

ETHIOPIA
TRACKING POVERTY REDUCING SPENDING IN HIPC_s
ASSESSMENT OF BUDGETING SYSTEMS

1. This assessment has been prepared by a joint World Bank-IMF mission led by Miria Pigato (AFTM2) and comprising Duvvuri Subbarao (AFTM2) and Alexander Kyei (IMF). The assessment is based on the discussions held by the mission with relevant Government Authorities in Ethiopia during October 15-20, 2001 as well as the field work done earlier for the 2001 Public Expenditure Review (PER). [The draft was reviewed and discussed with the Ministry of Finance and economic Development during the IMF-PRGF mission in November 2001.](#)

Ethiopia Context

2. To appreciate this assessment, it is important to bear in mind two contextual issues:
- (a) The Government's medium term program for public expenditure reform is contained in the Expenditure Management and Control Program (EMCP) which is one of the five components of the ongoing Civil Service Reform Program (CSRP). The main objectives of the EMCP are to bring about institutional and structural changes in public expenditure management so as to improve both its strategic and technical components. EMCP consists of the following components: (i) development and adoption of a new financial legal framework; (ii) basing planning and budgeting on a medium term Macroeconomic and Fiscal Framework; (iii) reform of the budgeting system; and (iv) improvement of and capacity building in the accounting and auditing systems.
 - (b) The evolution of fiscal decentralization is a crucial factor in determining the pace and sequencing of public expenditure reforms. In Ethiopia, the federal financial regulations are echoed at regional level. Nevertheless decentralization has important practical implications, e.g. in terms of the required information flows between federal and decentralized levels. In addition, the unusual degree of regional autonomy in Ethiopia raises fundamental questions about the setting of expenditure targets as well as the tracking of them. These are discussed in the main text of the PER (both in Chapter 3 and in Chapter 5, which addresses the regional perspective of public expenditures).

I. INVOLVEMENT OF DIFFERENT LEVELS OF GOVERNMENT

- Q1. What amount of total government poverty related spending is carried out by sub-national levels of government?
- Q2. What amount of expected additional spending (following receipt of HIPC debt relief) will be executed by sub-national levels of government?

3. In discussion with Ethiopian Authorities, the joint Bank-Fund HIPC mission (September 2001) identified education, health, roads and agriculture & natural resources as key poverty-related sectors. The regional (sub-national) share of combined federal-regional expenditure in these sectors in FY01 (preliminary actual figures) is about 63 percent (Table 1). If Roads, which is a large federal program is taken out, the regional share goes up to about 70 percent. The HIPC relief, expected to be of the order of USD75 million per year, will shift the balance in favour of the regions by about 2 percentage points.

Table 1: Federal - Regional Shares in Poverty Related Spending, 2000/01

Category	Total Expenditure (ETB million)	Percent of Total	Federal Share (%)	Regional Share (%)
Roads	1,379	23.8	59.7	40.3
Agriculture & Nat. Resources	1,483	25.6	35.4	64.6
Education	2,131	36.8	24.4	75.6
Health	794	13.7	37.7	62.3
Total	5,787	100.0	37.5	62.5

4. Regions are heavily dependent on federal funding, but this is transferred as an unearmarked subsidy.¹ This raises tracking issues both ex-ante and ex-post:

- (a) Ex post (reporting of expenditures), there are issues about the Federal Government's right to demand information from Regional Governments. However, the government does have the explicit constitutional right to audit all expenditures financed from the federal subsidy.² Moreover, the Ministry of Finance is able not only to demand regular reporting of regional expenditures but also to prescribe the formats to be followed. Therefore, in

¹ See Chapter 5 and Annexes 5.1 and 5.2 of draft PER 2001 for more detail on tax and expenditure assignments and on the federal budget grant formula.

² The federal subsidy is the major source of revenue for all regions except Addis Ababa. Apart from Addis Ababa, no region has own revenues sufficient to cover even its recurrent budget. However, regional budgets do not identify which items of expenditure are funded by the federal subsidy as opposed to their own revenues.

practice, ex-post regional tracking issues mainly concern the timeliness, reliability and classification of regional expenditure figures.

- (b) Ex-ante issues concern the setting of expenditure targets. Such targets may be expected to embrace regional as well as federal expenditures, but Ethiopia's federal system does not allow the federal government to dictate regional expenditure allocations across the board. However, discussion and mutual agreement on expenditure allocations, especially out of special dispensations such as HIPC, are not ruled out.

II. BUDGET FORMULATION

A. Comprehensiveness

Q3. How well does the coverage of the budget match the GFS definition of the general government sector?

5. The Federal Government compiles reports both on its own budgetary expenditures and on the consolidated expenditures of federal and regional governments to give aggregates for general government. There is a reasonable fit with GFS definitions, and the revised chart of accounts (discussed below) will further enhance the ability to provide analytical reports. However, extra-budgetary funds are not included in the budget, and monthly or quarterly reports following the economic classification are not available.

