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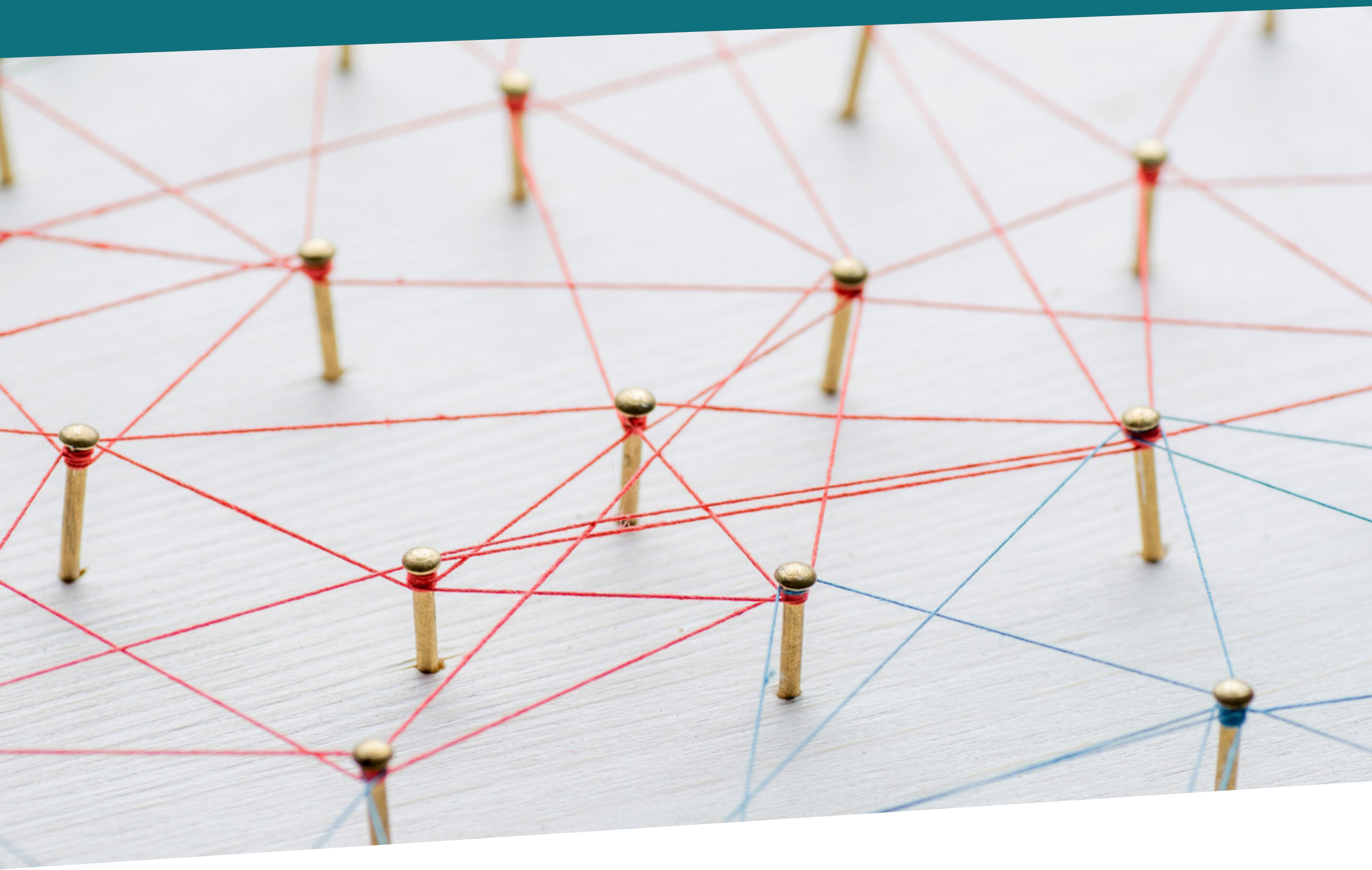
# Strengthening Budget Credibility through External Audits

## A Handbook for Auditors



United Nations | Department of Economic and Social Affairs

International Budget Partnership

# Strengthening Budget Credibility through External Audits

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The Department works in three main interlinked areas:

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ii. It facilitates the negotiations of Member States in many intergovernmental bodies on joint courses of action to address ongoing or emerging global challenges; and

iii. It advises interested Governments on the ways and means of translating policy frameworks developed in United Nations conferences and summits into programmes at the country level and, through technical assistance, helps build national capacities.

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The International Budget Partnership partners globally with budget analysts, community organizers, and advocates working to advance public budget systems that work for people, not special interests. Together, we generate data, advocate for reform, and build the skills and knowledge of people so that everyone can have a voice in budget decisions that impact their lives.

# Disclaimer



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# Chapter 1: Budget credibility and public financial management

**As countries increasingly focus on implementing policies in pursuit of the Sustainable Development Goals (SDGs), attention is often focused on the financing gap governments face in meeting their commitments. Not enough questions are being asked about the government's capacity to effectively manage and spend the resources that they already have – or say they have.[11]**

This chapter introduces the concept of budget credibility and provides an overview of the goals and processes of public financial management (PFM). After explaining how budget credibility is typically assessed, and reviewing recent research on the extent and determinants of credibility, this chapter also presents international standards and diagnostic tools relevant to budget credibility that auditors may find useful in their work.

## 1.1. What do we mean by "budget credibility"?

The standard definition of budget credibility refers to the government's ability to meet its revenue and expenditure targets during the fiscal year. These targets should be explicit in the budget that is approved by the legislature and enacted into law.[12] When government spending deviates from the approved budget, this action is described as:

- Underspending: if actual spending is less than what was allocated in the budget, or

[11] Paolo de Renzio, Jason Lakin, and Chloe Cho, 2019. Budget Credibility Across Countries: How Deviations are Affecting Spending on Social Priorities, IBP. at https://internationalbudget.org/publications/budget-credibility-across-countries/
[12] See the International Budget Partnership's Fact sheet on budget credibility

- **Overspending:** if actual spending is greater than what was allocated in the budget.

A country's budget may be underspent or overspent overall – i.e., in aggregate – or within a specific area or sector of the budget (e.g., in agriculture, education, defense, etc.), or both. When shifting of spending among sectors occurs after the approval of the budget, the composition of the budget is changed, and in such a case, compositional budget credibility is affected. Thus, theoretically, a national budget could be credible in the aggregate, while its compositional spending is significantly off. (See Figure 1.5 at the end of this chapter for an example of deviations in sector spending.)

Measurements of the extent and prevalence of budget credibility in Section 1.3 and the international standards and assessment tools presented in Sections 1.4 and 1.5 are all built around this definition of budget credibility. In Chapter 2 and in other parts of this handbook, however, the discussion also looks at ways auditors can assess budget credibility more broadly to examine the many factors and risks that influence the attainment of credibility.

