic building blocks of good financial governance set out above are in place, that their improvement is sequenced correctly and that the specific reforms undertaken are country-appropriate. A second aspect is to close the implementation gap by developing clear, time-bound strategies for the operationalisation of legislative changes and new processes.

It is important for good public financial governance in Africa that countries are more resistant to donor-driven PFM system reforms, rely more on local commitment, knowledge and capacity, and insist on realistic timelines for reform processes.

Align PFM choices and capacity

The implementation of robust budget and financial management systems is dependent on the professional capacity to operationalise systems being in place. Strategies to close the implementation gap should take account of capacity shortages and develop realistic timelines for implementing systems. The professionalisation of budget practitioners in African public sectors, albeit at the central or spending agency level, must be prioritised.

Address common weak linkages in the PFM chain

The paragraphs above highlight specific priorities for good financial governance in PFM. These include:

- improving revenue forecasting practices and capacity;
- strengthening incentives for credible forecasts;
- addressing the high usage of opaque extra-budgetary mechanisms;
- integrating capital and recurrent budgets;
- developing critical capacity at sector and line ministry level for strategic planning and medium-term budgeting;
- using performance information more effectively;
- using pre-budget statements to support discipline in the budget process;
- implementing single treasury account mechanisms;
- improving cash-planning and commitment practices;
- strengthening commitment controls;
- developing more robust payroll controls;
- strengthening procurement systems;
- building capacity for effective system-based internal audit;
- providing greater support for the implementation of consistent accounting standards;
- performing more regular bank and other reconciliations; and
- strengthening the management of IFMS reforms.

These priorities concern the improvement of specific systemic links in the PFM value chain. They may not apply to all countries, but are crucial to address in many countries. It is critical that countries assess the technical robustness of their PFM systems and identify key shortcomings.

Political leadership and ownership of, commitment to and involvement in the budget system

Political leadership of PFM reforms, and the political will to enforce formal rules and demand vertical accountability, is crucial for good financial governance. However, the research has highlighted that on average the opposite occurs in Africa, where political engagement with the PFM system is precisely about bypassing formal systems and can be destructive. A key priority for good public financial governance in Africa, therefore, is the strengthening of transparent, systematic and accountable political engagement with budgets and the PFM system by political actors. This should be supported by the political will of finance ministers and their commitment to enforcing formal system rules and demanding accountability.

Prioritise African management of aid and the integration of aid on budget

A key priority for good public financial governance in Africa is the integration of aid in budget processes, the reflection of aid on budget and ensuring that country oversight institutions are engaged on aid options and choices. This is particularly relevant to high-aid-receiving countries. African countries must look at the strategic integration of their aid management and PFM practices to ensure overall resource effectiveness. This includes making strategic choices about including aid on budget to optimise country benefit and development effectiveness from aid, while minimising country risk.

SECTION 4
GOOD GOVERNANCE OF PUBLIC LIABILITIES AND ASSETS IN AFRICA

Introduction

Public debt and financial asset portfolios carry risks for the fiscal sustainability of countries' policies, their ability to achieve their development objectives and overall financial stability. Sound management of public debt is concerned with the medium- and long-term sustainability of countries' debt burden, the capacity to raise funding when required, and managing the risk associated with debt and the cost of debt. The sound management of public financial assets includes the management of countries' investment in financial and commercial public enterprises, the focus of the research here.

Good governance of financial liabilities

Control over the incurring public debt and the issuing of guarantees, and the recording and reporting of government debt and guarantees are crucial system elements in the achievement of good governance of public debt. Good information on the level and forward cost of debt and the contingent risks associated with guarantees support governments in ensuring that debt is sustainable (i.e. that service costs in relation to government revenues are affordable and can be covered under a range of future circumstances). The structuring of debt to achieve an appropriate balance of risk associated with exposure to interest rate, currency and other fluctuations and cost objectives is another key aspect of public debt management.

Debt in Africa

Debt traps and HIPC: Unsustainable debt burdens have led to African countries benefiting from debt relief initiatives since the 1970s. Altogether, 31 countries in Africa are benefiting or set to benefit from the Enhanced HIPC Initiative. However, a 2006 evaluation of the initiative found that key debt sustainability ratios had regressed in all 14 countries that had reached completion point (IEG World Bank 2006). While the report found that a more optimistic outlook for debt sustainability was present in six of the eight countries in which the ratios had exceeded HIPC thresholds, they were still vulnerable to shocks, nonetheless. This illustrates the need for sound debt management institutions.

Debt to GDP/revenue and deficit: There are no common African stories of the factors that affect debt levels and cost. In the last decade, budget balances generally have been positive for oil-exporting countries, while non-oil exporting countries have experience stable deficits at around 2–3% of GDP. In addition, better macroeconomic policies and sustained growth have led to a decrease in debt to GDP levels. Both the highest and lowest levels of debt in the world are found on the continent, respectively Zimbabwe (283% of GDP in 2009) and Libya (4% of GDP in 2009).

Trends in debt management in Africa

Debt structure: Sound debt management practices entail that: (i) long-term costs are minimised; (ii) risk levels are appropriate; and (iii) government borrowing needs are met. Structuring debt with an adequate balance of different debt instruments helps in achieving the above conditions. For instance, increasing the local currency debt will reduce exchange rate risks, while debt in foreign currency may be less costly. Likewise, non-fixed instruments like inflation-linked bonds can reduce long-term borrowing cost.

The capacity of African governments to effect optimal debt structures is limited and it remains an issue on the continent: debt is mainly in foreign currency, and local currency debt has short maturities (Blommestein & Horman 2007).

The structure of debt in African countries is determined by the technical capacity available to governments to develop debt strategies, to engage with domestic and international capital markets and institutional lenders, to manage debt on a day-to-day basis and, importantly, to access domestic and international capital markets. The development of local capital markets and access to international capital markets is paramount to the adequate funding of government securities and to the reduction of debt costs for African governments. To date, the majority of foreign private fixed-income capital flows to the continent have gone to South Africa. In addition, many African countries are subject to capital flights. This indicates an opportunity for the development of domestic capital markets, with debt issued in local currency.

Debt management practices: In Africa, different countries' debt-management practices vary greatly. Poor reporting and recording of debt undermines a government's ability to have a sound and forward-looking debt strategy, making it vulnerable to shocks. Debt should be recorded and reported in a timely manner (ideally within a day). The World Bank Debt Management Performance Assessment (DeMPA) tool suggests that a secure debt-recording system should:

- capture all transactions relating to central government debt and government loan guarantees;
- record all categories of central government debt and loan guarantees; and
- be audited and reconciled frequently (PRMED 2009)**.**

Government contingent liabilities (in other words, liabilities that are due only if a certain event occurs) are particularly hard to measure. Such contingent liabilities include government guarantees on loans to state entities or guarantees given in respect of public-private partnership (PPP) contracts. Accurately recording the amount of state guarantees and the extent of liability in case of default allows governments to manage risk and plan for potential impact on their budgets.

The PEFA assessment framework provides cross-country information on the quality of debt-management institutions in Africa. It assesses the quality of debt data-recording and reporting, and the quality of systems that control debt contracting and the issuing of guarantees. While African countries perform relative well in both respects, compared to many other indicators in the assessment framework, on average they still lag behind assessed countries elsewhere. Country performance in Africa in terms of systems to control the incurring of debt and issuing of guarantees is also worse than performance in respect of debt recording and reporting. Therefore, challenges lie in improving debt reporting and recording and in controlling debt contracting and the issuing of guarantees.

While internal reporting on debt is important for good financial governance, regular reporting to the legislature and the public on the level and cost of debt, and the disclosure of contingent liabilities, are crucial incentives in managing debt. The OBI surveys show that improvements in internal recording and reporting of debt do not necessarily translate into the provision of information to parliaments and the public. Of the 23 countries assessed in Africa, ten were found not to provide any information in the budget and supporting documentation (or the information was not readily accessible).

Managing external debt: Managing external debt is an important part of an active debt-management system. Having too large a proportion of debt held by foreign entities or in foreign currency makes a country extremely vulnerable to debt traps. In Africa, sovereign debt is stable, on average, and debt services, as a percentage of the export of goods and services, are below 15%. However, the situation differs greatly between countries.

This is the case despite the emergence of new creditors in recent years. China, in particular, has been extending large loans to African governments. In 2009, Chinese Premier Wen Jiabao pledged US$10 billion in concessional loans to African nations over the following three years, twice the amount pledged in 2006. This influx of external debt signals the need for an active debt-management system.