Q4. How far are general government activities funded through defined extra budgetary funds?

6. There are a number of funds and activities which are not fully incorporated in the appropriation and reporting of the budget.³ These include:

- (a) The Road Fund. Its revenues and associated expenditures are not appropriated nor are they incorporated in the government's financial statements. However, the operating expenses of the Office of the Road Fund Administration that are met by the government are appropriated and the Road Fund operates in a quite transparent manner.⁴ Transfer of payments from the Fund to operating agencies (mainly the ERA and RRAs) are based on production of physical and financial performance reports against the agreed work plans and budget. Each road agency is required to keep a separate road fund account exclusive to road maintenance financing. In contrast to what

³ In response to this comment, the Government have clarified as follows: There are special funds which are established by law for specific purposes such as the Road Fund, Pension Fund etc. These funds have a special, as opposed to annual appropriation. Government are contemplating displaying the status of these funds as an annex the annual budget book. Similarly, in a further effort towards making the budget comprehensive and transparent, since the FY01 budget, Government have adopted the practice of showing food aid as an annex to the annual budget book.

⁴ See *Road Fund in Ethiopia: From Inception to Realization*, Office of the Road Fund Administration, January 2001. Requiring the administrative costs of the road fund to be appropriated is a check against extravagant or inappropriate use of road fund revenues.

happens with treasury funds, unexpended balances in these accounts are carried forward from one fiscal year to the next. The Road Fund Board is accountable to the Prime Minister.

- (b) Ethiopian Social Rehabilitation and Development Fund (ESRDF). This funding mechanism supplements expenditures which are directly appropriated through the budget. A comprehensive view of poverty-relevant public expenditures would require that ESRDF expenditures also be reported in detail. (Indeed, at an early stage in HIPC discussions, the use of the ESRDF itself as a mechanism for disbursement of HIPC resources was suggested.)
- (c) Food Aid. The Disaster Prevention and Preparedness Fund also operates as an extra-budgetary fund. More generally, food aid, of which Ethiopia is a major recipient, is not well reflected in the budget and expenditure reports.⁵
- (d) Industrial Development Fund (IDF) and Privatization Receipts. Public enterprises are required to deposit dividend income to the Industrial Development Fund Account at the National Bank of Ethiopia (NBE). The IFMS report⁶ was unable to ascertain whether all revenues are transferred from the IDF to the Treasury Central Account. The Prime Minister's Office (PMO) maintains a separate fund for privatization which is operated along the same lines as the IDF. However, transfers to this account comprise only the sale proceeds while the liabilities are transferred to another entity, the Board of Trustees for the Privatization of Enterprises.

The absence of regional extra-budgetary funds or accounts or extra-budgetary resources could not be confirmed at this stage.

7. The Budget Reform component of EMCP has led to the introduction, starting FY02, of an annex which describes expected food aid (though this does not form part of the budget appropriation). Additional annexes are planned to cover Special Funds, such as those noted in the previous paragraph, contingent liabilities, pensions and debt, and aid. Making these components of public resources more visible will increase the transparency of the budget, and is a necessary step towards increased accountability for resources that are, at present, extra-budgetary. The government is committed to produce consolidated federal and regional budget, including all extra-budgetary funds and accounts, for the past year and the current year, starting in FY02, as part of the HIPC completion point trigger.

Q5. To what extent are non-tax receipts (which are not included in the budget) or other non-budgeted funds available to spending units?

8. In general, accountability for and transparency in the area of retained revenues is weak. There is a standing finance instruction that enjoins all public bodies to submit

⁵ The issues involved are thoroughly discussed in a recent study for the European Commission: *Public Expenditure Management Aspects of Food Security*, Resal Ethiopia, April 2001. Table 4 on page 21 of the study estimates the value of food aid relative to regional budgets, and estimates that for most regions the value of food aid averaged at least 10% of budgeted expenditures over the five years to 2000; for Somali, Amhara and Tigray, the estimates were 30%, 37% and 52% respectively.

⁶ *IFMS scope, objectives and broad strategy*, Main report, PricewaterhouseCoopers, May 2001 (see ¶4.26).

to MOFED the amount they have collected and details of its utilization. Even so, the
~~The~~ quantum of retained revenues is not regularly and accurately reported on, and this erodes both efficiency of expenditure allocation as well as accountability. Both the ongoing EMCP and the recent IFMS have recommended a single consolidated treasury account system.

Q6. How would you describe the composition of the budget outturn at a functional or vote level relative to the originating budgeting?

