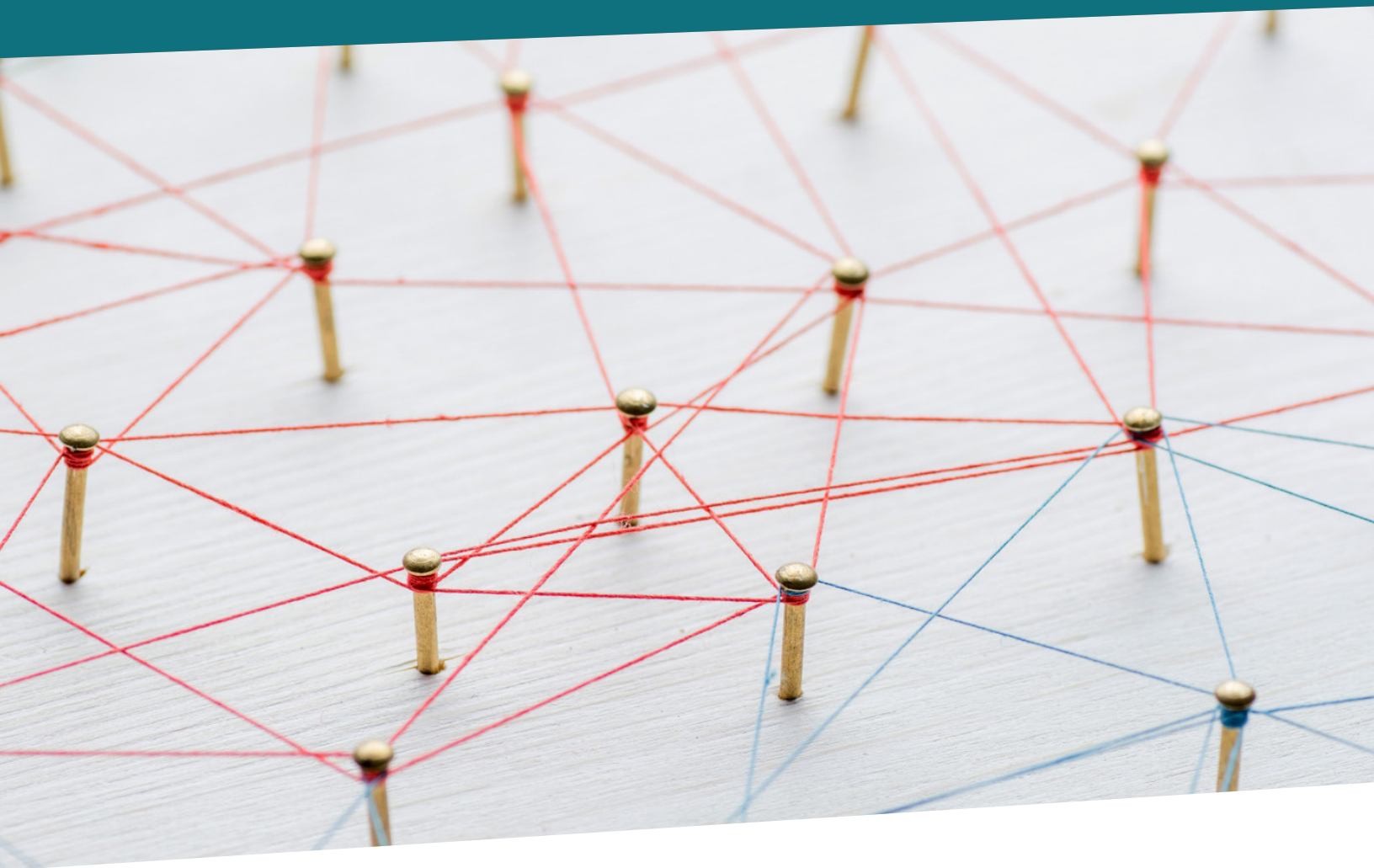


# Strengthening Budget Credibility through External Audits

**A Handbook for Auditors**



**United  
Nations**

Department of  
Economic and  
Social Affairs



**International  
Budget  
Partnership**

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A Handbook for Auditors

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## Chapter 4: Auditing the performance of the public financial management system

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**A sound PFM system is essential to ensuring an effective state that delivers goods and services to its citizens, reduces poverty, supports economic growth, taxes fairly and efficiently, and spends responsibly.<sup>90</sup> Improving the effectiveness of the PFM system can generate widespread and long-lasting benefits, and may in turn help to reinforce wider societal shifts towards more inclusive and effective institutions.<sup>91</sup> ...[which] generate trust, promote innovative energies, and allow societies to flourish.<sup>92</sup>**

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External audits on the performance of the public financial management (PFM) system can shed light on whether and how the institutional arrangements in place are contributing to budget credibility. Building on the experience of the SAIs of Indonesia and Zambia, in particular, as well as SAIs from several other countries, this chapter discusses different approaches to auditing the PFM system through performance audit techniques and by combining auditing with other reporting tools. The chapter discusses the challenges and impact of these audits and identifies opportunities to enhance the PFM system further.

### 4.1. Focusing on the performance of the PFM system

SAIs play an important role in the public financial management (PFM) system. Auditing and reporting on how governments mobilize revenues, allocate public funds, undertake public spending, and account for spent funds, are critical PFM processes.<sup>93</sup> To ensure proper oversight of the stewardship and use of public resources, SAIs should be independent, effective, and credible in the execution of their mandates.<sup>94</sup> Moreover, SAIs should have unrestricted rights of access to all

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<sup>90</sup> OECD, 2011. "Supporting Capacity Development in PFM - A Practitioner's Guide," 4th High-Level Forum on Aid Effectiveness.

<sup>91</sup> Lawson, 2015. cited in Albert Kasoma, 2018. Analysis of the Public Finance Management Act of 2018. Policy Monitoring and Research Centre. Lusaka, Zambia

<sup>92</sup> Daron Acemoglu and James Robinson, 2012. *Why Nations Fail: The Origins of Power, Prosperity, and Poverty*, NY: Crown; and Dani Rodrik, ed., 2003. *In Search of Prosperity: Analytic Narratives on Economic Growth*, cited in Lawson, 2015.

<sup>93</sup> Lawson, 2015.

<sup>94</sup> INTOSAI, 2019. INTOSAI P-12, The Value and Benefits of Supreme Audit Institutions – making a difference to the lives of citizens; INTOSAI P-1, The Lima Declaration; and INTOSAI P-10, The Mexico Declaration on SAI Independence

necessary information for the proper discharge of their statutory responsibilities.<sup>95</sup>

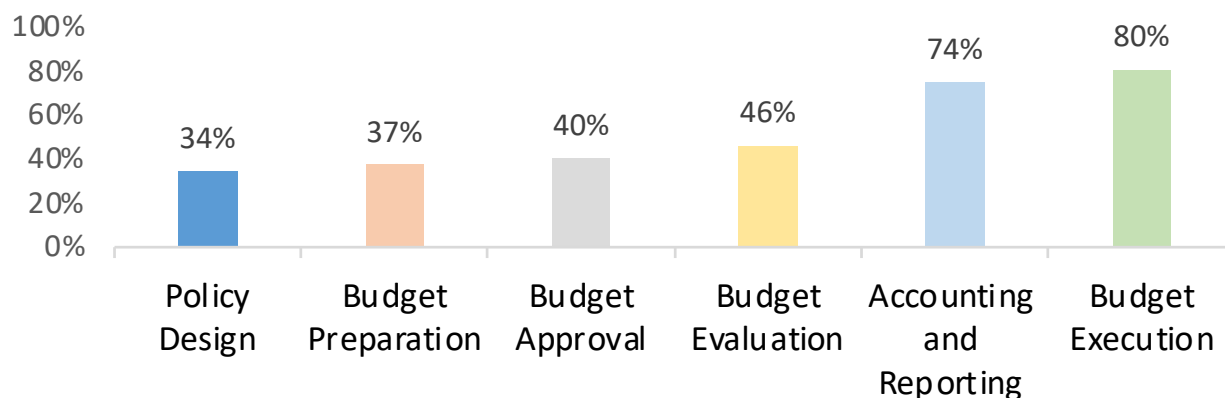
### Introducing the approach

External audits can assess budget credibility in different ways, including through scrutiny of the performance of the PFM system more broadly. For example, SAIs can evaluate how reliable and transparent budgets are, how assets and liabilities are managed, whether the budget is based on an assessment of fiscal trends or just ad hoc information, whether there is predictability in budget execution, the reasons for any

underspending or overspending, and whether accounting and reporting are effectively informing and supporting the other pillars of the PFM system, among other aspects.

