

**ETHIOPIA: TRACKING POVERTY-REDUCING SPENDING:  
SECOND ASSESSMENT AND ACTION PLAN (AAP)**

**Prepared by Fund/Bank staff<sup>1</sup>  
in collaboration with the Ethiopian authorities**

November 2004

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<sup>1</sup> The mission comprised Benedict Clements (head) and Renato Villela (both Fiscal Affairs Department), Duncan Last (AFRITAC-East), and Navin Girishankar and Jemal Omer (both World Bank).

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Table of Contents	Page
I. Introduction .....	4
II. Assessment .....	5
III. Strengthening PEM Systems in Ethiopia .....	37
Tables	
1. Public Expenditure Management AAP Indicators in Ethiopia .....	6
2. Ethiopia: Preliminary Actual Spending vs. Original Budget by Sectors and Sub-Sectors, 2000/01–2002/03 .....	13
3. Ethiopia: Aggregate and Sectoral Deviations .....	14
4. Situation of Submission of Monthly Accounts (EFY96/ 2003/04) .....	29
5. Action Plan to Upgrade PEM Capacity in Ethiopia.....	39
6. Overview of Technical and Donor Assistance in Public Expenditure Management in Ethiopia.....	42
7. Implementation Status of Actions to Strengthen Tracking of Poverty-Reducing Public Spending .....	43
Box	
1. Budget Management at Subnational Levels .....	9

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### Abbreviations and Acronyms

AAP	Assessment and Action Plan
BDA	Budget Disbursement and Accounting System
BIS	Budget Information System
BoFED	Bureau of Finance and Economic Development (Regional)
CAD	Central Accounts Department (Federal)
CBDS	Capacity Building for Decentralized Service Delivery (World Bank project)
CBE	Commercial Bank of Ethiopia
CFAA	Country Financial Accountability Assessment
CIDA	Canadian International Development Association
COFOG	Classification of Functions of Government
CPAR	Country Procurement Assessment Report
CPR	Council of the Peoples' Representatives (Federal)
CSRP	Civil Service Reform Program
DPCC	Disaster Prevention and Preparedness Commission
DSA	Decentralized Support Activity
EBF	Extrabudgetary Fund
EFY	Ethiopian Fiscal Year
EMCP	Expenditure Management and Control Program
ESRDF	Ethiopian Social Rehabilitation and Development Fund
FGE	Federal Government of Ethiopia
GFS	Government Finance Statistics
IDF	Industrial Development Fund
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
MCB	Ministry of Capacity Building
MDGs	Millennium Development Goals
MoEd	Ministry of Education
MoFED	Ministry of Finance and Economic Development
MTEF	Medium-Term Expenditure Framework
NDPPF	National Disaster Prevention and Preparedness Fund
NGO	Nongovernmental Organization
OFA	Office of the Auditor General
OFED	Office of Finance and Economic Development (Wereda)
PEM	Public Expenditure Management
PEP	Public Expenditure Program
PETS	Public Expenditure Tracking Survey
PIP	Public Investment Program
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
PSCAP	Public Sector Capacity Building Program
RF	Road Fund
RGA	Regional General Auditor
SDPRP	Sustainable Development and Poverty Reduction Program
SNNP	Southern Nations Nationalities and Peoples Region
UNCITRAL	United Nations Commission on International Trade Law

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## I. INTRODUCTION

**Bank/Fund staff carried out a comprehensive assessment of the public expenditure management (PEM) systems of Ethiopia in 2001.** The objective was to appraise how well existing systems tracked poverty-reducing spending in the context of the Enhanced HIPC Initiative. The Executive Boards of the IMF and World Bank have called for tracking *all* poverty-reducing spending, and not merely that financed from debt relief.<sup>2</sup> Only in this way can a country track increases in public spending on poverty reduction. Ethiopia has defined poverty-reducing spending in its Sustainable Development and Poverty Reduction Program (SDPRP).

**The 2001 assessment was based on 15 benchmarks covering budget formulation, execution, and reporting.** Overall, Ethiopia met 6 benchmarks—3 covering budget formulation, 1 budget execution, and 2 budget reporting. In relation to 23 other countries also assessed at that time, Ethiopia fulfilled slightly fewer benchmarks than average. It was viewed as requiring “substantial upgrading” of its PEM systems. Accordingly, the assessment identified a number of actions aimed at achieving this goal in the short and medium term, to be supported by different development partners.

**Ethiopia is implementing a number of PEM reforms embedded in its original action plan.** The staff review in March 2003 showed that Ethiopia had implemented or initiated a number of measures in the action plan.<sup>3</sup>

**The Executive Boards of the World Bank and the IMF have requested another comprehensive assessment.** Such a reassessment should help determine progress made in strengthening PEM systems since 2001. Well-functioning PEM systems should contribute to reducing reporting requirements by donors and provide assurance to both domestic taxpayers and development partners that funds are being used for their intended purposes. They also enhance efficiency in the use of public resources. Given the need to sustain donor support for achieving the MDGs by 2015, a strengthening of PEM systems in the short to medium term is critical.

**This assessment indicates that Ethiopia now meets 7 benchmarks, compared with 6 in 2001.** Improvements in two areas are of special note. First, the comprehensiveness of budget formulation and fiscal reporting has improved through the incorporation of extrabudgetary funds into consolidated general government fiscal reports. Second, the classification of expenditures has been strengthened through the development and dissemination of a new and improved chart of accounts.

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<sup>2</sup> This is because resources are fungible, and a country can offset HIPC assistance earmarked for poverty reduction by lowering its spending in those areas. See “Actions to Strengthen the Tracking of Poverty-Reducing Public Spending in HIPC,” SM/02/03, Revision 2, March 2002.

<sup>3</sup> “Update on Implementation of Action Plans to Strengthen Capacity of HIPCs to Track Poverty-Reducing Public Spending,” SM/03/90, March 11, 2003.

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**The latest assessment reveals, however, that the lack of timely fiscal reporting is a key concern.** The delay in reporting actual spending (as opposed to estimates based on disbursements) is having adverse effects on several aspects of PEM. First, it leads to long delays in auditing the fiscal accounts and reporting them to the Council of Peoples' Representatives (CPR). Secondly, it hampers the management of fiscal policy within the year, owing to the absence of reliable data on the evolution of spending. In this context, delays in the reporting of actual outlays for poverty-reducing activities are of special concern. Fiscal decentralization has been an additional obstacle to accelerate the pace of fiscal reporting. With the consolidation of the decentralization process now complete, rapid progress should be possible in this area.

**This second comprehensive assessment was prepared by the IMF and the World Bank, in collaboration with the Ethiopian authorities.** The mission is grateful to the authorities for their excellent cooperation and assistance in preparing this assessment.

## II. ASSESSMENT

**The high level of decentralization of government spending in Ethiopia makes the tracking of poverty-reducing spending an inherently difficult task.** The recent decentralization of budgets from regions to weredas has also complicated this activity, especially in light of the poor level of capacity in the latter. About one-third of all general government spending and roughly half of poverty-reducing outlays are now devolved to the local governments. This assessment, therefore, also covers the PEM systems at subnational levels.

**The assessment is organized in terms of 16 indicators.** Seven indicators are in the area of budget formulation, four each in budget execution and reporting, and one in procurement (Table 1). The last one is new and has been added since the last assessment. The discussion on each indicator is followed by an action plan to strengthen PEM systems, drawn in part from the government's Expenditure Management and Control Program (EMCP). It is envisaged that these actions could be reflected in the government's Public Sector Capacity Building Program (PSCAP), which serves as a vehicle to help coordinate the contribution of different donors to the government's reform agenda.

**The assessment is based on the functioning of PEM systems at the present time.** On the basis of ongoing reforms, some of these benchmarks could be achieved in the near future. The effective coordination and support provided by PSCAP provides further optimism regarding the outlook for improving PEM systems. At the same time, it is important to maintain the gains that have been recently achieved, such as the incorporation of the Extrabudgetary Funds (EBFs) into fiscal reports.

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Table 1. Public Expenditure Management AAP Indicators in Ethiopia

		Assessment		
		Standard Benchmark	2001 Assessment	2003-04 Assessment
<b>Formulation</b>				
<b>Comprehensiveness</b>				
1	Fiscal reporting adequately covers the Government Finance Statistics definition of the general government sector	A	B	A
2	Government activities are not funded through inadequately reported extrabudgetary sources to a significant degree	A	A	A
3	Budget outturn data are quite close to the original budget	B	B	C
4	Fiscal reports include grants projected to be provided by donors	A	B	B
<b>Classification</b>				
5	Budget expenditures are classified on an administrative, economic, and detailed functional or programmatic basis	B	C	B
6	Poverty-reducing expenditures are clearly defined	A	A	A
<b>Projection</b>				
7	Multi-year expenditure projections are integrated into the budget formulation process	A	B	B
<b>Execution</b>				
<b>Internal Control</b>				
8	There exists a small stock of expenditure arrears, with little accumulation of arrears over the previous year	A	A	A
9	Internal control is effective	A	B	B
10	Tracking surveys are in use, or are unnecessary	B	C	B
<b>Reconciliation</b>				
11	Satisfactory reconciliation of fiscal and banking records is undertaken routinely	A	B	B
<b>Reporting</b>				
<b>In-Year Reporting</b>				
12	Internal fiscal reports are received within four weeks of the end of the relevant period	B	B	C
13	Good-quality classification of poverty reducing spending is reflected in the in-year budget reports	A	A	B
<b>Final and Audited Accounts</b>				
14	Routine transactions are entered into the main accounting system (s) within two months of the end of the fiscal year	A	B	A
15	An audited record of the financial outturn is presented to the legislature within twelve months of the end of the fiscal year	B	C	C
<b>New</b>				
<b>Procurement</b>				
16	The procurement system supports efficiency and effectiveness in the expenditure of public funds through clear and enforceable rules that promote competition, transparency and value for money.	A		B
<b>Total number of benchmarks met</b>			6	7
<b>Note: Shaded cells indicate where the assessed indicator meets or exceeds the standard benchmark level.</b>				

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<b>Total n</b>				
<b>Note: Shaded cells indicate where the a</b>				

**Indicator 1: Coverage of the budget or fiscal reporting entity.**

**Question:** *How well does the coverage of fiscal information match the Government Finance Statistics (GFS) definition of the general government sector?*

**Benchmark:** *(A) Very close fit: Fiscal reporting covers the GFS definition of the general government sector, i.e., including central, regional, and local governments, and all government operations, whether funded through the budget or not.*

**Assessment:** *(A) Very close fit. The recent inclusion of EBFs has significantly improved the coverage of fiscal accounts.*

**This benchmark is met.**

**All relevant general government institutions are covered in the Federal Government of Ethiopia (FGE)'s quarterly fiscal reports.** Prior to this year, the Ministry of Finance and Economic Development (MoFED)'s quarterly reporting did not capture the major EBFs, and was based on federal budgetary institutions and regional government operations (including those of the weredas). The operations of the major municipalities are also included. Since November 2003, MoFED has been compiling quarterly fiscal reports that incorporate the major EBFs.

**The omissions in the quarterly reports are related to small municipal governments.** Based on information collected by the mission, these municipalities account for around ½ a percentage point of the consolidated budget.

**Until recently, municipalities were not included in the fiscal reports.** Many of these were set up more than half a century ago, and have been bypassed in the decentralization that occurred in the mid-1990s. The largest municipality is that of Addis Ababa, whose budget accounts for more than half of all municipal spending. According to the authorities, the major municipalities (including Addis Ababa) are now being incorporated into the fiscal reporting system.

**Municipalities, along with the existing urban weredas, are currently in the process of being transformed into city governments.** Some of them will be entitled to receive formula-based transfers from the regional governments.<sup>4</sup> The Ministry of Federal Affairs is preparing regulations on the administration of city governments, which have been approved

<sup>4</sup> The legal framework and expenditure assignments for towns and municipalities are being developed and rolled out across regions.

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by MoFED. These regulations are largely in line with current subnational financial practices in the country and provide for the utilization of the recently adopted chart of accounts. Nevertheless, there is room for improvement, especially regarding fiscal reporting to regions, which should be mandatory.