## 1.2. Public financial management (PFM) goals and processes

### What is PFM?

Public financial management (PFM) refers to the way governments manage public resources (both revenue and expenditure) to achieve the agreed-upon social and economic objectives of their country. It consists of processes defined by a broad set of rules and regulations that govern the management of public resources – i.e., revenue mobilization, the allocation of public funds to various activities, the actual expenditure on these items, and the accounting for spent funds.[13]

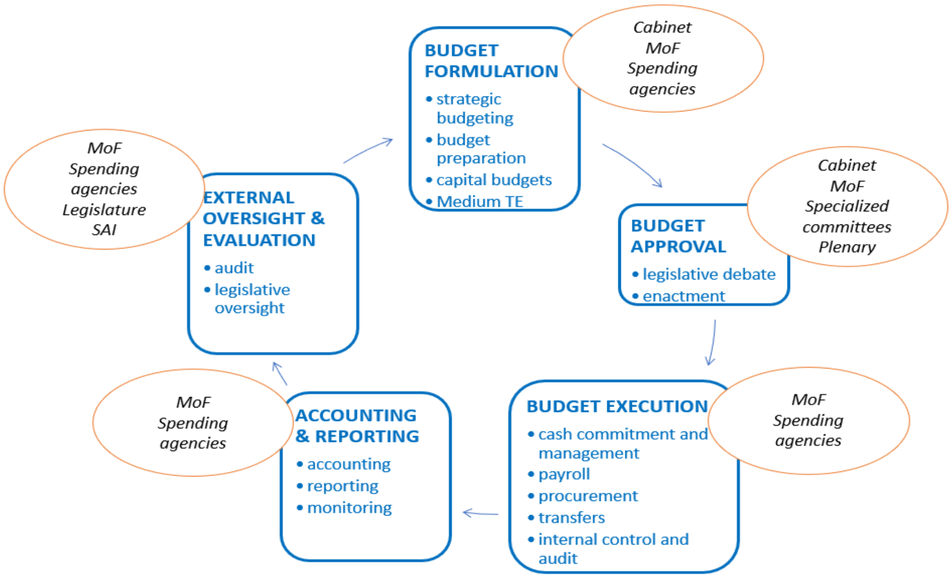
PFM systems are embedded in and influenced by the broader context of national institutions, bureaucratic systems and policy processes, which vary across countries. PFM comprises a variety of institutional arrangements. For example, while most countries have some form of external audit institution that checks the government's accounts, there are different models of Supreme Audit Institutions (SAIs) (judicial, collegiate/board, Westminster) with different mandates. Despite contextual differences, some processes in PFM systems are similar across countries, as described in the next section.

[13]Rebecca Simson, Natasha Sharma, and Imran Aziz, 2011. "A guide to public financial management literature. For practitioners in developing countries", December, London, Overseas Development Institute.
[14]Chapter 3 elaborates on the roles and responsibilities of the Ministry of Finance and the legislature.

## PFM processes and activities

PFM processes are commonly structured and described around the budget cycle. Each of the stages of the budget cycle can be further subdivided into key processes and activities that involve different stakeholders.[14] (Figure 1.1.)

**Figure 1.1. Overview of PFM processes and actors by stage of the budget cycle**




Source: A. Guillán Montero, 2023.

## Budget formulation

A new budget cycle begins with the government planning for the use of resources for the coming year. Many countries start the formulation of the budget with a strategic budgeting phase, also referred to as the "pre-budget phase," to ensure the budget is prepared with due regard to fiscal policies, strategic plans, and adequate macroeconomic and fiscal projections.[15] This involves translating policy goals into financial targets, given expected economic and social conditions. Revenue forecasts and expenditure estimations are produced. Many countries attempt to produce multi-year estimates, and some use this process to generate program or performance budgets. (Box 1.1.)

[15] Matt Andrews, Marco Cangiano, Neil Cole, Paolo de Renzio, Philipp Krause, and Resnaud Seligmann, 2014. "This is PFM," Center for International Development, Working Paper No. 285, July, Harvard University.

### Box 1.1. Program and performance budgeting

***Program budgeting*** is a method of organizing and classifying the budget according to programs with shared objectives.

***Performance budgeting*** introduces performance incentives through different approaches (e.g., considering performance objectives and indicators in the budgeting process). It is often introduced in combination with medium-term expenditure frameworks and usually draws on a program budget structure. (See also Box 6.6 on performance-based budgeting.)

Source: Simson, Sharma, and Aziz. 2011.

Budget preparation involves assembling and finalizing the budget proposal that will be submitted to the legislature, presenting revenue, expenditure, and financing plans for the entire government for the upcoming budget period. The budget proposal is usually produced on an annual basis and should contain, at least, the following elements: a macroeconomic framework and revenue forecast; a discussion of budget priorities, planned expenditure, and past outturns; a medium-term outlook; and details on budget financing, debt, and the government's financial position. Items in the budget proposal are classified according to the nature of financial flows.[16] Some countries use economic categories, others administrative units or specific functions and programs, and some actual performance.

Multiple entities participate in this process, but the Ministry of Finance plays a central role, producing projections and engaging with entities to assess their spending requests.

Each country's laws and regulations will specify how the budget documents should be prepared: by whom, by when (specified timelines), and with what content.[17] In accordance with international standards, budgets should be comprehensive, transparent, and realistic.

## Budget approval

Before the budget is approved, the budget proposal will be analyzed and debated in the legislature. Sometimes, the legislature will propose amendments. Amendment powers of the legislature vary across countries. The basis on which the budget is approved (e.g., by line item, program) is essential for accountability and reporting requirements and standards. The budget is ultimately enacted into law by the legislature, an action that subsequently authorizes the executive to raise revenue and spend resources.

[16] Simson, Sharma, and Aziz, 2011.
[17] The Fiscal Transparency Code: https://www.imf.org/external/np/fad/trans/Code2019.pdf

## Budget execution

Budget execution is the set of processes through which governments deliver on the proposals included in the budget.

**Expenditure control:** At this stage of the budget cycle, exerting tight and well-defined control over expenditure becomes the essential component of public financial management. Varying by country, the design of expenditure control can involve up to seven steps:[18]

1. authorization of expenditure;
2. apportionment of authorization for specific periods and spending units;
3. reservation of funds (less common);[19]
4. commitment of funds to all spending, including payroll and specific purchases;
5. verification (or certification) of deliveries;
6. payment order (authorization for specific payments); and
7. payment.[20]

Expenditure control frameworks differ greatly among countries – in terms of complexity, specific control measures, allocation of authority and responsibility, degree of centralization, and more – and the variation is largely influenced by administrative traditions.
A major challenge is how to manage the flow of resources to ensure that funds are available in time to meet payment obligations while preventing arrears accumulation, reducing the need for government borrowing, and maximizing returns on cash balances. Many governments use a single treasury account where all government revenue is deposited before its allocation for expenditure purposes,[21] while others manage public funds over separate bank accounts.

Governments typically use significant resources to pay the personnel costs of the civil service and to purchase goods and services. Therefore, PFM systems include processes for the procurement of goods and services as well as processes for human resource management, i.e., the payment of wages and salaries, benefits, and pensions for civil servants.

**Managing changes to the approved budget mid-cycle:** The Ministry of Finance is responsible for monitoring and managing any in-year budget reallocations due to unforeseen circumstances or other factors. Substantial changes to the budget should require a budget supplement or another prescribed arrangement to obtain legislative approval.

*"The budget should be implemented as formulated and authorized with as little deviation as possible, but there should be room to adjust to changing circumstances (e.g., genuinely unexpected events) by modifying the budget as necessary during the year. Budget modifications during the year are done according to legally prescribed processes (e.g., virements, contingency reserves, and supplementary/revised budgets), transparently, and in a way that promotes governments' chosen objectives."* [22]

[18] Sailendra Pattanayak, 2016. Expenditure Control: Key Features, Stages, and Actors. IMF Technical note. p. 6-8. See https://www.imf.org/external/pubs/ft/tnm/2016/tnm1602a.pdf
[19] Some countries (e.g., Spain, Portugal, and France) include this stage to reserve funds for a specific known expense for which no legal commitment has been issued yet.
[20] Simson, Sharma, and Aziz, 2011.
[21] Andrews et al., 2014.

In countries where PFM rules allow executives greater leeway during budget implementation without legislative oversight, significant under or over-spending is possible and can affect the delivery of goods and services. (Box 1.2)

### Box 1.2. Setting strict legal limits on adjustments to approved budgets

The Public Expenditure and Financial Accountability (PEFA) assessment (see Section 1.5) includes an indicator (#18.4) to determine whether there are "clear rules... for in-year budget adjustments by the executive... [and whether] the rules set strict limits on the extent and nature of amendments and are adhered to in all instances."

SAIs can play a critical role in monitoring and auditing whether the executive adheres to these rules during budget execution or not.

Source: PEFA Indicator 18.4, p 132: https://www.pefa.org/sites/pefa/files/news/files/16_08_30-Fieldguide_0.pdf

Internal control processes are designed to ensure compliance with established rules and procedures and the achievement of objectives. Internal audit provides information on areas of risk, where controls are lacking, and where failure to comply with management policies and rules may undermine the achievement of objectives.