Many SAIs already have experience auditing the performance of the PFM system, as indicated by two-thirds of the respondents to the UNDESA/IBP SAI survey in 2022.<sup>96</sup> Among these surveyed countries, SAIs are auditing specific PFM processes of the budget cycle including budget execution, accounting and reporting, budget approval and budget evaluation, and to a lesser extent budget preparation and policy design (strategic budgeting). (Figure 4.1.)

**Figure 4.1. Sample distribution\* of audit work on the performance of the PFM System, by budget stage**



\*Percentage of survey respondents (N 25) that conduct audits on aspect(s) of the PFM system

Source: Chapter authors, from UNDESA/IBP 2022 SAI survey data

<sup>95</sup> INTOSAI, 2019. INTOSAI P-12.  
<sup>96</sup> UNDESA/IBP SAI survey, 2022. p. 16.

As to methodology, an SAI can use a performance audit to assess the performance of the PFM system,<sup>97</sup> or, depending on its mandate, may conduct combined audits incorporating financial, compliance, and/or performance aspects. In such cases, the standards relevant to each type of audit should be complied with. Thus, an SAI may consider a combination of financial and performance audits or compliance and performance audits in assessing the performance of the PFM system.<sup>98</sup>

In addition to audit tools, auditors may also rely on available diagnostic and reporting frameworks to produce information that complements their assessment of the performance of PFM systems. SAI experiences with these different approaches will be presented in the following sections.

## Taking account of the particularities of national PFM systems

How PFM operates in practice differs across countries.<sup>99</sup> Some countries may experience institutional capacity constraints that undermine the system's performance. For example, some experience delays in the approval of the budget, or budget execution is driven by short-term needs rather than longer-term priorities and national objectives.

Auditors should be knowledgeable of both the common processes that structure the PFM system and the particular characteristics and features of the system in their own national context, including the normative framework, processes, activities, and main stakeholders. As an example, SAI Indonesia recounts its specific PFM process through the budget cycle with various stakeholders in Box 4.1.

### Box 4.1. An overview of the budget cycle and relevant stakeholders in Indonesia

The budget cycle at the central level of government in Indonesia is primarily regulated by the State Finance Laws (Law No. 17/2003, Law No. 1/2014, and Law No. 15/2004). The main budget/PFM processes and stakeholders are described below:

**Budget formulation:** The government prepares its fiscal policies, basic macroeconomics assumptions, the annual working plans, and allocates the budget for each work plan. All these materials are included in the draft of the state budget act to be discussed and approved by the legislature.

<sup>97</sup> Performance audits examine whether a government is using public resources in an effective, efficient, and economical manner. These audits identify the reasons for any underperformance, what is working well within audited entities, and/or measure how performance has improved due to changes in policy or operations. A performance audit may focus on a single program, policy, entity, or fund, or may focus on outcomes or systems. See INTOSAI-IDI, 2021 ISSAI Performance Audit Implementation Handbook; INTOSAI 2019, INTOSAI-P 1, The Lima Declaration, Section 4.

<sup>98</sup> ISSAI 300 Performance Audit Principles and ISSAI 400 Compliance Audit Principles.

<sup>99</sup> Chapter 1 presents the common processes, activities, and stakeholders of PFM systems while Chapter 2 highlights the contextual nature of PFM and the variety of institutional arrangements in different countries.

**Budget approval:** The proposal of the state budget act is discussed with the legislature. Based on the discussion, the legislature will specify the Proposal to be the State Budget Act. The bill on the state budget submitted by the President must be voted on by the legislature within two months before the end of the fiscal year (end of October). However, if the budget is not approved by the legislature, the Constitution provides for the reenactment of the state budget of the previous year.

**Budget execution:** The President issues a Presidential Regulation concerning the details of the Annual Budget (APBN). Starting January 1 of the new fiscal year, government agencies/ministries may carry out revenues and expenditures related to their mandate in accordance with the budget implementation document. The President, as head of government, holds the overall responsibility for state financial management. The finance minister as the fiscal manager is responsible for the overall administration of public finances, including the consolidation of the central government financial report which ensures accountability for the execution of the annual state budget. Expenditure controls are executed by the responsible financial officers at different levels of government and include mechanisms such as segregation of duties, authorization of approvals, and restrictions on access to resources and information.

The supervision of the implementation of the State Budget Act is carried out internally by the Inspectorate General within each government agency/ministry and the Financial and Development Supervisory Agency. The inspector general supervises the activities of ministries and agencies funded through the APBN. The Financial and Development Supervisory Agency supervises cross-sectoral activities, state treasury activities performed at the request of the Minister of Finance as the general treasurer and other activities per the President's request.

**Budget evaluation:** As a form of accountability for the implementation of the annual state budget, the government will submit the Central Government Financial Report to the Supreme Audit Institution (BPK RI) to be audited. Law No. 15 of 2004 on the Audit of State Financial Management and Responsibility provides the BPK RI with independence in audit planning, execution, and reporting of audit findings. The audit of financial statements considers compliance with the Government Accounting Standard, adequacy of disclosure, compliance with legislation, and effectiveness of internal controls. The SAI also conducts performance audits and special-purpose audits. No later than six months after the end of the fiscal year, the President will submit to the legislature a draft law on accountability for the implementation of the annual state budget along with the central government's financial reports that have been audited by the SAI.



## Assessing performance against the objectives of the PFM System

Auditors need to be aware of and identify the ultimate objectives of PFM systems against which performance can be assessed and measured. Chapter 1 presented the objectives that PFM systems are expected to support: aggregate fiscal discipline, allocative efficiency, operational efficiency, transparency and accountability,<sup>100</sup> equity and inclusion, as well as four other goals including budget credibility; prudent decision-making, and sustained fiscal health; reliable and efficient resource flows and transactions; and institutionalized accountability.

Ideally, the performance of the PFM system is assessed by measuring performance against these objectives. For example, the achievement of aggregate fiscal discipline can be measured through the PEFA assessment (see Chapter 1) which quantifies how closely revenue collection and spending adhere to the approved budget, and transparency and accountability can be assessed by the Open Budget Survey (OBS), which provides a reasonable proxy for transparency, oversight, and opportunities for public engagement in fiscal affairs.

However, measuring strategic allocation and operational efficiency requires in-depth studies. Some OECD countries and middle-income countries (e.g., South Africa) undertake these regularly through program evaluations or value for money audits. For example, as procurement

processes involve considerable expenditure and are a key component of the PFM system, regular auditing would ensure that value for money is achieved – or reported on, where it has not been.

In practice, however, the assessment of PFM systems usually focuses on the examination of the institutions, rules, and procedures that are most likely to ensure the achievement of the objectives of the PFM system.<sup>101</sup> Therefore, external audits may assess the achievement of these objectives of the PFM system, including budget credibility, and/or examine how the institutional arrangements in place contribute to their success. That is, auditors can directly examine how the PFM institutional arrangements work to ensure budget credibility (based on the processes defined in Chapter 1) and the causes of underperformance. Alternatively, they can focus on other important elements of the PFM system, such as transparency or fiscal discipline, and relate the audit findings with risks for budget credibility.

## SAIs' use of PFM assessment and reporting frameworks

In addition to audit tools, SAIs may also rely on existing PFM reporting frameworks to evaluate the performance of the PFM system in terms of budget credibility. These frameworks can be used by themselves, as sources of audit criteria, and /or in combination with audit methodologies and tools.

<sup>100</sup> Marco Cangiano, 2017. "What is Public Financial Management?" at [https://www.rgs.mef.gov.it/Documenti/VERSIONE-I/Comunicazione/Workshop-e-convegna/Seminario\\_2017-02-6\\_8/01\\_-\\_What\\_is\\_PFM\\_-\\_Cangiano.pdf](https://www.rgs.mef.gov.it/Documenti/VERSIONE-I/Comunicazione/Workshop-e-convegna/Seminario_2017-02-6_8/01_-_What_is_PFM_-_Cangiano.pdf); Lawson 2015

<sup>101</sup> Allen Schick, 1998. "Why Most Developing Countries Should Not Try New Zealand's Reforms", *The World Bank Research Observer*, Volume 13, Issue 1, February 1998, Pages 123–131, <https://doi.org/10.1093/wbro/13.1.123> cited in Lawson, 2015.

## International PFM assessment frameworks

Various ways to assess and compare national PFM systems against international standards were presented in Chapter 1. SAIs can use these

analytical tools, indicators, and frameworks in their audit work on budget credibility<sup>102</sup> and can combine them with in-country analysis and information from audits to further understand how existing PFM processes in place are working. (See Box 4.2.)

### Box 4.2. SAI Peru applies the PEFA framework to assess budget credibility

The General Comptroller of **Peru** has used the PEFA framework to evaluate the credibility of public spending in Peru for the period 2019-2021. SAI Peru found that significant deviations from the originally approved budget (54 percent on average over these years) inhibit proper scheduling of the contracting and execution processes, causing the accrual level to be a significantly lower proportion of the modified budget, particularly in the case of investments, and diverting funds away from intended priorities.