**EBFs provide summarized quarterly reports to MoFED on their revenues and disbursements.** These are included in the consolidated general government reports prepared and circulated by the Economic Policy and Planning Department of MoFED. In the case of the Road Fund (RF), where beneficiary institutions are themselves federal or regional bodies, the actual use of disbursements from the RF are not reported to MoFED by those bodies, which could lead to some discrepancies. The RF beneficiaries, the Ethiopian Roads Authority and Regional and Municipal Road Authorities, do not report their accounts financed by the RF. Rather, they only report the operations that are funded directly from the budget.

**MoFED's quarterly fiscal reports are disseminated within the government.** These reports are submitted to and approved by the Macroeconomic and Monetary Committee and sent to the Council of Ministers and the Council of Peoples' Representatives twice per year.

**In summary, the coverage of general government in the quarterly consolidated fiscal reports is close to 100 percent.**

*The benchmark is met.*

#### **Action Plan**

##### *Short-term measures*

- Review and amend draft regulations on city government finance administration. This should be done with a view to ensuring adequate fiscal reporting requirements from city governments to their regions, and to tighten borrowing conditions to ensure overall macro-fiscal stability and conformity with FGE regulations.

##### *Medium-term measures*

- Provide technical assistance to city governments to ensure the effective adoption and implementation of the new city government regulations.

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### Box 1. Budget Management at Subnational Levels

**Public spending began to be devolved in Ethiopia in 1994.** The legal framework was defined in the new Constitution adopted in 1993, in which the nine regional governments and two city administrations were established. In 2002, a second stage of decentralization was undertaken to the level of weredas in four regions.

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**There are three principal levels of local government.** The highest level comprises relatively well-staffed regional governments (Afar, Amhara, Benishangul Gumuz, Gambella, Harari, Oromiya, Somali, Southern Nations and Nationalities Peoples (SNNP), and Tigray) and two city administrations (Addis Ababa and Dire Dawa). Each region has its own elected parliament. Regions are divided into weredas, the number of which varies from region to region. Four regions (Amhara, Oromiya, SNNP, and Tigray) have now decentralized to the wereda level. Each wereda has its own elected council. The staffing levels of weredas varies considerably, from reasonably well staffed to very poorly staffed. The lowest level is the kebele, which generally have a very small number of employees devoted largely to administrative tasks. Federal taxes, which comprise the bulk of taxes collected in Ethiopia, are shared with regions in the form of a block grant system. Decentralized regions provide block grants to their weredas. Regions collect some taxes, as do weredas to a more limited extent. Kebeles also collect very limited taxes from the local population that they serve. Most regions have retained an intermediate level between regions and weredas, called zones. Most zones are administrative arms of the regional government, except in the case of SNNP, where they have been constituted as an additional level of elected government.

**Budget Planning.** Both regions and decentralized weredas prepare annual budgets which are subject to approval by their respective elected bodies. On the whole these are not framed in a medium-term context, although a start has been made in SNNP on a three-year rolling Public Expenditure Program. Projects developed at the regional level are funded through the capital part of the federal block grant system to the regions. Regional planning capacity varies from region to region, but on the whole capacity is limited.

**Budget Execution.** Budget execution is decentralized to sector bureaus (e.g. for health, education, agriculture, etc.) in both regions and decentralized weredas. Regional Bureaus of Finance and Economic Development (BoFEDs) disburse funds to sector bureaus, which prepare monthly accounts which the BoFEDs consolidate on a monthly basis. Wereda Offices of Finance and Economic Development (OFEDs) have a similar arrangement in most regions. Wereda sector bureaus are still responsible for preparing monthly accounts, which they send to BoFED through zones, where these exist. Local governments operate a significant number of bank accounts. At the regional level, each sector bureau may have one or more bank accounts, for recurrent and, where they have them, projects. The BoFEDs may also have several bank accounts for budget, revenues, donor funds, and projects. Decentralized weredas have either two bank accounts under the control of the OFED, one for recurrent, and one for capital, or they maintain individual bank accounts for each sector. Cash planning is still in the very early stages of development in regions and weredas.

**Accounting and Reporting.** Monthly accounting reports are consolidated in wereda OFEDs and sent upwards with varying time lags, from a few days to well over a month. OFEDs also send a summary fiscal (flash) report to the BoFEDs, which is then consolidated and sent to the federal MoFED for general government reporting. These flash reports also suffer from varying delays. Under the new accounting procedures, accounts include a bank reconciliation. The new accounting procedures are still being rolled out in the regions and weredas. The functional/COFOG dimension of expenditures is provided at a very aggregated level equivalent to the first level of COFOG. BoFEDs also consolidate the regional sector bureau accounts, and send a summary of these, along with the wereda flash report, to MoFED.

**Independent Audit.** Under the new Constitution, each regional government has its own General Auditor (RGA), answerable to the regional parliament. Capacity problems exist in the audit function at the regional level, which are being addressed through a capacity-building program under the Federal Auditor General (OFA). The OFA does not have jurisdiction over regional accounts, although according to federal regulations, the OFA may audit the use of the federal grant to regions. The RGAs audit the wereda accounts.

***Indicator 2: Degree of spending being funded by inadequately reported extrabudgetary sources.***

***Question:*** *To what degree are general government activities funded through inadequately reported extrabudgetary sources?*

***Benchmark:*** *(A) Not significant: Government activities are not funded through inadequately reported extrabudgetary sources to a significant degree (3 percent or less of total spending).*

***Assessment:*** *(A) Not significant. Although EBFs control a significant share of general government resources, they are regularly reported to MoFED and included in consolidated fiscal accounts.*

***This benchmark has been met.***

**All seven extrabudgetary funds are incorporated into the quarterly consolidated fiscal reports prepared by MoFED.** These are: Road Fund (RF); Industrial Development Fund (IDF); National Disaster Prevention and Preparedness Fund (NDPPF); Privatization Fund, which is only an account to receive the proceeds from the sale of public enterprises (from which funds are appropriated in the budget on an annual basis); Fuel Price Stabilization Fund; Pension and Social Security Fund; and Ethiopian Social Rehabilitation and Development Fund (ESRDF) (external credit and grant components only).

**EBF expenditures for Ethiopian Fiscal Year (EFY) 2003/04 are projected at 2.6 billion birr, or 11.0 percent of the consolidated budget.** As already mentioned in the discussion under indicator 1, the revenues and disbursements of these funds are captured in MoFED's quarterly reports.

**Looking forward, some of these funds could be eliminated or transformed into actual budgetary institutions.** Apart from the Pension and Social Security Fund, the EBFs were essentially set up in the past with a view to guaranteeing a stable source of revenues for specific priority programs. Even though Ethiopia's priorities may change over time, there is a tendency to keep such institutions, especially as they have been established by special laws, and have proved successful in earmarking revenues for selected programs. Over time, however, earmarking has led, in some cases, to the accumulation of significant surpluses (over Birr 1 billion in the case of the Road Fund), which cannot be used by the Treasury for other more urgent needs. If they were eliminated or converted into budgetary institutions, the programs they finance would have to compete for the limited budgetary resources alongside other programs of government, with ultimate allocations being set according to the priorities of the government.

**Budget institutions with their own revenues report on these receipts and include them in their budgets.** While there is no evidence that these institutions are underreporting such revenue, periodic audits of their activities may be needed to ensure compliance.

**In summary, although the aggregate government resources controlled by EBFs are significant, they are routinely included in government consolidated fiscal reports and therefore the benchmark is met.**

**Action Plan**

*Medium-term action*

- Review the need for EBFs and evaluate the possibility of transforming them into budgetary institutions.

**Indicator 3: Reliability of budget as a guide to the future.**

**Question:** How would you describe the level and composition of the budget outturn at an administrative or functional level relative to the original budget's appropriations?

**Benchmark: (B)** Budget data are quite close to the original budget.

**Assessment: (C)** Not close.

**This benchmark is not met.**

**Deviations in spending at the aggregate level are not large.** On average, outturns for aggregate general government spending (excluding special funds and EBF outlays and interest payments) deviated from the budget by 12.9 percent over FY2000/01 to FY2002/03 (figures calculated from Tables 2 and 3). Deviations have been most pronounced at the regional level (over 20 percent).<sup>5</sup>

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**Given delays in fiscal reporting, it is difficult to assess accurately the variability of spending by sector.** Because some donor-related capital spending cannot be properly booked to specific sectors until the accounts are closed, preliminary figures for actual spending by sector—especially for poverty-reducing activities heavily supported by donors—are well below the budget. All of the general government data in Table 2 are based on preliminary figures, as the last year for which accounts have been closed is 1999/00.

<sup>5</sup> Estimates based on data for 2000/01 and 2001/02.

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**Keeping this caveat in mind, spending by sector shows substantial deviations relative to the budget.** Table 3 measures the variation in spending by sector, aggregating capital and current spending where possible for sectoral categories. The unweighted average deviation of spending for the 17 categories of outlays was over 60 percent. On a weighted average basis, the average deviation was greater than 20 percent. Of special concern is the high deviation in poverty-reducing spending (education, health, roads, and agriculture).<sup>6</sup> At the same time, it is worthwhile to note that spending in some categories of outlays where foreign financing does not play a role—such as defense—are also prone to high deviations in outlays vis-à-vis the budget.

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**Data on spending outturns by sector exclude outlays on projects financed by external grants, contributing significantly to sectoral deviations.** Figures are available on the basis of original budget appropriations. This implies that outturn data will deviate significantly from the original budget. If the assessment is based on budget data excluding external grants, deviations are still significant, but lower. Improved reporting by donors, including NGOs, would facilitate the government's efforts to compile these data (see discussion on benchmark 4).

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**Weaknesses in budget preparation may also be contributing to deviations in actual spending from the budget.** At the aggregate level, coordination of the budget preparation process in MoFED is fragmented. At present, there are five separate departments in charge of the budget preparation in MoFED: four sectoral and one for consolidation. In addition, as noted in the discussion on benchmark 4, there is considerable uncertainty regarding how much donor-financed spending should be incorporated into the budget. At a more disaggregated level, line ministries consistently submit budgets that significantly exceed the initial budget ceilings that are given to them. As a result, the initial ceilings play little role in providing guidance on the level of resources that will eventually be allocated. The absence of a fully operational MTEF, and the lack of costing of initiatives in the PRSP, may also be contributing to difficulties in accurately preparing the budget. Weaknesses in budget reporting may also have an indirect effect on the ability to project donor-financed spending, including those financed by loans; because sectoral spending outturns are not known with certainty, it is difficult to use past experience as a guide for the future.

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<sup>6</sup> For further assessment of the deviations of actual spending from budget targets, see the World Bank's draft 2003 Public Expenditure Review.