## Accounting and reporting

This phase entails the internal recording, classifying, and summarizing of financial transactions to ensure compliance with budget rules and to demonstrate that public funds are used for their intended purposes.

While many countries still have cash-based accounting systems, where transactions are recorded only when cash is received or disbursed, others are transitioning to accrual-based accounting systems, which recognize transactions when they occur and thus record liabilities and assets.[23] Between these two, there are a variety of intermediate systems that incorporate elements of accrual accounting. The International Public Sector Financial Accountability Index tracks the distribution of countries using one accounting system or the other in their Global Impact Map.

[23] See the https://www.ifac.org/system/files/publications/files/IFAC-CIPFA-International-Public-Sector-Accountability-Index.pdf p 4.

## Box 1.3. Transition to an accrual-based accounting system in Tonga

**Tonga** is transitioning from a cash-based accounting system to an accrual system. This is an important step towards improving the country's budget credibility as it provides a more complete picture of the country's financial status by incorporating fair valuations of government assets and liabilities. The 2020 Public Accounts audit recommended systems and processes to facilitate this transition.

Source: Claire Kelly 2021, "Synthesis of findings for the Pacific SAIs", consultancy report for the budget credibility project.

Financial reports aim to improve compliance and enable the assessment of government performance. Compiling these reports entails extracting and presenting data from the accounting system in ways that facilitate analysis. Governments produce a variety of reports throughout the fiscal year and after the end of the budget period. There are international standards both for the production and publication of annual fiscal reporting.[24]

The need to monitor the results of expenditure has led to the establishment of government monitoring and evaluation systems that produce reports on financial and non-financial performance. Non-financial performance can be measured at the level of outputs, outcomes, and impacts. There are different tools, methods, and approaches for monitoring non-financial performance. Governments must define sound indicators and systems to keep track of their progress on policy goals, share this information with their citizens, and use the information to refine, adjust or plan accordingly.

### External oversight

Governments are required to submit their annual financial reports to independent bodies for external audit and accountability at the end of each budget cycle. SAIs play a critical role in providing oversight for the budget process. Depending on the type of SAI, they either report to the legislature or, if endowed with jurisdictional powers, may directly impose penalties or corrections. Information produced by SAIs can also be used by civil society and other stakeholders to promote accountability and remedial action.

## PFM system objectives

Traditionally, PFM systems are expected to support the achievement of three main objectives (Box 1.4):[25]

- Aggregate fiscal discipline: when aggregate levels of revenue and public spending are

[24] The Open Budget Survey assesses the extent to which each country makes eight key budget documents available to the public: pre-budget statement; executive's budget proposal; enacted budget; citizens budget; in-year reports; mid-year review; year-end report; audit report. See https://internationalbudget.org/open-budget-survey/
[25] PEFA (Public Expenditure and Financial Accountability) Secretariat, n.d. "Introduction: What is PFM and why it is important?", Washington D.C., PEFA Secretariat; Andrew Lawson, 2015. "Public Financial Management", Professional Development Reading Pack, No. 6, GSDRC; Mark Miller, Tom Hart, and Sierd Hadley, 2021. "Public finance and service delivery. What's new, what's missing, what's next?" ODI Working Paper 607, London, Overseas Development Institute.

consistent with targets for the fiscal deficit and do not generate unsustainable levels of public borrowing.

- Allocative efficiency: where public resources are allocated to agreed strategic priorities and reallocated from lesser to higher priorities.
- Operational efficiency: when maximum value for money in the delivery of services is achieved.

## Box 1.4. Institutional arrangements to support traditional PFM objectives

### Aggregate fiscal discipline

- Overarching fiscal rules are set in place.
- Limits on total spending are established before individual spending bids are considered.
- Total spending must be consistent with these limits.
- Limits are set for the medium term and budget decisions are made within a medium-term expenditure framework.

### Allocative efficiency

- Spending limits are established for sectors or portfolios, and ministers are encouraged to reallocate within these limits.
- Bids to reallocate must be based either on evaluative findings of program effectiveness or on plans to evaluate policy initiatives.

### Operational efficiency

- Operating costs are cash-limited but managers have discretion in using these resources, including carrying over unused funds or to pre-spending a small portion of the next year's running costs.
- Budgeted outputs are specified in advance and actual outputs are compared to the targets.
- Costs are allocated (ideally on an accrual basis) to the activities responsible for them.

Source: Simson, Sharma, and Aziz, 2011, adapted from Schick 1998.

More recently, experts agree that additional objectives are also essential, notably:

- **Transparency and accountability** calls for the PFM system to follow due process, make information publicly accessible in a timely manner, and to apply checks and balances to ensure accountability;[26] and
- **Equity, sustainability, effectiveness, and inclusion** should be guiding principles throughout the system.[27]

Some authors have highlighted that these commonly agreed objectives are only partially influenced by the PFM system.[28] For example, fiscal discipline is influenced by prudent and credible revenue and spending patterns, but also by changes in decision-making, or rents from natural resources, among other factors. Therefore, they suggest focusing on the direct impacts of the PFM system to assess its functionality. From this perspective, well-functioning PFM systems would achieve four goals:

- <u>Prudent decision-making and sustained fiscal health,</u> as demonstrated by:
    - Spending decisions are affordable (deficit, debt levels, and debt payments).
    - Public debt management (information on what is owed, payments on time).
    - Deficits, debts, cash, and obligations are not threatening solvency or economic stability.
- <u>Reliable and efficient resource flows and transactions</u> leading to actual results and service delivery, including:
    - Cash is provided to spending agencies in a timely manner and in agreed amounts.
    - Salaries are paid in a timely manner.
    - Arrears are low or non-existent.
    - Goods and services are procured as planned, at appropriate quality and price.
    - Contracts are paid on time.
    - Financing is available to capital projects when agreed and in agreed amounts.
    - Corruption and non-performance losses are minimal.
- <u>Institutionalized accountability</u>, which records financial operations in a reliable and timely manner so that they can be subject to oversight:
    - All financial flows are recorded.
    - Financial reports are comprehensive, timely, and accessible, and allow comparison between actual spending and budget decisions.
    - Independent assurance that funds are collected, managed, and spent for their intended purposes, in compliance with laws and regulations,

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[26] Lawson, 2015.
[27] Paolo de Renzio and Jason Lakin, 2019. "Reframing public finance. Promoting justice, democracy, and human rights in government budgets", IBP. https://internationalbudget.org/publications/reframing-public-finance-promoting-justice-democracy-human-rights-in-government-budgets/
[28] Andrews et al., 2014.

and with regard to value for money.
    * Concerns raised by independent assurance are transparently discussed by citizens' representatives and receive timely follow-up and redress by the executive.

- Budget credibility, which is evidenced by:
    * Comprehensive and regular budgets that give a binding expression to government public finance priorities and plans.
    * Actual revenue policies and collection performance reflect proposals and forecasts.
    * Actual spending reflects budgeted promises both at aggregate and detailed allocations.

External audits may assess the achievement of all these objectives of the PFM system, including budget credibility, and/or examine whether the institutional arrangements in place contribute to the achievement of these outcomes. (Chapter 4.) Of note, the first bullet under budget credibility (directly above), is more relevant to a broader view of budget credibility which is discussed further in Chapter 2.

## PFM reforms

Countries introduce PFM reforms to improve the performance and functionality of PFM systems, often with support from international organizations. These reforms tend to build on the results of assessment methodologies and tools (see Section 1.5) that evaluate PFM systems in terms of the degree to which they comply with international good practices, the quality of their processes, and/or their performance in certain areas. As a result, PFM reforms tend to coalesce around a common set of interventions. Table 1.1 summarizes some of the main areas of PFM reform introduced over the years.

