

# Delivering Excellent Public Finance: CIPFA's Whole System Approach to Public Financial Management

Volume 1: The Approach

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## Foreword

There is been a growing consensus about the importance of public financial management (PFM) for both developed and developing economies. Not surprisingly there has also been a parallel debate about the principal elements of strong PFM and the levers and interventions that enable sustainable improvements to be achieved successfully.

Whatever the level of development or economic circumstances in a country or region, citizens will rightly keep raising the bar with regard to their expectations about public service delivery. As pressures on budgets increase and additional demands are made, there is a pressing need to understand better the elements required for strong PFM, and how the organisations and relevant processes at all levels relate to each other. CIPFA believes that only by taking a holistic view and approach to reforms, taking into account the special characteristics of the public sphere, can sustainable improvements in outcomes for society, service delivery, transparency and accountability be delivered. Governments are under pressure to respond and CIPFA takes very seriously its public interest role in leading new thinking and developing practical solutions with our partners in the public services.

CIPFA published its original Whole System Approach to PFM in 2010. This was developed with the assistance of funding from the UK's Department for International Development (DFID), for which we remain extremely grateful. This consultation document builds on the original document, and takes our thinking forward in the light of our practical experience in supporting PFM reforms in the intervening period. In particular it is consistent with the thinking in the latest version of CIPFA's ground-breaking Financial Management (FM) Model, released in 2016, which is increasingly being used globally as an assessment and benchmarking tool. Both this document and the revised FM Model also reflect developments in a number of other frameworks and guidance, against which we have compared our updated approach.

One of the most important features of both CIPFA's original version, as well as this updated Whole System Approach to PFM, is the emphasis on Building Capacity. This aspect of PFM tended in the past to be overlooked or only partially addressed in international development programmes. However, we are pleased to note that since 2010 the importance of professionalisation, and the benefits of developing public sector professionals at the heart of the PFM international architecture, through initiatives such as the joint IFAC/donor MOSAIC agreement, and the IFAC Accountability.Now campaign.

Linked to the development of this updated Whole System Approach, CIPFA has now developed the on-line Developing Excellent Public Finance (DEPF) portal, which brings together various sources of information that can support reform design. The portal allows users to:

- consider what PFM is in its widest sense;
- look at what is covered in other international frameworks; and it
- provides a diagnostic tool to prompt consideration of jurisdictional-specific issues.

It may be accessed via [www.cipfa.org/depf](http://www.cipfa.org/depf).

Through issuing this updated Whole System Approach to PFM for consultation, we aim to further the debate on both the key elements of PFM, and the guidance and tools needed to support their implementation sustainably. In particular, this WSA update focuses explicitly on the role of accrual-based information as the foundation for strong PFM. This is because CIPFA believes that understanding the economic substance of financial transactions is essential to robust decision-making, delivery management and accountability, as well as transparency that strong PFM requires.

We look forward to receiving your comments on our proposals and to working with you to address the areas where further work is needed in order to improve the quality of PFM globally.

Rob Whiteman  
Chief Executive Officer

## Introduction

- 1.1 Public financial management (PFM) drives the performance of the public sector through the effective and efficient use of public money. Strong PFM ensures that public money is used well, and is made to stretch as far as possible, maximising the benefits for the population as a whole. It provides leaders and managers with information to raise finance, to know if they are using resources effectively and to make sound decisions. Managing finances in the public sector is about much more than accountancy – it is integral to a country's financial health and in delivering critically important public services.
- 1.2 CIPFA's Whole System Approach to PFM advocates a holistic system-wide approach to the design and improvement of public financial management. It proposes a new definition of PFM with a reference model that describes the processes of a fully functioning PFM system, and it presents a high level approach to charting the current institutional architecture that supports delivery of strong PFM, with illustrative maps of world regions.

## Purpose

- 1.3 The purpose of the updated Whole System Approach to PFM is to provide an analytical framework to support effective PFM in countries, enabling relevant, targeted public services for citizens. The Whole System Approach supports review of the performance of the PFM system, as a key element in the development of reform plans. In the international development context, it aims to support development partners in improving the functioning of PFM systems and the legacy impact of PFM initiatives.
- 1.4 CIPFA's original Whole System Approach to Public Financial Management explored three themes:
  - a universal definition of public financial management;
  - a model of the PFM processes in a fully functional PFM system; and
  - an approach to mapping the organisations that fund, execute and oversee public sector finances.
- 1.5 In particular, the second theme describes a model of the PFM processes in a fully functional PFM system. This takes a holistic approach, to stimulate thinking about the totality of a PFM system, the connectivity between its individual processes and its performance, recognising that it also requires a supportive institutional and social environment. CIPFA believes that the effectiveness and sustainability of reform plans are enhanced by analysing how processes are interrelated and can be reinforced, and isolated interventions are likely to be ultimately unsuccessful and /or unsustainable. The process framework therefore promotes a shared understanding of the elements of the PFM system, to guide those involved in design and improvement.
- 1.6 This updated version of the Whole System Approach reinforces CIPFA's views that PFM:
  - is about the effective and efficient use of public resources;
  - provides leaders and managers with information for better decision making (and the constraints on available options);
  - helps to provide better targeted services;

- gives the taxpayer better value for money; and
- relies on accrual-based information as a critical part of a much broader suite of processes and players for strong management and accountability.

## Audience

- 1.7 Both the Delivering Excellent Public Finance (DEPF) publication and on-line portal are intended to help governments, donors and their advisers and all those who participate in PFM strategy development. In practical terms they are relevant to the Ministry of Finance (or equivalent) in strengthening the PFM system, to sponsors, donors and advisers engaged in PFM reforms, and to PFM leaders seeking to improve the systems in operation.
- 1.8 The DEPF publication and portal provide an inventory of potential tools for PFM professionals who design, implement, operate, review and evaluate PFM systems and PFM improvement programmes. They are also intended for an audience wider than those professionals. Key professionals include:
- civil servants,
  - public sector financial staff,
  - public sector auditors, and
  - PFM practitioners.
- 1.9 Whilst the public sector professionals might use the tool for diagnostic purposes, others can use the tool to gain an insight into the whole system approach to PFM. Those other users might include:
- central ministries/departments responsible for designing the way in which public sector is shaped for delivery and therefore for overarching governance;
  - those charged with governance in public sector institutions;
  - Parliamentarians – the legislature determining the context within which governments operate and holding the executive to account; and
  - external stakeholders:
    - national and international institutions
    - investors and credit agencies
    - the public (taxpayers and service recipients)
    - commentators (media).