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Table 2. Ethiopia: Preliminary Actual Spending vs. Original Budget by Sectors and Sub-Sectors, 2000/01–2002/03 (In millions of birr)

Descriptions	2000/01		2001/02		2002/03		Deviation <sup>1</sup>		
	Orig. Budget	Prel. act.	Orig. Budget	Prel. act.	Orig. Budget	Prel. act.	2000/01	2001/02	2002/03
<b>Total Expenditure</b>	<b>18132</b>	<b>15737</b>	<b>18428</b>	<b>16681</b>	<b>21150</b>	<b>17493</b>	<b>-13.2</b>	<b>-9.5</b>	<b>-17.3</b>
<b>Current Expenditure</b>	<b>12266</b>	<b>10441</b>	<b>11366</b>	<b>10550</b>	<b>12522</b>	<b>12376</b>	<b>-14.9</b>	<b>-7.2</b>	<b>-1.2</b>
<b>General Services</b>	<b>5998</b>	<b>5165</b>	<b>4905</b>	<b>4630</b>	<b>5215</b>	<b>4679</b>	<b>-13.9</b>	<b>-5.6</b>	<b>-10.3</b>
Organ of the State	400	462	411	464	503	540	15.7	13.1	7.4
Justice	134	129	183	207	192	190	-3.0	13.0	-1.6
Defence	4204	3307	3000	2610	3000	2341	-21.3	-13.0	-22.0
Public order & security	550	607	582	574	684	792	10.3	-1.4	15.8
General services	710	660	730	775	836	816	-7.1	6.2	-2.4
<b>Economic Services</b>	<b>1024</b>	<b>954</b>	<b>1224</b>	<b>1049</b>	<b>1402</b>	<b>1223</b>	<b>-6.8</b>	<b>-14.3</b>	<b>-12.8</b>
Agricuilt. & Natural Resource	650	636	781	675	859	730	-2.1	-13.5	-15.0
Trade & Industry	62	56	161	116	209	213	-9.4	-28.1	2.0
Mines & Energy	31	28	35	32	38	39	-8.8	-8.0	0.7
Tourism	18	12	15	13	17	22	-37.0	-11.2	31.6
Transport & communication	97	86	76	63	104	50	-11.1	-17.0	-52.2
Urban devt. & construction	113	106	120	119	134	139	-5.7	-0.8	4.1
Economic development studies	54	30	36	30	41	30	-44.8	-16.9	-27.0
<b>Social Services</b>	<b>2248</b>	<b>2231</b>	<b>2567</b>	<b>2800</b>	<b>3127</b>	<b>3183</b>	<b>-0.8</b>	<b>9.1</b>	<b>1.8</b>
Education & training	1608	1508	1868	1777	2275	2276	-6.2	-4.9	0.0
Culture & sports	32	36	33	57	61	52	14.4	72.9	-15.6
Public health	466	468	534	522	661	526	0.3	-2.2	-20.3
<b>Pension Payments</b>	<b>0</b>	<b>18</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>...</b>	<b>...</b>	<b>...</b>
<b>Interest &amp; Charges</b>	<b>1527</b>	<b>1080</b>	<b>1248</b>	<b>1005</b>	<b>1280</b>	<b>1219</b>	<b>-29.3</b>	<b>-19.5</b>	<b>-4.8</b>
Internal debt	749	575	669	572	686	625	-23.2	-14.5	-9.0
External debt	778	505	579	433	594	594	-35.1	-25.3	0.0
<b>Subsidies</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>...</b>	<b>...</b>	<b>...</b>
<b>Miscellaneous</b>	<b>491</b>	<b>15</b>	<b>623</b>	<b>61</b>	<b>596</b>	<b>230</b>	<b>-97.0</b>	<b>-90.3</b>	<b>-61.5</b>
<b>In-kind food aid</b>	<b>978</b>	<b>978</b>	<b>782</b>	<b>1006</b>	<b>902</b>	<b>1844</b>	<b>0.0</b>	<b>28.7</b>	<b>104.4</b>
<b>Capital Expenditure</b>	<b>5866</b>	<b>5296</b>	<b>7062</b>	<b>6130</b>	<b>8629</b>	<b>5117</b>	<b>-9.7</b>	<b>-13.2</b>	<b>-40.7</b>
<b>Economic development</b>	<b>3554</b>	<b>2983</b>	<b>3580</b>	<b>3330</b>	<b>4706</b>	<b>3342</b>	<b>-16.1</b>	<b>-7.0</b>	<b>-29.0</b>
Natural resources	786	362	603	300	894	300	-54.0	-50.3	-66.5
Mining & energy	109	400	39	375	108	526	266.4	869.3	385.7
Industry	54	19	78	5	63	33	-64.3	-94.2	-48.3
Trade and tourism	2	1	7	3	6	8	-59.1	-56.5	35.7
Road construction	1607	1318	1910	1527	2384	1572	-18.0	-20.1	-34.1
Transport & communications	424	304	374	329	183	141	-28.2	-12.2	-23.1
<b>Social development</b>	<b>1879</b>	<b>1044</b>	<b>1635</b>	<b>994</b>	<b>2267</b>	<b>1331</b>	<b>-44.4</b>	<b>-39.2</b>	<b>-41.3</b>
Education	900	606	958	540	1169	793	-32.8	-43.6	-32.2
Health	765	297	465	273	862	298	-61.2	-41.2	-65.4
Social welfare	17	5	22	7	13	10	-69.3	-66.1	-24.2
Culture & sport	19	8	20	11	23	20	-60.9	-46.6	-13.5
<b>General development</b>	<b>378</b>	<b>589</b>	<b>549</b>	<b>693</b>	<b>290</b>	<b>444</b>	<b>55.9</b>	<b>26.2</b>	<b>53.0</b>
<b>Compensation payments<sup>2</sup></b>	<b>56</b>	<b>7</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>-87.4</b>	<b>...</b>	<b>...</b>
<b>External assistance<sup>3</sup></b>	<b>0</b>	<b>673</b>	<b>1299</b>	<b>1113</b>	<b>1365</b>	<b>0</b>	<b>...</b>	<b>-14.3</b>	<b>-100.0</b>

Sources: Ministry of Finance and Economic Development and mission estimates. Data for 2000/01 are reported in the World Bank's draft 2003 Public Expenditure Review.

1/ Defined as the percentage difference between the preliminary actuals and the original budget figures: (prel. actual ÷ orig. budget - 1) x 100.

2/ To make historical figures consistent, compensation payments are registered under capital. In recent years, budget documents have categorized these outlays as recurrent.

3/ Estimate of unallocated project assistance.

Sources: Ministry of Finance and Economic Development and mission estimates. Data for 2000/01 are reported in the World Bank's draft 2003 Public Expenditure Review.

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3/ Estimate of unallocated project assistance.

Descriptions

**Total Expenditure**  
**Current Expenditure**  
**General Services**  
  Organ of the State  
  Justice  
  Defence  
  Public order & security  
  General services  
**Economic Services**  
  Agricuilt. & Natural Resource  
  Trade & Industry  
  Mines & Energy  
  Tourism  
  Transport & communication  
  Urban devt. & construction  
  Economic development studies  
**Social Services**  
  Education & training  
  Culture & sports  
  Public health  
**Pension Payments**  
**Interest & Charges**  
  Internal debt  
  External debt  
**Subsidies**  
**Miscellaneous**  
**In-kind food aid**  
**Capital Expenditure**  
**Economic development**  
  Natural resources  
  Mining & energy  
  Industry  
  Trade and tourism  
  Road construction  
  Transport & communications  
**Social development**  
  Education  
  Health  
  Social welfare  
  Culture & sport  
**General development**  
  Compensation payments<sup>2</sup>  
**External assistance<sup>3</sup>**

Sources: Ministry of Finance and Econo

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**General development**  
  Compensation payments<sup>2</sup>  
**External assistance<sup>3</sup>**

Deleted: External assistance<sup>3</sup>

Table 3. Ethiopia: Aggregate and Sectoral Deviations <sup>1/</sup>  
Preliminary Actual Spending and Original Budget

	2000/01	2001/02	2002/03
	(in percent)		
<b>Total primary expenditure<sup>2</sup></b>	<b>11.7</b>	<b>8.8</b>	<b>18.1</b>
<b>Simple average of selected sub-sectors</b>	<b>48.2</b>	<b>80.5</b>	<b>54.2</b>
<b>Weighted average of selected subsectors</b>	<b>22.9</b>	<b>19.5</b>	<b>27.1</b>
Agriculture <sup>3</sup>	21.4	9.5	36.4
Trade, industry, and tourism <sup>3</sup>	35.7	47.7	6.4
Mines and energy <sup>3</sup>	205.3	451.8	285.0
Transport and communication <sup>3</sup>	25.1	13.0	33.6
Education and training <sup>3</sup>	15.8	18.0	10.9
Health <sup>3</sup>	37.9	20.4	45.9
Urban dev., housing, and construction <sup>3</sup>	18.7	2.7	4.6
Culture and sports <sup>3</sup>	14.2	27.5	15.0
Labor and social welfare <sup>3</sup>	43.2	31.4	16.4
Organ of the state	15.7	13.1	7.4
Justice	3.0	13.0	1.6
Defense	21.3	13.0	22.0
Public order and security	10.3	1.4	15.8
General services	7.1	6.2	2.4
Economic development studies	44.8	16.9	27.0
Rehabilitation	281.4	663.3	356.3
Road construction	18.0	20.1	34.1

<sup>1/</sup> Source: Mission estimates based on data from Table 2.

<sup>1/</sup> Defined as the absolute value of  $(\text{Prel. Actual} \div \text{Orig. Budget} - 1) \times 100$ .

<sup>2/</sup> Excludes interest payments and related charges.

<sup>3/</sup> Includes both recurrent and capital expenditures.

**Total primary expenditure**  
**Simple average of selected sub-sectors**  
**Weighted average of selected subsectors**  
Agriculture<sup>3</sup>  
Trade, industry, and tourism<sup>3</sup>  
Mines and energy<sup>3</sup>  
Transport and communication<sup>3</sup>  
Education and training<sup>3</sup>  
Health<sup>3</sup>  
Urban dev., Housing, and construction<sup>3</sup>  
Culture and sports<sup>3</sup>  
Labor and social welfare<sup>3</sup>  
Organ of the state  
Justice  
Defense  
Public order and security  
General services  
Economic development studies  
Rehabilitation  
Road construction  
Source: Mission estimates

1/ Defined as the absolute value of  $(\text{Prel. Actual} \div \text{Orig. Budget} - 1) \times 100$ .  
2/ Excludes interest payments and related charges.  
3/ Includes both recurrent and capital expenditures.

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**Total primary expenditure**  
**Simple average of selected sub-sectors**  
**Weighted average of selected subsectors**  
Agriculture<sup>3</sup>  
Trade, industry, and tourism<sup>3</sup>  
Mines and energy<sup>3</sup>  
Transport and communication<sup>3</sup>  
Education and training<sup>3</sup>  
Health<sup>3</sup>  
Urban dev., Housing, and construction<sup>3</sup>  
Culture and sports<sup>3</sup>  
Labor and social welfare<sup>3</sup>  
Organ of the state  
Justice  
Defense  
Public order and security  
General services  
Economic development studies  
Rehabilitation  
Road construction  
Source: Mission estimates

1/ Defined as the absolute value of  $(\text{Prel. Actual} \div \text{Orig. Budget} - 1) \times 100$ .  
2/ Excludes interest payments and related charges.  
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**The deviation of spending outturns from the budget must be less than five percent in each of the three years to achieve a rating of “A” for indicator 3.** In addition, the average deviation at the sectoral level must be less than 10 percent in at least two of the last three years. The lowest evaluation, of C, would occur when the deviation from the budget is larger than 15 percent in two of the three years or the average deviation by sector is at least 20 percent in two of the three years. Performance between A and C would merit an evaluation of B, which corresponds to the benchmark.

***In light of the high deviations of spending at the sectoral level, Ethiopia falls into category C and thus misses the benchmark.*** The high variability of spending at the sectoral level underscores the need to better plan and execute line ministry budgets. It also points to the urgent necessity of improving fiscal reporting, especially for projects financed by donor grants.

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### **Action Plan**

#### *Short-term measures*

- Separate submissions within ceiling and additional requests subject to negotiation during budget discussions.
- Review the institutional arrangements for the planning and budgeting function in MoFED, with a view to identifying options that will enhance coordination and linkages in the budget process.

#### *Medium-term measures*

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- Restructure the budget function in MoFED in order to improve coordination and management of the budget preparation process.

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**Indicator 4: Inclusion of donor funds<sup>7</sup>**

**Question:** *Are donor funds included in central, state, and local governments' budget(s) and/or fiscal reports?*

**Benchmark:** *(A) All: Budgets and/or fiscal reports at all levels of government include, without exception, grants projected to be provided by donors, and the investment and recurrent expenditure of all multilaterals and bilateral donor-funded activities.*

**Assessment:** *(B) Incomplete.*

***This benchmark is not met.***

**Aid flows are incompletely captured in the fiscal data.** The recent World Bank Public Expenditure Review estimates that on average, only about 60 to 65 percent of aid received by the country is recorded in MoFED's fiscal reports. For the 2002/03 fiscal year, the budget shows US\$636 million both in project aid and budget support, whereas aid estimates based on donor information corresponded to about US\$ 1,050 million.

**The major sources of inconsistencies relate to the relatively high amount of aid received in kind, especially food aid, and to different forms of reporting by the donors.** The fact that donors often report on a commitment (rather than disbursement) basis, contributes to discrepancies between donor and FGE estimates of aid. In addition, donors often report using time frames that do not correspond to the Ethiopian fiscal year, or may report on aid amounts that cover several years, without disaggregating the spending for each year. Furthermore, in some cases, donors are not reporting their spending, or are not reporting on expenditure data in a format that facilitates their routine incorporation into the government accounts. In this regard, additional dialogue may be needed between donors and the government to identify the obstacles to timely reporting.