Priorities for good debt governance

African governments should move from ad hoc management systems to active risk-based debt-management systems in which long-term costs are reduced to an acceptable level of risk. The following policies with regard to debt management are recommended.

Improve the structure of debt to reduce vulnerability to shocks. African countries should develop the technical capacity to structure their debt continuously to achieve optimal trade-offs between risks and cost. Possible interventions include reducing short-term debt, diversifying the debt portfolio, restructuring maturity profiles and enhancing liquidity, while reducing fragmentation on the yield curve. The development of local markets is also crucial to the potential of countries to diversify their public debt portfolios.

Build sound debt-management practices. It is important that African countries prioritise the development of sound policies and practices for debt management. This includes:

- less fragmentation of responsibility, and clear definition of who has the power to issue debt;
- the control and management of risks associated with state guarantees and contingent liabilities;
- co-ordination with macroeconomic and fiscal policy; and
- accurate debt recording and reporting

Improve transparency on debt burdens and cost. Improving pro-active transparency on debt burdens and cost, and on the extent and nature of contingent liabilities, is key for African governments to sustain the improved debt ratios many African countries have experienced recently. This would require the provision of regular reports to legislatures and the public on debt and contingent liabilities, including long-term analysis of debt profiles.

Management of public enterprises

The purpose of the research undertaken for this report was not to pronounce on the role of public enterprises in Africa's development, but merely to assess whether (where they do operate in economies) practices in African countries with regard to their management are sound and transparent, and contribute towards good public financial governance. Two particular aspects arise for consideration: (i) Is the ongoing management of public enterprises and their financial health transparent? (ii) Is governance of the privatisation of enterprises, where that occurs, transparent?

Good public financial governance practice requires that:

- flows from central government to the public enterprises (including the risk of flows) are made transparent in the budget process and in public financial reports;
- systems are in place to ensure that the financial health of the public enterprises is monitored, through the receipt of quarterly financial statements and audited year-end statements; and
- flows from privatising public enterprises, or investments in public enterprises, are transparent.

The PEFA assessment of 19 African countries with regard to the soundness of their systems to track the performance of public enterprises and autonomous government agencies shows that most countries have systems to receive at least annual reports on the performance of public enterprises, but that these reports are significantly incomplete or a consolidated overview is lacking. Only one country (Madagascar) scored at the highest level on the management of public enterprises, reflecting regular in-year monitoring practices and public consolidated reporting. Burkina Faso, Mauritius, South Africa and Morocco require at least annual reports, consolidate the information and provide an annual report themselves.

Transfers to public enterprises on the continent are also relatively opaque. Of the 27 African countries in the 2010 OBI index, 12 did not present any information on transfers, while only two (South Africa and Namibia) provided extensive information on transfers in the executive's budget proposal, including a narrative and financial estimates.

In general, subsidies to public enterprises from central government are not fully transparent. The history of privatisation of public enterprises in Africa points to practices that undermine good financial governance. The UNECA report on public management reforms in Africa found that governance in Africa is marked by state privatisation for the benefit of the ruling elite (UNECA 2003). Weak regulatory frameworks, low capacity for and difficulties in managing the process of privatisation, and lack of transparency during the process, were key factors in privatisation efforts that did not reach their objectives. Similarly, the granting of concessions through public-private contracting modalities is often opaque.

Priorities for improving the management of public enterprises

The establishment of regular practices that monitor the financial health of public enterprises, transparency to parliament and the public on transfers and subsidies to public enterprises and open, well-capacitated processes for divestment from enterprises are good public financial governance priorities for Africa.

SECTION 5 GOOD FINANCIAL GOVERNANCE THROUGH EXTERNAL AUDIT

Introduction

Effectively functioning financial governance mechanisms assume the integrity and political will of the government to serve citizens and to hold public officials accountable. Accountability requires that actions and decisions taken by public officials are subject to oversight. Effective accountability achieved through oversight is an essential ingredient in achieving the objectives of government in providing services to citizens. This involves both the political justification of decisions and actions, and the managerial accountability for implementing the agreed tasks (UNECA 2003).

External audit is the process whereby an independent person evaluates evidence regarding different aspects of an entity, and forms an opinion about the extent to which these aspects conform to set standards. Supreme audit institutions (SAIs) fulfil the functions of external auditors of governments and, therefore, play an important role in the process of accountability and in achieving good financial governance.

SAIs and good governance

There is an increasing consensus on the importance of SAIs in strengthening PFM and good governance (AfDB & World Bank 2009). The need for an external audit function in government has been recognised widely; consequently, all governments in Africa have SAIs in one form or another.

Effective SAIs make important contributions to financial governance as they:

- promote an increase in the transparency of public finances;
- minimise mismanagement and corruption, because government entities know that their financial transactions may be audited at any time;
- contribute towards the more efficient use of funds and other resources and, thus, increase the effectiveness of the public budget; and
- can effect a change, in the long term, in the government system by publicising cases of corruption and, thereby, contributing towards a change in the underlying culture (Santiso 2007; GTZ 2007).

International standards and SAI mandates

SAIs are guided by their national legislative frameworks. As a common frame of reference for public sector auditing, the applicable international audit standards (the International Standards of Supreme Audit Institutions, ISSAIs) set by the International Organisation of Supreme Audit Institutions (INTOSAI) can be utilised. INTOSAI was founded over half a century ago as an autonomous, independent and non-political organisation. All African countries have organisations responsible for audit functions as members of INTOSAI. AFROSAI is INTOSAI's regional working-group, with the main aim of providing support for African SAIs.[5]

5 AFROSAI is further sub-divided into organisations broadly for English-, French- and Arabic-speaking SAIs. These are AFROSAI-E, -F (CREFIAF) and -A respectively. With the exception of Libya, Arabic-speaking countries in Africa are also members of the Arab Organisation of Supreme Audit Institutions

The Mexico Declaration on Independence (ISSAI 10) adopted by the XIX Congress of INTOSAI recognises the following eight core principles for SAIs:

- *Principle 1:* The existence of an appropriate and effective constitutional/statutory/legal framework and of de facto application provisions of this framework;
- *Principle 2:* The independence of SAI heads and members, including security of tenure and legal immunity in the normal discharge of their duties;
- *Principle 3:* A sufficiently broad mandate and full discretion in the completion of SAI functions;
- *Principle 4:* An unrestricted access to information;
- *Principle 5:* The right and obligation to report on work;
- *Principle 6:* The freedom to decide on the content and timing of audit reports and to publish and disseminate them;
- *Principle 7:* The existence of effective follow-up mechanisms on SAI recommendations; and
- *Principle 8:* Financial and managerial/administrative autonomy and the availability of appropriate human, material and monetary resources.

These core principles are seen as the essential requirements of proper public sector auditing, and form the basis for evaluating the functioning of SAIs in Africa.

Traditional roles of SAIs

The mandates of SAIs are usually set by law and may include provision for the evaluation of reported financial information, compliance with laws and regulations, and of performance regarding the efficiency, economy and effectiveness of services. Consequently, SAIs undertake regularity or financial, compliance and performance audits. SAIs may also be required to evaluate performance information reported by government entities.

Traditionally, the role of SAIs was confined to financial or regularity audits and compliance audits. Financial audits evaluated and attested to the reliability and accuracy of a government's financial reports, either for each entity or for a government as a whole. The regularity part of such audits looks at compliance with laws and regulations for transactions contributing to balances in the financial reports. The internal controls and audit functions of financial systems are also identified and evaluated. The international standard requires the audit report to include a clearly stated opinion on the financial statements (ISSAI 1000: Par. 22).

Compliance auditing deals with the responsibility of the SAI to audit whether the activities of public sector entities are in accordance with the relevant laws, regulations and authorities that govern such entities. Checking whether transactions are in line with the appropriate budget usually also forms part of such audit (ISSAI 4000: Par. 1). Compliance audits can be performed and reported as part of a financial or a performance audit, or as a separate audit entirely. Compliance audit often has higher prominence in the judicial system of accountability.