Source: Nelson Shack and Rogers Rivera, 2022. Evaluación de la credibilidad presupuestal del gasto público en el Perú. Documento de Política en Control Gubernamental. Contraloría General de la República. Lima, Perú.

Available at <https://www.gob.pe/institucion/contraloria/informes-publicaciones/2781606-evaluacion-de-la-credibilidad-presupuestal-del-gasto-publico-en-el-peru>

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<sup>102</sup> Auditors should be mindful that some assessment frameworks only evaluate budget credibility at the aggregate level.

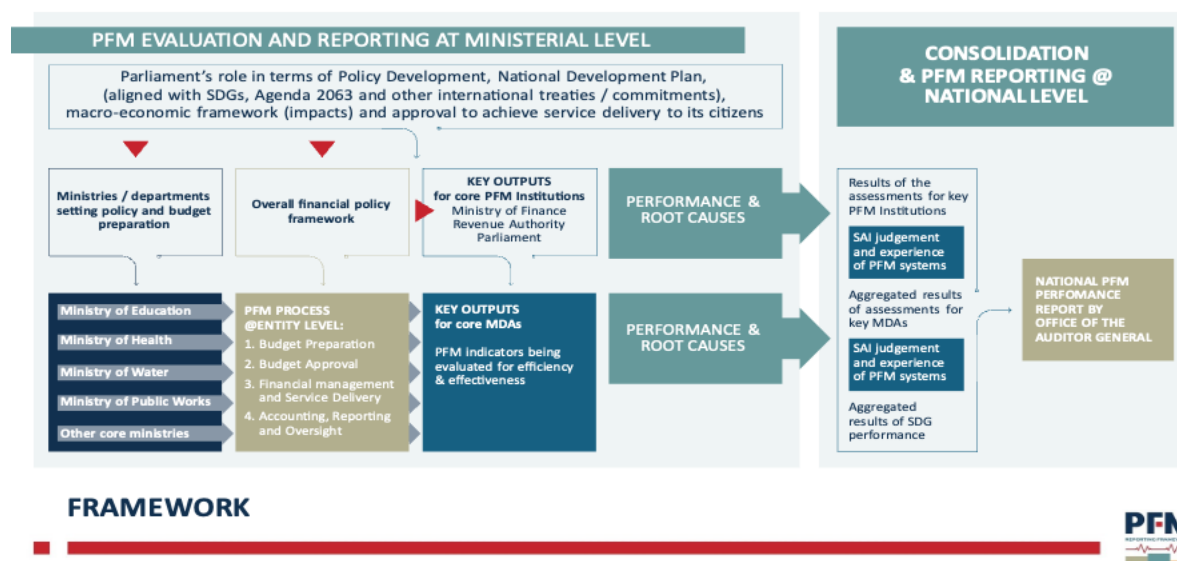
## SAI regional guidelines and reporting frameworks

AFROSAI-E and GIZ have developed the [PFM Reporting Framework](#) enabling auditors to assess the performance of PFM processes along the entire budget cycle.<sup>103</sup> This Excel-based tool covers all stages of the budget cycle starting with macroeconomic policy, fiscal policy, and strategic budgeting; budget preparation; budget approval; financial management and service delivery; and accounting, reporting, and oversight. The tool focuses on the core PFM institutions: the ministry of finance, the revenue authority, and parliament. In addition, the SAI selects line ministries (MDAs) to include, based on their country’s Sustainable Development Goal (SDG) priorities and their budgetary relevance.

verify the readiness of the national PFM system in supporting the SDGs. The tool includes audit procedures focusing on the resilience and disaster preparedness of the PFM system and combines audit procedures from financial, compliance, and performance audits. By recognizing the need to situate audit findings within the wider PFM system and highlighting the interlinkages of root causes for underperformance across audited entities, the PFM Reporting Framework aims to contribute to the drafting of meaningful audit recommendations. Unique methodological features of the tool are the application of root cause analysis (see also Chapter 7, Box 7.1) and the dashboard summary of results. These features result in positive spillover effects into other areas of audit and can be integrated into the annual statutory audit.

The PFM Reporting Framework allows auditors to

Figure 4.2. Overview of the AFROSAI-E PFM Reporting Framework



Source: GIZ/AFROSAI-E.

<sup>103</sup> Available at: <https://pfmreporting-tool.com/resources/#get-the-tool>

Since its inception in 2018, this framework has been applied in 15 countries in Africa, Europe, and Latin America. Several SAIs have moved to conduct the assessment a second time and aim for an annual application. Some SAIs, such as the Office of the Auditor General of Kenya, have integrated the PFM Reporting Framework into their standard audit software. Figure 4.2 summarizes the framework.

## 4.2. Auditing the performance of the PFM System

This section highlights some specific steps and provides examples of how they relate to budget credibility.

### Type of audit

As noted earlier, some SAIs rely on performance audit techniques to audit the performance of the PFM system or some of its processes, while others use other audit methodologies or a combination of various audit techniques. Some SAIs assess the performance of the PFM system for the purpose of forming an audit opinion on the government's financial statements or conduct performance audits that focus on specific aspects of the PFM system. For example, SAI New Zealand noted that "the Auditor General does not assess the performance of the public finance management system itself other than for the purpose of forming an audit opinion on the financial statements of the Government of New Zealand, or in the case of some performance audits where aspects of the PFM system are considered." Other SAIs, such as SAI Indonesia, have systematically conducted various performance audits to assess the performance of several PFM processes and systems in recent years.

### Relevant audit standards

As noted in other chapters of this handbook, to ensure high-quality assessments, SAIs should observe the relevant International Standards for Supreme Audit Institutions (ISSAIs) when conducting compliance, financial, or performance audits of the budget and reporting on the performance of the PFM system and its processes. Chapter 2 presents the international audit standards as they relate to budget credibility.

When auditing the performance of the PFM system, SAIs need to apply audit standards in accordance with the type of audit and objectives that have been set. To make it easier to determine audit criteria, it is recommended that an SAI refer to existing best practices. Each SAI will also have its own standards for performance auditing that should be used in evaluating the performance of the PFM system.

Numerous handbooks are available to assist auditors in conducting each type of audit, for example, the [Financial Audit ISSAI Implementation Handbook](#); the [Performance Audit ISSAI Implementation Handbook](#); and the [Compliance Audit ISSAI Implementation Handbook](#).

### Selecting the area and topic to be audited

When conducting an audit on the performance of the PFM system, it is prudent to have a specific strategy for selecting the key area(s) to be audited, identifying the audit topic, and developing the audit criteria.

## Key steps for selecting an audit topic

- Understand the interests and priorities of the ministry, legislature, government, and other stakeholders such as civil society organizations and/or the public.
- Use selection criteria to ensure audit topics are significant, auditable, and consistent with the SAI's mandate.
- Scan the audit environment by conducting risk, financial, and policy analyses.
- Prioritize audit topics and determine the SAI's highest priorities.

Audit topics related to budget credibility can be derived from two main sources: (1) from general issues identified by scanning the audit environment, including previous audits; government views, budget papers, etc.; agencies' annual reports and evaluations; media and external reports; previous audit fieldwork; analysis of performance indicators; discussion with agencies/entity; and review of legislative and government priorities; and (2) from requests or suggestions from relevant stakeholders, e.g., from

the legislature; government/executives; internal stakeholders; non-governmental organizations; and others.

If the country's PFM system has been assessed using PEFA indicators or another international assessment framework, the SAI can consider the results to identify areas that need improvement and can be the subject of an audit. Feedback from citizens might also be considered in selecting audit topics. (Box 4.3.)

### Box 4.3. Feedback from citizens can also inform the choice of audit topic

In 2013, the **Australia** National Audit Office (ANAO) decided to open all in-progress performance audits to input from members of the public through a web-based platform. Through the ANAO website contact page and social media platforms (Twitter, LinkedIn), members of the public are able to provide comments at any time and on any matter, for example, to raise concerns with an area of administration or to request that consideration be given to a potential audit topic.

Source: <https://intosajournal.org/journal-entry/civil-society-participation-in-audit-the-australian-national-audit-offices-approach-to-citizen-engagement-in-performance-audits/>

In selecting areas to be audited, SAI Indonesia frequently uses a quantitative method called RIAS (risk, impact, auditability, and significance) where each of these four factors are scored, and the area(s) with the highest cumulative scores are proposed as key area(s) for the detailed audit (see Annex 4.1):

- **Risk:** how much risk is management subject to when trying to accomplish the objectives.
- **Impact:** how beneficial is corrective action responding to the audit likely to be.
- **Auditability:** how feasible is the audit considering available audit staff and location.
- **Significance:** how significant is the program/ activity to the organization's goals.