Debate on PFM reform has focused on the choice of practices to be introduced and the sequence of reforms.[29] While some argue that governments in low- and middle-income countries need to focus on the basics of PFM systems before undertaking more advanced reforms,[30] striving to meet international standards even on "the basics" of PFM systems will help avoid problems in later stages.[31]

The success of PFM reforms will ultimately depend on the broader environment in which they are introduced. Not all PFM reforms are well-attuned to local problems, capacities, and institutional and political realities.[32] Different country contexts need different institutional solutions. More country-focused work and a better understanding of how systems operate in each country could support more effective PFM reforms. SAIs, through their audit work, play a critical role in providing information on bottlenecks and why they are arising at the country level.

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[29] Simson, Sharma, and Aziz, 2011; UNDESA, 2021. "CEPA Strategy Guidance Note on Fiscal and Budget Transparency", November, New York, United Nations.
[30] Miller, Hart, and Hadley, 2021.
[31] Sailendra Pattanayak, Racheeda Boukezia, Yasemin Hurcan, and Ramon Hurtado, 2022. How to Build Cash Management Capacity in Fragile States and Low-Income Developing Countries. IMF. https://www.imf.org/en/Publications/Fiscal-Affairs-Department-How-To-Notes/Issues/2022/03/01/How-to-Build-Cash-Management-Capacity-in-Fragile-States-and-Low-Income-Developing-Countries-498003
[32] For example, reforms that affect which resources go through the regular budget, in certain contexts, may contribute to budget credibility risks. To illustrate: a fiscal rule introduced in Brazil in 2000 may have created incentives for moving resources off-budget or outside the regular budget process to avoid a new spending ceiling. (Per a technical discussion on the draft handbook, June 2022, NYC.)

### Table 1.1. Select public financial management reforms

| Area of Reform | Description |
|---|---|
| Medium-term fiscal framework & medium-term expenditure frameworks | Multi-year strategic budgeting exercises that aim to create better linkages between policies and plans and revenue and expenditure forecasts. |
| Fiscal rules | Long-lasting constraints on fiscal policy, e.g., rules to limit spending, debt, and deficits. |
| Formalized budget preparation processes | Reforms focused on formalizing and structuring the budget preparation process (e.g., budget calendars, forecasting). |
| Budget classification systems | Coding and classifying budget items according to their economic, administrative, functional, or programmatic nature. |
| Program or performance-based budgeting | Changes in the budget classification system based on strategic objectives or anticipated results and changes to the processes of allocating resources, accounting for resource flows (to ensure a link between actual resource allocations and performance objectives), and the appropriation by legislatures. |
| Independent revenue collection agencies | Improving the transparency and efficiency of revenue policymaking and collections by creating independent revenue and customs bureaus and streamlining tax and customs policies and processes. |
| Treasury single accounts | Reforms to introduce single accounts that centralize financial stocks and flows in governments, ensuring that revenue is in one place and payments are also consolidated. |
| Integrated financial management information systems (IFMIS) | Automation of financial management processes, usually starting with accounting and reporting to streamline procedures and reduce opportunities for corruption. Usually require reform of existing processes and new human resource skills. |
| Public procurement | Reforms to promote transparent bidding processes and competitive procurement and to increase the efficiency and effectiveness of procurement. |
| Human resource management | Reforms to foster competitive hiring and merit-based civil service systems. Payroll reforms. Creating systems to record and track the number of people working in governments. |

| Area of Reform | Description |
|---|---|
| Internal control, audit, and monitoring | Introduction or strengthening of internal controls. Introduction of internal audit laws, units and processes. Monitoring mechanisms focused on performance and/or compliance. |
| Accounting and reporting | Reforms aimed at strengthening accounting and reporting activities, including standardizing charts of accounts and professionalizing the accounting function, as well as formalizing accounting and cash management procedures. |
| Legislative strengthening | Reforms to ensure time to assess budget proposals (e.g., budget calendar reforms), to enhance budget analysis capacity (e.g., setting budget offices), and to monitor budget implementation. |
| External audit and accountability reforms | Setting or strengthening the role of independent entities responsible for assurance and oversight. One recent trend is setting up Independent Fiscal Councils (IFCs) – some SAIs play this role. |
| Budget and spending transparency and participation | Enhance the availability of information on budget processes to make them more open to scrutiny by the public and so that adequate checks and balances can be established. |

Source: Based on Andrews et al. 2014, p. 8-9.

## PFM and service delivery[33]

In recent years, increasing attention has been focused on how PFM systems can more effectively contribute to improving the delivery of public services. Research on the effects of PFM in specific sectors, and, particularly in the health sector, have led to calls for strengthening diagnostic tools (such as PEFA[34]) to highlight constraints that undermine service delivery.

Accordingly, more scrutiny is being placed on factors that may limit PFM on service delivery. For one, when formulating the budget, how to better account for the complexities of allocation and ultimate downstream use of public revenues in the delivery of services. For example, in the health sector, this may mean trying to structure program budgets in different ways (e.g., by disease program).

On another front, the delegation of spending authority within the intergovernmental system can be critical for both PFM and service delivery. Questions surround (a) whether and how to

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[33] This section is based on Simson, Sharma, and Aziz, 2011.
[34] See Sections 1.4 and 1.5.

decentralize control over resources at different stages of budget execution, and (b) how the ultimate impact is affected when a wider range of actors and processes, outside the Ministry of Finance and the legislature, are engaged more effectively. For some countries or sectors, this may mean getting subnational governments and other local actors more involved in the control of spending public resources along the service delivery chain.[35]

Again, recognizing the contextual nature of PFM systems and the political nature of PFM reforms is important. Also, how to consider the tradeoffs and tensions between different objectives of the PFM system – e.g., providing predictable, reliable budgets to line ministries and service delivery units while maintaining control over aggregate spending and inflation in an uncertain economy can be tricky. (Box 1.5)

## Box 1.5. Rising inflation adds challenges for auditors and budget credibility

Reversing trends of low or declining inflation over the last two decades, a significant and widespread acceleration in price increases in the last two years is affecting not only emerging or low-income countries, which are more vulnerable to exogenous shocks, but also more developed economies. In fact, according to forecasts by the International Monetary Fund (IMF), global inflation reached 8.8 percent in 2022, the highest since 1996, and is expected to still be at 6.6 percent in 2023[36] . Furthermore, of the 192 countries for which the IMF made an estimate for 2022, 36 countries would witness a double-digit price increase and none of them would experience deflation, in clear contrast to what happened, for example, in 2019, when only 16 countries had double-digit inflation and 16 other nations had deflation.

**Inflation can significantly enhance the risks to budget credibility.** On the one hand, inflation hinders and adds variability to the economic projections on which the budget estimates are based, particularly, but not exclusively, that of tax revenues, with the consequent variability of the effective availability of resources. In addition, during the execution of the budget, the sustained and widespread increase in prices affects the purchasing and hiring processes of public entities as well as the execution of contracts. Periodic reviews are required to adapt and adjust contracts to the increase in prices, a difficulty that becomes worse when the inflationary event is unexpected. Contract renegotiations would

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[35] NYU/ODI, 2021. "An inter-governmental perspective on managing public finances for service delivery", May, New York, NYU-Wagner.

demand greater allocation of funds, which in turn would necessarily require a budget reallocation, without an impact on total expenditures, but on the production of public goods or, failing that, an expansion of total spending to ensure the provision of services originally planned in the budget.

**Inflation also affects oversight activities**. Statistics on budget execution must be adjusted to make them comparable, which adds an additional source of uncertainty and error to the analysis. Additionally, the persistence of inflation requires moving from a model of valuation of financial statements based on "historical values" to another model called "homogeneous currency,"[37] applying the mechanism known as "adjustment for inflation" to make figures from different periods comparable. This must be considered by the financial auditor. Moreover, as mentioned above, high inflation results in changes in the value of the original contracts and, consequently, new economic recognition by the supplier. These modifications must be factored into the development of compliance audits and when considering the economic dimension of performance audits.

In short, auditors must incorporate the new inflationary dynamics into their audit work and consider its effects when conducting different types of audits.

Other factors that may affect service delivery include the relationship between PFM and other systems, such as human resource management or the model for regulating public sector performance, the different roles that sector ministries play, and/or the capacity of sector ministries.

