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October 28, 2014

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UPDATING THE PUBLIC EXPENDITURE AND FINANCIAL ACCOUNTABILITY (PEFA) INDICATORS – DRAFT FOR PUBLIC CONSULTATION

Dear Sir/Madam:

The International Federation of Accountants (IFAC) values the opportunity to comment on PEFA's consultation, *Updating the Public Expenditure and Financial Accountability (PEFA) Indicators – Draft for Public Consultation*.

Through its current membership of 179 professional accountancy organizations in 130 countries and jurisdictions, IFAC represents approximately 2.5 million accountants in public practice, industry and commerce, government, and education.

For many years IFAC has consistently promoted the need for enhanced transparency and accountability in the public sector, noting in particular the risk that a lack of transparency and accountability presents to the efficiency of capital markets, global financial stability, and long term sustainability.

Achieving the level of transparency and accountability necessary for effective public sector financial management requires the preparation and publication of high-quality financial information by the public sector. High-quality information assists and promotes better quality decision-making by governments and provides more meaningful information to the public.

IFAC refers to its October 2012 response to PEFA's consultation *Guidance Note on Sequencing PFM Reforms* and several recommendations made relating to the need for greater focus to be placed on the accounting systems and processes in the PEFA framework—including the importance of elements such as accrual-based financial reporting and budgeting as the aim for all governments—and for implementing the necessary institutional arrangements required to enhance public sector financial management.

IFAC believes these elements are an essential part of good public sector financial management, and are crucial when making assessments of jurisdictions' public sector financial management and improvements that might be made. There is a risk that, by focusing on a range of separate performance indicators, advances and progress will be somewhat fragmented. Jurisdictions might well focus on adhering to the indicators, rather than focusing on the overall picture of reliability and coherency in the underlying processes and systems.

Without sound accounting systems and processes, founded on acceptable accruals-based financial reporting framework and standards, the preparation of financial and other reports and key documents will potentially be based on ad hoc systems and processes. They will lack the essential discipline that exists and is available from the adoption and implementation of high-quality international standards, such as International Public Sector Accounting Standards (IPSASs), and from important institutional measures that promote transparency and accountability.

Furthermore, without a strong foundation and common base for all jurisdictions, the usefulness of the performance indicators is somewhat diminished, as comparisons of the robustness of public sector financial management arrangements across jurisdictions will be much less meaningful.

Responses to the consultation questions are provided in the appendix to this letter.

Please do not hesitate to get in touch if you have any questions, or require further clarification of the comments provided.

Regards,

Fayez Choudhury
Chief Executive Officer

APPENDIX

QUESTIONS FOR CONSULTATION

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QUESTIONNAIRE

1. In your opinion, are the following changes introduced in the draft updated indicator set relevant? Is the suggested formulation adequate? Please provide comments to support your opinion that could help us improve the draft version.

IFAC has chosen not to complete the entire table—provided with the consultation—that aims to elicit comments on all Performance Indicators (PIs) that have been revised. Instead, IFAC offers comments only on selected changes. In its answer to question 2 (below) IFAC offers comments and perspectives on a number of PIs, including several that are not included in the table of revisions.

	Comments
Replaced/restructured indicators	
PI-7	IFAC suggests that the description of the PI be clarified. It is not clear to IFAC how an assessment can be made of "non-reported" items. That is, the description mentions "off-budget" and "off-account", but it is assumed that the operations are still recorded or reported somewhere (other than in primary budget documents) for such an assessment to be made.
PI-14	The dimension assessment in PI-14—and assessments in some other PIs which use similar metrics—focuses on "*entities that contribute more than 75% of government revenue*" (or 50%), which, by definition, might result in situations where only a very limited number of entities are included in the dimension if a country has a large number of entities in total, but a small number of very large entities. Consideration might be given to using a metric that aims to include a larger number of entities; for example, "*all entities that individually contribute 1% or more of total government revenue and which, when considered with other entities (as required), cumulatively contribute more than 75% of government revenue*".