When auditing the performance of the PFM

system, SAI Indonesia refers to previous audits to select audit topics. For example, based on a previous performance audit on budget preparation, the SAI found the planning and budgeting process lacked synchronization between the two separate ministries who handle the process. This finding led to the selection of synchronization of national development planning and budgeting as an audit topic.

## Designing the audit

Designing the audit involves formulating clear and relevant audit objectives, key questions, and identifying audit criteria that will be supported by the documentation of the audit plans and strategy

## Key steps in audit design

- Conduct a pre-study to better understand the audit topic.
- Determine the audit approach.
- Develop the objective(s) to establish the reason for the audit.
- Formulate audit questions to guide the specific areas of the audit.
- Identify suitable audit criteria to measure the audited entity's performance against what is expected.
- Develop the methodology to guide the collection and analysis of information.
- Document the design, such as with a matrix, and develop a project schedule.

## Audit objectives

Formulating the audit objectives is a key step when auditing the performance of the PFM system and is related to the SAI decision regarding the type of audit and audit approach to be followed. In a financial audit the objectives are more general in nature, usually verifying the government’s financial statements and rendering an opinion thereon. In contrast, performance and compliance audits usually have specific objectives and questions. Performance auditing seeks to provide new information, analysis, or insights and, where appropriate, recommendations for improvement according to the principles of economy, efficiency, and effectiveness. As the example of **SAI Zambia** illustrates later in this chapter, an assessment

of the performance of the PFM system can supplement the audit of the financial statements.

**Incorporating budget credibility:** Auditors are encouraged to formulate specific audit objectives and questions that focus on budget credibility as an objective of the PFM system or that relate the performance of the PFM system to budget credibility. As indicated in other chapters, for audits that do not focus exclusively on budget credibility, the audit objective should be flexible enough to allow auditors to relate the potential audit findings with budget credibility in the audit conclusions and recommendations. Some examples of audit objectives to audit the performance of the PFM system or some of its processes are presented in Table 4.1 and Box 4.4.

**Table 4.1. Examples of objectives for an audit of the performance of the PFM system**

SAI/Country	Audit objective	PFM/budget process	Audit objective’s connection to budget credibility
SAI Bosnia and Herzegovina	To assess the extent to which budget planning contributed to increasing the efficiency and effectiveness of budget expenditures.	Budget planning	<ul style="list-style-type: none"> <li>Reliability and transparency of budgets.</li> </ul>
SAI Bosnia and Herzegovina	To assess the effectiveness and efficiency of budget planning and execution.	Budget execution	<ul style="list-style-type: none"> <li>Reliability and transparency of budgets.</li> </ul>
SAI Egypt	To assess whether public funds are used in an economical, effective and efficient way in alignment with the national plan to achieve the Sustainable Development Goals (SDGs).	Budget execution	<ul style="list-style-type: none"> <li>Management of assets and liabilities.</li> <li>Verifying the reasons for under and/or overspending (indicators of budget credibility).</li> </ul>

SAI/Country	Audit objective	PFM/budget process	Audit objective's connection to budget credibility
SAI Latvia	To assess whether the budget planning process was effective.	Budget planning	<ul style="list-style-type: none"> <li>Systematic assessment of fiscal trends as a basis for budget formulation.</li> </ul>
SAI Myanmar	To determine whether the original purpose or objective of the PFM system is achieved, and the budget execution is effective, efficient, and economical.	Budget execution	<ul style="list-style-type: none"> <li>Verifying the reasons for under and/or overspending (indicators of budget credibility).</li> </ul>

### Box 4.4. Examples of audit objectives to assess the performance of PFM processes

**SAI Indonesia** has conducted several audits on the performance of specific PFM processes. These audits use performance and compliance methods. The following are examples of the audit objectives formulated for these audits.

- i. To assess the effectiveness of the preparation and provision of the state budget to support the implementation of the Government-Wide Work Plan.
- ii. To assess the effectiveness and quality of central government expenditure management in the framework of performance-based budgeting.
- iii. To assess the effectiveness of planning and budgeting activities as tools for accountability, management, and policy of COVID-19-related programs.
- iv. To assess whether the synchronization of planning and budgeting for national development in 2021 was conducted in accordance with laws and regulations, including (a) the process of synchronizing national development planning and budgeting, especially regarding government priority projects and major projects; (b) whether national development planning has been supported by a reliable integrated information system.



## Audit questions and criteria

The *audit question* is a description of the audit objectives that have been previously set. To its auditors, SAI Indonesia recommends arranging audit questions into at least three levels of questions such that sub-questions at the lowest level are answered by performing certain audit procedures. The audit sub-questions at the lowest level will also refer to the specific criteria that will be used and become the basis for gathering audit evidence.

*Criteria* in performance audits are often derived from audit questions. Criteria can be qualitative or quantitative with a focus on “*what should be*” based on laws/regulations/standards; “*what is expected*” according to good principles, scientific

knowledge, best practices, or “*what could be, given better conditions.*” After developing audit questions and audit criteria, the auditor then identifies the audit evidence and the procedures necessary to collect this audit evidence. SAIs can use Focus Group Discussions and benchmarking methods in designing the audit criteria and audit questions. (See Box 4.5.)

All the above information, ranging from audit objectives, audit questions, audit criteria, audit evidence, sources of audit evidence, and audit procedures are contained in an audit design matrix (ADM). This matrix must be able to show a logical relationship between the columns. An example of an ADM form used by SAI Indonesia can be seen in Annex 4.2.

### Box 4.5. Developing audit criteria to assess the effectiveness and quality of expenditure management

In 2018, **SAI Indonesia** conducted a performance audit to assess the effectiveness and quality of the central government’s expenditure management within the framework of performance-based budgeting.

Audit objectives focused on expenditure budget planning; expenditure budget execution; and expenditure budget monitoring and evaluation. The auditors set about developing the audit criteria by first identifying better management practices to improve the management of central government expenditure including (1) alignment of planning and budgeting processes to ensure the achievement of national targets; (2) a clear definition of quality spending by considering effective and efficient spending within fiscal limitations and national priority activities, as well as productive spending; (3) effectiveness of performance-based budgeting in accordance with the follow the money program policy; (4) effectiveness of budget implementation (right amount, right time and on target); and (4) effectiveness of the monitoring and evaluation activities that encourage quality spending.

The criteria were developed using various sources including regulations, relevant best practices, as well as preliminary audit results. The auditors held Focus Group Discussions with PROSPERA (Australia-Indonesia Partnership for Economic Development), SAI Indonesia SDG Auditors, and SAI Indonesia Secretariat. The main audit criteria were agreed upon with the Ministry of National Development Planning and the Ministry of Finance.

Ultimately, the *audit criteria* were formulated as follows:

- Activities and expenditures of ministries/agencies are planned and budgeted in a measurable and appropriate manner.
- The implementation of the expenditure budget is effective; and
- Expenditure monitoring and evaluation activities are integrated and effective.

## Conducting the audit

Auditors are required to conduct their audit work professionally and according to established

standards. An SAI can support its auditors with audit tools and skills/capacity development. In general, audit tools and skills needed for PFM audits are similar to other audits.

## Key steps in conducting the audit

- Understand the importance of collecting sufficient and appropriate evidence.
- Gather information and data by employing the approved methodology.
- Analyze the collected information and data using qualitative and quantitative methods.

During the audit, auditors may utilize audit techniques such as Focus Group Discussions (FGD) and Benchmarking to support their argument in areas that are not clearly stipulated in rules/regulations. Auditors can also hire experts to assist them with specialized skills such as statistical computation and analysis. For example, the Office of the Controller and Auditor General of New Zealand (NZ OAG) commonly uses independent external expertise to provide assurance to parliament and citizens that budget preparation is responding to the risks and challenges that arise in a period of increased public spending (e.g., such as during the national response to the pandemic and the implementation of the government's broader reform agenda).

Tools including guidelines/handbooks and computer software are also essential in the audit process. Audit guidelines/handbooks will guide auditors in designing, planning, executing, and reporting the audit to ensure that the audit process meets the requirements set by the standards.

Auditing the PFM system involves processing enormous amounts of data. Integrating big data analysis as part of the audit process requires sufficient hardware. Possession of high-end laptops/PCs accelerates data processing. For field analysis, auditors can consider using drones to reach remote areas to prove whether the government has built infrastructure (e.g., bridges, roads, irrigations) or buildings as stated in the budget execution/evaluation reports.

For computer software in general, computer-based audit tools such as ACL, SQL, office software, and statistics software, are used in the audit process. In addition, Geographical Information System (GIS) software and GPS would also be useful if the auditors need to assess some aspects in a certain area. For example, using geospatial data and analysis to track the scale of stable light in an area for certain longer periods as a proxy for the scale of economic activities.