## Scope

- 1.10 In setting out this approach CIPFA:
- emphasises PFM's contribution to the delivery of public services and the social benefits this can bring. The wider public finance functions of national economic management and fiscal policy are critical to a country's success, but are not the main focus of this paper;
  - offers an analytical framework, describing the components of a fully functional PFM system, to inform design and evaluation of PFM systems and reforms and to assist discussion on sequencing PFM improvement initiatives. The framework is relevant for all countries, but particularly for partners in the developing world;
  - emphasises whole system effects, including feedback loops and correction mechanisms, offering a basis to consider the complementarity, balance and completeness of reform components;
  - makes observations on ways in which international development partners could strengthen PFM practice.

- 1.11 There are also some things that the paper does not do. It does not:
- set out to be prescriptive about the course to be adopted by each country in creating a PFM system, or its strategy towards implementation. CIPFA expects that the design of a PFM system would be tailored to the characteristics, circumstances, capacities and priorities of each country, and implementation would be progressive. However, design should reflect the full range of processes that make up a whole PFM system;
  - create a new tool for measuring PFM practice, though it can stimulate thinking about future tools or the use of existing tools;
  - provide a critique of deficiencies in current PFM practice and how to overcome the practical obstacles to reform;
  - address issues of political and institutional drivers of change, while recognising their crucial importance for PFM effectiveness.
- 1.12 The PFM framework is intended to cover the financial resources deployed by the public sector<sup>1</sup>, including national and sub-national government and arm's length government agencies. However, it does not cover the internal operation of publicly owned Government Business Enterprises (such as airlines or banks), except to the extent of accountability for the public's ownership stake.

## Public interest perspective

- 1.13 This paper is based on the premise that public finances should be conducted in the public interest, with citizens having a legitimate stake in understanding how taxation and public finances have been used and managed. Support for financial accountability, citizen involvement and parliamentary scrutiny, integrity and the absence of corruption, and the effectiveness and efficiency of public services is derived from this concept. CIPFA's work with IFAC to develop the International Framework: Good Governance in the Public Sector<sup>2</sup> underlined the fact that this is a defining feature of good governance and strong PFM in the public sector. This fundamental concept is relevant to any country, regardless of its state of development, constitutional tradition or political alignment.

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<sup>1</sup> The term 'public sector' is defined by the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants as referring to 'national governments, regional (e.g., state, provincial, territorial) governments, local (e.g., city, town) governments and related governmental entities (e.g., agencies, boards, commissions and enterprises)'- (IPSASB terms of reference). The International Monetary Fund's (IMF's) manual for Government Financial Statistics defines the public sector as made up of the General Government Sector (including non-profit organisations) and public corporations. These definitions are concerned with financial and statistical reporting, rather than with management and match the System of National Accounts (joint EC, IMF, OECD, UN and World Bank, 2009) statistical framework. Many of the management processes and entities discussed in this paper apply across the wide public sector, such as the obligation to produce financial accounts and reports. However some, such as procurement rules, access to information, the extent of parliamentary scrutiny and the particular applicable accounting standards, will apply only to a more limited extent to Government Business Enterprises. For the avoidance of doubt therefore the term public sector is used in this paper to refer to the General Government Sector and the government's ownership interests in Government Business Enterprises, but not to the latter's internal commercial operations.

<sup>2</sup> <http://www.cipfa.org/policy-and-guidance/standards/international-framework-good-governance-in-the-public-sector>

# Defining public financial management

## What is Public Financial Management?

- 2.1 The significance of sound public financial management for effective government is widely acknowledged. For example, the foreword to the report on the use of country systems by the Joint Venture (JV) on public financial management<sup>3</sup> for the Accra Forum in July 2008, begins: *“The development community has long understood that a robust public financial management (PFM) system is vital to a country’s development efforts and to the effectiveness of the aid funds that support those efforts”*. And yet the concept of PFM, what is included in it and what is outside, is far from clearly defined. The Paris Declaration lists it merely as one of the elements of the financial infrastructure, separate from audit and accounting<sup>4</sup>: Its edges are fuzzy – is procurement in or out?<sup>5</sup> The JV calls PFM multidimensional – and liable to differ between countries.
- 2.2 The public sector<sup>6</sup> must meet exacting standards of probity and accountability and demonstrable efficiency in the use of public resources. To cope with limited funding and increasing demand and expectations from citizens, new and creative solutions that make public money go further continually have to be found. Change and transformation must therefore go hand in hand with the robust stewardship and accountability expected of public bodies. In the public sector:

***‘Governance comprises the arrangements put in place to ensure that the intended outcomes for stakeholders are defined and achieved. The fundamental function of good governance in the public sector is to ensure that entities achieve their intended outcomes while acting in the public interest at all times.’<sup>7</sup>***

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<sup>3</sup> Report on the Use of Country Systems: report of the Joint Venture on Public Finance Management (JV on PFM) to the Accra High Level Forum on Aid Effectiveness July 2008

<sup>4</sup> Country systems and procedures typically include, but are not restricted to, national arrangements and procedures for public financial management, accounting, auditing, procurement, results frameworks and monitoring.” (Paris Declaration 2005, Paragraph 17)

<sup>5</sup> The differing interpretations are acknowledged in Report on the Use of Country Systems: report of the Joint Venture on Public Finance Management (JV on PFM) to the Accra High Level Forum on Aid Effectiveness July 2008 chapter 1.