	Comments
Replaced/restructured indicators	
PI-15	The comment included in parentheses starting on the fifth line of the fourth paragraph of this PI description (i.e., "NB: this doesn't assume or imply an accrual based accounting system: the data and reports used for assessing this indicator are based on cash accounting") is not necessary. These arrangements would be the same whether accrual-based or cash-based reporting is used. The key difference is that with an accrual-based system the difference between the amounts levied and amounts received would be recorded as revenue, whereas using cash accounting only amounts received are revenue.

2. Are there other issues the draft version of the updated indicator set does not address or cover adequately? What are they? How could they be better addressed or covered?

IFAC offers the following comments:

(i) PI-25: Quality and timeliness of annual financial reports

IFAC is pleased to see the reference to IPSASs in the description of PI-25. Consistency of reporting across jurisdictions is important and can only be achieved through the global adoption and implementation of IPSASs, and PI-25 recognizes that IPSASs are the only globally recognized, high-quality, public sector financial reporting standards.

However, IFAC is of the view that an "A" score for this PI would indicate that a government had published a full set of accrual-based financial statements, prepared in accordance with high-quality reporting standards, such as IPSASs. As currently presented, it seems that an "A" score might be achieved by preparing financial statements using a cash-based or modified cash system. While IFAC recognizes that many countries are on a journey from cash-based accounting to accrual-based systems, it believes that there should be proper incentives for governments to strive for full accrual-based financial reporting. Accrual-based accounting standards ensure greater transparency and accountability in public sector finances as well as better monitoring of government debt and liabilities.

As such, an "A" score should be reserved only for those who have achieved this objective.

(ii) PI-26: Effectiveness of external audit

The discussion of external audit in this PI description appears to confuse an audit of financial statements with engagements that are designed to provide assurance on other forms of reporting—e.g., performance or compliance engagements, or a budget execution report or process. This is most evident in the fourth paragraph of the description, where "financial audit" seems to be a reference to an audit of financial statements.

IFAC suggests that the wording be revised to clearly delineate between audits—which are audits of financial statements—and other assurance engagements; this may also assist in providing greater clarity in PI-28, as well as discussion about the types of reports that are being scrutinized by the legislature. In addition, it would allow for references to be included to relevant assurance standards, such as the International Standards for Assurance Engagements (ISAEs) issued by the International Auditing and Assurance Standards Board (IAASB).

Finally, IFAC is pleased to see the reference to International Standards on Auditing (ISAs) which, as the footnote of page 48 of the consultation paper indicates, are the foundation for the International Standards of Supreme Audit Institutions (ISSAIs). However, the reference to IFAC in the second line of the third paragraph should be deleted; ISAs are issued by the IAASB, which is supported by IFAC, but which operates independently and has governance arrangements in place that protect the public interest and safeguard the independence of the standard-setting process.[1]

(iii) PI-6: Comprehensiveness of information included in budget documentation

The first of the basic elements in this PI description is “Forecast of the fiscal deficit or surplus (or accrual operating result)”. As per the comments above (point (i)) IFAC is of the view that an accrual-based operating result should be the goal of enhanced public sector financial management and reporting; hence, rather than having accrual-based reporting as an option, it should be seen as necessary for achieving an “A” score.

(iv) PI-9: Fiscal risk management

This PI reinforces the need for financial statements to be prepared on an accrual basis. It is important that not just contingent liabilities are assessed and disclosed, but that all liabilities for which the government is responsible are identified, reported, and considered as part of a government’s risk management arrangements. However, IFAC believes that risk management practices would be enhanced if it was a requirement that accrual-based reporting be adopted and implemented.

(v) PI-19: Transparency, competition and complaints mechanisms in procurement

The assessments for dimensions (i) and (iii) for this PI make the assumption that all of the criteria listed in both of the assessments are of equal importance, and hence should be given the same priority; however, dimension (iv) notes that one particular criteria (of the six shown) must be met for scores of “A”, “B”, or “C”. IFAC’s view is that all of the criteria included in dimensions (i) and (iii) are not of equal importance, and therefore suggests that consideration be given to determining and clearly identifying priorities for these criteria.