Performance auditing is becoming more common as an SAI mandate. It is an independent examination of the efficiency and effectiveness of government programmes and institutions, with due regard to economy, with the aim of leading to improvements. Performance auditing provides answers to questions such as: Are we getting value for money? Are the right things

(ARABOSAI). There are five Portuguese-speaking (Lusophone) countries and one Spanish-speaking country (Equatorial Guinea) belonging to either AFROSAI-E (Mozambique and Angola) or to AFROSAI-F (Cape Verde, Guinea Bissau, São Tomé et Principe, and Equatorial Guinea).

being done? Are things being done in the right way? Performance auditing completes the circle of accountability, as it provides an insight for taxpayers, legislatures and executives into the running and outcome of different government activities. A criterion of good governance is that all public services (or all government programmes) are subjected to performance audits at some point (ISSAI 3000: 7–12). Performance audits can be done by embarking on separate audits or by incorporating elements of performance into routine audits.

Shift to risk-based auditing
The focus on good financial governance in recent decades, coupled with reforms in government, has brought about reforms to the auditing profession, with additional focus being put on the following:

- the introduction of risk-based thinking in audits, allowing for greater emphasis to be placed on audit planning, which requires a thorough understanding of the audited entity and its environment;
- stronger incentives, monitoring and follow-up of performance, in order to achieve more efficient and effective public spending;
- increased focus on fraud and internal controls while auditing; and
- making SAIs model public sector organisations, enforcing institutional-level requirements on the leadership of the SAIs.

In summary, the focus of the above reforms has been to audit only ‘what really matters’ to the stakeholders, including the audited entity and parliament. This approach aims to replace the common practice of auditing each and every transaction in order to identify all irregularities. The process of prioritising attention should free up audit resources. Such resources may be used to assess additional aspects like the efficiency and effectiveness of service delivery, internal controls and any possible involvement in fraud.

Forms of SAI in Africa

How SAIs function is determined by their accountability environment. The Westminster and the judicial systems of accountability are the two major practices found in African countries. As a general rule, Anglophone countries follow the Westminster system, while Francophone, Lusophone and Arabophone countries mostly apply the principles of the judicial system with some variations. In Westminster countries, the INTOSAI member is the office of the auditor-general. In judicial-system countries, the INTOSAI member is either the court of accounts or the inspector-general of state.

SAIs in judicial systems
SAIs in a judicial system form part of the judiciary and are referred to as ‘courts of accounts’ or, in some countries, ‘chambers of accounts’. The work of these bodies generally includes, but is normally not limited to, the assessment of the work of public accountants as far as the adequate processing and legality of financial transactions are concerned. Public accountants in judicial systems are placed in each government entity and are personally responsible for the proper expenditure of funds and for drawing up annual financial statements and reports. SAIs often simultaneously audit several years of accounts prepared by public accountants. A cyclical approach is frequently adopted and applied, therefore, particularly for smaller and lower-spending entities. When the SAI or courts of accounts judge the legality of the public accountant’s actions, they can either ‘discharge’ the public accountant from further liability, if satisfied that the

transactions are legal, or impose a penalty or sanction on the public accountant where illegal transactions are found to have occurred.

Further responsibilities of the SAI or courts of accounts may include reporting to parliament on the audit of government accounts compiled annually by the ministry of finance. Parliament can rely on this report in granting a 'discharge' of responsibility to the government for the year if it is satisfied with the way the government has managed public funds in that year. In addition, the SAI or courts of accounts may also be mandated to audit different government entities.

The inspector-generals of state currently represent several Francophone African countries in INTOSAI,[6] even if these countries also have a court or chamber of accounts. As a result, the institutional arrangements for external audit in judicial systems have been argued to be unclear, complex or subject to controversy (AfDB & World Bank 2009). Inspector-generals of state report either to the president or the country's prime minister instead of to parliament, which contributes to the often raised concern regarding their independence. However, they have a high degree of functional and organisational independence from the entities they audit. In addition, the audit reports issued by such institutions are not normally made public documents. However, the Inspector-generals of state normally employ professional PFM staff and have access to all state institutions, public servants and their documents.

Westminster SAIs

Under the Westminster model, the work of the SAI is intrinsically linked to the system of parliamentary accountability. In this model, the role of parliament is emphasised. An annual cycle is followed, starting with the authorisation of expenditure by parliament, followed by the production of annual accounts by all government departments and other public bodies, the audit of those accounts by the SAI, the submission of audit reports to parliament for review by a dedicated committee and the issue of reports and/or recommendations by the public accounts committee (PAC) to be adopted by parliament. The cycle concludes when the government responds to the PAC's reports. SAIs in Westminster countries comprise the auditor-general and his office.

An enabling environment for effective external audit

SAIs do not function in isolation from the government, parliament and broader civil society. The way they fit into the government's processes, and their links with other entities responsible for financial control and oversight, is vital.

Legal frameworks should provide for the independence of SAIs. Frameworks should seek to minimise undue influence by executive government over: the allocation of operational and developmental funds to SAIs and the transfer these funds; selection, recruitment and remuneration of audit staff; determination of the scope of audits; provision of unrestricted access to information; and the identification of standards to be applied during audits. Legal frameworks can also provide special status, immunity or protection for auditors when circumstances require. Legislative frameworks guaranteeing the SAI's independence need to be combined with the demonstrated desire for transparency and the political will to enforce accountability on the part of government officials.

SAI operations are a reflection of the legislated governance arrangements of government entities. Appropriate budgetary and oversight functions and clear reporting frameworks adopted

6 Burundi, Cameroon, Central African Republic, Guinée (Conakry), Mali and Togo. Some commentators put this form of SAI as a third accountability system in Africa. For the purposes of this report, however, we include this type of SAI under the judicial system of accountability because of its similarity to 'pure' judicial systems in respect of the remainder of the discussion.

by the government influence the scope of audits and the effectiveness of external audit functions. Meaningful and timely presentation of financial information is vital for a timely and effective audit. The presence of internal audit committees and internal audit functions, and provisions for an approach to identifying and managing the main risk areas of government are critical to the success of modern external auditing practices.

Efforts to co-ordinate the work and functions of the SAI and other institutions contributing towards accountability, such as parliament, oversight committees, anti-corruption agencies and internal audit, are critical. One of the last steps in the process of accountability is to have an effective oversight mechanism outside of the SAI, which is tasked with following up audit issues. Oversight committees should use audit reports to monitor the extent to which public sector entities are implementing audit recommendations. Even a professionally functioning and adequately financed SAI can become ineffective when the government fails to implement mechanisms that utilise and follow up on audit reports.

Finally, external audit is enabled by a level of public awareness regarding the SAI's reports and the role that civil society and the media play (and are allowed to play) in this process.

Current status of SAIs in Africa: Progress and challenges

SAIs in Africa have made substantial progress in recent years towards becoming the autonomous professional organisations envisaged by INTOSAI. There are many good practices and examples that can be shared and used as a basis for learning. At the same time, there is a definite need to further emphasise some of the essential prerequisites identified in the Mexico Declaration of Independence for effectively functioning SAIs. Although there may be differences between African countries in terms of their systems of accountability, the challenges faced by SAIs appear to be similar.

Audit practices

Most SAIs in Africa perform audits in line with the applicable INTOSAI standards. The applicability of different standards depends on the mandate and practices followed by SAIs.

Audit practices in Westminster systems

In most Anglophone countries, external audit revolves around giving assurance on the financial statements provided by the government and/or government entities. According to financial or regularity audit standards, such audits should follow a risk-based approach and issue an audit opinion on the appropriateness of the financial statements. Yet, Anglophone countries report that regularity audit practices, to a large extent, still follow an approach whereby each transaction or 'voucher' is scrutinised for irregularities. The extent to which the audit work links to the financial statements is also not always clear. Audit planning, or the identification of focus areas, is not given due consideration and is often overlooked altogether. The audit work performed is rarely documented in depth, other than in highly repetitive and symptomatic findings that lack conclusions on the financial statements or overall accounts. Audit findings are not always supported by evidence and this makes external reviews difficult.

Audit practices in judicial systems

Under a judicial system, audit work tends to concentrate more on the functions of public accountants as far as the legality of expenditures or the compliance with laws and regulations are concerned (Lienert 2003). The audit most often looks at individual financial transactions

from a compliance perspective, because financial statements are not always available or do not form part of such audit. In some cases, auditors also look at general management issues, including expenditure decisions by budget holders. Audit conclusions are delivered in the form of judgments, and SAIs normally have the power to administratively sanction responsible government officials. Actual practices in terms of institutional set-ups, scope, mandates and audit work performed may vary to a large extent from country to country.