*Big data analytics (BDA)* is essential in assessing government-wide data. It can be used to analyze data at the whole-of-government level as part of audits on the performance of the PFM system. For example, through BDA, auditors can analyze government budget behavior and discern the trends of each government account over time, both at the whole-of-government level and ministries/agencies level. BDA has been used to analyze and compare the databases of the planning and budgeting systems to determine whether these processes are synchronized. This enables auditors to recognize anomalies in the budget cycle such as whether budget performance indicators (output/outcome) stated in the budget documents are aligned with the indicators stated in the planning documents. BDA has also been used to identify anomalies in the procurement process.

## Box 4.6. Using big data analytics in auditing PFM performance

**SAI Indonesia** has used big data analytics for analyzing and comparing:

- The planning and budgeting systems.
- The data on social grant recipients in the payment system with the master database of recipients.
- Recipient databases from different programs and ministries to determine eligibility of government social grant programs.
- Government budget behavior over time.

SAIs can help develop auditors' competency in auditing the performance of the PFM system through training on topics including system thinking, root cause analysis (RCA), problem-solving, effective communication, IT literacy, and big data analysis, among others.<sup>104</sup> Seminars and Focus Group Discussions (FGD) can also help develop auditors' capacities. During the audit, auditors can also use FGD to identify and address relevant issues regarding budget credibility, collect additional data and information, and confirm identified issues. If needed, auditors can hire experts to assist them in several aspects during the audit (e.g., on statistical analysis).

## Developing audit findings, conclusions and recommendations, and reporting

Where PFM processes show deficiencies or underperformance, auditors analyze the evidence, develop audit findings, and produce recommendations that can highlight areas that affect budget credibility. SAIs should communicate the audit findings to the auditee to receive comments and further clarification on the findings. The expectation is that the main problems identified in the findings will be solved once the audited entity implements the appropriate audit recommendations.

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<sup>104</sup> System thinking is a holistic approach to analysis that focuses on the way a system's constituent parts interrelate and how systems work over time and within the context of larger systems. Root cause analysis (RCA) is the process of discovering the root causes of problems to identify appropriate solutions. See Box 71.

## Key steps in developing audit findings, formulating recommendations, and reporting

- Identify the audit findings.
- Balance positive and negative findings.
- Draft conclusions and recommendations, if applicable.
- Structure the report to effectively communicate the audit results.
- Draft the report in accordance with SAI guidance.
- Obtain the audit entity's comments on the draft report.
- After receiving SAI management approval, finalize and publish the report.
- Communicate the audit results to the relevant parties.

In auditing the performance of the PFM system as it relates to budget credibility, auditors follow their adopted audit standards and practices for the documentation and analysis of audit findings. Communication is essential for developing audit findings; auditors need to maintain effective

and proper communication with the relevant stakeholders within the SAI and the audited entities. Box 4.7 provides a look at SAI Indonesia's audit findings on expenditure management, a key aspect of PFM.

### Box 4.7. SAI Indonesia: Audit findings on expenditure management using the performance-based budgeting framework

#### Expenditure budget – planning

- *The government did not have an explicit policy to define and set indicators of quality expenditure:* The quality of government spending is important to manage state finances in a way that supports economic growth and ensures fiscal sustainability. However, the Indonesian government did not have specific arrangements to define and measure quality expenditure nor a roadmap for ensuring the quality of spending in order to support the achievement of the targets included in the medium-term national development plan in a sustainable and comprehensive manner.

- *Lack of a mechanism to disaggregate the performance indicators of performance-based budgeting:* The government did not have a technical guide to establish the hierarchy and accuracy of the target indicators according to the logical relationship between them. There were problems of alignment between targets and activities and sub-activities, and the performance targets had not been fully used as the basis for selecting programs/activities. In addition, the development target indicators included in the 2015-2019 Medium-Term National Development Plan were not disaggregated at the level of activity output indicators. Some indicators were unclear, not relevant or could not be measured.
- *Sharing data processes between the planning and the budgeting information systems were less than optimum.*

#### **Expenditure budget – execution**

- Some budgets were not executed in a timely manner. The cash withdrawal plan was not optimally used as a performance indicator in evaluating budget implementation due to accuracy problems. The absorption of state spending accumulated at the end of the year. Some outputs of the execution of the expenditure budget were not as planned.

#### **Expenditure budget – monitoring and evaluation**

- The existence of three monitoring and evaluation information systems for execution and budgeting undermined the consistency of data between the budget ceiling and budget realization. Some national priority targets of 2017 were not reported.

Recommendations to correct the deficiencies and other findings identified during the audit are developed, as needed. Auditors should communicate their recommendations as early as possible and should discuss and obtain the audited entity's comments on the audit findings and recommendations before publishing the report and submitting it to the government and the parliament. Many SAIs (including SAI Indonesia) require the audited entity to prepare an action plan detailing the actions to be undertaken to implement the audit recommendations, as well as the proposed timeline. Chapter 7 elaborates on this practice and the follow-up to audit recommendations.

Conclusions allow auditors to make a concise and persuasive argument that action is needed to address a deficiency. When drafting conclusions, the audit team should critically consider how they relate to the audit findings, evidence, audit criteria, and the audit objective.

### **Following up on audit results**

As indicated in other chapters, audits that examine the performance of the PFM system or some of its processes and activities should observe the reporting requirements established by

the SAI, following international practice. Chapter 7 provides examples and practical information on how SAIs may address budget credibility and improve the performance of the PFM system through well-crafted audit recommendations, effective monitoring and follow-up, and engagement with stakeholders.

### 4.3. Combining assessment tools and auditing to evaluate PFM: Zambia's experience

Some SAIs have reviewed the performance of their PFM system by combining available assessment frameworks with audit methodology. For example, SAI Zambia has combined the PFM Reporting Framework developed by AFROSAI-E with the process of annual financial audits to assess the performance of the main entities of the PFM system. This section presents detailed information and practical steps to using this approach based on the experience of SAI Zambia.

#### Zambia: Approach and methodology

SAI Zambia has used several methodologies and procedures to conduct the assessment in combination with audit techniques. First, to facilitate compliance with the requirements of

INTOSAI-P-12, the SAI used the PFM Reporting Framework tool (discussed earlier in this chapter), an assessment tool with 112 questions.<sup>105</sup> Second, the audits were conducted using the financial audit methodology. The audit findings were analyzed using the "5 Why model" to understand the root causes/deficiencies that led to the audit findings. The findings and key observations were linked to one or more of five institutional capacity areas: (i) policy and legal framework; (ii) organizational structure and human resources; (iii) information systems; (iv) governance and oversight, and (v) communication and stakeholder management.

Third, the performance assessments of the PFM processes and entities were done using the PFM Reporting Framework dashboards. The processes were scored from zero (no process implemented) to a maximum of four (performance functioning ultimately as designed). A performance score below two indicated a risk area. Fourth, interviews were conducted with key personnel and the management of the institutions involved to gather an understanding of the key PFM processes.

Finally, a review of documents helped the auditors obtain sufficient and appropriate audit evidence. A list of the useful documents reviewed is presented in Box 4.8.

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<sup>105</sup> The PFM tool can be accessed from the website <https://pfmreporting-tool.com/resources/#get-the-tool>.

## Box 4.8. Documents reviewed to assess PFM performance in Zambia

- Constitution of Zambia (Amendment), Act No. 2. of 2016.
- Appropriation Act of 2019.
- 2020 Annual Economic Report.
- National Planning and Budgeting Act.
- Public Finance Management Act No 1 of 2018.
- Service Commission Act.
- Voluntary National Review on the Sustainable Development Goals (SDGs).
- Seventh National Development Plan (NDP).
- Medium-term Expenditure Framework and Green Paper.
- Budget Process in Zambia.
- Central Government Accounting Policies.
- Guidance on Risk Management Framework.
- Budget Outturn Report.
- Output Based Budget.
- Budget Speech.
- Public Financial Management Handbook for Members of Parliament and Staff.
- Debt Statistical Bulletin.
- Debt Sustainability Analysis.
- Central Bank of Zambia Annual Report on National Payments Systems in Zambia.

The criteria applied to select entities for auditing included (i) those that received large budgetary allocations in relation to the overall national budget; (ii) those that had institutional capacity to contribute to the achievement of the SDGs as outlined in the country's National Development Plan (NDP).