<sup>6</sup> Public sector: That part of the economy where funding comes largely from government and is defined by the System of National Accounts 2008 (see also footnote to paragraph 1.9 above). Public Services: Goods or services provided on a not-for profit basis to the general public or for social benefit. Public service organisation: One or more bodies managed as a coherent entity with the primary objective of providing public services. The category encompasses both public sector bodies and other organisations whose primary objective is to provide goods or services for the general public or social benefit rather than providing a financial return to equity shareholders.

<sup>7</sup> <http://www.cipfa.org/policy-and-guidance/standards/international-framework-good-governance-in-the-public-sector>



2.3 CIPFA's definition of PFM focuses on its contribution to delivering good governance:

***“Public Financial Management (PFM) is the system by which financial resources are planned, directed and controlled to enable and influence the efficient and effective achievement of public service outcomes.”***

2.4 This definition of PFM applies equally across multiple or single bodies, and at all levels of government. It can therefore be used in the context of national governments or regions, localities or individual public service organisations. The only change made to the definition adopted in the original Whole System Approach has been to replace 'goals' with 'outcomes in order to provide consistency with the CIPFA/IFAC International Framework: Good Governance in the Public Sector.

2.5 Using money well is the business of every manager charged with delivering public services. High-performance means consistently demonstrating strengths in leadership, public financial management and performance management. Public financial management is not just about accountants keeping score. With devolved financial responsibilities the leadership and managers need to be financially literate and finance professionals need to contribute challenge, interpretation and advice; allied with control and compliance.

2.6 The aim of the CIPFA PFM definition is to place relevance and effectiveness at the centre of PFM objectives. In linking strong PFM to good governance, and relating PFM to public purposes that will benefit the citizen and taxpayer, it highlights system effects, stressing the importance of the interactions between system components in creating sustainable improvements. It seeks to counter danger that operational effort at country level could be targeted on improving performance measures to move up the PEFA ladder rather than on improving outcomes and changing people's lives for the better. In doing so it moves on from other earlier definitions based on clusters of core processes, mainly budgetary, internal control, reporting and audit, which have been used in the international development context.

2.7 The World Bank describes PFM in terms of its component parts:

*“For countries, financial management refers to the budgeting, accounting, internal control, funds flow, financial reporting, and auditing arrangements by which they receive funds, allocate them and record their use.”<sup>8</sup>*

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<sup>8</sup> [https://elibrary.worldbank.org/doi/abs/10.1596/978-1-4648-0484-7\\_financial\\_management](https://elibrary.worldbank.org/doi/abs/10.1596/978-1-4648-0484-7_financial_management)

- 2.8 Other definitions also tend to cluster around the budget as the central theme.<sup>9</sup> PFM has perhaps become most potently described by the content of the PEFA performance assessment framework.<sup>10</sup>
- 2.9 A definition based on control and budget also risks focussing on technical expertise when leadership and practical financial management is much needed from financial practitioners in an increasingly decentralised donor approach. It may also underplay the importance of knowledge transfer and learning from the stock of existing experience, rather than repeating the mistakes inevitable in a learning-by-doing process. The CIPFA definition allows for PFM to be about more than control, probity and compliance. It is also directed to supporting resource management and value for money, and to enabling the public sector to progress and adapt to new challenges.

## The P in PFM

- 2.10 Although PFM has many features in common with other financial management environments the overarching objective of acting in the public interest creates its own distinctive concerns in terms of pressures on revenue:
- a public interest, taxation-based, relationship with citizens and service users, rather than one defined principally by consumer interests and choice. This relationship calls for high standards of governance, probity, sound financial administration, stewardship of public assets and resources and overt compliance with regulatory standards;
  - heightened values of integrity, transparency and accountability to the public, who have an interest in knowing how their taxes are being spent;
  - inelastic resources – there is competition for resources between service demands that can always consume more funds, and that may be beyond direct control, such as demographic change. Funding envelopes may be determined independently of expenditure pressures, or the relationship may be inverse, for example when a recession increases demand whilst reducing tax base and income sources; and
  - dependency on external funding sources of variable reliability, that can create instability in planning and implementing expenditure programmes.

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<sup>9</sup> For example, IMF Survey: Low-Income Countries Need Upgrades Richard Allen and Duncan Last IMF Fiscal Affairs Department July 19, 2007 “Public financial management comprises the institutional framework, systems, and procedures that govern the preparation, execution, and reporting of the budget.” <http://www.imf.org/external/pubs/ft/survey/so/2007/POL0720A.htm>

See also “Public Financial Management includes all phases of the budget cycle, including the preparation of the budget, internal control and audit, procurement, monitoring and reporting arrangements, and external audit.” Harmonizing Donor Practices for Effective Aid Delivery – Good Practice Papers – A DAC Reference Document, OECD, 2003, quoted in Public Expenditure Working Group, Strengthened Approach to Public Financial Management Reform, World Bank, 2008.

<sup>10</sup> PEFA – Public Expenditure and Financial Accountability - is a partnership between the World Bank, the European Commission, the UK’s Department for International Development, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, and the International Monetary Fund. PEFA aims to support integrated and harmonised approaches to assessment and reform in the field of public expenditure, procurement and financial accountability.

- 2.11 Achieving intended outcomes while acting in the public interest at all times also creates distinctive pressures in terms of both service delivery, cost control and value for money:
- a culture of cost centres rather than profit centres. Efficiency and value for money drivers may need to be internally generated, rather than result from market forces. In some areas the difficulty is compounded by problems of measuring outputs, outcomes and impact, including difficulties in attribution;
  - service delivery may take place in a system of devolved financial responsibility, that increases the complexity and risks to understanding financial implications;
  - management of demand levels that are constrained not by price, but by other techniques, that may involve difficult choices like queuing and rationing;
  - a balance to be continuously negotiated between the objectives of funders, whether government or external donors, and more locally driven priorities; and
  - a set of administrative processes that is characteristic of the public sector, such as tax administration or concessionary charging. These typically involve a politically judged tension between social outcomes (e.g. anti-poverty policies) and administrative efficiency (e.g. maximising income collection
  - a political environment that imposes pressures and risks that may be calibrated differently from business risks. For example, the risks of ceasing a service feel much greater for a politically driven organisation. Electoral timetables influence the timing of decisions. Prioritisation and resolution of the competing demands for resources is essentially a 'political' and value driven process rather than a technocratic solution.
- 2.12 These are all distinctive features of PFM. They pose particular challenges if regulation, codified good practice, advice, support, and capacity development have to rely on generic professional organisations that do not have a specific background in these issues.