In sum, improving public spending on service delivery requires considering both technical issues and the broader institutional and political context of a country. Various stakeholders have different and competing interests that influence resource allocation and use. Budgetary changes, PFM reforms, and approaches to service delivery are influenced by decision-making structures and have an impact on different stakeholders and their interests. Therefore, an in-depth understanding of the dynamics of PFM systems and service delivery in a country is needed. Through external audits, SAIs can provide relevant information on both the performance of PFM systems and service delivery programs and entities.

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[36] IMF, 2022. World Economic Outlook Update: Gloomy and More Uncertain https://www.imf.org/en/Publications/WEO/Issues/2022/07/26/world-economic-outlook-update-july-2022
[37] NIIF 29 – Financial information in hyperinflationary economies.

## 1.3. Measuring budget credibility, its prevalence, and related factors

Budget credibility, as it is typically defined, relates directly to budget execution.[38] Budgets are considered credible when governments collect and spend funds according to their legislatively approved budgets. But at what point does a deviation from the approved plan become a credibility issue?

**Measuring budget credibility:** Three dimensions of budget deviations can be examined: (1) expenditure deviations, (2) revenue deviations, and (3) deviations in spending composition.[39] The Public Expenditure and Financial Accountability methodology, widely known as "PEFA" has become the acknowledged standard for PFM assessments.[40] PEFA establishes a 5 percent deviation of expenditure between the approved and executed budget (underspending or overruns) as a best practice not-to-exceed reference threshold for aggregate and compositional levels of spending (3 percent for contingency funds). The best practice for revenue variation is to be within 97-106 percent of the plan at an aggregate level and not to veer more than 5 percent off the plan's target at a compositional level.[41]

Many PFM or budget laws set thresholds that constrain how much executives can shift from either the aggregate or budget line items or spend additional revenues within the fiscal year, without prior authorization from the legislature. Such laws contribute to maintaining budget credibility (Box 1.6).

### Box 1.6. Tracking countries' laws on the shifting or spending of funds without legislative approval

In establishing a country's "oversight score", the biennial Open Budget Survey (OBS) of the International Budget Partnership (IBP) also evaluates countries' practices on the following questions:

- OBS Q115. Does the executive seek approval from the legislature prior to shifting funds between administrative units that receive explicit funding in the Enacted Budget, and is it legally required to do so?
- OBS Q116. Does the executive seek approval from the legislature prior to spending excess revenue (that is, amounts higher than originally anticipated) that may become available during the budget execution period, and is it legally required to do so?

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[38] See Chapter 2 for a more expansive discussion on auditing not only the defined elements of budget credibility but also those factors which affect them.
[39] Paolo de Renzio and Chloe Cho, 2020. "Exploring the determinants of budget credibility" https://internationalbudget.org/wp-content/uploads/determinants-of-budget-credibility-june-2020.pdf
[40] https://www.pefa.org/resources/pefa-2016-framework
[41] See also Chapter 2, Box 2.1.

**Colombia, Costa Rica, the Dominican Republic, Peru, Rwanda, Republic of Korea, Sri Lanka, Thailand,** and **Viet Nam** are among the countries that scored well on this measure in 2021.

Source: See https://internationalbudget.org/wp-content/uploads/2021-01-14-2021-OBS-Guide-and-Questionnaire_Final-ENGLISH.pdf for OBS methodology and https://internationalbudget.org/open-budget-survey/country-results

**Recent research:** A study conducted by IBP on 35 countries of different income levels gives an idea of the extent of budget deviations. On average, underspending of the annual national budget in aggregate reached nearly 10 percent over the group as a whole, i.e., well above the 5 percent deviation threshold set forth by the PEFA standards. Underspending was even higher in low-income countries, where it averaged approximately 14 percent in aggregate. When underspending affects key social or economic sectors, such as health or agriculture, it can have far-reaching consequences on people's lives.[42]

In other recent research by IMF staff, data for 152 countries in the period 2005-2020 showed significant cross-country differences in terms of the deviation of aggregate expenditure from the approved budget. While 27 percent of countries in the dataset showed small deviations between 5-10 percent, 34 percent of countries experienced significant deviations (10 to 15 percent), and 39 percent had large budget deviations (greater than 15 percent). Some countries have made improvements in the credibility of their budgets over time, while others have regressed, and these results vary across income groups.[43]

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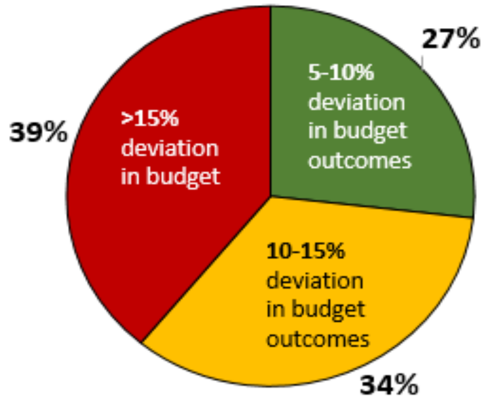
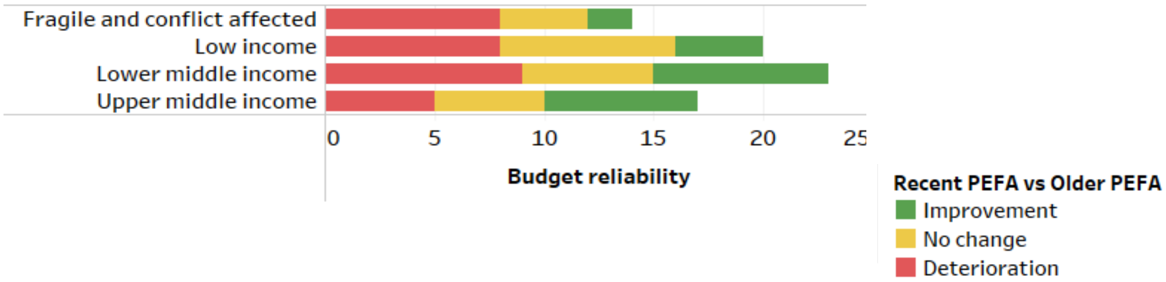
[42] de Renzio, Lakin, and Cho, 2019.
[43] Presentation by Fazeer Rahim, IMF, at the meeting on "Handbook on SAIs' contribution to strengthening budget credibility through external audits" (New York, June 14-17, 2022).

**Figure 1.2. Aggregate expenditure: Extent of deviation from the approved budget**




Source: Fazeer Sheik Rahim, IMF (2022), based on data from PEFA for 152 countries from 2005-2020

**Figure 1.3. Changes in budget credibility over time, by country income category**




Source: Fazeer Sheik Rahim, IMF (2022), based on data from repeated PEFA assessments

**Factors affecting budget credibility:** Explaining the determinants of cross-country differences in terms of budget credibility is complex. Multiple factors explain budget credibility challenges and risks, including PFM processes and institutions (such as the role of the Ministry of Finance, preparation of fiscal forecasts, and internal and external oversight), the broader governance context (e.g., civil service independence, corruption risks), and exogenous factors and shocks (e.g., changes in commodity process, economic downturn, COVID-19).[44] For example, due to the pandemic, most regions had significant budget deviations mainly in the direction of underspending (e.g., on average 12 percent in Oceania; 6 percent in Latin America and the Caribbean, with a few countries reaching 41 percent). Deviations of overspending were concentrated in Europe and North America (8 percent on average, but with some countries deviating up to 41 percent).[45] (See Box 1.7 on COVID responses.)

## Box 1.7. Accounting for COVID spending and its impact on budget credibility

The outbreak of the pandemic at the beginning of 2020 justified unforeseen and exceptionally important fiscal stimulus to mitigate its negative effects on health, activity, employment, and poverty.