Under the general state inspectorate system (a subset of judicial systems in Francophone countries), audits verify the whole procedure of management of public funds. All those who are involved in the process of collection and execution of public funds are concerned. In accordance with INTOSAI standards, they undertake financial audit and compliance audit, with less emphasis on performance audit of the public entities. In some countries, audit reports are forwarded to the judiciary for action. In Cameroon, in particular, many reports have been transmitted not only to a quasi-judicial court (the Financial and Budgetary Disciplinary Board) for administrative action, but also to the judiciary for legal action. As a result, many senior government officials have been sentenced for mismanaging public funds.

Independence of SAIs

SAIs should have legal, financial, managerial and administrative independence from the executive branch of government.

Legal independence
Most SAIs from AFROSAI-E member countries, and 60% of AFROSAI-F (CREFIAF) and Arabic-speaking member SAIs are constitutional bodies. Reforms in eight members of AFROSAI-E and six of AFROSAI-F relating to the independent functioning of SAIs resulted in new or updated lower-order legislation, which set out the functions and responsibilities of SAIs. In some of these countries, this meant that more detailed provisions for external audit were separated from the general financial legislation or 'Finance and Audit Act'. In many countries, however, the legislation governing the functions of SAIs has not been updated recently. SAIs would benefit from laws providing them with greater financial and operational independence.

Financial independence
Financial independence was found to be lacking in 10 English-speaking (50%) and 11 AFROSAI-F (CREFIAF) member countries (52%), marking this as one of the most pressing challenges in the region. In most of these cases, it was found that the approval of the executive was required for the SAIs' budgets, with no effective role for parliament. Almost all Arabic-speaking countries, however, indicated having the required financial independence.

Managerial and administrative independence
In addition, the influence of the executive in the appointment and removal of the head of an SAI is an element that may affect the willingness of the head of the SAI to report on pressing issues publicly, thus diminishing the SAI's effectiveness. The involvement of parliament or the judiciary in the process of nominating or approving the appointment of the head of an SAI can reduce undue executive influence. In AFROSAI-F (CREFIAF), only 5 countries (25%) indicated such involvement. Parliaments in AFROSAI-E countries were more involved, as 14 countries (66%) indicated their involvement in appointing the head of an SAI. The Open Budget Initiative survey confirmed this as a problem area, with an average of 71%, including 4 Arabic-speaking countries, in which it was found that the executive may remove the head of the SAI without the final consent of the legislature or judiciary.

The dependence of SAIs on the government for recruiting and remunerating their staff is a challenge in most countries. The expectations and requirements of SAIs in the appointment of qualified personnel are usually high, yet they often do not have the necessary discretion to recruit the desired quality of staff and to remunerate at the levels necessary to retain employees.

Identification of audit areas

Most countries, with very few exceptions from the AFROSAI-F (CREFIAF) member countries, are able to decide fully on their annual audit programme, including the identification of entities for audit and focus areas. Thus, this is not considered to be an overall problem area in Africa. However, for the small number of countries that do not have such autonomy, it remains a challenge.

Code of ethics

Professional auditors should be aware of and follow a code of ethics for professional conduct to ensure their independence, objectivity and legitimacy. High ethical demands are placed on auditors, including the need for objectivity, political neutrality, confidentiality and due care when engaging in audits. The INTOSAI Code of Ethics is directed towards auditors at all levels of the SAI (ISSAI 30: Par. 1–11). Most governments have a legislated code of ethics to be followed by government officials. The introduction of some additional provisions for SAIs in terms of the INTOSAI Code of Ethics brings about challenges in implementation. Additional requirements may have to be legislated separately or included in the originally legislated code of ethics. Most AFROSAI-E and Arabic-speaking countries have formulated a code of ethics. AFROSAI-F (CREFIAF) member countries, however, still experience a challenge in this regard, with 12 countries (57%) indicating the lack of a formalised code of ethics for staff.

Reporting

SAIs should have the freedom to decide on the content and timing of audit reports and to publish and disseminate them. SAI reports should be made available to the public and should be tabled in parliament in a timely manner.

When looking at the SAIs' freedom to disseminate audit reports to the public, all Arabic-speaking and 86% of the member countries of AFROSAI-E have indicated their ability to do so in one form or another. The situation in AFROSAI-F (CREFIAF) countries, however, is less positive, with only 43% of SAIs issuing public reports. In many countries, only summary reports and not the detailed reports are made public. The fact that such summary reports may be cleared of sensitive or material findings may reduce the effectiveness of the reports.

In 71% of Westminster countries, audit reports are tabled in parliament. In judicial systems, however, the role of parliament in external audit is limited to the discharge of all of the government's accounts, with the result that the audit reports are formally tabled in parliament in only 52% of countries.

Timely reporting

The relevance and impact of audit findings diminish over time. Often, information is presented to auditors after statutory deadlines have passed; and, when it is submitted, it is frequently of poor quality. These circumstances put auditors under pressure to meet their reporting time frames and may also influence the quality of their audit reports. AFROSAI-E member countries have shown substantial improvements recently, resulting in 79% of SAIs managing to table audit reports in parliament within 12 months after the financial year-end in 2009. However, audit

reports in AFROSAI-F (CREFIAF) and Arabic-speaking countries are generally issued more than 24 months after the year-end, as government entities are audited every 3 to 5 years.

Accessibility and usefulness of reports

Audit reports should address the needs of specific stakeholders. Failing to provide user-friendly, understandable and relevant reports to stakeholders, including members of parliament, PACs or oversight committees, executives, ministers, accounting officers and the public at large, undermines the links between SAIs and other accountability institutions. Skills in addressing audiences are essential for SAIs, and include the understanding of differences in user expectations. Auditors should strive towards clear and concise reports, but simultaneously give enough detail to convince the users of the audit findings (Van Zyl, Ramkumar & De Renzio 2009). Audit reports in many African countries were found still to be repetitive and to describe findings in too much detail and in overly technical language, despite improvements in some countries.

Communication and stakeholder management

SAIs need to promote public support through the development and implementation of an external communications strategy that includes parliament and oversight committees, other relevant institutions and civil society. The aim of encouraging a formal dialogue is an attempt towards improving service delivery by governments (ECA 2003).

The relationship between the SAI and parliament is often the weakest link in the accountability process. Frequently, SAIs do no more than send their reports to parliament; in some countries, this communication is missing completely (Van Zyl et al. 2009). The development of appropriate and documented communication practices needs to be emphasised.

Civil society organisations (CSOs), the media, trade unions, community associations, religious leaders and non-governmental organisations (NGOs) can play a very important role in promoting good governance and accountability. Some good practices in the region were identified where the work of CSOs promoted the effective functioning of SAIs and the government as a whole.

SAIs should also be aware of the objectives, activities and reports of other institutions (for example, internal audit, anti-corruption agencies, oversight committees and the ombudsman). Co-ordinated efforts, such as regular communication, a common voice and an understanding of how objectives are linked between such institutions, can be found on a national level, but it is more often left to the individual entities, including, SAIs to initiate communication.

Follow-up on recommendations

Mechanisms should be put in place to ensure regular follow-up on audit findings and to provide assurance on the status of implementation of recommendations. Follow-up mechanisms should include both the SAI and parliament and its committees. Good relationships and regular communication between the SAI and the oversight committee are very important contributing factors in allowing the government to derive the full benefit of the SAI's work.

The follow-up by SAIs on previous findings was found to be well entrenched in English- and Arabic-speaking countries. However, in AFROSAI-F (CREFIAF) member countries, nearly half of the SAIs were not mandated or not able to freely follow up on previous recommendations. However, SAIs with judicial functions may sanction public accountants to refund money involved in irregular activities or to impose fines for illegal acts.

Most countries have oversight committees such as PACs with identified functions that include the studying and reviewing of reports of the SAI and the holding of government executives accountable. In countries following the Westminster system, parliaments and PACs do not always discharge oversight functions effectively. An effective means to follow up on the SAIs' reports should receive additional emphasis in AFROSAI-E member countries where SAIs do not have sanctioning powers. In judicial system countries, the emphasis of parliament and oversight committees may not be on the SAIs' reports, limiting their role.

In general, the results of the Open Budget Survey (OBI 2008) show the follow-up function to be very weak across Africa, making this an important area deserving of further attention.