## Definition Boundaries

- 2.13 CIPFA's definition of PFM relates to the management of public sector finances. The UK's Department for International Development (DFID) identifies three overall objectives of PFM: maintaining fiscal discipline; allocating resources strategically; and operational efficiency. It notes that there may be tensions between these objectives, and that the balance between them may vary in different times and conditions. CIPFA's paper focuses primarily on finance allocated to the delivery of public services. It does not seek to cover national roles, properly part of a public finance system, in ensuring overall management of the economy, such as banking regulation or fiscal policy. It does include national and local financial processes such as debt management and taxation administration.
- 2.14 Even so, the whole system approach is not immune from the debate about what is in or out of PFM. Environmental factors, categorised here as forming a contextual framework outside PFM, can be influential, and sometimes decisive, in the success of PFM reform. Such factors include legislative and institutional traditions, social organisation and cultural norms, political stability, economic conditions, technology and the level of managerial capacity. Although this topic is outside the scope of CIPFA's paper it can be very important to address such contextual issues alongside projects for improving PFM processes themselves.

- 2.15 In chapter 5 on the organisational PFM architecture, organisations have been included by virtue of the specific functions they perform in relation to managing public finances. Both organisations and process elements are brought into CIPFA's PFM model where they operate directly on the management of public finances, and where they form part of the checks and balances that are needed to ensure a healthy PFM contribution to policy results. They have a key role in creating the climate within which PFM can be effective in bringing about lasting results,<sup>11</sup> when they are treated as contextual issues.
- 2.16 Thus procurement rules are included in so far as they are key to sound decision-making, involving financial commitment, probity and value for money, but procurement is also recognised as a wider discipline in its own right. Central Bank functions of debt management and paymaster administration are included but not wider public finance activities in relation to economic regulation, inflation control or money supply management.
- 2.17 Similarly, a cluster of resource related and general management disciplines are closely linked to making money go further through productivity and efficiency. Examples include general risk management, IT strategy, property and estates management, knowledge management, procurement and commissioning, workforce planning and natural resource management. The scope of PFM is intended to cover such processes only to the extent that they relate directly to financial effectiveness.

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<sup>11</sup> By analogy there are a number of complementary diagnostics to the PEFA assessment, including the World Bank's Country Policy and Institutional Assessment, see the Joint Venture of Public Financial Management Working Party on Aid Effectiveness July 2008 P42

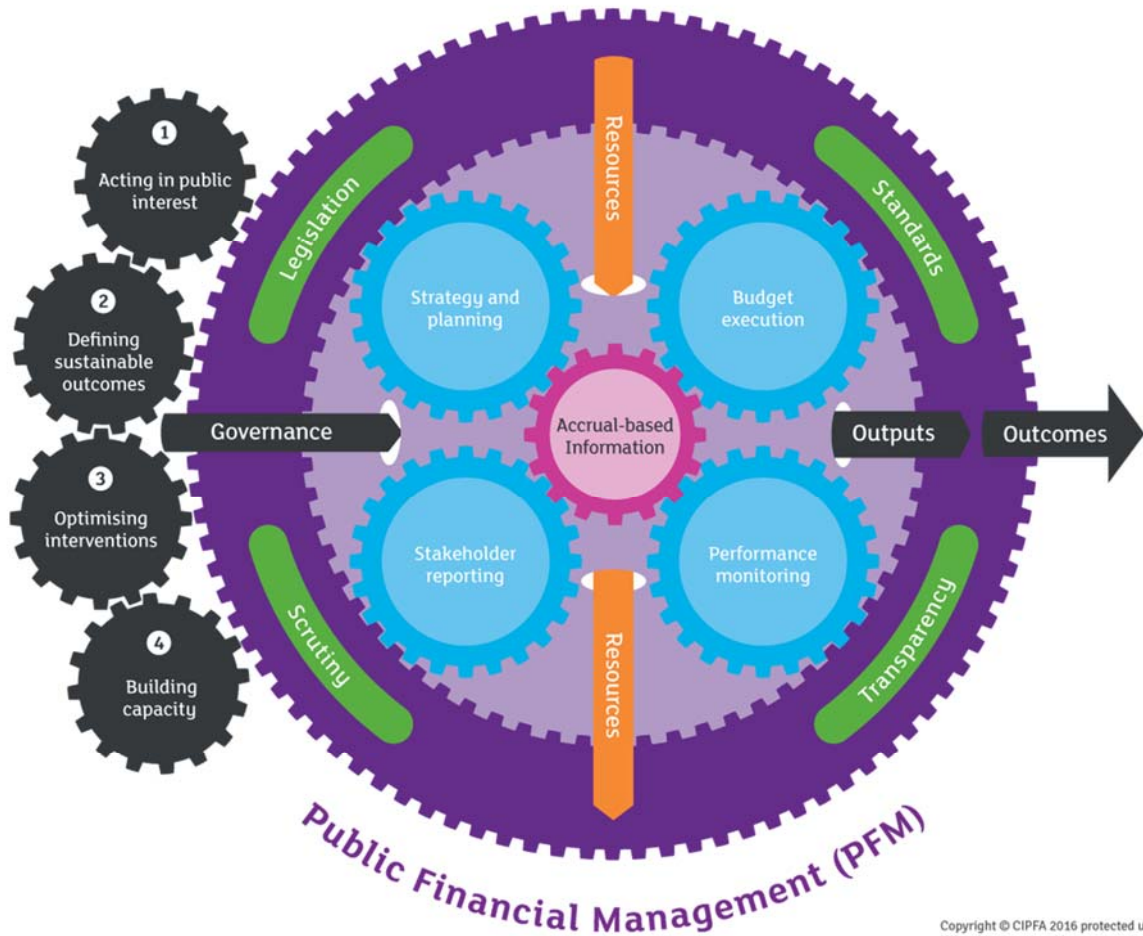
### CIPFA's Whole System Approach to PFM

- 3.1 CIPFA's Whole System Approach to PFM design and improvement is based on the premise that it will be more effective and more sustainable if there is a balance across the full range of PFM processes, buttressed by effective national, sub-national and supra-national organisations and, in the context of international development, supported by relevant donor contributions.