9. Budget outturns in aggregate tend to be very close to the totals appropriated by the legislature. Expenditure controls are effective in preventing excess or unauthorized expenditures. Large gaps between capital budget estimates and actual implementation are precluded by including in the budget only those projects with secured financing. Additional projects are brought in via supplementary budgets if mid-year financing is secured on a confirmed basis.

Q7. Are donor funds included in the budget?

Q8. Are outturn data on expenditures financed by donors made generally available?

Q9. Are outturn data on such expenditures timely?

10. Government's financial regulations require the inclusion of all donor funds in the budget and in reported expenditures. In practice this has been difficult to achieve. Ability to capture funds (either ex-ante in budget appropriations or ex-post as memorandum information) varies according to the nature of the aid and the channel of funding adopted. Thus:

- Channel 1 funds (which follow the normal government financial channels) are, by definition, captured. Channel 2 funds (where funds are disbursed via the sector rather than the financial bodies of government) are more likely to be captured than ~~and~~ Channel 3 funds (disbursed directly by donors) ~~are less likely to be captured.~~
- Certain categories of assistance (notably food aid and technical assistance) are generally not included and not appropriated.
- Loans are captured more thoroughly than grants.

11. Efforts to improve the capture of donor funds in the budget are continuing,⁷ and the issue was extensively reviewed in PER 2000. It noted that MEDAC has the responsibility for maintaining an overview of aid flows, but that its ability to collect reliable data on actual disbursements is complicated by several factors:

- (a) many donor programs are very segmented and different disbursement channels and procedures are being used;
- (b) many projects are implemented at regional or zonal level and these administrative entities do not always have the capacity to report adequately on disbursements;
- (c) MEDAC depends to a large extent on supplementary information provided by line ministries (notably for SDPs) which are not necessarily the most efficient in gathering and communicating the relevant data; and
- (d) unwillingness, according to MEDAC, of some donors to provide information. (PER 2000, ¶4.15)

⁷ As noted in ¶7, it is planned to present a Budget Annex with details of aid flows.

12. External aid accounts for a substantial proportion of public expenditures at both federal and regional levels. In FY01, external grants and loans accounted for as much as 28 percent of the total expenditure. PER 2000⁸ provided the following figures on the percentage of aid in the regions' capital budgets:

Year	Percentage of aid in the capital budget ⁹
1996/97	26
1997/98	21
1998/99	25
1999/00	44
2000/01	48

13. The amount of aid that is not presently captured is quite significant, and aid is directed disproportionately to a sub-set of activities which includes those deemed to be poverty-related. Thus it is quite possible that the apparent trends in both the levels and the shares of public expenditure on particular budget categories will be distorted by improved capture of aid flows.

14. In recent years, a particular concern has been to provide expenditure reports for the sector development programmes. These have been sought at two levels: (a) overall reports on federal and regional sector expenditure that could be compared with the expenditure targets agreed during the formulation of the SDPs; (b) a system for in-year reporting on expenditure of earmarked funds disbursed via Channel 1 (the so-called Channel 1b, which, in practice has been used only by the World Bank). Reports have been gradually improving, but a number of difficulties have been apparent, including:

- delays in aggregation of regional expenditure reports (reflecting uneven capacity among regions and delays in closing end-year accounts);
- lack of desired detail in reporting (reflecting weaknesses in the classification system – see below – and the fact that the original SDP expenditure projections did not follow the government budget format);
- introduction of an interim tracking system for Channel 1b expenditures which did not fulfill expectations;
- continued difficulty in capturing donor funding via Channels 2 and 3.

⁸ See PER 2000, p53.

⁹ Aid includes external grants as well as loans.

B. Classification

Q10. Indicate the levels of classification that apply to budget transactions.

Q11. To what level does the functional classification break down?

15. Ethiopia has administrative and functional (sector and some sub-sectors) classifications for expenditure. The systems for making an economic classification are in place, but their operationalization is hampered by capacity constraints. In its present form, the economic classification is is under development and in its present form is both unreliable and highly aggregated. As part of the EMCP, a new classification system and chart of accounts are being introduced, which will enable expenditures to be tagged down to cost center and program level. The revised classification scheme is fully described in Version 2.1 of the Budget Reform Design Manual. Among other features, it will ensure common coding across recurrent and capital budgets, rationalize expenditure codes into a single series with a more consistent economic classification and assign unique revenue codes to each (donor or domestic) source of funding.

16. The new classification is currently being introduced at federal level, and will be rolled over to the regions in the next 2-3 years.

Q12. What is the principal means for executing, tracking and recording HIPC-related spending?

17. There are at present no explicit systems to track poverty-related spending. However, the reformed budget classification would allow for: (a) the tracking of specific functional classifications of expenditure; (b) the assignment of a distinct revenue code for HIPC-derived funding (the 'virtual fund' approach); or (c) a hybrid of both approaches.