According to the IMF's ***Fiscal Monitor Database of Country Fiscal Measures in Response to the Covid-19 Pandemic***,[46] all countries provided to a greater or lesser extent, an unexpected fiscal stimulus to face and mitigate the effects of the pandemic. According to this survey, at a global level, fiscal aid totaled 15.9 percent of GDP in 2020, including 9.7 percent of GDP from additional expenses and loss of resources due to tax incentives. The rest of support measures totaled 6.2 percent of GDP, focused on improving the liquidity of companies (e.g., capital injections, purchase of assets, and guarantees, among others).

IMF information shows a positive correlation between the degree of relative development and exposure to the pandemic of each country and the magnitude of the fiscal measures. At the same time, there was high heterogeneity in the magnitude of the fiscal effort by each country. For example, while Mauritius aid accounted for 46.5 percent of GDP, Somalia's support reached only 0.2 percent of GDP.

Besides the magnitude of the fiscal effort, the processes of procurement, contracting, and providing direct assistance to companies and people in the face of the emergency took place under conditions of urgency, which significantly weakened accountability and oversight mechanisms, enhancing the risks of improper use of public resources.

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[44] Ibid. (Presentation by Fazeer Rahim IMF).
[45] PEFA Secretariat, 2022. SDG Indicator 16.6.1 speaks how budgets are affected by COVID-19 pandemic. https://www.pefa.org/news/sdg-indicator-1661-speaks-how-budgets-are-affected-covid-19-pandemic
[46] IMF Fiscal Affairs Department, 2021. Fiscal Monitor Database of Country Fiscal Measures in Response to the COVID-19 Pandemic. https://www.imf.org/en/Topics/imf-and-covid19/Fiscal-Policies-Database-in-Response-to-COVID-19

The measures adopted had not been properly planned or contemplated in the originally approved budgets, forcing budget modifications and increases in spending. In many cases, these amendments to the budget were enacted without the intervention of the legislature and often under exception mechanisms. At the same time, the urgency also forced the use of exceptional and more discretionary contracting mechanisms, avoiding regular procurement processes that usually require a longer execution period and are supposed to be carried out with greater oversight and transparency. (See the International Budget Partnership's Covid assessment.)

The allocation of extraordinary resources without adequate planning, in a very short period, mostly executed through more discretionary procurement mechanisms, together with a lack of transparency, amplified the risks of improper conduct in the use of taxpayer's money. These factors negatively affected the credibility of fiscal institutions as a whole and of the budget. In turn, budget credibility also suffered as the original budget objectives, both financial and the delivery of public goods and services, were significantly modified. Audit work by SAIs on the specific measures implemented during the pandemic is not only useful to identify deviations and/or improper conduct but also to improve government management in the throes of crisis contexts, thereby strengthening budget credibility.

The fiscal dynamics imposed by the pandemic revealed the need to strengthen governance, transparency, and accountability for the use of public resources. SAIs play a key role in achieving these objectives. Of note, the countries that received financing from the IMF during the pandemic have committed to implementing different measures to strengthen transparency and oversight such as i) publishing information on contracts; ii) publishing the end beneficiaries of the companies awarded the contracts; iii) reporting pandemic-related expenses; and iv) carrying out ex-post audits of those expenses.

Deviations between the approved and executed budget per se may not necessarily indicate failures in the performance of PFM systems. For example, some deviations may be justified due to an unexpected macroeconomic shift such as inflation or a pandemic, or because of increases in government efficiency in spending. Regardless, for the public to understand whether deviations are justified, the reasons for deviations should be documented and explained in budget implementation reports or performance reports. The assessment of credibility also depends on the reasonability and transparency of the reasons that explain those deviations as well as the impact of the deviations themselves (e.g., on service delivery). Ultimately, those reasons and the impacts of budget deviations are also dependent on contextual factors.

SAIs can strengthen their work on the assessment of reasons for underlying deviations, which is often missing in audits (e.g., compliance). Of note, SAI Sweden finds that the reasons provided by their government to explain budget deviations have improved over the years, including as a result of the SAI's audits.[47]

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[47] Input from SAI Sweden at the UNDESA-IBP Technical Meeting on the development of this handbook, May 2021.

## Box 1.8: Are deviations from the budget explained?

The importance of governments explaining deviation from the approved plan is upheld in several international standards, for example:

- The highest score on the PEFA framework's indicator 16.4 is awarded to countries that explain "all changes to expenditure estimates" at the ministry level.
- IMF's Fiscal Transparency Handbook – e.g., Principle 1.4.3 (explanations for variances between different reports on budget implementation versus forecast) and Principle 2.4.3 (explanations related to either policy change, macroeconomic factors, or other factors as to why forecasts are changing over time).

IBP has highlighted the importance of explanations in in-year reports (IYR), mid-year reports (MYR), and year-end reports (YER) (see Guide to Transparency in Government Budget Reports), and identified the following criteria for government explanations:

1. Identify a causal link between a set of facts (A) and deviations from the budget (B) (minimum condition)
2. Explain the mechanism by which a set of facts (A) has caused deviations (B) and, where possible, the factors (C) that caused (A) in the first place
3. Provide sufficient detail to explain any variation in outcomes
4. Show how explanations are consistent with past experience or why conditions have changed
5. Explain the most important deviations

Source: Lakin, 2018. Assessing the Quality of Reasons in Government Budget Documents.

Given the multiplicity of drivers that lead to budget credibility, and the complex interrelation between them, some experts suggest considering not only the predictability and reliability in budget execution as an indicator of budget credibility but also other dimensions of PFM performance, including, among others:[48]

- Reliability and transparency of budgets
- Management of assets and liabilities
- Systematic assessment of fiscal trends as a basis for budget formulation
- Sound accounting and reporting systems

These different dimensions of PFM performance can be assessed by auditors as conditions that either affect and/or create risks for budget credibility. Chapters 3 to 6 illustrate how SAIs in different regions are auditing some of these dimensions.

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[48] Presentation by Srinivas Gurazada, PEFA Secretariat, at UNDESA-IBP Technical Meeting on the development of this handbook, May 2021.

Whether to focus more narrowly on the defined parameters of budget credibility or to assess the range of factors affecting budget credibility has implications in terms of audit methodology. Chapter 2 explores this further and looks at the concept of budget credibility and its operationalization for auditing.

## 1.4. Relevant international standards on PFM and budgeting

Several international standards related to PFM and budgeting have recognized the importance of the credibility of government budgets and sound governance principles, including transparency.

### Sustainable Development Goal 16

The importance of budget credibility for effective, accountable, and transparent institutions has been recognized in the 2030 Agenda through Sustainable Development Goal 16 on peace, justice, and strong institutions. Progress on target 16.6 is measured by two different global indicators, one of which – indicator 16.6.1 – is dedicated to budget credibility. The indicator measures credibility as "primary government expenditures as a proportion of the original approved budget (by sector, budget codes or similar),"[49] but only at the national aggregate level.

### Public Expenditure and Financial Accountability Initiative (PEFA)

The PEFA Initiative provides a framework for assessing and reporting on the strengths and constraints of public finance management systems using quantitative indicators to assess performance. Research shows a strong correlation between average performance across the PEFA pillars and budget credibility, with differences across pillars. Countries with better PFM institutions and processes tend to have better budget reliability. (See Section 1.5. for more on the assessment framework.) PEFA data is the source for UN member states' reporting on SDG 16.6.1.

### Fiscal Transparency Code

The IMF's Fiscal Transparency Code[50] is the internationally recognized standard for the disclosure of information about public finances. It comprises a set of principles built around four pillars: fiscal reporting; fiscal forecasting and budgeting; fiscal risk analysis and management; and resource revenue management. The Code includes three elements related to budget credibility: (1) independent evaluation -- whether the government's economic and fiscal forecasts and performance are subject to independent evaluation; (2) supplementary budgets – whether any material changes to the approved budget are authorized by the legislature; and (3) forecast reconciliation – whether budget documentation and updates explain any material changes to the

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[48] United Nations A/RES/71/313 "Global indicator framework for the Sustainable Development Goals and targets of the 2030 Agenda for Sustainable Development". Available at https://unstats.un.org/sdgs/indicators/indicators-list/; More information on the SDG global indicator framework is available at https://unstats.un.org/sdgs/dataportal
[50] The Fiscal Transparency Code 2019 can be found here: https://www.imf.org/external/np/fad/trans/Code2019.pdf

government's previous fiscal forecasts. The Fiscal Transparency Handbook (2018) provides detailed guidance on the implementation of the Code's principles and practices, with many examples from countries around the globe.