#### System overview

- 3.2 The Whole System Approach to PFM comprises an integrated series of PFM elements. These include checks and balances which, acting together, can maximise PFM effectiveness. The aim is to encourage consideration of whether PFM elements are operating together and are mutually supportive and to suggest where there may be practical gaps and weaknesses in the support that the major organisations offer to less developed countries. The approach is intended as an objective base for analysis and improvement, complementing existing assessment tools rather than creating additional ones.
- 3.3 The chart below provides high level delineation of the Delivering Excellent Public Finance model. It stresses the link to outputs and outcomes, as a means of converting money to social benefit, whether this accrues to individuals, communities or to the public at large. In the international development context this should also generate results that meet donor objectives.

## Delivering Excellent Public Finance



### The PFM Elements

3.4 The Delivering Excellent Public Finance model provides an overview of the elements of a fully functional PFM system, distinguishing a number of different elements, pictured in the chart above, which are then described in summary below. Each of these elements needs to be developed to its full potential, but equally none is sufficient without the others.

3.5 The system is described in progressive levels of detail<sup>12</sup>:

- PFM Elements: a grouping of PFM processes, each of which performs a different function in the overall PFM architecture.
- PFM Sub-elements: the high level processes, on which each element depends, are listed below under each element, and explained in more detail in Volume 2.

<sup>12</sup> CIPFA's 2009 consultation showed broad consensus about the components of the model, although the model does now reflect some detailed amendments suggested by commentators.

3.6 This system constitutes a generic model, not a description of an actual country's arrangements. CIPFA recognises that countries will bring to bear their own legal structures and administrative and cultural traditions, and that PFM will be mediated through local circumstances and capacities. It also recognises that the quality of implementation may be as important as the process itself in determining effectiveness. However, an understanding of the whole picture of PFM processes is essential in planning interventions and improvements. In particular, lack of technical understanding and practitioner experience in the donor community of what PFM involves can undermine donor strategies for improving aid effectiveness and its legacy impact. Reforms are at risk therefore of underperforming in terms of speed, effectiveness, quality and sustainability.

3.7 The PFM Elements comprise three groups:

- Governance (G);
- External Elements (E); and
- Internal Elements (I)

Maximising the impact of each element depends on the Resources available to the entity, and fundamentally on the availability of Accrual-based information.

3.8 The Governance Elements are drawn directly from the International Framework: Good Governance in the Public Sector:

- Acting in the public interest – integrity and ethics, respect for law, and stakeholder engagement;
- Defining sustainable outcomes – economic, social and environmental;
- Optimising interventions – taxes and transfers, services, and regulation; and
- Building capacity – developing an entity's capacity, its leadership, and the role of the CFO/professional finance skills, developing the capability of individuals, and recruitment retention and reward.

3.9 PFM is influenced by, and implemented through both internal and external elements. A public sector entity's operations are heavily influenced by the external PFM elements which comprise:

- Legislation – primary and secondary (including rules, regulations and instructions);
- Standards – covering procurement, accounting and audit;
- Ensuring transparency – defining appropriate reporting units and ensuring consistency and comparability in budget coverage to deliver external accountability; and
- Scrutiny – by the legislature, constitutionally independent audit arrangements, through public challenge mechanisms, and by other forms of independent external scrutiny.

3.10 These external elements can also affect the operation of the 'internal elements' within an entity. The internal PFM elements comprise:

- Strategy and planning – strategic vision, medium-term financial strategy, annual planning, and risk management;
- Budget execution – targets and indicators, internal controls, and budget execution reports;
- Performance monitoring – managing for results, in-year/management reporting, and internal audit; and
- Stakeholder reporting

- 3.11 Further information on each of these elements and sub-elements is provided in Chapter 1 of Volume 2, as well as in the DEPF portal.
- 3.12 In updating its Whole System Approach, CIPFA has compared its approach with those in the latest versions of the following well-established frameworks and guidance:
- IMF Fiscal Transparency Code;
  - Public Expenditure Financial Accountability (PEFA); and
  - SIGMA: The principles of public administration.
- 3.13 Chapter 2 of Volume 2 compares the updated model against these frameworks, as well as the original Whole System Approach, and the updated version of CIPFA's own FM Model. In making these comparisons a number of gaps in the available standards and guidance have been identified, where CIPFA aims to work with others to ensure they are addressed.

## The PFM environment

- 3.14 Strong Public Financial Management is only one of the factors that make for success in public sector expenditure programmes. It sits alongside other contextual aspects, such as leadership, transparency and accountability, levels of resources and staff capacity, and is influenced by many aspects of the social, political and economic environment. However CIPFA believes that good financial management generates vital information for better decision making, better services, and better value for money if resources are managed and controlled transparently and effectively. So PFM is worth doing well.
- 3.15 The PFM system context is shaped by politics, society, economy and demography. Some of the relevant environmental features are illustrated below, although this is not intended to be comprehensive and includes a degree of overlap. Within these broad categories some elements will impinge closely on PFM, such as the level of resources, civil service competency and cultural traditions of patronage, while others will be more remote or generalized in effect (such as the health of the workforce).