C. Multiyear Projections

Q13. How would you describe the out-year estimates (medium term) for spending?

Q14. What level of detail is provided for such estimates?

18. The government has adopted financial regulations committing itself to systematic medium term planning of expenditures. A federal Macroeconomic and Fiscal Framework (MEFF) is to be prepared each year, on the basis of which funds available for federal recurrent and capital expenditure and for the regional subsidy are to be calculated. The MEFF is expected to provide the basis for the setting, and approval by the Council of Ministers, of ceilings – Indicative Planning Figures (IPFs) – for the capital expenditures of federal public bodies, which are consolidated into a three-year rolling Public Investment Programme. According to regulations, only projects that are prioritized in the PIP are eligible for inclusion in the annual capital budget. A detailed financial calendar, developed as part of the budget reform, spells out the responsibilities of different bodies as well as the annual timing of each stage

of the exercise.¹⁰ The PIP was intended to be a stepping stone towards a Public Expenditure Programme (PEP), which would programme federal recurrent as well as capital expenditure. Implementation of these reforms to planning and budgeting would amount to the application of a Medium Term Expenditure Framework.

19. In practice, as successive PERs have noted, preparation of MEFFs and PIPs has hitherto been only a shadow exercise. The MEFF and PIP have never been submitted to the Council of Ministers for approval, and neither the procedures nor the timing mandated in the financial calendar have been adhered to. The Government's principal explanations for the failure to implement these reforms have been (a) the uncertainties associated with the border conflict, and (b) difficulties in forecasting of external resources. However, in connection with the Economic Rehabilitation Support Credit, the government has now given undertakings to make these reforms effective.¹¹

20. The regions have adopted similar financial regulations committing themselves to the development of PIPs and PEPs but, through the preparation cycles for budgets up to FY2001/02, none had begun to do so. However, the Sector Development Programmes (Health, Education, Roads) did incorporate five-year expenditure projections for both recurrent and capital expenditures, taking account of anticipated external as well as domestic resources, and setting targets for regional as well as federal expenditure. Timely medium-term projections by the government are virtually a precondition for meaningful medium-term planning by the regions, because they need to know the projected level of the federal subsidy which is under the control of the government, and the availability of external aid which is managed by the government.

21. In September 2001, there was a pilot initiative to begin preparation of PEPs at regional level, with the federal government undertaking to provide two-year projections of the federal subsidy as a basis for medium-term plans at regional level.¹² This timely intimation of resource envelope will enable the regions to make budget allocations better matching the priorities ascertained from the communities.

¹⁰ The proposed financial calendar is reproduced in Appendix 2 of PER 2000 (Volume II).

¹¹ See World Bank, Report No. P7441-ET (*Economic Rehabilitation Support Credit*), April 30, 2001. Annex B (Letter of Development Policy), ¶21, includes the following undertakings:

Before the end of 2001/02, we are planning to undertake the following measures. By October 2001, the Council of Ministers will adopt a Macro-Economic and Fiscal Framework (MEFF) and a Public Investment Programme (PIP), which will lead to the budget for 2001/2002 [*sic, but should read 2002/003*] .. and by December 2001 it will submit it to the Council of People's Representatives. We will also prepare any legislation relating to the PEP and present it to the Council of Ministers. Furthermore, MEDaC, in coordination with the MOF, will prepare a plan that lays out the resource requirements and a timetable to help the regional states in carrying forward their multi-year planning and budgeting process.

¹² The planned approach is described in Perran Penrose, *Medium Term Expenditure Framework (MTEF) and Public Expenditure Programme (PEP)*, DSA Project Report P-43, April 2001.

D. Budget Composition¹³

The HIPC Expenditure Tracking questionnaire does not address the issue of budget composition, but this is relevant because an apparently appropriate expenditure allocation may be undermined if there are chronic imbalances within it (e.g. between recurrent and capital expenditures, or between wage and non-wage recurrent expenditures).

22. PER 2000 examined this issue, and found that while Ethiopia avoids the extreme compression of recurrent expenditures that is found in many countries, there are still significant concerns about the adequacy of funding of operating costs. (These concerns were reiterated in the Regional PERs undertaken as part of the PER 2001 cycle). Moreover, there is no analysis of the balance between wage and non-wage recurrent expenditure. The present budget formulation system fails to address such issues in a systematic fashion. It is expected that the introduction of PEP will improve the balance between recurrent and capital expenditures and thereby the efficiency of overall expenditures.

III. BUDGET EXECUTION

A. Internal Control

Q15. What are the principal forms of control to ensure that spending reflects the authorized budget?

Q16. (i) Do these controls involve or are they supplemented with commitment controls to limit expenditure commitments to available cash resources?

(ii) If cash rationing is a feature of the control system, describe the basis of decisions made about which activities should receive cash and which should not? Is there a way to protect cash for poverty reducing expenditures (describe)?