### **Zambia: Findings, recommendations, and expected benefits in terms of budget credibility**

***Significant findings.*** A combination of using various sources of information and audit methodologies helped the Zambian auditors identify the following:



- The SDGs were incorporated into government policy documents, including the planning documents of the NDP, and responsibilities were distributed among various institutions through cluster advisory groups. The country prepares a five-year NDP which reflects the government agenda (and is aligned to the electoral/political process).
  - Although institutional strategic plans are aligned to the NDP, most of these plans are not regularly updated due to delays in the preparation of the NDP and the high turnover of key personnel.
  - While the Ministry of Finance consults various stakeholders who are required to submit their budget proposals regarding expenditure and tax and non-tax revenues, participation in the consultation process by some stakeholders was limited.
  - Most of the budgeting documents, such as strategic plans, were not costed. Ultimately, the budgets prepared by the institutions were usually cut and the final allocations in the approved budgets by the legislature were less than requested, largely due to the budget ceilings set by the Ministry of Finance.
  - The SAI found weaknesses in several areas related to budget execution including procurement, payroll management, internal controls and audit, cash management, and insufficient monitoring of SDG implementation and service delivery.
  - Other significant findings included the lack of alignment between the debt management policy and the medium-term fiscal strategy; weak mechanisms for tracking and accounting for resources disbursed to the institutions (due to the lack of integration of the Financial Management Information Systems); and the inaccuracy of revenue, grants, and expenditure projections, which were below the actual outturns.
- Recommendations.** To address these findings, the SAI recommended the following actions:
- Implement stakeholder awareness programs on the importance of participating in the budget process to ensure that public concerns are addressed during the formulation of the budget.
  - Ensure various core PFM institutions update their strategic plans in line with the current NDP in a timely manner.
  - Ensure the Revenue Authority makes realistic revenue projections that reflect the tax base and takes steps to enhance taxpayer awareness of the importance of paying their tax obligations.
  - Establish a system to manage the expansion of debt by the Executive such that the approval of any new debt must be approved by the legislature.
  - The Ministry of Finance's debt management system should be interlinked with the Central Bank to ensure debt settlement is supported by available resources.
  - During budget approval, the Ministry of Finance should ensure that the budget ceilings set for ministries, departments, and other spending agencies (MDAs) are sufficient for them to carry out their mandates and to accomplish the objectives included in the Strategic Plan and NDP.
  - Budget documents should be costed with proper/realistic estimates to enable adequate

funding that allows institutions to fulfill their obligations and mandates under the NDP.

- Financial Management Information Systems (FMIS) should be integrated and rolled out from head offices to the lowest-level spending units to ensure timely preparation of financial and other reports, sharing of information, and accountability.
- The payroll system should be robust and integrated. Information should match the actual workforce and be regularly reviewed.
- Enhance public procurement regulations.
- The Audit Committees should adequately carry out their oversight functions on the financial reporting processes, reviewing the institutions' internal control environments.
- Improve the use of Commitment Controls to effectively establish a system of expenditure control and prevent entities from incurring unauthorized commitments.
- The ministries should put in place adequate monitoring mechanisms, including staff training, to identify shortcomings in service delivery and take corrective actions as needed.

**Benefits to budget credibility.** The implementation of these recommendations would strengthen PFM and enhance budget credibility by increasing accountability over the utilization of public resources and the likelihood that funds are used, as intended, for the benefit of the designated beneficiaries. Improved access to information

and stakeholder engagement programs would contribute to a more inclusive budgetary process and the informed participation of citizens in the budget process. The improved flow and sharing of information between different financial systems, internal controls, and oversight institutions would also help in preventing fraud.

Budget documents that are costed with proper/ realistic estimates, based on up-to-date strategic plans, would enable MDAs to negotiate more appropriate budget ceilings (i.e., based on the cost of meeting their sector objectives and relative contribution to GDP) during the budget hearings and negotiations of the budgeting process. This could transform the budget hearing/negotiation process away from being a purely formal exercise. Rather, MDAs could present realistic budgets, reflecting their actual resource needs to meet their respective sector objectives outlined in the NDP. The Ministry of Finance and the Parliament should be aware of this information and provide appropriate feedback to the MDAs to inform their future budgeting.

Increased awareness and adherence by taxpayers on the need to pay their tax obligations would result in both the expansion of the tax base and more revenue to support the Ministry of Finance in its budget preparation process.

Linking the debt management systems of the Ministry of Finance and the Central Bank would make it easier to establish a clear and comprehensive country debt position, and enable the Ministry of Finance to make informed and coordinated decisions on debt contracting and management.

The rolling out of the Integrated Financial Management Information System (IFMIS) to all government institutions would facilitate the dissemination of financial information to enable efficient production of financial statements and support the monitoring of budget execution. It would also help the timely and comprehensive capture of financial transactions by units under MDAs that are not connected to the IFMIS for reporting purposes. Making the IFMIS more flexible and relaxing certain procedures to facilitate quick disbursement in case of emergencies, while adequately accounting for those resources, would increase disaster preparedness and the timely response to emergencies at both national and institutional levels.

#### 4.4. Additional SAIs share significant audit findings, recommendations, and impacts

In the 2022 UNDESA/IBP SAI survey, several SAIs highlighted examples of significant impacts of their audit work on the performance of the PFM system. This section presents some of them, organized by PFM process.

### Policy design – Findings, recommendations, and audit impacts

A common finding at the policy design stage is that the models and assumptions used as the basis for policy-making are not up-to-date.

**SAI Netherlands** recommended the government improve legal provisions and control, and that the parliament actively verify draft budget estimates. As a result, the parliament has successfully pressed the government to adopt the same accountability regime that applies to the regular budget laws to several newly installed funds that contribute to major fiscal expansion. Similar but more technical issues have also been found by SAI Latvia and SAI Indonesia.

In an audit on the effectiveness of budget planning, **SAI Latvia** revealed that no assessment was conducted on the level of debt that Latvia could afford. Also, there was no economically sound assessment of the optimal level of debt that Latvia could incur in the long-term considering pessimistic demographic growth estimates. Identified impacts of this audit included the setting of a clearer and more equal procedure for reviewing the base expenditure of institutions; the term “budget investment” was more clearly defined and the budget remarks provided more complete information on the planned public investment projects by sector; and the budget explanations disclosed information on the impact of the most significant tax reliefs (rebates) on the state budget for the ensuing years.

On the revenue side, **SAI Indonesia** found that the government had not fully considered all possible impacts from policies in the taxation

sector when preparing the tax revenue budget. In addition, in the non-taxation sector, the revenue target from the sale of oil and gas was not based on the lifting targets agreed upon by the authorities and the contractors. The SAI recommended the finance minister establish a mechanism for preparing revenue targets that considers the impact of each tax policy or tax policy plan and that the government determine the mechanism for calculating the oil and gas non-tax revenue budget in the annual budget in line with the reliable oil and gas lifting target. Based on these recommendations, the government has considered tax policies while budgeting for tax revenue.

**SAI Portugal** discovered that vast reforms of public financial management, with very ambitious schedules, were undertaken with insufficient strategy and coordination, a lack of human and material resources, and insufficient skills and training in public administration. The audit recommended the government define the leadership and coordination of the reforms and update the implementation strategy by setting priorities and phased processes. As a result of the audit, leadership and coordination were enhanced and professional training was planned for the implementation of the new accrual accounting system. Half of the public entities completed their transition to the new accrual accounting system and reported their 2020 accounts under that

regime. The public financial management reforms were included in the Portuguese Recovery and Resilience Plan, ensuring the allocation of required financial support in the following years.

## Budget preparation: Findings, recommendations, and audit impacts

A timely and transparent budget preparation process can be an indicator of a sound and well-performing PFM system.

**SAI Bosnia & Herzegovina** found the budget preparation process was not timely nor sufficiently transparent and clear responsibilities for defining goals, programs, and related budget funds were not always established. Up-to-date and complete information on the budget was not always available to all interested parties. The SAI recommended the government ensure the timely completion of budget preparation; consider how to establish a politically-driven budget review process; and increase the use of performance information in the budget preparation process – with an ultimate goal of making the latter the primary criterion for budget decision-making.

### Box 4.9. SAI Indonesia – Budget preparation: Findings, recommendations and impacts of PFM audits

#### Findings:

- The setting of indicative ceilings had not considered the performance of ministries in previous years.
- The government had no specific and explicit policy to set definitions or indicators of quality expenditure; and
- Management of performance-based budgeting had no performance indicator cascading mechanism.

#### Recommendations:

- To the government: improve the mechanism preparing the indicative ceilings and consider the performance of ministries in previous years when allocating the budgets.
- To the finance minister: determine the definition and indicators of quality expenditure.
- To the national development planning minister: establish guidelines on performance indicator cascading mechanism.

#### Impacts:

- The government has developed a framework to define and set indicators of quality spending.
- The budget execution performance indicator as well as performance evaluation have improved.

### Budget execution: Findings, recommendations, and audit impacts

The issues raised by the SAIs at the execution stage usually revolve around the inaccuracy of receipts and expenditures compared to the approved budget.