**The inclusion of donor-financed spending at the regional level may also be hindered by the disincentives to report such outlays.** In particular, since the federal grant formula reduces domestic transfers by the projected amount of foreign assistance, there is a heavy incentive for regions to underreport on these expected outlays at the time of budget formulation. This problem is especially acute for regional projects financed by in-kind grants, which are more difficult for the federal government to monitor than loan-financed projects.

**These uncertainties regarding the amount of donor funds received by the government are problematic.** The failure to include all donor-financed spending can lead to inefficiencies in the composition of government spending. For example, it is difficult to

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<sup>7</sup> This section draws substantially on the World Bank's draft 2003 Public Expenditure Review.

know whether the government should finance the purchase of textbooks when there is uncertainty regarding whether donors have already provided for this. Macrofiscal management is also made more difficult, as available information on how actual spending compares with what was budgeted is distorted.

**Shifting the composition of donor assistance towards direct budget support would significantly alleviate these difficulties.** Direct budget support now accounts for 30 percent of donor assistance, compared with just 5–6 percent two years earlier. Through the SDPRP process, donors can now provide input into the government’s poverty reduction strategy and support this strategy through this direct budget support, which is fully captured in the fiscal accounts.

**Better reporting by Nongovernmental Organizations (NGOs) on their operations will also facilitate more complete data, particularly from those NGOs that support government programs.** In this context, the Disaster Prevention and Preparedness Commission (DPPC) has recently made progress on improving this information flow from NGOs.

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**There have been recent moves on the part of some donors to deal directly with regional governments.** While this may provide donors with a more direct interface with beneficiaries of their assistance, it is essential to maintain some oversight at the level of MoFED to ensure that complete information on aid flows is reflected in the fiscal reports. To this end, a review of current responsibilities regarding the authority to negotiate with donors should be made to ensure that MoFED is always kept firmly in the loop. Given the incentives noted above to underreport on this spending, these direct dealings with regions may further exacerbate the challenges to comprehensive fiscal reporting.

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*This benchmark is not met.*

### **Action Plan**

#### *Short-term measures*

- Reach agreement with all donors on a standard expenditure reporting form, consistent with the FGE chart of accounts. Include the requirement to report using the standard expenditure reporting form in all new donor financing agreements. Special emphasis should be placed on ensuring that donors improve their reporting of grant-financed projects destined for regional governments.
- Evaluate the “aid platform approach” for use in MoFED to capture all donor-related spending.
- Improve the MoFED’s ability to accurately estimate all donor inflows and their destinations, through closer coordination with the National Bank of Ethiopia, supervising ministries, and donors.

- Evaluate progress under the DPPC and evaluate whether additional steps are needed to improve reporting by NGOs.

*Medium-term measure*

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- Strengthen regulations governing MoFED approval for all donor financing agreements and issue directives for their effective application.

***Indicator 5: Classification***

***Question:*** *What types of classification apply to the budget and budget expenditures?*

***Benchmark: (B)*** *Administrative, economic, and functional (to subfunctional level) or administrative, economic, and programmatic basis.*

***Assessment: (B)*** *Budget expenditures are classified on an administrative, economic, and programmatic basis.*

***This benchmark is met.***

**Since the 2001 assessment, major improvements have been made in budget and accounting classifications.** The new classifications were rolled out to the FGE in 2001 and used for the EFY95 (2002/03) budget. The classification was subsequently rolled out to five regions accounting for about 87 percent of total regional spending in 2003 and these have been used for their EFY96 (2003/04) budgets. As such, the new classification system covers about 94 percent of general government spending (excluding the extrabudgetary funds). All government spending units covered by the new chart of accounts, as well as the extrabudgetary funds, report on actual spending using the program classification. Plans are already in place to roll the classifications out to the remaining regions, a task that is expected to be completed in 2006/07. The roll out in the regions includes roll out to weredas. EBFs have not, so far, adopted the new classifications, although there is now an obligation for them to report to MoFED using the new classifications.

**The new classifications include institutional, sector and sub-sectors, programs, activities and projects, and economic/object/input classifications.** The economic/object/input classifications cover revenue, expenditure, and financing, and are closely based on the GFS 1986 framework. Institutional classifications include both agency and sub-agency. The program classification covers both recurrent and capital expenditures and allows for a consistent aggregation of spending in these categories. Programs are specific to agencies. Program classification is reported in Volume 1 of the federal budget document.

**So far, the MoFED has not adopted a functional classification,** although given the detail available for programs, activities, and projects, the assignment of functional codes would not

present specific difficulties. In the meantime, the authorities use their sector/sub-sector classifications to track “functional” expenditures, although the level of aggregation is not sufficient for a detailed analysis of spending. Sub-sectors are equivalent to the first level of the UN’s Classification of Functions of Government (COFOG).

One option open to the authorities is to introduce functional classification (e.g. COFOG) which can be mapped to existing programs, activities, and projects. This will involve an initial effort at both federal and regional levels, following which the flash reporting can be modified to include at least second-level functional codes. However, capacity constraints, especially at the wereda level, will have to be carefully considered before moving forward on this.

**One potential difficulty that has arisen is the inconsistent use of program coding between federal and regional governments.** This could make it difficult to consolidate by program across all levels of government. This problem is recognized by the authorities and solutions are currently being sought. The problem is particularly compounded by the grouping of functions within an agency at the regional level, which in the case of the federal level are separate agencies.

*In brief, the new classifications include institutional, programmatic and economic classifications, and **therefore the benchmark is met.** The addition of functional classification will enable the authorities to upgrade to the top rating.*

### **Action Plan**

#### *Short-term measures*

- Identify extent of program coding differences between regions, and between federal and regional budgets, and assess options to ensure consistent coding across general government to facilitate consolidation and analysis.
- Adopt the COFOG functional classification for standardized analysis and reporting of budgetary expenditures. In the initial phases, it may only be possible to produce COFOG functional data for the spending of the federal government and the regions using the new chart of accounts. Given that over 90 percent of general government spending is covered by the new chart of accounts, it would clearly be worthwhile to implement this reform as soon as possible.

#### *Medium-term measures*

- Roll out the new chart of accounts, and associated Budget Information System (BIS) and Budget Disbursement and Accounting (BDA) system computerization, to the remaining regions, weredas, and city governments in line with the EMCP strategy.

- Issue, if required, directives to ensure consistent coding of programs across general government to facilitate consolidation and improved analysis.

***Indicator 6: Identification of poverty-reducing spending***

***Question:*** *What is the principle means for tracking poverty-reducing spending?*

***Benchmark: (A)*** *Use of the existing budgetary classification system through a so-called Virtual Poverty Fund: Poverty-reducing expenditures are clearly identified in the budget.*

***Assessment: (A):*** *The existing budgetary classification system is used to identify poverty-reducing spending.*

***This benchmark is met.***

**The definition of poverty-reducing spending is very broad in Ethiopia.** This includes all spending on education, health, roads, agriculture, and water. Both investment and recurrent spending under each of these categories are identified as poverty-reducing in the SDPRP. According to the annual SDPRP of December 2003, these outlays will average about 19 percent of GDP during 2003/04-2005/06 under the baseline scenario. The existing budgetary classification system is used to identify poverty-reducing spending.

**The lack of disaggregated data by subfunction is an obstacle to tracking a more refined definition of poverty-reducing spending.** For example, if the Poverty Reduction Strategy Paper (PRSP) process were to result in a definition of poverty-reducing spending that was narrower, the current fiscal reporting system would be unable to measure these outlays. Improving the timeliness of accounting data, and aggregating by program or according to full COFOG functional classification, would be needed in this case.

***The benchmark is met.***

## **Action Plan**

### *Short-term measure*

- Disaggregate budgeted outlays for poverty-reducing spending, by federal government and for available regions, to at least the program level.

#### **Indicator 7: Integration of medium-term forecasts**

**Question:** *How would you describe the application of out-year estimates (medium-term) for spending?*

**Benchmark:** *(A) Integrated: Multi-year expenditure projections are integrated into the budget formulation process.*

**Assessment:** *(B) Macroeconomic projections exist, but they are too aggregated for effective use in detailed budget formulation.*

***This benchmark is not met.***

**Ethiopia prepares an annual macro fiscal framework with a horizon of three years.** This framework is used to set overall budget ceilings, as well as indicative ceilings, by sector, in the early stages of budget preparation. In principle, the preparation of the framework takes into account the new and ongoing policy initiatives envisaged over the three-year period. However the projections are made at a very aggregate level, and only the first-year ceiling is communicated to budget users in the circular letter.

**For the investment budget, FGE prepares a three-year rolling Public Investment Program (PIP).** The PIP is prepared with the involvement of the sector ministries, and is fully detailed down to the individual project level. The first year of the PIP is incorporated into the annual budget, which does not show the outer years projections. Regional governments are not using the PIP. As such, there is no detailed coordination of investment plans by sector at the general government level, although the PRSP process does, to some extent, provide an opportunity to articulate the government's broad goals for investment spending in poverty-reducing activities.

**A more comprehensive Public Expenditure Program (PEP) was also considered for the FGE two years ago, but was not put into operation.** The PEP was designed to include both recurrent and investment expenditures, with a three-year horizon. The approach was not implemented as other reforms, such as the new chart of accounts, were considered more pressing at the time. The MoFED is currently reviewing its options for a medium-term expenditure framework, as demand for a more comprehensive and detailed expenditure

policy framework is being generated by recent initiatives under the Civil Service Reform Program (CSRP), led by the Ministry of Capacity Building (MCB).

**At the subnational government level**, medium-term expenditure frameworks are still in a very early stage of development. This year, SNNP has adopted the PEP approach, with assistance from the USAID-financed Decentralized Support Activity (DSA) project. This experience in SNNP is being closely watched by other regions, which may follow its example in the next few years. Budgets at the wereda level are formulated as a purely annual exercise.

**Finally, the new chart of accounts introduced the notion of programs in the budgetary structure.** So far, this process has resulted in the identification of programs, very few of which have been adequately developed with objectives, results, and outcomes. Programs have therefore remained of limited use, and do not play a significant role in the preparation or execution of the budget. Their use, therefore, in the development of medium-term forecasts is not widely practiced. Key related reforms are underway under the CSRP, piloted by the MCB, which include the Strategic Planning and Management initiative, aimed at developing capacity in line ministries to design appropriate strategic plans with medium-term objectives and outputs, and the Service Delivery Improvement initiative, which focuses attention on the efficiency and cost effectiveness of government operations. These two key reforms must be closely linked to the program approach, initiated with the new chart of accounts implemented in 2002/03, if they are to be successful. In particular, the strategic plans and service delivery choices must be fully compatible with available resources and be fully reflected in budgetary allocations.

**In summary, while the MoFED has an operational macrofiscal framework, which provides indicative budget ceilings at a highly aggregate level, it has yet to implement a suitable medium-term expenditure framework.** The framework, at present, does not allow the government's policies to be translated into clear budgetary allocations. In subnational governments, medium-term expenditure frameworks are still at their initial stage of development in one region.

*The benchmark is not met.*

### **Action Plan**

#### *Short-term measures*

- Identify and adopt a medium-term expenditure framework for both recurrent and investment expenditure for the FGE, fully linked to the CSRP initiatives.
- Review the MTEF options for regional governments that will ensure that they prepare their budgets in the context of a medium-term framework. Adopt a common approach for all regions and prepare an action plan for its rollout over the next few years.

*Medium-term measures*

- Develop output-based program/performance budgeting methodology to ensure that programs become the main focal point for translating government policies into budgetary allocations. Reflect program objectives, results and outcomes, and indicators by which to measure them, in the annual budget documents.
- Provide support to regions to develop their medium-term expenditure forecasting capacity.