## Box 1.9. SAIs use of international budget standards

In its performance audits of the budget process, SAI Indonesia has used the IMF Fiscal Transparency Code as a source of audit criteria, in addition to applicable laws and regulations, and relevant good practices. SAI Jamaica has applied the IMF Fiscal Transparency Code. The United States GAO (Government Accountability Office) uses OECD and IMF international practices and standards as references in its budget work.

## OECD Principles of Budgetary Governance

The OECD Principles of Budgetary Governance aim to provide practical guidance for designing, implementing, and improving budget systems to make a positive impact on citizens' lives. One of the principles highlights that budgets must be managed within clear, credible, and predictable limits for fiscal policy. The principles also emphasize the importance of closely aligning budgets with the medium-term strategic priorities of the government. Another principle refers to the need to present a comprehensive, accurate, and reliable account of public finances. Comprehensiveness, transparency, and realism form an international standard against which the soundness of the budget is often assessed (Box 1.10). In OECD countries, these standards are achieved by designing annual, united, and universal budget systems.[51]

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[51] IMF, 1999. "Guidelines for public expenditure management, Section 3, budget preparation", available at https://www.imf.org/external/pubs/ft/expend/guide3.htm

## Box 1.10. International standards for a sound budget

### Comprehensiveness

- Is the coverage of government operations complete?
- Are estimates gross, or does netting take place?

### Transparency

- How useful is the budget classification? Are there separate economic and functional classifications that meet international standards?
- Is it easy to connect policies and expenditures through a program structure?

### Realism

- Is the budget based on a realistic macroeconomic framework?
- Are estimates based on reasonable revenue projections? How are these made, and by whom?
- Are the financing provisions realistic?
- Is there a realistic costing of policies and programs and expenditures (e.g., assumptions about inflation)?
- How are future cost implications taken into account?
- Is there a clear separation between present and new policies?
- How far are spending priorities determined and agreed upon under the budget process?

Source: IMF, 1999. Guidelines for Public Expenditure Management: https://www.imf.org/external/pubs/ft/expend/guide3.htm

## Global Initiative for Fiscal Transparency (GIFT)

GIFT is a global network that facilitates dialogue between governments, civil society organizations, international financial institutions, and other stakeholders on strengthening fiscal transparency and participation. In 2011, GIFT reviewed the numerous relevant norms and standards circulating around the world for comprehensiveness and consistency to summarize the essence of each in an aggregate overall format. Their work informed the development of the High-Level Principles on Fiscal Transparency, Participation, and Accountability in 2012 which was subsequently recognized that same year by the United Nations General Assembly.[51] GIFT continues to update and review the international standards,[53] against which countries can assess their strengths and weaknesses and progress on their commitments related to budgetary governance, in general, and to budget credibility, in particular.

### Box 1.11. Excerpts from two of GIFT's ten High-Level Principles relating to budget credibility

Principle 3 on the quality of reporting on budget execution, calls for the presentation of fiscal information to be "...consistent across the different types of reports or include an explanation and reconciliation of differences."

Principle 8 on process, highlights that "no government revenue should be raised, or expenditure incurred or committed without the approval of the legislature through the budget or other legislation."

## 1.5 Diagnostic tools and assessments relevant for budget credibility

Building on international standards, in recent years, several different diagnostic and assessment frameworks, methods, and tools have been developed.[54] They tend to assess and compare national systems with different levels of practice within the standards. Used to inform PFM reform strategies, monitor reform progress, and assess risks, generally, these tools can be used in combination as they provide complementary assessments. They may be useful for auditors in their audit work on budget credibility. At the same time, in-country analysis and information provided by SAIs further the understanding of how existing PFM systems and processes work.

### PEFA's Public Financial Management Performance Measurement Framework

The PEFA Initiative has also developed the PFM Performance Measurement Framework. This indicator-based tool provides an integrated assessment of PFM systems against seven performance pillars: (1) budget reliability, (2) transparency of public finances, (3) management of assets and liabilities, (4) policy-based fiscal

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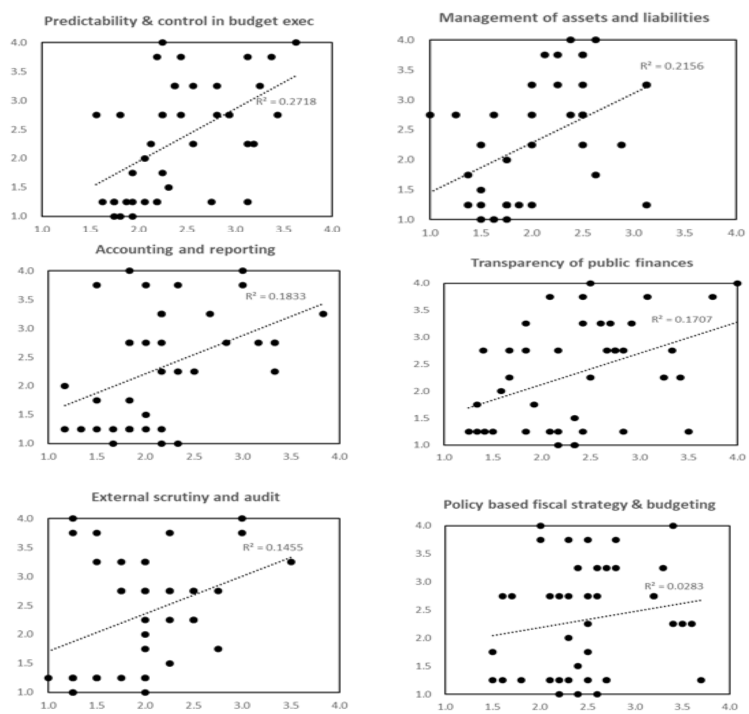
[52] United Nations A/RES/67/218 on "Promoting transparency, participation, and accountability in fiscal policies", 21 December 2012. Available at https://financing.desa.un.org/document/ga-resolution-67218-promoting-transparency-participation-and-accountability-fiscal
[53] In 2018, GIFT published an Expanded Version of the High-Level Principles on Fiscal Transparency, Participation, and Accountability and more recently the useful Summary of the Expanded High-Level Principles on Fiscal Transparency, Participation, and Accountability.
[54] UNDESA, 2021. "CEPA Strategy Guidance Note on Fiscal and Budget Transparency", November, New York, United Nations.

strategy and budgeting, (5) predictability and control of budget execution, (6) accounting and reporting, and (7) external scrutiny audit. (See Figure 1.4.) Within these seven broad domains, PEFA defines 31 specific indicators, disaggregated into 94 dimensions, that focus on key measurable aspects. It then assesses the likely impact of PFM performance levels on three desired budgetary outcomes: aggregate fiscal discipline, strategic allocation of resources, and efficient service delivery.

Since 2012, over 600 assessments have been conducted worldwide in 154 countries. PEFA assessments have been used to conduct cross-country research on the performance of PFM systems,[55] as well as on the determinants of budget deviations.[56] The initial framework developed in 2011 was updated in 2016. PEFA has also been expanded with supplementary assessment tools on gender, climate, and guidance for sub-national governments with a particular focus on service delivery. More information on the assessment tool, cross-country reports, and country case studies is available at [PEFA framework.]

**Figure 1.4. Predictability and expenditure control have the strongest correlation with budget credibility, among PEFA pillars**




Source: Fazeer Sheik Rahim IMF Presentation at review meeting (June 2022)

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[55] Paolo de Renzio, 2009. "Taking Stock: What do PEFA Assessments tell us about PFM systems across countries?" Working Paper 302, Overseas Development Institute, May, London, UK.
[56] de Renzio and Cho, 2020.