Accountability of SAIs

SAIs should be held accountable for their performance by means of regular, independent external audits and systematic monitoring and reporting of their performance for oversight. The research found that, with only a few exceptions, SAIs' accounts are generally not subjected to external audit. This may also contribute to the fact that SAIs do not often strive to 'lead by example' as organisations. The issuing of reports on their performance is not widely practiced in member countries of AFROSAI-F (CREFIAF), where only 22% of SAIs compile such reports. In Anglophone countries, the figure is 53%, and in Arabic-speaking countries it is 60%. The accountability of SAIs needs to be developed in most African countries.

Capacity of the SAIs and use of INTOSAI standards

SAIs should be provided with adequate human and financial resources to enable the effective discharge of their functions, using INTOSAI standards and guidelines as a frame of reference for their audit performance. As professional organisations, SAIs should have an adequate human resource capacity both in numbers and in quality of personnel. The onerous requirements of standards and mandates of SAIs require them to keep abreast of all changes in the public sector.

Human resource capacity
For 21 AFROSAI-F (CREFIAF) member countries, there is an average of 35 auditors in each SAI. In comparison, 23 AFROSAI-E member countries have an average of 289 auditors per SAI. The size of countries does not provide a complete explanation for this difference. Low numbers of external auditors in AFROSAI-F (CREFIAF) member countries may be linked to many SAIs reporting more than 24 months after the year end. Another reason for the large difference in staff numbers may be the organisational arrangements of the two different systems. It has been argued that the centralised internal control systems of the AFROSAI-F (CREFIAF) member countries may seem to require fewer audit personnel. However, studies suggest that countries with judicial systems do not necessarily have more effective expenditure controls, indicating that low numbers of auditors may be less justifiable.

Lack of capacity in terms of both numbers and skills has been identified repeatedly as an obstacle for many SAIs. This obstacle links strongly to the lack of adequate financing received from governments, and remains an issue requiring greater emphasis in the region. SAIs should assess the capacity of their staff and compile training plans based on the assessment results. There have been achievements, though, as 15 AFROSAI-F (CREFIAF) member SAIs (71%) and all Arabic-speaking and AFROSAI-E member SAIs reported mechanisms to assess the training needs of staff to varying extents. Training plans are partially in place in 12 AFROSAI-F (CREFIAF) member SAIs. Arabic-speaking countries again seem to have no identified challenges in this

area. Seventy-one percent of AFROSAI-E countries have in-house training capacity, with training strategies in place in half of the SAIs.

Annual appraisals of staff performance can inform and benefit most other processes of the SAI. Yet, performance appraisal systems are scarcely found in our region. SAIs in 7 AFROSAI-F (CREFIAF) member countries (33%) have attested to using mechanisms that assess the outputs of staff. Altogether, 52% of SAIs from the AFROSAI-E countries indicated that they have performance appraisal systems with performance agreements in place. Altogether, 80% of Arabic-speaking countries indicated that they have mechanisms to review the performance of their staff.

The use of INTOSAI standards and audit manuals
Almost all SAIs utilise INTOSAI standards as the basis for their audits. However, SAIs experience problems in the implementation of such standards for various reasons. Lack of technical capacity and knowledge of standards have been quoted as some of the main challenges faced by SAIs. PEFA country evaluations dated between 2006 and 2008 confirm that although some countries, including South Africa, Zambia and Mauritius, have made strides in applying audit standards, most countries in Africa still rate below international and African averages. Practically documented audit manuals are essential for the systematic and consistent application of standards and the performance of audit work. While 100% of Arabic-speaking SAIs and 95% of AFROSAI-E members indicate using audit manuals, only 43% of AFROSAI-F (CREFIAF) members do.

SAIs should establish policies and procedures designed to promote an internal quality culture. Such policies and procedures should be set by the head of the SAI, who retains overall responsibility for the system of quality control (ISSAI 40, Element 1). It was found that only six member countries (32%) of AFROSAI-F (CREFIAF) have quality-control systems or mechanisms in place. In the Arabic region, the figure is 60%, while in the AFROSAI-E region only 35% of SAIs have established and functioning mechanisms. The problem has been acknowledged in the AFROSAI-E countries, and a further nine SAIs have indicated that they have plans in place to address this issue. The practice and system of external peer reviews is also not widely practiced in the region. Only four AFROSAI-F (CREFIAF) member countries indicated that peer reviews have taken place. Peer reviews are not performed by SAIs in the Arabic-speaking region. AFROSAI-E has implemented a peer review mechanism that aims at reviewing SAIs on a rotational basis every three years. Such reviews are under the supervision of the AFROSAI-E Secretariat, but also involve reviewers from SAIs in the region and institutional partners.

Strategic planning
Strategic plans are aimed at identifying the vision, mission and objectives of SAIs. In addition, a strategic plan should provide a necessary mechanism for SAIs to proactively communicate their needs, in terms of human resources and funding, to relevant stakeholders. SAIs should demonstrate the ability to project future visions by the proper planning of activities, the anticipation of challenges and the identification of actions or solutions in their strategic plans. In AFROSAI-F (CREFIAF) member countries, seven SAIs (33%) indicated having strategic plans in place, out of which two SAIs had prepared related operational plans for implementation. Arabic-speaking SAIs have covered this area, with 80% having strategic and operational plans. AFROSAI-E member countries have focused on this aspect with the assistance of the AFROSAI-E secretariat and, as a result, member countries are seemingly in a better position regarding operational planning.

Computerisation – the use of information technology (IT) in auditing
Computerisation of the public sector has been one of the focus areas of new-age reforms. Similarly to the government, the SAI itself must undergo changes in order to audit the government's IT systems. A lack of knowledgeable IT auditors to evaluate the controls built into the government's systems creates problems for SAIs. SAIs access to the full use of computer-assisted audit technologies and electronic working papers is still limited mainly in the AFROSAI-E and AFROSAI-F (CREFIAF) member countries. SAIs should be able to invest in developing or obtaining the relevant tools and training audit staff to use such tools. SAIs should also be able to recruit qualified IT auditors to assist with auditing the government's systems.

Capacity for performance auditing
Performance auditing has been considered to be the luxury of developed countries by some observers. It has been argued that SAIs in developing countries should concern themselves only with financial and compliance issues. However, given the importance of service delivery performance in government and the fact that this is one of the main concerns of stakeholders, it is hard to see how the implementation of performance auditing can be avoided in the long term (Van Zyl et al. 2009).

The challenges faced by SAIs begin with the specialised nature of performance auditing. Practices of performance auditing in different countries show considerable variations in mandate, organisation and methods used. Guidelines on performance auditing cannot comprehensively embrace all possible approaches, methods and techniques and, therefore, no specific guidelines are available for the teams. The question of how to find, train and retain skilled performance auditors returns the focus to the human resource and capacity-development problems discussed earlier.

Results of questionnaires show that more Arabic-speaking and AFROSAI-E member countries have separate performance audit units than is the case for AFROSAI-F (CREFIAF) members, where separate functional performance audit units exist in only 30% of the SAIs. Fourteen AFROSAI-E member countries indicated having functional performance audit units, with a further three countries in different stages of development. However, the percentage of performance auditors to the total number of auditors employed by SAIs still remains small – around 5% in AFROSAI-E member countries. A minimum of ten auditors is suggested as a threshold for establishing a performance audit function. South Africa, Tanzania and Botswana audit performance information. In general, however, the concept is not well established.

Reform priorities

The priorities identified below reflect matters concerning the environment within which SAIs operate, as well as their internal environment.

Changes in executive practice

Risk-management practices
In order to be more proactive in managing risk, governments should implement risk-management processes. Risks identified via these processes should guide important government decisions (for example, decisions on prioritising budget items or projects). In addition, government entities should have appropriate governance arrangements in place, including internal audit and audit committees linked to these risk-management processes.

Financial reporting framework
Adequate financial reporting frameworks, including clear reporting timelines for government entities, should be provided for and enforced. In addition to the reporting of financial information, provision should be made for the introduction of performance information in a meaningful and understandable manner.

Co-ordination of functions
More effective co-ordination should be provided for to improve SAI functions and the relationships between the SAI and other institutions contributing towards accountability. These institutions include parliament, oversight committees, anti-corruption agencies and internal audit bodies. Provisions may include the establishment of platforms to share experiences and ideas, raising awareness and understanding on how such functions and responsibilities link, and even performing parallel audits where applicable.

Accountability
Clear reporting mechanisms should be set up for SAIs in order to hold them accountable for the effective discharge of their functions. This includes periodic financial and performance reporting similar to that on other public sector entities subjected to external audit scrutiny.