***Indicator 8: Evidence of budget execution problems–Arrears***

***Question:*** *What do you estimate as the level of the stock of expenditure arrears at the end of last financial year?*

***Benchmark:*** *(A) Very few or none: Small stock of expenditure arrears, with little accumulation of arrears over the previous year.*

***Assessment:*** *(A) Very few or none: There are no significant instances of arrears in Ethiopia.*

***This benchmark is met.***

**Ethiopia does not have any significant arrears.** The budgetary system, in particular the discipline imposed, and exercised, during budget execution, prevents the build-up of arrears. The absence of arrears is confirmed in both internal and external audit reports. This is the situation in federal, regional, and wereda governments.

**Although a commitment control system was introduced several years ago, budget institutions do not, on the whole, systematically record commitments in their vote control books.** This lack of commitment control can lead to the potential build-up of arrears, should the current discipline in budget execution be weakened in the future. Furthermore, the FGE avoids the potential build-up of arrears through domestic borrowing, mainly in the form of overdrafts at the National Bank of Ethiopia. Again, should this be tightened in the future, the government may face a situation where it is unable to fund the budget, and cutbacks late in the year may generate the build-up of arrears. Finally, it should also be noted that commitment control will significantly assist in cash-flow planning, which is the focus of a new initiative in the Treasury Department.

***The benchmark is met.***

## **Action Plan**

### *Short-term measure*

- Strengthen the use of the commitment control system by budget institutions by including commitments in their monthly reports to MoFED.

**Indicator 9: Effectiveness of the internal control system**

**Question:** *How would you describe the internal control system?*

**Benchmark:** *(A) Effective: Internal control is effective.*

**Assessment:** *(B) Partial.*

**This benchmark is not met.**

**Internal audit is underdeveloped in the FGE.** While the MoFED Inspection Department plays a critical investigative role when problems are identified in financial management, other aspects of internal audit are less satisfactory. Line ministry internal auditors have been largely focused on ex-post verification of all transactions. This high level of inspection helped ensure the integrity of financial transactions and compensated for some of the weaknesses inherent in the single entry accounting system in force until recently. So far, internal auditors have had little involvement in systems audits aimed at improving PEM processes within their respective ministries.

**Internal auditing is especially weak at the subnational level.** Bureaus of Finance and Economic Development (BoFEDs) of the regions also have their own internal auditing. Federal auditors do not validate payments made by regions, even though an increasing percentage of regional expenditure is funded through the federal subsidy, and FGE financial regulations stipulate that these should be fully accounted for. Some check is made on capital expenditures, but the ex-post verification of all transactions—which mitigated against the shortfalls of the single-entry system—is not practiced at the regional or wereda level. There are shortages of skilled personnel, resulting in unfilled vacant positions at both the federal and regional level. This is partly due to sharp differences in salaries with the private sector.<sup>8</sup>

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<sup>8</sup> For example, the salary for a mid-career auditor (10–12 years of experience) in the line ministries is less than 2,000 birr per month, while those with similar qualifications in the private sector would earn approximately three times this amount.

**The authorities have recognized the need to modernize the internal audit function and are moving towards system auditing.** In preparation for this, a manual delineating new procedures will be disseminated in 2004/05, supported by training at both the federal and regional level.

**The role of MoFED Inspection Department needs to be clarified in light of the new role that is envisaged for internal audit.** In addition to the valuable investigative role mentioned above, the Inspection Department also devotes considerable resources to annual ex-post auditing of FGE institutions. However, they may no longer need to carry out ex-post auditing of budget institutions, now that the external audit function has been strengthened. Furthermore, MoFED will need to retain an internal audit oversight capacity which will provide guidance, procedures, and training to line ministry internal auditors, and this function would best be performed by the Inspection Department.

*This benchmark is not met.*

#### **Action Plan**

##### *Short-term measures*

- Disseminate new manual on internal audit procedures in FY2004/05 and provide training at federal and regional level.
- Review and clarify the roles and responsibilities of federal and regional inspection departments in the context of the new internal audit function, and distinguish their activities from those of the external auditor.

##### *Medium-term measures*

- Implement system auditing as the main function of internal auditors beginning in FY2005/06.
- Implement redefinition of roles and activities of inspection departments.

**Indicator 10: Tracking surveys are in use**

**Question:** *Is internal control supplemented by public expenditure tracking surveys (PETSs) that follow funds to the ultimate service provider or beneficiary?*

**Benchmark:** *(B) Yes, PETSs have been tried, and are in the process of becoming a regular feature of the PEM system, or an alternative PEM system that can reliably track resource transfers is being put in place.*

**Assessment:** *(B) PETSs have been initiated in 2004.*

***This benchmark is met.***

**Progress has been made since the last assessment in designing and initiating PETSs and similar instruments.** As part of its ongoing 2004 Poverty Assessment, tracking surveys of school and health facilities are currently being undertaken and should provide the first systematic exercise with the PETS methodology. The relevant surveys have been completed in Amhara, and will soon be rolled out in Oromiya. It is anticipated that the findings from these surveys will be incorporated (and disseminated), *inter alia*, through the government's Annual Progress Report on the SDPRP before the end of the current fiscal year.<sup>9</sup> They will also be reported in the Health Country Status Report. Furthermore, a performance-tracking facility has been established (with financing under the CBDSD Project) to provide technical assistance for the development of expenditure tracking, input tracking, and client score cards.

**Benchmarking surveys will introduce a mechanism similar to PETS for measuring resource flows and performance.** As part of the implementation of PSCAP, the Government intends to launch annual wereda and municipal benchmarking surveys that capture data related to revenue, expenditure, and human resource management, as well as performance in select sectors. The surveys, which are under development, are intended to provide the basis for a nation-wide benchmarking system on the performance of local governments, including monitoring of resource flows and their implications for decentralized service delivery. The Government is committed to undertaking these benchmarking exercises each year under the PSCAP.

***This benchmark is met.***

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<sup>9</sup> A related exercise has been launched to help measure performance and resource flows for various activities, such as client report cards and business process reviews initiated as part of the Civil Service Reform Program (CSR). These exercises are rudimentary and will need to be significantly improved to more systematically capture data on resource flows or other inputs, as well as the outputs produced at the point of delivery.

## **Action Plan**

### *Short-term measures*

- Complete PETSs in health and education under the 2004 Poverty Assessment, and report their results in SDPRP Progress Report for 2004, and integrate results into poverty reduction strategy. Initiate PETSs in other priority sectors.
- Complete and disseminate results of wereda benchmarking exercise.

### *Medium-term measure*

- Develop domestic capacity to design and carry out PETSs.

#### **Indicator 11: Quality of fiscal information**

**Question:** *Is there a regular reconciliation of all government bank accounts (those held in the central bank and the commercial banks) with government accounting records?*

**Benchmark:** *(A) It occurs satisfactorily in a timely and routine way.*

**Assessment:** *(B) It occurs satisfactorily in most cases, but not in a timely way. There are significant delays in reconciling bank accounts with government accounting records, particularly at the wereda level.*

***This benchmark is not met.***

**The recently introduced double-entry accounting procedures prescribe the preparation of monthly accounts fully reconciled with bank accounts.** On the whole, budget institutions adhere to this regulation in preparing their accounts, as bank reconciliation is checked by MoFED/BoFED accountants before accepting the accounting statements. As such, reconciliation is fully satisfactory, as any discrepancy between the banking and accounting data must be addressed before accounts are accepted by the Central Accounts Department. However, budget institutions do not prepare their monthly accounts in a timely manner, as discussed in detail under indicator 12. In quite a few cases, the reports have been returned for corrections by the MoFED/BoFED, contributing to delays.

**Most budget institutions prepare their accounts manually, with little or no computerization.** Although the FGE has initiated an Integrated Financial Information Management System (IFMIS) project, experience elsewhere shows that, in its current configuration, it will take at least 3 years before it can be rolled out to all users. In the meantime, the MoFED has an operational budget disbursement and accounting system

developed specifically to meet Ethiopia's current accounting needs, namely the BDA system. With relatively little effort this system can be rolled out to all budget institutions within a reasonable timeframe. Use of the BDA system will help familiarize budget institutions with computerized accounting and will contribute significantly to improved timeliness in producing accounts. In addition, it will help compensate for some of the capacity constraints in accounting, by providing a tool that can be used by less skilled personnel. The choice of application to be used for the IFMIS project should also be carefully reviewed, given that the FGE has already made significant investment in its own applications, which a wide range of staff are now familiar with.

**One area where reconciliation is proving difficult is the recording of donor-financed payments, particularly those that are made offshore.** These are not recorded in a systematic and timely manner, which has led, in the past, to significant discrepancies between fiscal and monetary accounts. A recent intensive exercise was carried out to reconcile fiscal and monetary accounts at the federal level for FY2000/01 and FY2001/02, during which the most serious problem identified was the timing of recording of transactions in the accounts. This reconciliation exercise managed to reduce unexplained differences between fiscal and monetary accounts to a manageable level. Reconciliation of fiscal and monetary accounts at the regional level has not been undertaken, though discrepancies are likely to be less important.

**In summary, the accounting system in Ethiopia prescribes regular monthly reconciled accounts, though in practice a significant number of institutions fail to do so in a timely manner. In addition, discrepancies between fiscal and monetary accounts remain a matter of concern, which the authorities should continue to monitor closely. *The benchmark is not met.***

#### *Action Plan*

The need to improve the capture of donor financed transactions has already been dealt with under Indicator 4, and therefore action plan measures are not repeated here.

#### *Short-term measures*

- Introduce computerization for the preparation of accounts in budget institutions. The MoFED should urgently consider rolling out the BDA III double entry accounting system to all FGE institutions, at least as an interim measure pending the development and roll out of the IFMIS.
- Undertake a strategic review of the directions to be taken under the IFMIS project, in the light of existing computerization, investment, and training.

*Medium-term measure*

- Monitoring and periodic reconciliation of federal fiscal and monetary accounts should be maintained. Monitoring and reconciliation of regional fiscal and monetary accounts should also be initiated.

**Indicator 12: Regularity of timely internal fiscal reporting**

**Question:** *When are the budget-tracking reports from line ministries, other spending units and the treasury received by the central financial authority?*

**Benchmark: (B)** *They are received between two weeks and four weeks of the relevant period.*

**Assessment: (C)** *Most Addis Ababa-based FGE units submit their reports within one month, while most units outside Addis Ababa, as well as units with significant own revenues, are up to one year late. Reporting from regional governments is also subject to significant delays, due mainly to untimely reporting from weredas. Reporting on grant-financed projects is also incomplete.*

**This benchmark is not met.**

As discussed under Indicator 11, accounts are prepared, according to the regulations, on a monthly basis by each budget institution. However, timeliness remains a serious problem at both federal and subnational levels, with some being several months in arrears as shown in Table 4 below. The most common reason given for this lack of timeliness in preparing the accounts is lack of qualified staff. In addition, the recent rollout of the new chart of accounts and double-entry accounting procedures is also a cause for delays in some institutions. Finally, there is a general tendency to aim to clear all suspense account items before releasing the monthly accounts, which can contribute to significant delays.

Table 4. Situation of Submission of Monthly Accounts (EFY96/ 2003/04)

Government level	Number of reporting budget institutions	Accounts 1–2 months late	Accounts 3–6 months late	Accounts over 6 months late
Federal	165	49	28	28
Amhara region	26	15	3	
Amhara weredas	113	91	1	1

Sources: MoFED and Amhara BoFED, situations as of mid-March 2004.

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**The FGE institutions send their accounts to the Central Accounts Department (CAD) of MoFED.** While many budget institutions send their monthly accounts within one month of the end of the period, a significant number are not timely, with a few institutions being more than six months in arrears. This prevents the CAD from preparing a consolidated FGE

account within a reasonable (and useful) timeframe, making reliance on accounts as a basis for fiscal reporting impossible. Instead, the fiscal reporting relies on budget disbursements from the Treasury Department for in-year reporting, which is at best an approximation to actual expenditures, and can lead to significant differences when actuals are finally available.

**The practice in regional governments varies between regions.** In the Amhara region, which the mission visited, weredas send their monthly accounts to the zone offices of BoFED, which check, record, and compile the accounts. The monthly accounts are not, however, forwarded to BoFED for consolidation. In fact, BoFED only receives annual accounts from the weredas, through the zones, with a significant delay. Recently, weredas have been sending, separately, a summarized report to BoFED for the purposes of fiscal reporting. BoFEDs forward these to MoFED for national consolidation, from which quarterly general government fiscal reports are prepared for internal use, as well as reporting obligations to the IMF.