**SAI Myanmar** observed that revenues were not

fully collected and expenses were not effectively utilized as per the budget proposal in most of the line ministries and agencies. SAI Myanmar recommended that these institutions collect the relevant revenues fully and utilize the expenditures effectively and efficiently as per the budget proposal.

Issues with unutilized budget provisions resulting from non-implementation or the delay in the implementation of significant projects were found

by **SAI Mauritius**. The audit advised management to put in place an adequate mechanism for the prompt implementation of projects.

**SAI Japan** noted a large amount of carry-over and unused budget. The audit recommended that ministries and agencies analyze the causes to accelerate the implementation of measures related to COVID-19; make an effort to execute the projects in a timely and appropriate manner; and provide the public with information on the budget implementation status of the projects. Based on these recommendations, the government provided more information on the status of budget execution regarding COVID-19 measures and initiatives ahead of the Tokyo Olympic and Paralympic Games.

**SAI Cuba** discovered that the automated systems for budget control at all budget levels were

not interconnected with other systems of the state financial administration, and there were weaknesses in the implementation of internal control systems in budget units. To solve these issues, SAI Cuba recommended prioritizing actions to hasten the move to the computerization strategy of the state financial administration systems to enable real-time monitoring of budget execution, with the use of CAATs<sup>106</sup> incorporating BIG-DATA and data analytics. These recommendations would facilitate improvements in the treasury system; the implementation of the government accounting system and approval of measures to strengthen the general accounting of and financial discipline of entities; and strengthen tax control and the implementation of measures to combat tax evasion.

### Box 4.10. SAI Philippines – Budget execution: Findings, recommendations, and impacts of PFM audits

#### Findings:

- **Underspending:** Fund releases under the Department of Budget and Management (DBM)-administered Financial Assistance (FA) to Local Government Units (LGUs) and Assistance to Cities (AC) were only 46.3 percent and 5.7 percent, respectively, of the total appropriations for Fiscal Year (FY) 2018; thus, resulting in missed opportunities to provide the services intended for the public under the said funds.
- **Delays** of 2 to 132 working days were noted in the processing of Special Allotment Release Order (SAROs) under the Local Government Support Fund (LGSF) for FY 2018, thereby hindering the timely implementation of priority projects and programs financed by the fund.

<sup>106</sup> CAATs are computer-assisted audit tools.

### Recommendations:

- *For FAs to LGUs:* assign the DBM Regional Offices the tasks of providing technical assistance to LGUs, conducting an initial review of LGUs' requests and of the completeness of their documentary requirements, and forwarding the compliant requests to the Central Officer (CO) for evaluation.
- *For ACs:* consider providing technical assistance to those LGUs that do not have the financial capacity to hire consultants to conceptualize the design of complex projects. Also, increase the number of seminars and workshops to be conducted to inform the city officials concerned of the documentary requirements to be complied with.
- *For management:* require the Local Government and Regional Coordination Bureau (LGRCB) to ensure that all requests/endorsements from LGUs/Department of Interior and Local Government are processed and approved within 15 working days as committed in their Office Performance Commitment and Review (OPCR).

### Impacts:

- The DBM has improved its management of LGSF in CY 2019 and the years thereafter. On the other hand, the Bureau of the Treasury (BTr) was able to properly monitor their budget vis-à-vis actual expenditures and improve reporting in the Statement of Budget and Actual Amounts, through compliance with the audit recommendations.
- The government has developed a framework on definitions and indicators of quality spending.
- The government has improved the budget execution performance indicator as well as performance evaluation.

## Accounting and reporting: Findings, recommendations, and audit impacts

Information and reporting mechanisms are critical to assessing the performance of the PFM system. Accounting and reporting mechanisms ensure some standardization of what items need to be reported on, to whom, and how. However, SAIs have identified some critical issues in this area.

**SAI Azerbaijan** observed incorrect reporting of individual components of public finance, non-compliance of accounting and reporting

with legal provisions and best practices, and lack of knowledge on budget documentation. The SAI advised the government to consider the provisions of legal acts, introduce new fiscal institutions, widen the application of best practices, and prepare a Budget Code. This guidance led to the implementation of new fiscal institutions, improvements in the MTEF and budget regulations, and improvement of budget documentation.

**SAI Bosnia-Herzegovina** noticed that the availability of information on the achievement of program goals was limited. Reports and information on the effectiveness of programs

and institutions were rare, and often unavailable to the public and to those responsible for the preparation and adoption of the budget. For most of the program budget objectives, information on their implementation was not included in the existing reports. The SAI recommended the government ensure all interested parties have immediate access to all available information on the implementation of defined program goals of institutions and that the government improve the information system and establish financial reporting according to the program classification.

**SAI Egypt** pointed out that with the issuance of the Unified Public Finance Law no. (6) for the year 2022, it was necessary to make some accounting amendments that the audited entity was informed about. This resulted in the proper utilization of

public funds; promoted the performance of the PFM system to achieve the SDGs; and facilitated auditing the extent of the commitment to implementing the State Financial Policy.

**SAI Netherlands** found that the government is not systematically registering its assets and that the reporting of government performance is fragmented and lacks a common architecture. Therefore, it recommended adopting government-wide accrual standards to improve asset registration and management, and to select a limited number of key national indicators to be monitored independently. As a result of these recommendations, the government announced it would integrate a set of independently monitored key national indicators in its budget process.

### Box 4.11. SAI Yemen – Accounting & reporting: Findings, recommendations and impacts of PFM audits

#### Findings

- Final accounts data did not include the results of actual implementation of the budget of the economic institution.
- Failure of most enterprises/units of the economic sector to complete their financial statements on time, resulting in a discrepancy between the financial statements issued by the respective economic units/enterprises and the final account statements issued by the Ministry of Finance.
- The final calculations of the budgets of the units of the economic sector did not realistically reflect the actual withdrawal of external financing in those units, where the resources achieved from external loans according to the final accounts data amounted to about one billion Yemeni riyals, while the actual withdrawal from the reports of loans and assistance issued by the Ministries of Finance and of Planning and International Cooperation was over eight times that amount.



### **Recommendations**

- Require the economic units to complete their financial statements on time as set by the Financial Law and its relevant regulations/bylaws.
- The Ministry of Finance must not accept any final account for any economic unit unless its financial data are obtained from the approved financial statements of that entity and for the same period.
- The Ministry of Finance should require the sector specializing in loans and external assistance to coordinate with the Ministry of Planning and International Cooperation to reconcile financial information of loan centers with the economic units benefiting from this external financing, and monitor the estimates of allocations in annual budgets and the actual use of them in the final accounts in order to avoid the discrepancies and disparities that appear annually.

### **Impacts**

- Most economic units complete their accounts and submit them to the agency and the Ministry of Finance on the legally set dates.
- Completion of the financial statements of most economic units on time.
- Coordination between the foreign relations sector of the Ministry of Finance and the respective sectors in the Ministry of Planning and International Cooperation to determine the actual withdrawal of loans and foreign assistance, which leads to showing f all the amounts withdrawn in the final accounts of the economic units

## Budget evaluation: Findings, recommendations, and audit impacts

Adequate management and evaluation tools are needed to conduct an effective budget evaluation in the last part of the PFM cycle, before starting the next.

**SAI Bosnia-Herzegovina** reported that independent monitoring has not been organized for most of the program objectives of their institutions, and evaluation reports were rare. Ministries and Council of Ministers (CoM) bodies did not have oversight in place for all areas under their responsibility. Available assessment reports in some areas are not tailored to the needs of those responsible for preparing the budgets. The limited availability of information on the realization of program budget objectives limits the potential impact of results on future budget allocations. Without information on the program objectives and their implementation, it is difficult to prepare and adopt a budget that encourages the efficiency and effectiveness of budget expenditures. SAI Bosnia Herzegovina recommended the Parliament and the CoM consider how to develop a politically-driven budget review process.

**SAI Philippines** observed that the Department of Budget and Management (DBM) did not have a complete monitoring and evaluation system over the release of funds under the Local Government Support Fund (LGSF), particularly on the financial assistance (FA) to local government units (LGUs) and assisted city (AC) components. Therefore,

no overall assessment was made to determine whether the primary objectives of the programs were achieved. SAI Philippines recommended the Director of the Local Government and Regional Coordination Bureau (LGRCB) establish a complete monitoring and evaluation system by (a) preparing a consolidated report on the status of project implementation and fund utilization from FYs 2016 to 2018 and for the years thereafter pending the development of the Unified Reporting System (URS); (b) drafting and issuance of policy guidance for monitoring and evaluation of projects; and (c) carrying out of an evaluation of the completed projects at the regional level to validate the status provided in the reports submitted by LGUs. Moreover, SAI Philippines recommended imposing appropriate sanctions to LGUs that do not comply with the reporting requirements and with prescribed project timelines, as reflected in their Program of Works.<sup>107</sup>

## 4.5. Challenges in auditing the performance of the PFM system

SAIs experience some common challenges, both internal and external, when auditing the performance of the PFM system.