Legal, financial and managerial independence of SAIs
The government should promote the independent set-up and functioning of the SAI. Independent functions mean that SAIs should be able to conduct audits and issue reports without undue influence from the executive. SAIs should receive appropriate funds to enable their proper functioning. This is said with due consideration to the fact that the available funds for African governments are often limited. Managerial independence should ensure that SAIs have freedom to appoint and remunerate staff without prior approval from other government entities (for example, public service commissions).

Follow-up of mechanisms
Effective mechanisms should be put in place to enable the regular follow-up of recommendations by the SAI and also by parliament and its oversight committees. Firstly, SAIs should have the freedom to follow up on previously reported issues. Secondly, the role of parliament, the PAC and oversight committees regarding the reports of SAIs in the process of accountability should be emphasised. This should include the scrutiny of audit reports, public hearings by oversight committees and subsequent feedback provided by the executive in the form of reports.

Reporting
The SAIs' reports should be public documents disseminated on a timely basis. Governments should set deadlines for reporting and tabling in parliament, and institute mechanisms to monitor compliance with such timelines. Audit reports, to the extent possible, should be made available in their original format, with additional summaries and interpretations where necessary. Making audit reports public documents presumes the basic principles of freedom of expressing an opinion and access to information for all.

Changes in practice by SAIs

Communication and stakeholder management
The SAI should foster the awareness of the public and key stakeholders regarding the role and function of SAIs and audit report issues. A comprehensive communication strategy should assist SAIs in identifying stakeholders, understanding their functions and information needs, and allow them to co-ordinate efforts where necessary. There needs to be a public 'appetite' for

audit reports, and civil society can play a very important role in creating awareness and raising the expectations of the public. SAIs should be aware of and interact with these organisations in order to improve the effectiveness of external audit functions.

Capacity of SAIs and use of INTOSAI standards

SAIs should have formalised mechanisms providing for continuous training of staff, starting with an assessment of staff to identify developmental needs. SAIs should measure their own performance and auditing guidance against the INTOSAI standards, and strive towards implementation of applicable INTOSAI standards in accordance with their mandate and national legislation. Practical and documented audit manuals, functioning quality-control systems providing for ongoing evaluation of audit work, and better utilisation of existing IT tools should complement this process.

Priority should be given to increasing the capacity of SAIs to conduct performance audits and the audit of reported performance information where such reports are available. Performance audit units should aim to employ ten full-time auditors in order to remain sustainable.

SAIs should take a proactive approach in identifying new practices and improvements where necessary and possible. Details of long-term objectives and areas of priority should be documented in the SAI's strategic plan.

SECTION 6
GOOD FINANCIAL GOVERNANCE THROUGH LEGISLATIVE OVERSIGHT

Introduction

In most countries, the legislature is constitutionally mandated as the institution through which governments are held accountable to the electorate. The way the constitution is designed decides the accountability mechanisms available to the legislature. Legislative oversight aims at scrutinising and authorising revenues and expenditures, and ensuring the proper implementation of the national budget. In this respect, legislatures play a key role in the budget process working transparently, openly and accountably. An effective legislature is necessary for good financial governance. A number of enabling factors must be in place for legislatures to take up their role in the accountability system.

In recent decades, there has been a positive trend towards legislative budget activism (Wehner 2002; Schick 2003; Wehner 2004). This development reflects expanding possibilities for legislative action in previously closed budgetary systems within an overall trend to enable citizen voice and democratisation. Recent developments in some African legislatures reflect this international trend. South Africa, Uganda and Kenya, for example, have recently passed acts that increase the legislature's influence in the budget process. On the whole, however, there is great variation across Africa in the nature and effect of legislative involvement.

Stapenhurst (2008) describes the overall budget system as a continuing and integrated budget cycle process, with legislatures playing a key role at different stages of the cycle. As emphasised in Section 5 of this paper, the role of the legislature in the *ex post* budget process to review the reports of SAIs is particularly important for enforcing accountability, especially in Westminster systems.

An effective role for the legislature in the *ex ante* process, however, is more controversial. In the literature, the fear has been expressed that legislative activism in approving the executive's proposed budget may weaken fiscal discipline. This can be countered by noting that legislatures can rein in bad government spending and, thereby, can limit other causes of overspending (Wehner 2004). An effective role *ex post* is dependent to some degree on effective powers in the *ex ante* budget processes (Fölscher 2006). Another argument for legislative involvement is that even if it might affect fiscal discipline negatively sometimes, this may be an acceptable price to pay for greater public consensus around the budget (Wehner 2004). The extent of legislative influence, however, depends on the empowerment of the legislature in budgetary matters and transparency on its role, in turn.

Key factors in this regard are the relationship between the executive and the legislature, and the design of the political system as determined by the constitution. Legislatures in presidential systems (i.e. systems where presidents are elected separately from parliamentary representatives and where the executive is formed by the president) usually play a more significant role in budget formulation than is the case in parliamentary systems. Whereas the executive draws its members from the legislature in the latter, the separation of powers in presidential systems may lead to conflict between the executive and the legislature, as has occurred in Nigeria (Wehner 2004). The constitution also shapes the role of the legislature in the *ex post budget phase. Pelizzo and Stapenhurst* (2004) suggest that government reporting and legislative scrutiny of

public accounts is more common in parliamentary and semi-presidential systems than in presidential systems. Another difference is that committee hearings and hearings in plenary sittings occur frequently in parliamentary systems, but commissions of inquiry are used more frequently in presidential systems. Further factors determining legislative efficacy are the legal mandate of legislatures in respect of amendments, reversionary budgets and executive powers of virement, and institutional factors such as time to scrutinise the budget, the structure and use of legislative committees and the quality of budgetary information available to the legislature.

Legislative engagement in the budget process in Africa

Across Africa, the performance of legislatures in the budget process is mixed, with legislatures performing better on average in *ex ante* rather than *ex post* processes. The PEFA assessment framework tests for legislative scrutiny of the annual budget law and audit reports. Out of 23 countries tested on effective scrutiny of the executive budget proposal, nine (40%) scored an A or a B, while only one scored at this level on the *ex post* processing of audit reports. In contrast, 13 countries scored at a D or D+ level on the audit side, compared to only five on the *ex ante* processes. If all the PEFA indicators on legislative effectiveness are grouped together on an index, 12 out of the 22 countries score 50 or higher, with South Africa, Mozambique, Burkina Faso and Botswana scoring above 70 out of a potential 100.

The 2009 African Governance Report (UNECA 2009) found hopeful signs that legislatures are becoming more assertive in performing their functions and fulfilling their constitutional responsibilities. In addition to African parliaments enacting legislation to ensure a more active role for themselves in the budget process, some examples of good oversight practices are emerging. In Botswana, standing and ad hoc committees of the legislature monitor sector activities undertaken by the executive; in Zambia, committees established by the legislature study, report and make recommendations on the mandate, management and operations of the executive; and the PACs in Nigeria and South Africa are noted for checking government expenditures. On the other hand, however, many African legislatures lack the independence to perform their constitutional functions, because they depend on the executive for their human and material resources and funding (ECA 2008, 2009).

Overall, therefore, while some legislatures have developed deliberate processes to strengthen *ex ante* and *ex post* oversight, this has not been a consistent trend. Rather, for the most part, the executive has disproportionate power in economic governance. This is often on account of overarching constitutional factors or the way in which party political structures cut across institutions. In many cases, it is also as a result of weak formal powers, together with the rudimentary development of the necessary institutional arrangements for the use of available formal powers, as discussed below.

Formal powers

Amendment powers

The potential for legislative changes to the executive budget proposal is determined in law. In the African context, there are several legal restrictions that are noticeably shaped by administrative heritage. Legislatures in many Francophone countries are not allowed to increase the deficit, whereas a large number of countries with a Westminster heritage allow legislatures to make cuts to existing items only. According to the 2008 CABRI/OECD survey of budget practices, 19 of 26 surveyed African countries prohibit certain types of amendments. In five countries (Ethiopia, Liberia, Mozambique, Namibia and Nigeria) legislatures have unlimited amendment power. In one

case (Malawi), the legislature may not make any changes; it can only approve or reject the budget. Originally, the South African parliament belonged to the latter category; however, the national assembly recently passed the Money Bills Amendment Procedure and Related Matters Act 9 of 2009, which outlines a procedure for amending the budget (CABRI & AfDB 2008).