*The benchmark is not met.*

#### *Action plan*

The consolidation of accounting information on a monthly basis will provide a more realistic and reliable picture of fiscal data, and both the FGE and regional governments should aim to achieve this in a timely and comprehensive manner. It is recognized that a significant reason for delays is capacity in some FGE budget institutions and in weredas.

#### *Short-term measures*

- **Urgent measures** are needed to ensure the timely preparation of monthly accounts in all institutions. The FGE should identify which institutions consistently fail to meet the deadlines, and ensure that appropriate staff are recruited where this is the reason for delays. It should also identify and analyze the other causes for delays and undertake remedial actions to eliminate them. In the interim, assistance to those institutions with weak capacity, using for example a mobile team of accountants, should be provided as a matter of urgency.
- Regional governments should focus on those weredas that consistently fail to prepare their monthly accounts in a timely manner, and provide them with assistance, again in the form of mobile teams of accountants, until such time that appropriate staff are recruited.

#### *Medium-term measures*

- Once the issue of timeliness is redressed, fully reconciled monthly accounts should be consolidated in MoFED and BoFEDs, with a **delay of no more than one month**, and these data should be used as the basis for fiscal reporting.

- The government's accounting approach should be refocused to include regular reporting to senior management with appropriate time delays set to make accounting reports useful for in-year budgetary management.

***Indicator 13: Regular fiscal reports track poverty-reducing spending***

***Question:*** *What in-year reports are published for tracking budget expenditure by function?*

***Benchmark:*** *(A) Good quality functional classification or virtual poverty fund is presented.*

***Assessment:*** *(B): Functional data are presented in the in-year reports, but there are concerns with their quality.*

***This benchmark is not met.***

**Data on actual spending on poverty reduction is based on disbursements, rather than actual spending.** Due to the delays in submitting monthly and end-of-year accounts, spending figures on the basis of expenditure reports are not available. Thus, there are serious concerns regarding the quality of these data. Furthermore, it has been problematic to disaggregate spending on capital outlays by sector for poverty reduction financed by donor grants. Fiscal data have been reconciled with those from the balance of payments to provide an estimate of the total amount of these outlays.<sup>10</sup> As such, the recent IMF staff report table—which draws from MoFED data—does not provide a breakdown of poverty-reducing capital spending by sector.

**Without urgent attention to improve the timeliness of monthly accounts submitted by budget institutions, the quality of in-year fiscal reports is unlikely to be expanded in the short term.** Improving the timeliness of these data would allow them to be used for in-year fiscal monitoring. Furthermore, the richer level of detail of actual expenditure data, based on the new chart of accounts, would also facilitate the tracking of a more detailed definition of poverty-reducing spending, if one was so chosen in the PRSP.

***This benchmark is not met.***

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<sup>10</sup> For the past fiscal year, for example, this discrepancy was in the neighborhood of about 1 percent of GDP.

## **Action Plan**

### *Short-term measures*

- Provide annual reporting of poverty-reducing spending on the basis of actual expenditures, rather than flash reports based on disbursements.
- Disaggregate annual reports on poverty-reducing spending to at least program level, for federal government and regions that have adopted the new chart of accounts.

### *Medium-term measures*

- Provide full functional detail in in-year fiscal reporting, in particular for poverty-reducing expenditures, on the basis of actual expenditures.
- Prepare monthly consolidated poverty-reducing spending on the basis of actual expenditures.

***Indicator 14: Transactions are recorded in the accounts in a timely fashion.***

***Question:*** *What is the longest period between the end of the fiscal year and the routine booking of transactions?*

***Benchmark:*** *(A) Routine transactions are entered into the main accounting system(s) within two months after the end of the fiscal year.*

***Assessment:*** *(A) Routine transactions are entered into the accounting system within one month of the end of the year.*

***This benchmark is met.***

**Following the end of a financial year, annual accounts are kept open for a period of one month in both federal and subnational governments.** At the Federal level, the Treasury Department strictly controls all payments made during this complementary period. This is achieved by transferring all remaining balances to the main treasury account at the end of the financial year, forcing budget institutions to submit special requests to the Treasury for any outstanding payments. Similar arrangements are in force in regional governments.

**Although the recording of transactions are limited to one month after the end of the fiscal year, the preparation and submission of accounts remains a matter of serious concern.** End-of-year preparation of final accounts is straightforward when monthly accounts are presented on a regular basis. However, delays in monthly reports, as discussed

under Indicator 11, are significant, leading in turn to delays in preparing annual accounts. The current situation of the preparation of annual accounts is as follows:

- Federal level
  - EFY92 (1999/2000): accounts submitted to Auditor General mid-2003, and Auditor General report submitted to Council of Peoples' Representatives.
  - EFY93 (2000/2001): accounts completed except for final formatting, expected to be submitted to the Auditor General in the next month or so.
  - EFY94 (2001/2002): all FGE budget institutions have submitted accounts, although a few still have to complete corrections requested by CAD. Overall budget consolidation has to be finalized.
  - EFY95 (2002/2003): most FGE budget institutions have submitted their accounts, with 20 out of 174 institutions remaining (some of these have had their accounts returned for corrections).
  
- Regional level
  - EFY93 (2002/2001): all regions have submitted their accounts to CAD.
  - EFY94 (2001/2002): all regions, except Somali region whose accounts were returned for corrections, have submitted their accounts to CAD.
  - EFY95 (2002/2003): no regions have submitted their accounts to CAD.

**The above delays in compiling annual accounts are not satisfactory, although it represents an improvement from 2001, when annual accounts were 4–5 years in arrears.**

*The benchmark is met, given the strict adherence to the one-month complementary period, although the timeliness of submission of annual accounts remains a matter of serious concern.*

#### **Action Plan**

##### *Short-term measure*

- Clear the backlog in outstanding accounts and reduce the lag in submitting accounts to the Auditor General to six months after the end of the fiscal year.

##### *Medium-term measure*

- Envisage the preparation of consolidated general government accounts by the FGE, to be reviewed by the OFA, separately from FGE accounts.

***Indicator 15: Timeliness of audited financial information***

***Question:*** *How soon after the end of the relevant year is the audit report on the annual accounts (either short-form audit report accompanying the final accounts or as part of loi de règlement) presented to the public and/or the legislature?*

***Benchmark: (B)*** *An audited record of the financial outturn should be presented to the legislature within twelve months of the end of the fiscal year.*

***Assessment: (C)*** *Central government accounts are still submitted to the Auditor General with a lag of more than one year, despite recent efforts.*

***This benchmark is not met.***

**The Office of the Auditor General (OFA) of the FGE prepares an audit report within four months of receipt of the accounts from MoFED.** The audit report is then sent to the MoFED for comment within a delay of one month, following which the report is forwarded to the Council of the Peoples' Representatives (CPR).

**The accounts, however, are submitted to the OFA with a significant delay of two years.** This delay has been shortened in the last two years from a situation where the accounts were 3–4 years in arrears. The last accounts sent to the Auditor were for EFY92 (1999/2000), for which the audit report has already been finalized and submitted to the CPR.

**Regional governments submit their accounts to Regional General Auditors (RGAs), which have been established under the provisions of the Constitution.** The OFA provided technical assistance for the establishment of the RGAs, to which over half of the OFA staff of over 300 was transferred. The 11 RGAs have an average staffing level of 15 auditors, while the OFA now have a reduced staff of 189 auditors, plus 11 trainees. Staff retention has been difficult, particularly in RGAs, due to the salary levels compared to the private sector, and the recent creation of the Anti-Corruption Office has also taken staff away from the OFA.

**One of the complications of FGE external audit is that the federal Financial Regulations of 1996 stipulate that the FGE must provide an account of the block grants given to regional governments.** The CPR also insists on the FGE providing this account. This has created some confusion of what this account should, and can, consist of, since the block grant is one source of revenue of the regional governments, which are combined with their own revenues to finance their expenditures. Under the present arrangements, it is impossible to distinguish the source of federal grant financing in regional accounts. The OFA has justified their insistence on FGE reporting of regional use of block grants on the relatively weak state of regional RGAs, though in the medium-term they expect to be able to place more reliance on them to audit the regional accounts effectively.

**Another issue raised by the OFA regarding the financial regulations concerns the absence of a time delay on the FGE producing its accounts.** The regulations stipulate that MoFED must *'close its books as soon as possible'* while the same regulations stipulate that the OFA must complete its audit *'within 4 months of receipt'*. This oversight in the financial regulations implies that the FGE is able to delay the production of accounts without censure from either the OFA or the CPR.

**In addition to its regular compliance audits, the OFA has also started a number of performance audits.** In the current fiscal year, it has carried out five such audits focused mostly on procurement. The target organizations have been the Electricity Supply Company, the Environment Agency, the DPPC (which is responsible for early warning and food security), the Ethiopian Roads Authority, and Ethiopian Telecommunications Company.

**The OFA submits its audit report to the Minister of Finance for comment before forwarding it to the CPR one month later.** In its audit reports, the OFA has noted that accounts are incomplete and untimely, that some transactions are excessively high for the purchases being made, and wide variations exist between budgetary estimates and actuals.

The OFA has just started receiving technical assistance from the Canadian International Development Association (CIDA), which will focus on capacity building for the OFA and two regional government RGAs (Amhara and Benshangul-Gumuz).

***This benchmark is not met.***

#### ***Action Plan***

##### ***Short-term measure***

- The current backlog of accounts must be cleared as a matter of utmost urgency.

##### ***Medium-term measures***

- The financial regulations need to be reviewed to put a time limit on the FGE submission of accounts to the OFA.
- The provision in the financial regulations that requires the FGE to produce an account of utilization of the federal grants by regional governments needs to be more clearly interpreted as its current interpretation by the OFA and the CPR is impossible for the FGE to meet. The authorities should consider an interpretation that requires FGE to obtain extracts from the regional government accounts showing that they have recorded the grants as revenue in their books.

- Continued efforts should be made to improve capacity and staff retention in the government audit offices, particularly in the RGAs. In particular, the OFA should continue to strengthen its performance auditing capacity.
- Include audit of selected large government procurements as an integral component of the annual external audit process.

***Indicator 16. Efficiency and effectiveness of the public procurement system***

***Question:*** *To what extent does the public procurement system provide for efficient and effective use of public funds?*

***Benchmark:*** *(A) An efficient and effective public procurement system exists: The procurement system promotes efficiency and effectiveness in the expenditure of public funds through clear and enforceable rules that promote competition, transparency, and value for money.*

***Assessment:*** *(B): The procurement system operates in a weak governance environment and lacks controls.*

***The benchmark is not met.***

**The development of an adequate procurement system remains a work in progress.** The Country Procurement Assessment Report (CPAR), undertaken in 2002, and subsequent assessments made in the context of the Poverty Reduction Support Credit (PRSC) dialogue in 2003, indicate that the system is still hampered by weak accountability, poor capacity, and inadequate enforcement mechanisms. To address these weaknesses, a modern legislative and regulatory framework, the development of relevant human resources, and a robust audit system are needed. The urgency of these tasks is further underscored by wereda decentralization, given weaknesses in procurement practices in the regions and human capacity constraints at the wereda level.

**Substantial progress has been made in laying the groundwork for a new procurement framework.** Since the 2001 AAP, the Government has made progress in clarifying the legal and regulatory framework for public procurement, as well as institutional responsibilities of public bodies.<sup>11</sup> Specifically, a procurement code compliant with the United Nations Commission on International Trade Law (UNCITRAL) has been prepared for the federal level. Standard bidding documents and procurement procedures manuals are under preparation in parallel. In addition, MoFED has issued a directive decentralizing the

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<sup>11</sup>Additional efforts will be needed to ensure the consistency of the procurement code, the draft code of ethics for civil servants, and the manuals (under development) for the Anti-Corruption Commission.

procurement function to all federal budgetary institutions. Furthermore, in line with this policy of decentralizing the procurement function, the Government has decided to transform the Procurement Department in the MoFED into a regulatory directorate within MoFED, with the responsibility for oversight of the procurement function at the federal level.<sup>12</sup> Under the World Bank-financed CBDSD project, efforts are also underway to train staff in the new draft code as well as UNCITRAL principles and practices. The Government is also taking steps to “contract in” international expertise in procurement on an ongoing basis in order to enhance the capacity of officials involved in public procurement.