Q17. What do you estimate as the level of the stock of expenditure arrears at the end of the last financial year?

Q18. Are (government approved) supplementary budgets used to add to or substantially change the pattern of government spending?

23. Disbursement procedures are concisely described in the IFMS report.¹⁴ Disbursements to public bodies are made by the MOF Treasury Department on request. Procedures are different for salaries, recurrent operating expenditure, and capital expenditure. For salaries, Treasury cash flow projections assume a monthly outflow of one twelfth of the annual allocation, but actual disbursements depend on requests supported by payroll documentation. Requests for recurrent operating expenditure, normally submitted monthly, also require supporting documentation. Requests for capital expenditure financed from the Treasury Central Account are made only when funding is required, and again require documentation such as payment certificates and bid documents.

¹³ The importance of this issue was pointed out by Stephen Peterson, US-AID consultant.

¹⁴ *ibid.*, ¶4.42–4.47.

24. Disbursement processes at regional government level are very similar, except that:

- For recurrent operational expenditure, regions may request the Treasury Department to make direct payments to suppliers; alternatively, there may be months when cash flow requirements are such that a region requires more than the average monthly federal allocation; Treasury takes these factors into account in its monthly instructions to the central bank – the National Bank of Ethiopia (NBE).
- Funds for capital expenditure are routed through the NBE and the Commercial Bank of Ethiopia (CBE); Treasury Department notifies the NBE of each region's appropriated subsidy, and this governs the funding facilities allowed to each region by CBE. CBE reports all withdrawals to NBE which provides periodic consolidated reports to the Treasury Department;
- Regional finance bureaus are responsible for authorizing disbursement requests and releasing the subsidy element of funding to sector bureaus at the regional level, and to zone finance departments, which in turn authorize and disburse funds to zone sector departments and woreda finance offices. Disbursements are made net of revenue collections at the woreda level, and are therefore cyclical, reflecting the seasonality of collections (see under Question 5 above).

25. Spending agencies must keep each line item of expenditure within approved estimates. As a part of the reform effort, effective last year, public bodies have been delegated the power to transfer resources from one budget head to another within certain limits. For transfers beyond their delegated powers, public bodies have to approach MOF. Approval of the Council of Ministers is required for (a) transfers from one public body to another; and (b) transfers from recurrent to capital. There are strict controls on virement between lines of expenditure. The Council of Ministers (or Regional State Council) must approve transfers between public bodies, or from recurrent to capital expenditure, and supplementary expenditure requires legislative approval.

26. This system has generally been effective in controlling expenditure without the need for cash rationing, although cash controls were reportedly applied during the later stages of the conflict with Eritrea.

27. The main weaknesses of the system are the following:

- Sub-optimal cash management. The system operates through large numbers of bank accounts (the federal government has around 500 bank accounts at NBE and some regional governments have over 100 bank accounts), and this makes it difficult to manage overall liquidity efficiently. Studies under the EMCP have recommended Single Treasury Account system.
- Lack of any effective system of commitment control. This was a weakness noted in early analyses by the Civil Service Reform Task Force. Although financial regulations require heads of public bodies to maintain

commitment records, this does not appear to happen. (However, the insistence that projects do not appear in the budget before funding is secured, makes it less likely that a serious overhang of unbudgeted commitments could build up, at least on the capital side.)

- The rigor with which expenditure controls are applied has costs in terms of ability to utilize available resources efficiently. Essentially, the process of expending the capital budget is not allowed to begin before funds are budgeted (and notification of capital budgets may reach spending agencies only well after the commencement of the FY). One result is an extreme bunching of capital expenditures in the final months of the FY. Utilization of donor funds for SDPs has been delayed by the need to follow the standard procedures for budgeting the funds as supplementary expenditures before they could be disbursed.

Q19. How would you describe the internal audit function?

28. Both internal and external audit functions have been targeted for reform under the EMCP, but for various reasons have experienced delay in securing donor TA.

29. Internal auditing is not developed within Ethiopia's civil service. Traditionally internal audit activities have been more of a "pre-audit" nature, serving simply as an additional step in the expenditure approval process.

30. The internal audit component of EMCP has been designed to develop and implement a proper, modern internal audit capacity in all government institutions, federal and regional, but in the absence of donor assistance there has been little progress beyond the design phase.

Q20. Is internal control supplemented by public expenditure tracking surveys that follow funds to the ultimate service provider or beneficiary?

31. There have been no specific tracking surveys along the lines carried out in other countries. However, given the strength of expenditure controls, it is believed that budgeted funds reach the intended spending agency. Prima facie, the more important issues appear to be the quality and usage of public services and facilities, rather than the diversion of funds.