Legislatures with relatively weak formal powers still influence budgetary decisions. The Finance Committee of Ghana, for example, has influenced the budget process successfully by requiring pre-budget consultations with the minister of finance, coupled with quarterly statements on budget execution from the finance minister to the PAC.

Reversionary budgets

Reversionary budgets are those that take effect should legislative approval occur only after the start of the fiscal year. The more the executive can implement the budget without the legislature finally enacting the budget, the more the bargaining position of the legislature is weakened. In nine of the CABRI/OECD survey countries (Botswana, Madagascar, Morocco, Sierra Leone, Tunisia, Zambia, Lesotho, South Africa and Uganda), a reversionary budget takes effect if the budget is not voted by the start of the fiscal year. In Lesotho, South Africa and Uganda, however, this happens only on an interim basis. In 13 countries (Benin, Congo (Brazzaville), Ethiopia, Guinea, Malawi, Mali, Mauritius, Mozambique, Namibia, Nigeria, Rwanda, Swaziland and Zimbabwe), the previous year's budget takes effect on an interim basis, whereas in Burkina Faso, Ghana and Kenya the legislature has to vote on other interim measures. Liberia is the only case in the survey where expenditure without approval is not allowed at all (CABRI 2008).

Executive flexibility during budget Implementation

Executive flexibility during implementation refers to what could be called the amendment power of the executive after the budget proposal has been agreed by the legislature. The extent to which the executive can change legislative approvals is a variable that directly affects the legislature's power in the budget process. Possible ways for the executive to alter spending after legislative approval take the form of powers to impound or vire approved budgets and/or having access to a contingency reserve (CABRI & AfDB 2008). Some executives can even introduce new spending without legislative approval. The more flexibility the executive has, the more legislative control over budget implementation is diminished (Wehner 2006). While poor budget execution can undermine fiscal policy, distort allocations and undermine operational efficiency (Ablo & Reinikka 1998; Stasavage & Moyo 2000), overly rigid execution rules can be detrimental to performance (Campos & Pradhan 1995; Blöndal 2003).

Overall in Africa, the executive has significant flexibility during budget implementation. In only five out of 26 African countries surveyed (Benin, Lesotho, Madagascar, Malawi and Namibia), the government could not cancel spending approved by the legislature. In 14 countries (Burkina Faso, Congo (Brazzaville), Ethiopia, Ghana, Guinea, Kenya, Liberia, Mali, Mauritius, Morocco, Rwanda, South Africa, Tunisia and Uganda), this is possible only with restrictions, and in six countries (Botswana, Mozambique, Nigeria, Sierra Leone, Zambia and Zimbabwe), the government can cut, cancel or rescind spending without any restrictions.

In seven countries (Ethiopia, Ghana, Liberia, Morocco, Mozambique, Nigeria and Rwanda), the executive needs approval to increase spending. In nine countries (Guinea, Kenya, Lesotho, Malawi, Mali, Mauritius, Tunisia, Uganda and Zimbabwe), overspending is allowed up to a certain limit. In another seven countries (Benin, Botswana, Congo (Brazzaville), Madagascar, Namibia, South Africa and Swaziland), overspending is possible only if justifiable against limited criteria. In Burkina Faso, Sierra Leone and Zambia, the executive can overspend without any limit and without prior approval of the legislature.

All 26 survey countries have at least some leeway for the reallocation of funds between line items; however, different restrictions and/or procedures of allowance apply. Nine countries in the sample have no contingency reserve. One supplementary budget per year is submitted in the majority of countries. In no country are more than four supplementary budgets permitted (CABRI & AfDB 2008).

Organisational capacity

Timing of the budget

Budgets are complex sets of information that are put together over many months. A few weeks are not sufficient for any legislature to attain sufficient insight into the proposed budget (Wehner 2006). This is why the timing of the budget has direct consequences for the legislature's performance of its oversight function. According to international experience, the budget should be tabled at least three months in advance of the fiscal year in order to allow for meaningful legislative scrutiny (Wehner 2006). The median in Africa is two months prior to the start of the fiscal year (CABRI & AfDB 2008). In only eight of the 26 countries surveyed (Mozambique, Benin, Guinea, Nigeria, Burkina Faso, Congo (Brazzaville), Mali, Rwanda) is the budget tabled three months prior to the start of the fiscal year. In Zambia, on the other hand, the budget is tabled only one month after the start of the fiscal year.

Committees

For effective parliamentary influence in the policy-making process, a well-developed committee system, which links a central budget (appropriations) committee with sector committees, is a necessary condition. The benefit of committees is that they establish a division of labour that facilitates the development of expertise and allows parliaments to deal with various matters simultaneously (Wehner 2006).

About 50% of the CABRI/OECD survey countries rely on a single budget committee. These 14 countries are Burkina Faso, Congo (Brazzaville), Guinea, Kenya, Malawi, Mali, Mozambique, Rwanda, Zimbabwe, Benin, Ethiopia, Liberia, Madagascar and Nigeria. Within this country group, differences exist with regard to the co-operation between the budget committee and sector committees. In the case of Ghana and Tunisia, there is no budget committee; sector committees deliberate on the budget. In five countries (Botswana, Lesotho, Mauritius, Namibia and Zambia), the budget is discussed on the floor of the house only (CABRI & AfDB 2008).

Furthermore, if different committees deal with *ex ante* and *ex post* matters, they can play an important role in monitoring implementation through the development of expertise. In parliamentary or semi-presidential systems, PACs are crucial in ensuring that legislative recommendations based on the audit function are reflected in future budgets. Major factors promoting or hampering the effectiveness of PACs are: the breadth of their scope and mandate; their ability to choose subjects for examination; their capacity for competent analysis and dissemination of conclusions; their use of effective follow-up procedures; and the support they receive from SAIs and parliamentary research staff. PACs are constrained when political and bureaucratic practices undermine the willingness of the executive to engage with their recommendations, when the media and the public are not involved in the legislative oversight process and when there is a generally weak ethical culture (Stapenhurst 2008). *Ex post* legislative budget processes in Africa, however, are not well developed. The legislature provides recommendations for audit follow-up in only 37% of the 19 countries assessed against the relevant PEFA indicator, while recommendations are not provided or are not acted upon by the executive in 63% of the countries. Hearings are slightly more common. In 42% of countries, the legislature undertakes hearings on most or all of the adverse audit opinions.

Access to budgetary information and research capacity
Access to comprehensive, accurate, useful and timely information on budget policy and execution is critical for effective legislative oversight. The documentation accompanying the executive's proposed budget allocations, in-year revenue and expenditure updates and high-quality audit reports are important (Pollitt, in Wehner 2006).

The 2010 International Open Budget Survey and Index (OBI 2010) shows that 12 countries in Africa improved their scores in 2010 over the previous two surveys on the legislative strength sub-index of the survey. The survey tests for the breadth (past expenditure, as well as budget year and forward estimates) and depth (classification dimensions) of information on allocations. It also tests for the availability of information on non-financial performance, the fiscal framework and on debt, contingent liabilities, extra-budgetary funds and aid. It also tests the breath and depth of in-year, year-end and audit reports, and asks questions about the quality of the ex post budget process in parliament. Altogether, nine countries achieved reduced scores on the survey (while two remained at the same score and two were surveyed for the first time). Furthermore, only eight of the 25 African countries achieved an index score of over 50, while six out of the ten countries worldwide that scored 20 points or less on the index were in Africa. This indicates that the breadth and quality of budgetary information provided to African legislatures is deficient, despite improvement in some countries.

Research support is also meagre. At the time the 2008 CABRI/AfDB survey was conducted, only five out of 26 countries reported that their parliaments had access to specialised research capacity in the form of legislative budget offices. These countries were Benin, Kenya, Morocco, Uganda and Zimbabwe. While the office in Uganda had a total staff of 27, the staff number in the other four offices ranged from only three to six people (CABRI & AfDB 2008).

Party political majorities and party cohesion
As it is an expression of the power relations of the political actors that participate in the process, budgeting takes place in a broad political setting. The *de facto* power that parliament has with respect to its involvement in the budget process is to a large extent determined by party politics. Contrary to legal frameworks, party political dynamics can be far more fluent (Wehner 2004). Party political majorities have an important effect on the role of parliament in the budget process (Leston-Bandeira 1999 and Young 1999, in Wehner 2004), as does party cohesion or discipline (Von Hagen 1992, in Wehner 2004). In Africa, the ruling party's majority influence and the weakness and fragmentation of opposition parties, however, often means that executive dominance persists (Salih 2005; Olowu & Sako 2002; UNECA 2009).