**Building on the federal level experience as a prototype, regional states are planning to launch complementary procurement reforms over the next year.** Efforts to more clearly define wereda and municipal level procurement responsibilities will be critical in this regard.

*The benchmark is not met.*

*Short-term measures*

- Implement UNCITRAL-compliant procurement code at the federal level and in four regions.
- Establish Regulatory Directorate in MoFED and in four regional BoFEDs.
- Train staff in the new procurement code at the federal, regional, and local levels.

*Medium-term measure*

- Implement UNCITRAL-compliant procurement code in remaining regions.

### III. STRENGTHENING PEM SYSTEMS IN ETHIOPIA

The elements of the Action Plan proposed above have been compiled in Table 5. In addition, Table 6 provides an overview of ongoing assistance on PEM in Ethiopia, while Table 7 indicates progress made in implementing the Action Plan agreed during the 2001 Assessment and Action Plan (AAP) exercise.

The Action Plan can be viewed as a roadmap for improving PEM. Areas that are considered of high priority are indicated in bold. If all the measures in the Action Plan are implemented, and there are no slippages in other areas, it could be expected that Ethiopia would be able to reach a greater number of benchmarks in any future assessment. Progress in implementing

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<sup>12</sup> While international experience suggests that the regulatory function should be governed by an arms-length relationship, the decision to establish such a body within MoFED is designed primarily to limit administrative costs and will be monitored closely.

these actions could be monitored as part of the joint Intergovernmental Fiduciary Assessments that have now become part of the annual PRSP process.

Table 5. Action Plan to Upgrade PEM Capacity in Ethiopia

It is understood that all PEM reforms are framed within the context of the EMCP sub-program of the CSRP of Ethiopia, and that TA delivery is now to be harmonized through the PSCAP plans at federal and regional levels. Where possible TA needs have been identified, these will need to be defined in the PSCAP plans in order to ensure coordination in implementation. (Actions in BOLD should be given high priority).

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Short-Term Measures (within next 12 months)						Medium-Term Measures (12 months to 3 years)				
No.	Action	Relates to Indicator	EMCP & PSCAP Reference	TA Provider	No.	Action	Relates to Indicator	EMCP & PSCAP Reference	TA Provider	
<b>Formulation</b>										
Comprehensiveness	1	<b>Review and amend draft regulations on city government finance administration, to ensure adequate reporting requirements from city councils for general government accounts, and to tighten borrowing conditions to ensure overall macro-fiscal stability and conformity with FGE regulations.</b>	1		Not required	24	Provide technical assistance to city governments to ensure the effective adoption and implementation of the new city government regulations.	1		PSCAP/pool GTZ CBDS/DWB
	2	Separate submissions within ceiling and additional requests subject to negotiation during budget discussions.	3 & 7		Not required	25	Review the need for EBFs and evaluate the possibility of transforming them into budgetary institutions.	2		TA to be defined
	3	<b>Review the institutional arrangements for the planning and budgeting function in MoFED, with a view to identifying options that will enhance coordination and linkages in the budget process.</b>	3		TA to be defined	26	<b>Restructure the budget function according to the chosen option from the review process.</b>	3		TA to be defined
	4	Reach agreement with all donors on a standard expenditure reporting form, consistent with the FGE chart of accounts. Include requirement to report using the standard expenditure reporting form in all new donor financing agreements. Ensure that donors improve their reporting of grant-financed projects destined for regional governments.	4		TA to be defined	27	Strengthen regulations governing MoFED approval for all donor financing agreements and issue directives for their effective application.	2		
	5	Evaluate 'aid platform approach' for use in MoFED to capture all donor-related spending.	4		PSCAP					
	6	<b>Improve the MoFED's ability to accurately estimate all donor inflows and their destinations, through closer coordination with the National Bank of Ethiopia, supervising ministries, and donors.</b>	4							
	7	Evaluate progress under the DPPC. In particular, evaluate whether additional steps are needed to improve reporting by NGOs.	4							
Classification	8	<b>Identify extent of program coding differences between regions, and between federal and regional budgets, and assess options to ensure consistent coding across general government to facilitate consolidation and analysis.</b>	5		TA to be defined	28	<b>Issue, if required, directives to ensure consistent coding of programs across general government to facilitate consolidation and improved analysis</b>	5		TA to be defined
	9	<b>Adopt COFOG functional classification for standardized analysis and reporting of budgetary expenditures.</b>	5 & 13		IMF (Statistics)	29	<b>Roll out the new chart of accounts, and associated BIS and BDA computerization, to the remaining regions, woredas, and city governments in line with the EMCP strategy.</b>	6		DSA project (USAID, Ireland, EU) PSCAP

Table 5. Action Plan to Upgrade PEM Capacity in Ethiopia (continued)

It is understood that all PEM reforms are framed within the context of the EMCP sub-program of the CSRP of Ethiopia, and that TA delivery is now to be harmonized through the PSCAP plans at federal and regional levels. Where possible TA needs have been identified, these will need to be defined in the PSCAP plans in order to ensure coordination in implementation. (Actions in **BOLD** should be given high priority).

Short-Term Measures (within next 12 months)						Medium-Term Measures (12 months to 3 years)				
	No.	Action	Relates to Indicator	EMCP & PSCAP Reference	TA Provider	No.	Action	Relates to Indicator	EMCP & PSCAP Reference	TA Provider
<b>Projection</b>	10	<b>Identify and adopt a medium-term expenditure framework for both recurrent and investment expenditure for the FGE, fully linked to the CSRP initiatives.</b>	7		<i>TA to be defined</i>	30	Develop output-based program/performance budgeting methodology to ensure that programs become the main focal point for translating government policies into budgetary allocations. Reflect program objectives, results and outcomes, and indicators by which to measure them, in the annual budget documents.	7		<i>TA to be defined</i> East AFRITAC PSCAP/WB GTZ
	11	<b>Adopt and implement a common medium-term expenditure framework methodology for the major regional governments, to be used in the preparation of their budgets.</b>	7		<i>TA to be defined</i> USAID/DSA	31	<b>Complete coverage of medium-term methodology to remaining regions. Provide support to regions to develop their medium-term forecasting capacity.</b>	7		<i>TA to be defined</i>
	12	Complete PETSs in health and education under the 2004 Poverty Assessment, report their results in the SDPRP Progress Report for 2004, and integrate them into the poverty reduction strategy. Complete and disseminate results of wereda benchmarking exercise. Initiate other priority sector PETSs.	10		WB/Poverty assessment CBDS GTZ	32	Develop internal capacity to design and carry out PETSs.	10		PSCAP/WB CBDS GTZ
<b>Execution</b>										
<b>Internal Controls and Reconciliation</b>	13	Strengthen the use of the commitment control system by budget institutions by including commitments in their monthly reports to MoFED.	8 & 9		Not required	33	<b>Implement system auditing as the main function of internal auditors beginning in FY 2005/06.</b>	9		Not required
	14	<b>Disseminate new manual on internal audit procedures in FY2004/05 and provide training at federal and regional levels.</b>	9		Ireland/PSCAP					
	15	Review and clarify the roles and responsibilities of federal and regional inspection departments in the context of the new internal audit function, and distinguish their activities from those of the external auditor.	9		<i>TA to be defined</i>	34	<b>Implement redefinition of roles and activities of inspection departments.</b>	9		<i>TA to be defined</i>
	16	<b>Urgently address the issue of untimely preparation of monthly accounts in federal and subnational institutions. Identify defaulting institutions and determine reasons for untimely submission of accounts. Provide interim support from mobile team of accountants, pending resolution of capacity problems.</b>	11, 12 & 13		<i>TA to be defined</i>	35	<b>Consolidate fully reconciled monthly accounts in MoFED and BoFEDs, with a delay of no more than one month, and use this data for fiscal reporting.</b>	11 & 12		Not required
	17	<b>Urgently consider rolling out the BDA III double-entry computerized accounting system to all FGE institutions, as an interim measure pending the development and roll-out of the IFMIS. Roll out the BDA III system to major regions.</b>	11 & 12		<i>TA to be defined</i> Regions - DSA project (USAID, Ireland, EU) CBDS	36	<b>Complete the BDA III roll-out to remaining regions. Refocus the government's accounting to include regular and timely reporting to senior management in order to make accounting reports useful for in-year budgetary management.</b>	11 & 12		Regions - DSA project (USAID, Ireland, EU) <i>TA to be defined</i>
	18	<b>Undertake a strategic review of the directions to be taken by the IFMIS project, in the light of existing computerization, investment, and training.</b>	11 & 12		<i>TA to be defined</i>	37	<b>Monitor and periodically reconcile fiscal and monetary accounts at both federal and regional levels.</b>	11		<i>TA to be defined</i>
						38	Provide full functional detail in in-year fiscal reporting.	13		Not required

Table 5. Action Plan to Upgrade PEM Capacity in Ethiopia (concluded)

It is understood that all PEM reforms are framed within the context of the EMCP sub-program of the CSRP of Ethiopia, and that TA delivery is now to be harmonized through the PSCAP plans at federal and regional levels. Where possible TA needs have been identified, these will need to be defined in the PSCAP plans in order to ensure coordination in implementation. (Actions in **BOLD** should be given high priority).

Short-Term Measures (within next 12 months)					Medium-Term Measures (12 months to 3 years)					
	No.	Action	Relates to Indicator	EMCP & PSCAP Reference	TA Provider	No.	Action	Relates to Indicator	EMCP & PSCAP Reference	TA Provider
<b>Reporting</b>										
In-year Reporting	19	Provide annual reporting of poverty-reducing spending on the basis of actual expenditures rather than flash reports based on disbursements.	13		Not required	39	Prepare monthly consolidated poverty-reducing spending on the basis of actual expenditures.	6, 13		Not required
	20	Disaggregate annual reports on poverty-reducing spending, to at least program level, for federal government and for regions that have adopted the new chart of accounts.	6, 13		Not required					
Preparation of Final Accounts and Reporting	21	<b>Clear the backlog in outstanding accounts and reduce the lag in submitting accounts to the Auditor General to six months after the end of the fiscal year.</b>	14 & 15		TA to be defined CBDSD	40	Envisage the preparation of consolidated general government accounts by the FGE, to be reviewed by the OFA, separately from the FGE accounts.	14 & 15		TA to be defined
						41	<b>Review the financial regulations to put a time limit on the FGE submission of accounts to the OFA. Clarify and possibly amend the provision in the financial regulations that requires the FGE to produce an account of utilization of the federal grants by regional governments with a view to limiting the requirement to extracts from the regional government accounts showing that they have recorded the grants as revenue in their books.</b>	15		TA to be defined
						42	Include detailed audits of selected large government procurements as an integral component of the annual external audit process.			
						43	Continue to improve capacity and staff retention in the government audit offices, particularly in the RGAs. In particular, the OFA should continue to strengthen its performance auditing capacity.	15		
<b>New</b>										
Procurement	22	<b>Implement UNCITRAL-compliant procurement code at federal level and in four regions.</b>	16		Not required	44	Implement UNCITRAL-compliant procurement code in remaining regions.	16		Not required
	23	Establish Regulatory Directorate in MOFED and in four regional BOFEDs. Train staff in new procurement code at the federal, regional, and local levels.	16		PSCAP, CSRP/World Bank					

Table 6. Overview of Technical and Donor Assistance in Public Expenditure Management in Ethiopia\*