Procurement procedures and standards

The HIPC tracking questionnaire has no explicit enquiry on the quality of public procurement procedures, although these would appear very relevant to an assessment of the overall quality of public expenditure management. Moreover, donors often cite concerns over procurement as a reason for earmarking their aid and insisting that their own procurement rules take precedence over the government's.

32. A Country Procurement Assessment Review (CPAR) was undertaken in 1998. National procedures for procurement of works, goods and services were found to be wanting in several areas; the government responded by making some changes in its financial directives in this regard but further revisions are needed to make the procedures acceptable in terms of their rigour and transparency. An ideal system would be for government procurement procedures to attain UNCITRAL certification. Experience from other countries indicates that analysis, adoption and absorption of the system under UNCITRAL could take up to 4-5 years. This is an issue that needs to be taken up in the bank's CPAR scheduled for FY02/FY03.

B. Recording Expenditures

Q21. When are budget tracking reports from line ministries and treasury received?
Q22. Are the (internal) tracking reports supplemented by information on accounts payable or pending bills?
Q.23. Is there regular reconciliation of all government bank accounts (those held in the central bank and the commercial banks) with the government's accounting records?

33. Each level of the financial disbursement system receives monthly reports from the bodies to which it disburses funds. These reports are suited more for expenditure control rather than analysis of expenditures for management purposes. However, it is very difficult to obtain aggregate reports at regional and national levels because of delays and lack of comprehensiveness of reports from lower levels.¹⁵ Thus ESDP and HSDP have experienced great difficulty in obtaining periodic aggregate expenditure reports for their sectors (although in their case the problem is compounded by the fact that initial expenditure targets were not configured to match the government budget structure and classification). Systematic information on commitments is not available.

34. The IFMS report notes that the federal and regional governments maintain very large numbers of bank accounts. While the NBE indicated that they send a reconciliation statement on the consolidated fund account to the MOF daily and reconciliation statements on respective accounts to the spending agencies on a monthly basis, reconciliation of fiscal and monetary accounts is a major weakness in

¹⁵ The recent *Diagnosis of Existing Control Capacities in Ethiopia* (page 23) comments on reporting as follows:

The legal framework requires that all administrations (federal, regional, zonal and woreda) report on their financial and physical performance on a monthly, quarterly, semi-annual and annual basis. However in practice we found that this was not the case. A delay in collating data at all levels renders the basic monthly reports impossible to prepare reliably and consequently has an impact on other reports.

In addition there is a potential misunderstanding as to the definition of what the reports should disclose. Some bodies show disbursement while others try to show actual expenditure, similarly disclosure of revenue is either actual revenue or predicted. Without clear definitions the regions, and then the federal level, are receiving reports that are inconsistent. The problem is compounded by the lack of detailed checking. Our investigations identified the source of the problem at the woreda level where there is difficulty in collating data from remote regions and there is insufficient trained staff.

the current system. No aggregate systematic reconciliation is performed on a regular basis, among others because of difference in timing of accounts (Fiscal accounts use the Ethiopian year, while monetary accounts use the calendar year). The government's annual consolidated reports do not provide an account of how government has obtained and utilized cash and cash equivalents (this would normally be done by showing "below-the-line" accounts).¹⁶

Q24. In (monthly or otherwise) reports of the consolidated operations of government, how large has the statistical discrepancy between revenue minus expenditures (derived from MOF data) and financing items (derived from banking data) been on average over the past two years?

35. The gap between estimated deficits and financing totals can be as high as 1.5 percent of GDP. The gap is attributed, among others, to gaps in reporting by sub-national governments and lack of reconciliation between monetary and fiscal accounts.

IV. BUDGET REPORTING

A. Regularity and Reliability of Reports

Q25. What in-year reports are published for tracking budget performance?

36. The IFMS report describes the reporting system as follows:¹⁷

All institutions that receive budget allocations are required to submit the following reports to MOF:

- Monthly reports referred to as the Ge/He 29xxs series incorporate information on recurrent revenue, recurrent expenditure, capital expenditure and fund transfers between the treasury and the relevant institution.
- Annual reports referred to as "Zegeba reports". Essentially Zegeba reports analyze variances between budget appropriations, actual disbursements from Treasury and actual expenditure incurred by the institution.

37. The Central Accounts Department [CAD] uses the accounts module of the BDA system [a computerized Budget Disbursement and Accounts system developed under the budget reform project] to capture and consolidate monthly returns received from public bodies and regional governments. CAD reconciles consolidated information from the BDA system with Zegeba reports and seeks explanations for any variances from the relevant public body/regional government. This provides a basis for generating annual reports on "budgetary revenue and expenditure".

¹⁶ *ibid.*, ¶4.86–4.91.

¹⁷ *ibid.*, ¶4.83ff.