Legislature performance on aggregate
On aggregate, African legislatures performed worse than their OECD counterparts in the 2007 OECD/CABRI survey. At the time of the survey, not a single legislature out of the 26 countries surveyed obtained a score of 50 or higher in respect of overall legislative capacity, whereas more than one-third of OECD countries obtained a score of 50 or higher. This suggests that African legislatures have, on average, less institutional capacity for financial scrutiny than their counterparts in the OECD. Another very important finding within the African country group was that six of the seven countries with the lowest institutional capacity in the budget process (Botswana, Ghana, Kenya, Lesotho, South Africa and Zambia) are of Westminster heritage, which was similar to the trend in the OECD group. Nigeria and Liberia, both of which have a constitutional inheritance influenced by United States arrangements, obtained the highest scores in the African sample. These results suggest that a legislature's institutional capacity in the budget process is determined partly by administrative heritage or other constitutional influences (CABRI & AfDB 2008).

Other important findings are that the *ex post* legislative function is particularly weak, and that in 20 of the 26 African countries formal powers exceed institutional capacity. Only for Uganda, Morocco, Kenya, South Africa and Tunisia did the scores for capacity variables exceed those of formal powers. As the formal powers are by nature much more time-invariant than organisational features, the latter are often very suitable for capacity-building initiatives (CABRI & AfDB 2008).

Priorities for good governance in legislative oversight

The quality of financial governance in Africa is undermined by weak legislative participation in the budget enactment and oversight phase of the budget process. Weak oversight allows informal systems to persist and affects fiscal discipline, budget credibility, quality of spending and service delivery. The discussion above highlights that this is to a significant degree not on account of weak formal powers, but rather because of institutional factors and entrenched weak oversight practices. A priority for good financial governance in Africa is to build sound legislative institutions, processes and capacity for budget oversight.

PART C: CONCLUSION

Good public financial governance is a prerequisite for Africa to mobilise its own revenues and to grow out of aid. It is intrinsic to delivering more and better public infrastructure and improving the lives of Africa's citizens. Above all, it is essential for development effectiveness.

Over the past two decades, many countries in Africa have invested enormous resources in building institutions and processes to advance financial governance. Progress is evident. Yet, it is a slow: advances in one area all too easily are frustrated by stasis in another; relapses in the overall governance environment can reverse gains; changes to process and rules all too frequently are not followed by changes in behaviour. Overall experience has shown that effective reform of the financial governance functionality of systems is not a linear path: better reform choices are almost inevitably informed by lessons learnt from the less favourable options pursued in the past. African countries are also learning that adapting the financial governance solutions of industrialised nations to the developing country contexts of Africa can be a road of pitfalls, disappointment and wasted resources. We learn best from our own experiences and the experiences of our peers on the continent.

As networks of financial governance practitioners, ATAF, CABRI and AFROSAI recognised that these challenges are common to their respective areas of the public resource management cycle. They, therefore, embarked on this study to recognise progress made, but also in order to reach a common understanding of financial governance challenges and priorities for consideration by African ministers of finance. This is because successful financial governance reforms – the shared focus of the networks' endeavours – require a commitment by Africa's leaders and bureaucracies to take charge of reforms in the first place, and to manage resources in a prudent, accountable and transparent manner.

The study has confirmed the need for Africa's governments to commit themselves unequivocally to operationalising proactive fiscal and budget transparency and to ensuring that the conditions are in place for the constitutional oversight institutions to enforce accountability. The focus must be on uprooting entrenched informal systems and replacing them progressively with effective formal institutions in the public resource management cycle, by being transparent and shoring up accountability mechanisms. The form and shape of these institutions have to be the choice of African political leaders and their expert officials, based on their own assessment of priorities, context and political and technical feasibility, even when taking into account the advice offered by external stakeholders. These are key principles of financial governance reforms in Africa.

It is also necessary to recognise that building human resource capacity is a prerequisite of institution building. Poor human resource and system capacity can derail any reform initiative. When overly complex institutions are attempted in contexts where professional capacity is scarce, countries run the risk of being worse off because of the reforms. Capacity issues need to be taken into account in reform choices at the same time as African governments need to develop measures to recruit, train and retain the necessary skills for financial governance.

Besides these overarching areas, the study highlighted several technical priorities.

In order to mobilise revenues, fund development and grow out of aid, African countries need to address tax evasion, stop illicit capital flows, fight transfer pricing, end preferential tax treatment, build a taxpayer culture and improve the capacity to manage their tax systems efficiently. They need to tax their natural resources transparently and accountably, channelling the revenue to their developmental goals.

Building sound budget management, execution and reporting systems will shore up the ability of governments to collect taxes to fund development. Enforcing transparency and accountability, instituting technical improvements in tandem with capacity development, and taking ownership of budget reforms to ensure that they are country-appropriate, realistic and sequenced well are crucial steps towards the establishment of effective budget management functions.

The need has been highlighted for a focus in upstream technical reforms on revenue forecasting and the transparency of forecasting practices, extra-budgetary mechanisms, effective medium-term planning, the integration of capital and recurrent budgets, the use of performance information and the development of capacity at sector level.

There is a critical need to prioritise downstream budget reforms, including the operationalisation of single treasury account mechanisms, improved cash planning and commitment practices, strengthened commitment controls, more robust payroll controls, regularised reconciliations and strengthened procurement practices. Building effective risk-based internal audit systems will ensure ongoing improvements in budget execution practices. Governments should prioritise the flow of accurate and timely information by operationalising their commitment to accounting standards and taking ownership of the development of FMISs.

In order to achieve these goals in the tax and budget management systems, governments need to be free of political interference, while operating under political guidance in respect of tax, fiscal and budget policy choices.

A key priority for good financial governance in Africa is the integration of aid in budget processes, the reflection of aid on budget and ensuring that country oversight institutions are engaged on aid options and choices.

Improvements to tax management and budget processes in the executive will be limited unless African governments also significantly strengthen the role of SAIs and parliaments. Initially, this requires ensuring the *de jure* and *de facto* (financial and managerial) independence of SAIs, as well as the creation of enabling conditions for an effective audit function. These include strengthened risk-management practices in government, improved financial reporting frameworks, mechanisms to co-ordinate the functions of SAIs and other accountability institutions, confirmation of SAIs' freedom to report to parliament and the public, and the establishment of effective mechanisms to enable regular follow-up of audit recommendations. SAIs themselves can raise their effectiveness by fostering the awareness of the public and key stakeholders of the role and function of SAIs and audit reports, developing their own capacity to implement international standards and strengthening their own accountability.

Finally, the quality of public financial governance in Africa is undermined by weak legislative participation in the budget preparation and oversight process. A priority for good financial governance in Africa is the building of sound legislative institutions, processes and capacity for budget oversight.

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This status report is the outcome of a joint research project undertaken by the African Organisation of Supreme Audit Institutions (AFROSAI), the African Tax Administration Forum (ATAF) and the Collaborative Africa Budget Reform Initiative (CABRI), respectively the professional peer-learning networks of supreme audit institutions, tax administrators and senior budget and planning officials in Africa. The project was co-ordinated by CABRI and undertaken with support from the African Development Bank (AfDB), the Deutsche Gesellschaft fur Internationale Zusammenarbeit (GIZ) GmbH and the United Nations Economic Commission for Africa (UNECA).

The report presents the following as the core principles for financial governance reforms in Africa:

- *Transparency:* Progress towards good financial governance will be limited unless African governments, in general, effect significant improvements in fiscal and budget transparency.
- *Accountability:* A commitment by African political leaders and senior public servants to restore and build the functionality of internal and constitutional accountability systems is necessary.
- *Institution building:* African governments need to focus on building transparent, accountable and effective institutions in the public resource management cycle.
- *A result orientation in public financial governance:* The reform of public financial governance systems and, indeed, the raising of resources and budgeting for their expenditure, must be oriented towards a guiding concern with the socio-economic consequences of fiscal decisions, resource mobilisation and the expenditure of public funds.
- *Balancing reforms and capacity growth:* Capacity issues need to be taken into account in reform choices at the same time as African governments need to develop measures to train, recruit and retain the necessary skills for good financial governance.
- *Autonomy in reform choices:* This means that African countries must decide for themselves what their reform priorities are. Ministers of finance have an important leadership role in this regard to manage donor demands and proposals for reform.

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