## Relevant PFM Environmental Factors



- 3.16 The model therefore highlights collaboration and coordination of interests in originating and prioritising expenditure policies and programmes. Planning is driven by government, with formal representation through parliamentary organisations. However, the direct involvement of citizens and service users, delivery organisations and contributing donors in decision making should help to improve the effectiveness and relevance of social outcomes.
- 3.17 PFM is also powered by qualitative factors, such as the quality of leadership; the responsiveness of government; the capability of the civil service and the influence of civil society organisations and the media; and the quality of donor coordination. It is influenced by the work of national and international organisations setting the terms of financial and economic stability<sup>13</sup> and the catalysts of think tanks, academia and research.
- 3.18 CIPFA's Whole System Approach to PFM is therefore set within a country context whose circumstances, capabilities and culture will condition how it operates<sup>14</sup>. The design of PFM improvements needs to take account of the external environment and of the formal and informal rules that can reinforce or undermine PFM effectiveness. Much has been written elsewhere on the significance of the political economy and political will in PFM reform, to the extent that an adverse political environment can frustrate improvement. However CIPFA has focused on the formal elements of the PFM system and its components, as a necessary basis for planning improvement.

## The organisational architecture

<sup>13</sup> See the World Bank's Reports on the Observance of Standards and Codes and their relevance for the international financial architecture <http://www.imf.org/external/NP/rosc/rosc.aspx>

<sup>14</sup> J Dendura has suggested a PFM description that focuses on system workings. *"Public finance management is a term describing a set of sub-systems forming a coherent system linked together by flows of information and bounded by internal and external forces. That system defines formal and informal rules by which the public service's businesses are directed, controlled and influenced, to support the delivery of assigned goals."* Response to CIPFA consultation draft 2009

- 3.19 The architecture represents the structure of agencies and organisations that are directly involved in funding and executing public sector expenditure, and in promulgating, operating, developing and overseeing PFM standards and practices. These organisations constitute a powerful resource for development partners that they need to mobilise in order to achieve public sector goals.
- 3.20 CIPFA has summarised in the diagram below this collection of organisations, and an approach to their mapping. The aim is to help development partners – governments, donors and their advisers - to understand, use and enhance the functionality of the PFM architecture, by providing a simple overview. It aims to offer those who operate and oversee the PFM framework an entry point to analyse its strengths and possible gaps and identify priorities to improve its effectiveness.

<b>Organisational Framework</b>	
<b>International sponsors</b>	<ul style="list-style-type: none"> <li>- World Bank</li> <li>- IMF</li> <li>- Donors</li> <li>- OECD</li> <li>- Others</li> </ul>
<b>Global bodies</b>	<ul style="list-style-type: none"> <li>- CIPFA</li> <li>- IFAC</li> <li>- PEFA initiative</li> <li>- INTOSAI</li> </ul>
<b>Regional bodies</b>	<ul style="list-style-type: none"> <li>- Funders</li> <li>- Associations</li> <li>- IFAC organisational &amp; accountancy groupings</li> <li>- Advisory bodies</li> <li>- Training providers</li> <li>- INTOSAI working groups</li> </ul>
<b>National bodies</b>	<ul style="list-style-type: none"> <li>- Government &amp; legislature</li> <li>- Regulators</li> <li>- Standard setters</li> <li>- Accountancy bodies</li> <li>- SAIs</li> <li>- Others</li> <li>- Mainly private sector</li> </ul>
<b>Sub-national and sectoral bodies</b>	<ul style="list-style-type: none"> <li>- Central government</li> <li>- Local authorities</li> <li>- Government Business Enterprises</li> <li>- Others</li> </ul>

- 3.21 Chapter 3 of Volume 2 provides further details of some of the key actors in the PFM field. They are ordered by different levels of organisation: international, regional, national; and by types, based around their broad function: international sponsors, who inject resources into the public sector and oversee practices; finance professional bodies providing expertise and leadership on standards, practice and evaluation in branches of PFM; PFM executive bodies and scrutiny institutions, including central government; and organisations devoted to training and capacity development. Maps showing the principal PFM organisations in relation to the main regions of the world are also provided.

### Applying the Whole System Approach in Practice

- 4.1 The structural skeleton of PFM comes from governments and other major organisations. But the whole system also comprises the set of processes that underpin them: a circulatory system of funding flows; processes for monitoring, balancing and regulating, formal and informal feedback systems for learning and adapting; and generative processes for organisational growth. All these elements need to operate together if development inputs are to reinforce virtuous cycles of improvement and to be self-sustaining for the longer term.

### Optimising System Performance

- 4.2 Sound PFM is fundamental to achieving development objectives and reducing poverty. It enables aid funds to be managed and spent efficiently and with integrity and it helps to give donors necessary confidence against their own fiduciary risk. It is a lever to broader country development, to raising revenues effectively, planning and executing budget decisions reliably, and to building trust for donors and investors.
- 4.3 A systems model looks for mechanisms to optimise total output rather than the performance of individual elements. Single or poorly coordinated PFM interventions can generate progress, but this may be limited by other parts of the system, possibly in ways that emerge only after a time delay. A systems stress on interconnectedness can help to indicate where failure or even short term success may bring consequences elsewhere. A whole system approach emphasises the concepts of interdependence, congruence and dynamism, as PFM improvements feedback into a strengthened political, social or economic context.
- 4.4 The idea that the individual aspects of reform are vitally connected is not new<sup>15</sup>. The World Bank agrees that: *"A good PFM reform plan shows that interventions in processes interact to achieve final goals"*<sup>16</sup>. The effectiveness of the PFM system in any country depends on a network of interlocking processes, within a framework of organisations at global, regional, national and sub-national level. The quality of PFM depends on how well the individual organisations work, the quality of inputs provided to the system, the feedback and control mechanisms that ensure a focus on objectives, and on how well the system functions as a whole. CIPFA aims to support a systems approach by presenting an overview of the system of PFM processes, to serve as a reference model and a framework for analysing the congruence between sets of processes.