38. In addition, the Policy and Research Department within MOF compiles reports on the federal ~~government's~~ ~~tion's~~ fiscal performance on a monthly basis, within six weeks from the end of the month. The lag in preparing a consolidated statement for the combined federal-regional governments is longer. —a considerable lag.— These reports provide information on revenue, expenditure and financing. To compile this report the department depends largely on the disbursement records maintained by the Treasury.

39. While the system is well established, actual reports remain highly aggregated, and there are considerable delays in obtaining reports that incorporate regional as well as federal expenditures. These deficiencies reflect (a) the weaknesses of the classification system (which are being addressed as indicated under Question 10 above); and (b) delays in receiving information from lower decentralized levels, which reflect the length of the communication chain involved, weaknesses in capacity, and the operation of manual systems.

Q26. How often does the public and/or legislature receive budget tracking reports?

40. Budget estimates are reported on an annual basis to the legislature, and hence the public. There is no routine in-year reporting to legislature or public.

B. Final Audited Accounts

Q27. What is the period between the end of the fiscal year and the routine booking of transactions?

Q28. How soon after the end of the relevant year are the accounts forwarded to audit?

Q29. How soon after the end of the relevant year are the audited final accounts presented to the public and/or the legislature?

41. Routine booking of transactions is closed after a grace period of one month following the end of the fiscal year. The gap could be longer, extending up to four months, in the regions.

42. One of the primary objectives of the accounts project within EMCP has been to clear a four-year backlog in closing regional and federal accounts. Progress was held up by a diversion of attention to the introduction of the interim tracking system for Channel 1b funds, but the backlog has again been substantially reduced and at least two major regions are now effectively current.

43. However, there are a number of outstanding issues concerning the auditing of accounts. Within the present constitutional framework, each Regional State has a responsibility to audit its own accounts. The Federal Auditor General is responsible for auditing the accounts of federal ministries and other federal agencies, but the Federal Government also has the right to audit all regional expenditures that are funded through the federal subsidy. The IFMS report¹⁸ raises two sets of concerns:

¹⁸ *ibid.*, ¶3.26–3.30.

(a) that the accounting information available to the Auditor General is not a satisfactory basis for arriving at the required judgements (e.g. because the AG is not presented with sufficient information on assets such as bank accounts to support the MOF accounts of revenues and expenditures); and (b) lack of transparency, in that there seems to be no comprehensive report by the Auditor General that is in the public domain.

44. It was intended that expenditure reports on ESDP and HSDP would be certified by the Auditor General, but this has not occurred.

45. An EC-sponsored study to review the quality of financial controls in Ethiopia has concluded that:

On the whole the project team found controls to exist but not necessarily to comply with those prescribed by the Ethiopian Government in the relevant proclamations and directives. The controls over financing are strong, and there is no evidence of overspending of the budget. The major weaknesses found in the existing system were:

- the budget process is seriously affected by resource and time constraints leading to inconsistencies in the way budgets are prepared and serious delays in setting the budget
- the reporting process is seriously delayed due to lack of qualified staff at the local government levels. As a result, the Federal administration is three years behind schedule in the preparation of the annual consolidated accounts
- the role played by Internal Audit is confused and ineffective; and
- the external audit department is understaffed and, as a result, is not capable of fulfilling all of its duties.

46. The study makes a number of recommendations for rationalization of procedures and, in particular, for strengthening of staffing in audit and accounting units across regional and federal government. There is particular stress on the need for targeted training for woreda and zone financial staff, and for review of staff complements at local levels

47. Within the CSR/EMCP, the component for strengthening external audit has, as yet, failed to obtain donor funding.

V. BUDGET EVALUATION

Q30. Are any efforts being mounted to assess the effects of spending on the incidence of poverty?

- a) Tracking studies of HIPC-related funds or targeted evaluation of sector or other poverty programs
- b) Broad social indicators of poverty
- c) None

48. The relationship between public expenditure and poverty has been one of the main topics investigated by PER 2001. Findings are fully set out in a background paper¹⁹ and also reported in Chapter 3 of the main PER document. In brief the findings are:

- (a) The sector programmes for health and education include agreed sets of performance indicators and a procedure for annual joint donor/government reviews of performance. Tracking studies of HIPC-related funds is not yet applicable.
- (b) Basic surveys to monitor poverty overall are adequate in scope, frequency and sample size. They form part of an overall welfare monitoring system which is well-conceived but has yet to be made properly effective. The main problems are to do with timely processing of data and reporting, and the need to go beyond the basic measures of income poverty in order to exploit available data more effectively. Delays in reporting means that use of poverty information in policy formulation and resource allocation is limited. There is a particular need to disaggregate data, especially on a geographical basis, and to make the resulting information available at regional and zonal levels.
- (c) General programme evaluation of outcomes is extremely rare, though systematic information on outputs is available for a number of sectors, including health, education and roads.²⁰

Q31. Please identify current providers of technical or donor assistance and their plans in the table provided.