## Open Budget Survey (IBP)

The Open Budget Survey (OBS) is an independent, comparative, and fact-based research instrument measuring three essential aspects of governance and accountability: transparency (i.e., the timely publication of the requisite documents for sound public financial management), opportunities for public participation in fiscal affairs, and the extent of oversight by the legislature and SAI. This biennial review is completed with in-country researchers and is currently evaluating 125 countries. (See also Box 1.6.)

## Fiscal transparency evaluations (IMF)

Fiscal transparency evaluations assess country practices against the standards of the IMF's Fiscal Transparency Code. The assessments provide information on the scale and sources of fiscal vulnerabilities, including measures of the coverage of fiscal reports, the quality of fiscal forecasts, and the size of unreported contingent liabilities. They also assess the strengths and weaknesses of country practices related to fiscal transparency through a set of summary "heatmaps," which facilitate benchmarking against comparator countries, the identification of reform needs, and the prioritization of recommendations.

These evaluations support the identification of fiscal transparency strengths, weaknesses, and challenges and place greater emphasis on fiscal transparency issues that are macro-critical and complement other public financial management standards and frameworks.

## OECD Budgetary Governance Reviews

The OECD Budgetary Governance Reviews look at good practices in budgeting and provide guidance on designing, preparing, approving, implementing, and reviewing budgets to ensure they are effective, efficient, and relevant and comply with the principles of budgetary governance. Reports are available at https://www.oecd.org/gov/budgeting/ The OECD International Database of Budget Practices and Procedures contains information on budget institutions from 97 countries, including 31 OECD member countries and 66 non-members from the Middle East, Africa, Eastern Europe, Asia, Latin America, and the Caribbean.

## BOOST

Budget credibility has also been recently analyzed using a dataset from the World Bank created in 2010. The BOOST dataset aims to facilitate access to budget data and promote their effective use for improved decision-making, transparency, and accountability. The dataset contains information on the approved budget, revised budget, and actual expenditure amounts broken down by government level, administrative unit; sub-national spending unit; economic classification; functional classification (sector and sub-sector); program classification; and financing source. BOOST data has also been used to support Public Expenditure Reviews, which evaluate the effectiveness of public finances.

### Box 1.12. An example of the type of data found in the BOOST database

In the case of **Uganda**, the BOOST database presents data on expenditures executed by the state and local governments. The data was provided by the Ministry of Finance and covers the period 2004-2016. It is organized following the country's budget classification system which includes an administrative, economic, functional, and geographic classification. The database includes data on the allocated budget, revised budget, and expenditures of central and local government agencies.

## Public Financial Management Reporting Framework (PFM-RM)

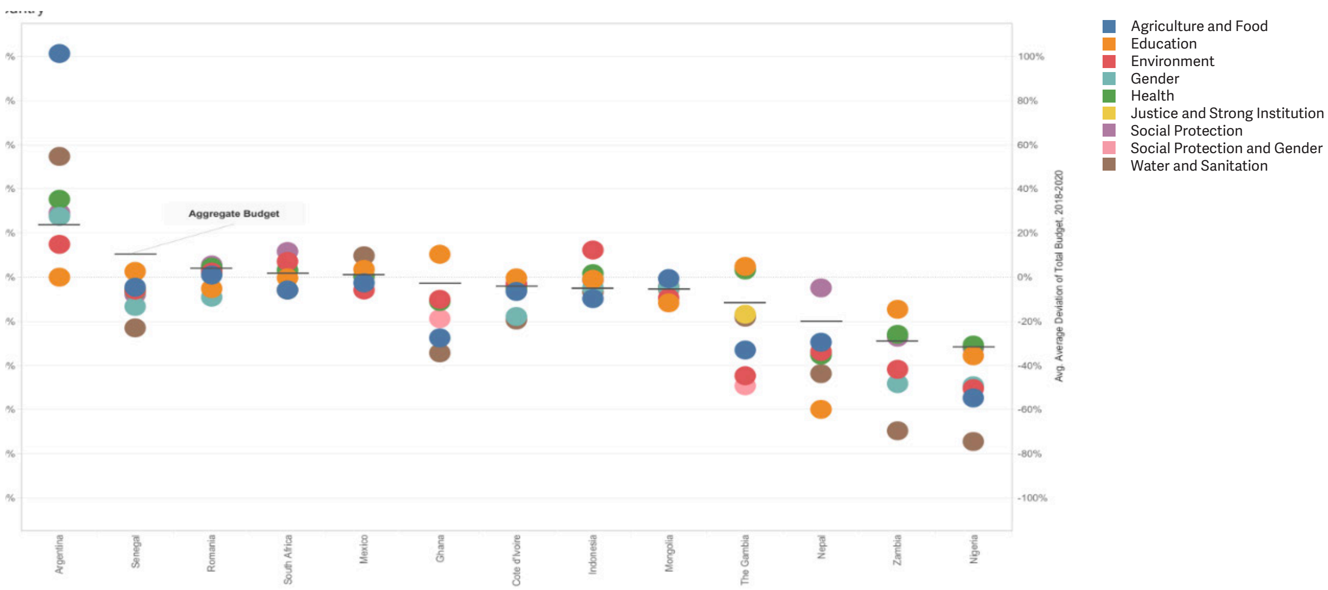
The Public Financial Management Reporting Framework (PFM-RM) developed by AFROSAI-E (the African Organization for English-Speaking Supreme Audit Institutions) and GIZ (the main German development agency, *Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH*) is an assessment tool developed specifically for auditors. The PFM-RM is a diagnostic assessment tool to assess the performance of PFM processes (macroeconomic policy, fiscal policy and strategic budgeting; budget preparation; budget approval; financial management and service delivery; and accounting reporting and oversight) along the budget cycle. The assessments are entity-specific (and thus provide disaggregated information at the entity level) and allow auditors to assess each process in each entity (core PFM institutions as well as selected ministries, departments, and agencies), and compare results across them. Further information on this assessment tool and its application is presented in Chapter 4.

## Using other publicly available budget data

Other assessments rely on publicly available budget data at the national level. As indicated earlier, one limitation of the SDG indicator 16.6.1 on budget credibility, which relies on PEFA data, is that it is an aggregate indicator. Using publicly available budget data allows for disaggregated assessments at sector or program levels. This approach has been used in recent research conducted by IBP in 13 countries across seven sectors related to 10 SDGs for the period 2018 to 2020. The results show that governments often reduce the share of spending in social sectors related to SDGs during implementation, as compared to the aggregate budget.[57] Understanding how credible budgets are at the sectoral level is important for analyzing the implications of budget credibility for achieving the SDGs. See Figure 1.5.

[57] IBP, 2022. "Budget credibility and the Sustainable Development Goals" available at https://express.adobe.com/page/kZhNwex9ayQ9C/

**Figure 1.5. Average deviation between approved and actual spending from 2018 to 2020** ***(in seven sectors of 13 countries, by functional or administrative classification)***




Source: IBP and partner CSO original research based on publicly available budget data (Nov. 2022)

## External audits complement the use of diagnostic tools in assessing budget credibility

Auditors often use PEFA and other available assessment tools to get an overall picture of the PFM system in their countries. PEFA examines and measures budget credibility and budget deviations at the aggregate level. However, PEFA does not analyze the causes and institutional factors that explain the aggregate budget credibility score and/or changes (improvements or regressions) over time.

In contrast, audits can help illuminate the causes and institutional factors, both systemic and contingent, that explain budget deviations and changes in budget deviations over time. Audits can make recommendations to address those causes, enhance budget credibility, and improve the performance of PFM processes and systems. Therefore, assessment tools such as PEFA and external audits complement each other to conduct a better analysis of budget credibility and to improve the performance of the budget process and PFM systems.

**Strengthening Budget Credibility through External Audits: A Handbook for Auditors**

Supreme Audit Institutions (SAIs) have an important role to play in strengthening the implementation of sustainable development promises and ensuring that their country's budget is on track. Drawing on SAI's experience, the handbook explores different approaches to auditing that can contribute to improving budget credibility.

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