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<sup>15</sup> For example: *"Reforms in external audit are unlikely to have a sustained impact unless parliamentary committees, such as Public Accounts Committees are able to provide effective legislative scrutiny of audit reports."* - Report on the Use of Country Systems in Public Financial Management July 2008 P23 Joint Venture of Public Financial Management Working Party on Aid Effectiveness.

For example: *"Reforms of PFM systems are more effective if they are part of a broader public sector reform of the civil service, governance and transparency, and of the legal framework."* **IMF Survey: Low-Income Countries Need Upgrades**, Richard Allen and Duncan Last, IMF Fiscal Affairs Department July 19, 2007.

<sup>16</sup> Background and Summary of an Integrated PFM Model  
<http://www.siteresources.worldbank.org/INTPRSI/Resources/383606-1119904390686/bbl121905background.pdf>

- 4.5 The DEPF model can be used to examine, formulate and improve PFM design. Understanding and analysing the international PFM architecture should facilitate better designed support for the development of country systems and the capacity to operate them, targeting interventions appropriately and allowing donors collectively to allocate resources more efficiently.
- 4.6 A PFM reform programme based on individual or uncoordinated initiatives risks underperforming since there may be no process to assess interactions or optimise total results across the whole PFM system. Some examples of sub-optimal outcomes can be illustrated by reference to weakness in the processes or individual organisations:
- assessing the performance of individual PFM components rather than optimising the outputs of the whole system;
  - individual organisations underperforming: for example, local training providers may be lacking in technical skills or in other resources to play their role, leading to inadequate training that leaves no lasting impact;
  - absence of some organisations e.g. accountancy bodies, in certain countries, or where present they may represent only the private sector;
  - insufficient coordination and knowledge sharing, particularly at regional and country levels, failing to lever the benefit of development inputs;
  - absence of a region-wide perspective, leading to fragmented and uncoordinated solutions by individual countries.

## Determining priorities

- 4.7 The Whole System Approach offers a range of ways to determine priorities for improvement, for example:
- strengthening individual financial processes;
  - analysing the separate activities that contribute to targeted outcomes and focussing on the ones that will make most difference;
  - looking across all the processes that need to come together, and targeting improvement plans on areas where change will have the biggest impact on overall effectiveness;
  - identifying core processes in sequencing PFM improvements along with the developments that will sustain them in the future;
  - suggesting complementary programmes that are not directly to do with financial management but may be blocking reform.

- 4.8 An emphasis on the whole system argues that the effectiveness and sustainability of PFM depends on a healthy balance across the system components. This is not to advocate a rigid implementation of every item. There should be room for what the Overseas Development Institute (ODI) calls 'astute and opportunistic PFM interventions'<sup>17</sup> - but these aspects of Realpolitik should be located in the big picture and mindful of their system effects and possible unintended consequences.
- 4.9 It is also clear that it would be beyond the capacity of almost all countries to implement PFM improvements across the whole range of processes at the same time. In practice more limited objectives will be required. CIPFA aims to provide a platform for analysis of the most relevant path to PFM improvement for countries, and to assist those thinking about sequencing, rather than to prescribe a universal hierarchy of basic processes.
- 4.10 The selection of PFM improvement programmes therefore depends on local priorities and circumstances. For example, building revenue systems and paying security forces are likely to be priorities for a post conflict country. In more stable low income countries, initial attention may be on establishing a comprehensive budget which recognises all revenues and expenditures and provides a basis for allocating and controlling public expenditure<sup>18</sup>. Training in basic financial skills up to accounting technician level is likely to be a first generation capacity development. A staged approach to PFM reform, focussing on mutually reinforcing components, might focus initially on cash management, moving to budgeting, and improving the quality of processes in subsequent rounds of reform.
- 4.11 However a PFM system is dynamic. It is not simply linear, enabling a fixed staircase towards the goal of a fully functioning system. 'Basic' processes are not always enough at an early stage of development. A Ministry of Finance introducing a new PFM system needs to draw on relatively sophisticated understanding to act as conduit for donor assistance and champion of PFM reform, to create, lead and direct implementation, and to act as client to consultants.
- 4.12 A whole system perspective can focus reforms on wider or longer term consequences. For example, whole life cost assessment may not be selected as one of the techniques for first generation PFM reforms. But in fact its relevance appears early in many development programmes, such as the maintenance requirements of IT and physical investment. In general, aid interventions should address the ability of recipients to maintain the momentum of improvement. There is a risk that sustainability will be underplayed if:
- building capacity is not explicitly addressed in development plans;
  - donors' justifiable concerns with fiduciary risk lead them to stress compliance and control aspects of PFM at the expense of resource management and other aspects of the system that focus on its performance and sustainability;
  - donors prioritise short term fiduciary concerns over longer term results;
  - donors' assistance is short term or its quality compromised by poor procurement, including inconsistent terms of reference and unrealistic timescales or prices.

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<sup>17</sup> Overseas Development Institute: CAPE Public Finance Conference – Concept Note 'Reforming for Results: Can PFM reform uplift government performance?' November 2008 P2

<sup>18</sup> Comments on the differing perspectives relevant to countries with different circumstances are particularly indebted to DFID and to Noel Hepworth.

- 4.13 Feedback mechanisms are important in strengthening effectiveness and sustainability. For example:
- codifying standards and creating common concepts across the PFM architecture enables information to be aggregated, exchanged, devolved, compared and interpreted, and supports transparency<sup>19</sup> which in turn helps to create and sustain a demand for better financial information and scrutiny;
  - a whole system approach embraces standard techniques of capacity building such as training, but also how countries can take responsibility for growing professionalisation through their own associations and peer relationships, helping to strengthen and embed an improvement trajectory.
- 4.14 Key concepts in applying the whole system approach are therefore congruence, leverage, flow and sustainability. Congruence emphasises the importance of system improvements working together. It has significance for the selection of initiatives and the coordination of donor contributions. Leverage focuses initiatives on the processes that can have most impact on the proposed goals, through their individual effect and their connections to other parts of the system. Flow refers to the connections between processes that determine how, and whether, activity in one area of the system relates to effects in another area. Sustainability examines the processes, including feedback mechanisms, which buttress change management and enable improvements to be maintained after the initial project has been completed.