(vi) PI-22: Accounts reconciliation and financial data integrity

The first sentence of this PI description unfairly impugns the competency and integrity of accountants, by suggesting that “*reliable reporting of financial information requires constant checking and verification of the recording practices of accountants*”. The point that is being made in this PI—that there is a need to segregate duties between those who perform transaction processing and recording, and those who undertake account reconciliations—is valid. However, IFAC asserts that the statement is incorrect in so far as professional accountants are concerned and should be deleted from the description. Professional accountants who are competent and comply with ethical principles of

[1] Refer to Policy Position Paper 3 *International Standard Setting in the Public Interest*; and Global Knowledge Gateway Viewpoint *Shared Standard Setting in the Public Interest: A Strong Model*

integrity, objectivity, and professional behavior are a critical part of an internal control environment that produces high-quality financial information.

Additionally, reconciliations of suspense and clearing accounts should not merely focus on the timeliness of the clearance of items, but also the nature of the items themselves. For example, a person may be fraudulently using a suspense or clearing account by using it as a "float"; passing an entry to an account that is reconciled monthly on the first day of the month and clearing it on the last day of the month. The item, effectively, has been cleared in a timely manner, but the person committing the fraud may have invested the amount for that month and received interest thereon.

3. Could you share your views about the arrangements presented in the accompanying note to support comparability over time? Do you have any suggestions to complement these arrangements?

IFAC believes the arrangements presented in the accompanying note to support comparability over time are generally appropriate. However, it notes that the use of subjective assessments will always make direct comparisons difficult, unless there are very detailed prescriptions of how assessments are performed and/or if the same people are able to undertake the assessments. For example, the assessment for dimension (iv) of PI-16 requires a determination of whether budget allocations are done "in a transparent and predictable way", "a fairly transparent way", or "with some transparency". It is not clear what each of these assessments mean and, for example, where the "border" lies between, say, "fairly transparent" and "transparent".

Additionally, there are many "numeric" assessments with broad ranges that will require heavy reliance on qualitative assessments and descriptions to enable meaningful comparisons. For example, dimension (i) of PI-12 has assessments that relate to coverage of "at least 75%", "at least 50%" and "at least 25%". One jurisdiction moving from a "B" score (at least 50%) to an "A" score (at least 75%) might be moving from 51% to 95%; this is vastly different from a country moving from 74% to 76%. Clearly, the former country has progressed significantly more between the two assessments than the latter country.

Although comparisons are primarily being done across time and not necessarily between countries, readers of assessment reports will need to be sensitized to such differences to be able to reach appropriate conclusions. This highlights the potential need for appropriately worded qualitative assessments and discussions to assist readers in their understanding.

4. Could you share your views about the transitional arrangements presented in the accompanying note? Do you have any suggestions to complement these arrangements?

IFAC offers no comments or suggestions to complement the proposed transitional arrangements. However, it notes the importance of giving adequate consideration to differences between jurisdictions in establishing appropriate transitional arrangements.

5. Would you like to share any other comments on the draft updated indicator set?

IFAC offers no further comments with respect to the draft updated indicator set.

6. **Do you have any suggestions for the overall update of the framework, including, for example, the organization/grouping of the indicators, the format/content of the PFM Performance Report, the Summary Assessment, and the general guidance provided in the Framework booklet?**

As noted in the covering letter, IFAC is of the view that the PEFA framework should aim to have a greater focus on accounting systems and processes—including the importance of accrual-based financial reporting and budgeting as the aim for all governments—and on implementing the necessary institutional arrangements required to enhance public sector financial management. As well as its October 2012 response to PEFA's consultation *Guidance Note on Sequencing PFM Reforms*, IFAC refers to its Policy Position Paper 4, *Public Sector Financial Management Transparency and Accountability: The Use of International Public Sector Accounting Standards*, which covers in more detail many of the points raised in the October 2012 response.