Donor/ Provider	Recent**/Ongoing Assistance by Major Project		Planned Assistance by Major Project	
	Description	Dates	Description	Dates
World Bank	Capacity building for decentralized service delivery - CBDSD	2003/04 - 2005/06		
	Public sector service delivery capacity building - PSCAP	2003/04 - 2008/09		
IMF/East AFRITAC	<i>TA on the federal grant formula</i>	Jan-Apr 2004	TA on cash management/regional level	2005
	TA on cash management / federal level	Apr-04	TA on the reorganization of MoFED	2005
			Program-based budget methodology	2005
			TA on aid management	2004
IMF	TA on government finance statistics	2004	Follow up TA on government finance statistics	2004/05
European Commission	PSCAP Implementation	2003/04 - 2004/05		
	IFMIS	2002/03 - 2005-06		
	<i>Municipal leadership program</i>	2003/04 - 2005/06		
UNDP	CSRP - Public sector reform support	2003/04 - 2004/05		
	Decentralization - Public sector reform support	2003/04 - 2005/06		
	<i>Urban management</i>	2003/04 - 2005/06		
USAID	New chart of accounts methodology	2003/04 - 2004/05		
	DSA - BIS/BDA systems/four major regions	2001/02 - 2003/04	DSA - BIS/BDA Systems/other regions	2004/05 - ?
CIDA	Capacity building of the Ethiopian Auditor General	2003/04 - 2005/06		
	<i>Support to Parliament capacity development</i>	2003/04 - 2005/06		
	<i>Regional administration support program</i>	2003/04 - 2005/06		
	<i>Enhancing development and governance</i>	2003/04 - 2005/06		
DFID	PSCAP preparation	2003/04	PSCAP implementation	2004/05 - 2005/06
	<i>CSRP - Freedom of information legislation</i>	2003/04	<i>CSRP - Top management systems</i>	2004/05 - 2005/06
			CSRP - Public financial management	2004/05 - 2005/06
DCI (Ireland)	CSRP-EMCP - support to internal audit function	2003/04	<i>PSCAP - federal grant formula</i>	2004/05 - 2005/06
	CSRP-EMCP - support to external audit function	2003/04 - 2004/05	<i>Parliament capacity building</i>	2004/05 - 2005/06
	CSRP-EMCP-DSA	2003/04 - 2005/06		
	<i>Support for the parliament information system</i>	2003/04		
Netherlands Embassy			Support for PSCAP implementation	2004/05 - 2005/06
Italian Cooperation			<i>UBCBP - Capacity building for the urban management reform in Addis Ababa and Dire Dawa</i>	2004/05 - 2005/06
German KfW			<i>UMCBP - Urban management capacity building program</i>	2004/05 - 2005/06
German GTZ	<i>UMDP/MMPDP - Municipal management and policy development program</i>	2003/04		
	<i>RDPP - Regional development and planning program</i>	2003/04		
* Drawn from recent PSCAP donor matrix.				
** Within the last 12 months				
Note: Activities shown in italics are likely to also have other components outside the PEM area.				

Table 7. Implementation Status of Actions to Strengthen Tracking of Poverty-Reducing Public Spending

No.	Actions	Timing (S/M) <sup>3</sup>	Status (FI/II/NS) <sup>2</sup>	Date Achieved	Comments
<b>Actions to strengthen budget formulation</b>					
1	Implement comprehensive budgetary classification at federal level, including training, and assessment of early experience.	S	FI	Mar. '03	As part of EMCP, the new classification system and chart of accounts have been completed in all FGE institutions.
2	Review intergovernmental relationships at federal, regional and woreda levels, including transfer mechanisms	S	II		Wereda level decentralization has been completed in four regions (Amhara, Oromiya, Tigray, and SNNP). Region-to-woreda block grants have been designed and implemented. Federal to regions block grant under review for FY 2004/05.
3	Adhere to financial calendar	S	II		FGE financial calendar has been adhered to for the last two years, although notification of the federal grant to regions has been late, with implication of late notification of block grant to weredas. Regional adherence to the financial calendar has been improved. Wereda adherence to the financial calendar has been mixed, but is improving.
4	Include all extrabudgetary funds and accounts, and food aid into the federal and regional budgets	S	NS		EBFs not yet included in budget documents, although information of EBFs now included in fiscal reports.
5	Consolidate federal and regional budgets (ex-ante), starting FY2002/03, at the beginning of the year.	S	FI	Sept. '03	MoFED produced consolidated budget for 02/03 after nine-month lag. Subsequently improved and reduced the lag to only three months following the end of the FY.
6	Link planning and budgeting (relate MEFF and PIP to annual budget)	S	II		FGE: The financial regulation issued (1996) and the new calendar explicitly requires the link between the MEFF, Public Investment Plan (PIP) and the annual budget. A more comprehensive PEP has not been implemented (see below).
7	Introduce two-year Public Expenditure Program (PEP) at the federal level.	S	II		PEP not implemented at FGE level. A three year public investment plan (PIP) in effect at the federal government level. A three-year PEP implemented in SNNP region.
8	Implement comprehensive budgetary classification at regional levels, including training	M	II		New budget and accounting classifications implemented in four regions (SNNP, Tigray, Amhara, and Addis Ababa). Roll-out to remaining regions on-going.
9	Include all donor activities into federal and regional budgets.	M	II		Though effort continued with increasing signing on of donors to harmonization around the SDPRP, a significant proportion (estimated at about 30 %) of aid remains outside the budget.
10	Introduce cost center budgeting at regional level	M	II	03 /04 FY	Cost center budgeting implemented in four regions with the roll-out of the BIS system.
11	Include all extrabudgetary funds and accounts, and food aid into the regional budgets	M	NS		Road Fund transfers and Food Aid remain outside of regional budgets.
12	Introduce three-year Public Expenditure Program at the federal and regional levels	M	II		See comment on action 7 above.

No.	Action
<b>Actions to strengthen budget formulation</b>	
1	Implement comprehensive budgetary classification at federal level and assessment of early experience
2	Review intergovernmental relationships at regional and woreda levels, including transfer mechanisms
3	Adhere to financial calendar
4	Include all extrabudgetary funds and food aid into the federal and regional budgets
5	Consolidate federal and regional budgets (ex-ante), starting FY2002/03, at the beginning of the year.
6	Link planning and budgeting (relate MEFF and PIP to annual budget)
7	Introduce two-year Public Expenditure Program (PEP) at the federal level.
8	Implement comprehensive budgetary classification at regional levels, including training
9	Include all donor activities into federal and regional budgets.
10	Introduce cost center budgeting at regional level
11	Include all extrabudgetary funds and accounts, and food aid into the regional budgets
12	Introduce three-year Public Expenditure Program at the federal and regional levels

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Table 7. Implementation Status of Actions to Strengthen Tracking of Poverty-Reducing Public Spending (Continued)

Actions to strengthen budget execution					
1	Review, and reform if necessary, the institutional and legal framework for control and internal audit.	S	II		Institutional and legal framework for internal audit and inspection under review, expected to be completed in 2004/05 at FGE level. Roll out to regions to follow.
2	Introduce cost center budgeting, double entry bookkeeping, modified cash (commitment) accounting, at federal level; design manuals and provide training.	S	FI		Cost center budgeting implemented at FGE level. Double entry accounting implemented in all FGE institutions. Computerization using BIS and BDA on-going.
3	Strengthen control and internal audit by training; development of manuals and work plans [and enforcement of existing regulations].	S	II		Preparation of internal audit manuals and related training started, to be completed during FY 2004/05. Systems audit under development as main internal audit responsibility.
4	Review procurement procedures	S	II		Legal and regulatory framework and institutional responsibility clarified and regulations prepared for adoption. Roll out to regions in planning stage.
5	Conduct a survey of the number of bank accounts at the federal and regional level	S	II		FGE accounts at the NBE surveyed and rationalization started. Banking arrangements in 4 regions with wereda decentralization have been modified, with general tendency towards single treasury account.
6	Reconcile monetary and fiscal accounts, starting with FY 2001/02.	S	FI	Dec. 03	As part of HIPC completion trigger, MoFED and NBE supported by TA from the IMF reconciled the 01/ 02 and 02/ 03 FY FGE accounts.
7	Strengthen control and internal audit by training; development of manuals and work plans [and enforcement of existing regulations] at regional level.	M	II		See action 3 under budget execution.
8	Conduct public expenditure tracking surveys.	M	II		Currently a number of surveys under way including as part of the 2004 Poverty Assessment, Client Report Card and business process survey as a bases of tracking performance at the point of service delivery in Addis Ababa. Other PETS currently being undertaken or planned, including wereda benchmarking.
9	Introduce cost center budgeting; modified cash (commitment) accounting, double entry bookkeeping, at regional level; design manuals and provide training.	M	II		Cost center budgeting and double entry accounting implemented in 4 regions, with roll out to remaining regions planned through end 2005.
10	Adopt and implement procurement code	M	II		New procurement manuals for decentralized procurement under preparation, to be implemented in 2004/05 in FGE institutions. Roll out to regions expected during 2004/05

Table 7. Implementation Status of Actions to Strengthen Tracking of Poverty-Reducing Public Spending (Concluded)

Actions to strengthen financial reporting					
1	Review the impact of reporting procedure on the quality of fiscal data, at the federal and regional levels	S	II		Significant efforts made to ensure more timely collection of fiscal data from FGE, regions and weredas. Data from EBFs and major municipalities also collected. Data currently based on disbursement information, pending improvements to the delivery of timely accounting data.
2	Clear backlog of accounts at federal level.	S	II		Accounts backlog reduced from 4-5 years to 1-2 years in both FGE and regions. Efforts to clear remaining backlog planned for 2004/05.
3	Improve reporting (timeliness and accuracy) of monthly reports from the federal and regional governments to MoFED.	S	II		Some improvement to backlog of FGE monthly accounts, as well as regions with decentralized weredas. Reforms are on-going.
4	Consolidate federal and regional budget outturns (ex-post), starting FY 2001/02, at the beginning of the year.	S	II		
5	CFAA to identify the strengths and weaknesses of the accountability systems and to develop, among other things, a strategy for strengthening accountability systems	S	FI	Apr. 03	CFAA carried out in 2002, final report issued 2003.
6	Prepare IFMIS pilot project for five federal agencies	S	II		IFMIS inception report completed. TA for IFMIS development under tender. Development expected to start in 2004/05. Project scope under review.
7	Review, and reform if necessary, the institutional and legal framework for external audit (including making the Auditor General independent).	S	II		The Auditor General is independent and accountable to the Parliament. The external audit project under EMCP so far developed a comprehensive manual in the area of financial audit and control audit, and training modules. Training in financial and control audit initiated for federal and regional auditors. Performance audit started.
8	Clear backlog of accounts at regional levels.	M	II		Accounting backlogs reduced in 4 regions, remaining regions expected to reduce backlogs during 2004/05.
9	Consolidate federal and regional budget accounts, at the beginning of the year	M	II		
10	Maintenance of uniform accounting system	M	II		A modified double entry cash basis of accounting system developed. This system has been implemented in all FGE institutions and rolled out in the SNNP, Tigray, Amhara regions and Addis Ababa administration.
11	Introduce IFMIS at the federal and regional levels	M	II		IFMIS project started. Development for FGE expected during 2004/05 with full roll out over several years.
12	Strengthen external audit by training; development of manuals; capacity building	M	II		External audit manuals and training on-going.
13	Development of audit and accounting professions.	M	II		External and internal audit professional associations established.

Actions to strengthen financial reporting	
1	Review the impact of reporting quality of fiscal data, at the fed
2	Clear backlog of accounts at fe
3	Improve reporting (timeliness a reports from the federal and reg MoFED.
4	Consolidate federal and region: post), starting FY 2001/02, at t
5	CFAA to identify the strengths accountability systems and to d things, a strategy for strengthen systems
6	Prepare IFMIS pilot project for
7	Review, and reform if necessar legal framework for external au the Auditor General independe
8	Clear backlog of accounts at re
9	Consolidate federal and region: beginning of the year
10	Maintenance of uniform accou
11	Introduce IFMIS at the federal
12	Strengthen external audit by tra manuals; capacity building
13	Development of audit and acco
N	
Actions to strengthen public procure	
1	
2	
N	

1/S - Short-term action (within 12 months of action);

M - Medium-term action;

2/FI - Fully implemented;

II - Implementation initiated;

NS - Not started.

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***Indicator 1: Coverage of the budget or fiscal reporting entity.***

***Question:*** How well does the coverage of fiscal information match the Government Finance Statistics (GFS) definition of the general government sector?

***Benchmark: (A) Very close fit:*** Fiscal reporting covers the GFS definition of the general government sector, i.e., including central, regional, and local governments, and all government operations, whether funded through the budget or not.

***Assessment: (A) Very close fit.*** The recent inclusion of EBFs has significantly improved the coverage of fiscal accounts.

***This benchmark is met.***