## Service delivery

- 4.15 Focussing directly on the contribution of PFM to service delivery highlights processes that deserve a high profile in PFM improvement programmes. They support decision makers and managers, rather than directly targeting finance specialists, whose role is to analyse and interpret financial information and offer advice and options. Such processes (see box below) include:
- Integrating financial and policy/service planning.
  - Financial literacy for leaders and service managers.
  - Budget forecasting for budget managers.
  - Managing dependency on subsidies.
  - Techniques of public service demand management.
  - Equipping finance staff to support managers.

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<sup>19</sup> For example, IPSASB's objective for high quality accounting standards: *"This will enhance the quality and transparency of public sector financial reporting and strengthen public confidence in public sector financial management."* – An Overview of IPSASB's role and standard setting process – website <http://www.ipsasb.org>

- 4.16 Examination of the system aspects of service delivery suggests that Governments could direct PFM reform more systematically at the elements that exercise greatest leverage on service outcomes and public benefit, supported by donors.

**Supporting service delivery: key processes to support decision makers and service managers**

Integrating financial and policy/service planning, providing relevant information on accurate costing, identifying financial implications, and supporting risk management and efficient implementation. Bringing financial considerations together with strategic planning and operational design is fundamental to efficient resource allocations, financial risk management and to resourcing priorities.

Financial literacy for the leaders and service managers who are responsible for decision making, and who are very often not financial experts. PFM has to operate close to the point of decision on financial commitments, which may be in devolved administrations. Non-financial decision makers at senior level (that can include ministers as well as managers) need to understand how to use financial information in their decision making, when to seek expert advice, how to manage financial risks and how to improve their use of resources. Without this leadership there is a risk that the impact of reforms may be limited.

Budget forecasting for budget managers (not just finance staff), enabling corrective action to be taken to reconcile available budget with achievable policy.

Managing dependency on subsidies, including risk management, contingency planning and exit strategies.

Techniques of public service demand management in circumstances of financial stress.

Finance staff equipped with skills to interpret financial information, with sufficient standing to offer advice to decision makers and managers.

## Sustaining PFM improvement

- 4.17 Analysis of mechanisms also has implications for training and development methods. A list of the usual solutions to capacity development would include short courses, one-off aid funded training programmes, academic training by universities, employing skilled staff from the private sector, and long term programmes linked to international standards of the accountancy profession<sup>20</sup>. In order to maximise the impact of training it would include an assessment of need, based on the 'service quality supply chain', on relevance and on the probability of take-up in practice. A sustainability based approach might result in a greater emphasis on modalities designed to accelerate learning, share experience and build a continuing network, such as peer support, mentoring, improvement networks and communities of practice, alongside course based learning aimed at technical information. Leverage considerations suggest senior decision makers should be part of such initiatives, without whose leadership learning may not trickle through to real policy changes.

<sup>20</sup> David Gray, DFID December 2008, Presentation: Introduction to governance

- 4.18 The 2005 Paris Declaration committed countries to strengthen their PFM systems and donors committed to use these systems to the maximum. The 2008 Report on the Use of Country Systems in Public Financial Management noted that the aggregate numbers on the latter front have changed little. It helps to clarify what it means to use a country's PFM system<sup>21</sup>. Country led reform logically starts by addressing the country's need for PFM support. In turn this benefits from donor understanding of what PFM involves across its whole scope. Without that technical understanding, aid risks proceeding as isolated projects with limited impact, that do not raise countries' longer term PFM capacity. In short, governments could apply system thinking more directly to PFM improvements, analysing and directing reform more systematically at the elements of PFM that exercise greatest leverage on service outcomes and public benefit. Donors could do more to encourage, develop and support this kind of methodology, which also lends itself well to donor coordination.

## PFM evaluation and relationship to other tools

- 4.19 CIPFA's DEPF model provides a base for examining the functionality of a country's PFM system. To perform well all components of the PFM system need to function, and all need to be connected into the whole system. For example, laws on accruals accounting, intended to account better for the use of resources, achieve nothing if they are not observed and are not connected into other parts of the system concerned with monitoring and reporting.
- 4.20 The process architecture provides a platform for developing existing and new tools. It does not compete with, or replace, measurement tools for assessing maturity or progress in PFM such as the European Union's Public Internal Financial Control (PIfC) manual, or other good practice guidance.
- 4.21 The assessment framework developed by PEFA is a key measurement tool, which itself identifies a sub-set of core financial management processes. This is a quantitative assessment, focussing on a selection of priorities, including donors' fiduciary concerns. CIPFA's Whole System Approach complements PEFA's approach, with a more broadly defined system. In particular CIPFA treats Building Capacity as an integral part of the PFM system, rather than a catalyst and spur to performance – a role that PEFA itself helps to fulfil. Other complementary tools, such as analysis of the actors in reform will also enhance the model's usefulness.
- 4.22 CIPFA's framework for analysis is also consistent with a platform approach to PFM reform, which gives particular attention to co-ordinating and sequencing the steps needed, as part of a country led approach. The approach has been defined by DFID in a July 2005 Briefing Paper as:
- "The platform approach aims to implement a package of measures or activities designed to achieve increasing levels ("platforms") of PFM competence over a manageable timeframe. Each platform establishes a clear basis for launching to the next, based on the premise that a certain level of PFM competence is required to enable further progress to take place."*
- 4.23 Planning the approach requires careful deliberation with partner governments. It requires full consideration of process, absorptive capacity, the institutional and motivational measures underpinning the platform design, and emphasises the benefits of partners harmonising reform programmes.

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<sup>21</sup> "Only a few donors have adopted a definition of the use of country PFM systems and these definitions tend to differ." Report on the Use of Country Systems in Public Financial Management – Joint Venture on Public Financial Management, July 2008 P37