¹⁹ Mokoro Limited, *Tracking of Public Expenditures for Poverty Reduction*, Ethiopia PER 2001 Discussion Paper, August 2001.

²⁰ PER 2000 included (in Chapter 5) a review of the scope for shifting attention from inputs to results, and its Appendix 5 provided an overview of available output and outcome indicators.

Table 2: Technical Assistance

Institution	TA up to 2002	TA beyond 2002
Possible IMF (to be confirmed)	<p>Examination of comprehensiveness of budgetary classification of the new chart of accounts, taking into account GFS standards.</p> <p>Consolidation of federal and regional budgets (ex-ante and ex-post), starting FY 2001/02.</p> <p>Review of the impact of reporting procedure on the quality of fiscal data, at the federal and regional levels.</p> <p>Reconciliation of monetary and fiscal accounts, starting with FY 2001/02.</p>	
World Bank	<p>PERs in collaboration with the government to provide analytical underpinnings for PE reform. Topics covered included: (i) Aid management; (ii) Tracking of poverty related spending; (iii) Regional public finance issues; (iv) Shifting from inputs to results.</p>	<p>PERs will (i) sharpen and deepen regional focus; (ii) study impact of social sector expenditures; (iii) provide analytical basis for tracking surveys; (iv) surveys to evaluate impact of public expenditure at the facility level.</p> <p>Under the Capacity Building component, the focus will be on strengthening expenditure management and control, especially at the sub-national level. In parallel, the Bank will support analytical work on intergovernmental fiscal and administrative relationships within regions in order to identify specific reforms necessary to ensure the efficient, sustainable, and prudent transfer of untied resources to local governments.</p>
US-AID	<p>Implementation of the following components of the EMCP: (i) Legal Framework; (ii) PIP; (iii) Budget Reform; (iv) Accounting Reform. The progress has been varied across the different components.</p>	<p>(i) Making MEFF the basis for planning and budgeting; (ii) Rolling over new chart of accounts to regions; (iii) Shift over from PIP to PEP at federal and regional levels; (iv) development of BIS; (v) Cost-centre budgeting; (vi) Roll over of budget reforms to regions.</p>
European Union	<p>Feasibility study of IFMS.</p>	<p>Design and implementation of IFMS to make expenditure management more efficient and scientific.</p>
UNDP	<p>Training and dissemination of financial proclamations and regulations. Setting out the implementation of a legal</p>	<p>Preparation of Internal Audit manual and training on that.</p>

TRACKING POVERTY-RELATED SPENDING IN HIPCs: ETHIOPIA				
			ASSESSMENT	
		Benchmark	Results	Results versus benchmark
				Remarks
I. BUDGET MANAGEMENT				
Formulation				
1. Budget reporting follows GFS definition of consolidated general government.	A	BB		
2. Government activities are not funded through extra-budgetary sources to a significant degree.	A	A	Meets	<u>All funds are brought to the Consolidated Fund before they are appropriated.</u>
3. Budget outturn data (levels, functional allocation) are quite close to that of the original budget.	B	B	Meets	
4. Budget includes capital and current expenditure financed by donors.	A	B		
CLASSIFICATION				
5. Budget classified on an administrative, economic, functional basis.	B	C		
6. Poverty-related expenditure clearly	A	A	Meets	

	identified in the budget .				
	PROJECTION				
	7. Multi-year expenditure projections integrated into the budget cycle .	A	<u>B</u>		<u>The Governemnt has committed to submitting the MEFF and PIP for Cabinet s well as Parliament for approval.</u>
Execution	INTERNAL CONTROL				
	8. Stock of expenditure arrears less than X percent of total expenditure; little accumulation of new arrears over past year.	A	<u>A</u>	<u>Meets</u>	
	9. Internal audit is active.	A	B		
	10. Tracking surveys supplement internal control.	B	C		
	RECONCILIATION				
	11. Fiscal and banking reconciliation undertaken in a routinely.	A	<u>B</u>		
Reporting	REPORTING				
	12. Internal budget reports from line ministries/Treasury received within four weeks of the end of the relevant period.	B	<u>B</u>	<u>Meets</u>	
	13. Functional classification is reflected in the in-year budget reports.	A	<u>A</u>	<u>Meets</u>	<u>Given the depth of decentralization, in-yer budget reports to the relevnt level of Governemnt are functionally classfied.</u>
	FINAL AUDITED ACCOUNTS				
	14. Closure of the accounts occurs within two months after the end of the fiscal year.	A	B		Can take as long as 4 months
	15. Audited account presented to the legislature within 12 months of the end of the fiscal year.	B	C		

		Meets			
	Formulation	32	4329%		
	Execution	10	25%0%		
	Reporting	20	50%0%		