### Internal SAI challenges

#### 1. Lack of expertise on PFM issues.

Auditing the performance of the PFM system is

<sup>107</sup> This case is related to the one presented in Box 4.10 on the Local Government Support Fund, but here the focus is directly on the monitoring and evaluation system of the Fund. In Table 6.2 (under Timing of Spending), a related issue is also presented as an example of a risk factor.

different from auditing the financial statements, which is the work that auditors are most familiar with. One challenge is to map the key areas and processes to be examined and select/develop suitable criteria. Inadequate human resources and insufficient skills (e.g., ability to mine big data) may limit the audit scope.

SAIs can address these shortcomings by facilitating knowledge sharing, providing comprehensive training programs, and organizing workshops for auditors. In addition, SAIs could design the audits incrementally. For example, to audit how the government manages debt financing, auditors need to understand several aspects starting from budget formulation, budget execution, and cash management. Therefore, the audit could be designed incrementally, starting with auditing budget formulation in year  $x$ , then budget execution in year  $x+1$  and  $x+2$ , cash management in year  $x+3$ , and debt management in year  $x+4$ .

## **2. Limited resources.**

SAIs may have allocated most of their resources to mandatory and/or priority audits. In addition, SAIs may not have sufficient support for acquiring computer hardware and software or for the IT infrastructure needed to work with the large databases where most of the data used for the PFM system are stored.

## **3. Siloed organizational structure and working methods.**

Conducting a performance audit of the PFM System requires coordination of several units within the SAI since the PFM system involves many government agencies across all levels. Different SAI units are responsible for auditing the central government, local government agencies,

and state-owned and local government-owned enterprises. Therefore, it is crucial to coordinate all audit activities to produce comprehensive audit reports about the PFM system. If the audit agencies only focus on their respective duties and functions, it will be difficult to get a comprehensive picture of the PFM system. Hence, SAIs need to adopt a “whole-of-SAI” approach and break the “silos” within the organization.

SAI Indonesia addressed this challenge by conducting an audit with a National Thematic Audit Approach. This approach involved several units in SAI Indonesia to conduct audits on specific themes related to the SDGs. For example, five different audit units worked together to produce a comprehensive audit report on the quality of education that engaged several government agencies (e.g., Ministry of Education, Local Government Education Agencies, National Statistics Agency, Ministry of Social Affairs, National Planning Agency, and Ministry of Financial Affairs).

During the pandemic, in an effort to break the silos and deliver coordinated sound recommendations, SAI Indonesia initiated Audit Universe, an audit strategy involving all the audit units in the organization to ensure accountability and transparency of government efforts in combating Covid-19 across all government bodies vertically and horizontally.

## **4. Lack of customized assessment frameworks.**

Not all SAI regional organizations or INTOSAI groups have issued customized PFM assessment frameworks that may help SAIs to conduct their assessments. Therefore, SAIs may need to design and develop their own approaches, drawing on existing frameworks.

## External process challenges

### **1. Multiple (potentially conflicting) objectives of the PFM system** (e.g., expansive budgeting policy versus fiscal rules) **can make it difficult for auditors to determine audit objectives.**

As to audit objectives, SAIs need to find, assess, select, and determine the most important issues or problems in their national PFM systems.

### **2. Inadequate internal controls.**

The government may not have implemented adequate internal controls over financial reporting and management activities. In these cases, the integrity, reliability, and even the quantity of data and documents processed by the government will be limited and the SAI may need to conduct extra work in certain areas. Auditors can assess this problem as part of their auditability analysis to determine whether the audit can be carried out or not. Auditors can also consider conducting an audit to improve internal control.

### **3. Complexity of the system and audited entities plus a lack of synergies and collaboration among key stakeholders of the PFM system.**

PFM is complex. First, multiple budget cycles usually take place simultaneously. The external audit and accountability process for a previous year's spending takes place while resource management processes are active for the current year. At the same time, the strategic budgeting process has already begun for the following year. Secondly, each process involves a wide range of government bodies, entities, and agencies, each with their own characteristics, priorities, and interests. Spending entities want to see

their budget allocation increase, for instance, but finance ministries are tasked with keeping overall spending under control. These tensions make the PFM process a competitive and contentious one. International organizations contribute to this mix in many countries, advising governments on reform initiatives and sometimes financing a substantial share of public spending.

For example, in Indonesia, the planning and budgeting functions are carried out by two different ministries (the Ministry of National Development Planning and the Ministry of Finance). This separation of duties discloses several issues of synergy and synchronization between the planning and budgeting process. Some planned programs may not have a budget allocation, some budgeted programs are not included in the planning documents, and different information systems are used for each process which ushers in redundancy and challenges for monitoring and evaluation.

In addition, each government agency may have its own data collected and processed for its programs. However, the data of one government agency may lack integrity and interoperability with the data of other government agencies. The lack of data interoperability among government agencies would be the main drawback of implementing a social support program since different data are used for different programs resulting in inclusion and exclusion errors. Therefore, an SAI needs to collect and analyze data from many different government agencies.

### **4. Limited access to information.**

An SAI may face challenges regarding data availability, especially for confidential documents related to budget approval by parliament and approved macroeconomic assumptions. Auditors

may have to go through several steps (that take up audit time) to access the data.

SAIs need to evaluate the necessity of confidential information for the audit conclusion and to ensure enough time to obtain such information if it is deemed significant for the audit.

## 4.6. Recommendations for SAIs

- 1. Understand the SAI mandate** – Auditors should familiarize themselves with their SAI mandate so as to identify entry points for auditing the performance of the PFM system.
- 2. Use and develop big data analytics to support audits of the PFM system** – SAIs need to enhance their IT hardware and software capacity as well as the auditor’s IT skills to collect and analyze data from various government sources.
- 3. Cooperate with other SAIs on capacity development** – SAIs may jointly improve their organizational capacity and professional competence in some areas, such as on fiscal and macroeconomic policy, budget credibility measurement using the Public Expenditure and Financial Accountability (PEFA) framework, the IMF Fiscal Transparency Code, Fiscal Transparency Evaluation, economic and financial analytical data, and forecasting for future trends such as computational assumption analysis on economic growth, inflation, and long-term fiscal sustainability.
- 4. Select the area of PFM in greatest need of an audit** – Identify areas that most need improvement and for which the audit could have an impact. If several areas are identified, the SAI may consider conducting a series of audits.
- 5. Ensure the effectiveness of follow-up to audit recommendations** – Follow-up on the audit recommendations by the government needs to be monitored. SAIs should have an effective follow-up mechanism. Further discussion on this issue is presented in Chapter 7.

# Annexes

#### ANNEX 4.1. Applying the RIAS method to examine the performance of expenditure management – an example from SAI Indonesia

A RIAS form is used for the following audit:

**Audit Objective:** To assess the effectiveness of expenditure management by the central government in the framework of performance-based budgeting

**Audited Entities:** (1) Ministry of Finance; (2) Ministry of National Development Planning; (3) Ministry of Health

**Audit Scope:** The budget year 2018 and the first semester of 2019

No.	Potential Key Areas To Be Audited	Selecting Factor (Score) <sup>6)</sup>				Total Score	Order of Priority of Key Area	Decision (Chosen/ Unchosen) <sup>5)</sup>
		Risk <sup>1)</sup>	Impact of Audit <sup>2)</sup>	Auditability <sup>3)</sup>	Significance <sup>4)</sup>			
1	Design of Performance-Based Budgeting	2,13 <sup>1)</sup>	2,50 <sup>2)</sup>	2,75 <sup>3)</sup>	2,00 <sup>4)</sup>	8,38	4	Unchosen
2	Planning and Budgeting	2,50 <sup>1)</sup>	2,33 <sup>2)</sup>	2,75 <sup>3)</sup>	2,33 <sup>4)</sup>	8,91	2	Chosen
3	Budget Execution	2,50 <sup>1)</sup>	2,83 <sup>2)</sup>	2,75 <sup>3)</sup>	2,33 <sup>4)</sup>	9,41	1	Chosen
4	Monitoring and Evaluation	2,25 <sup>1)</sup>	2,67 <sup>2)</sup>	2,75 <sup>3)</sup>	2,00 <sup>4)</sup>	8,67	3	Chosen

- Risk** is related to how much risks are faced by management in achieving the objectives set out in the economy, efficient, and effective framework. (See Annex 4.1.1)
- Impact** is related to how much benefit and improvement could be gained by the entities if they implemented the audit recommendations on each key area. (See Annex 4.1.2)
- Auditability** is related to the feasibility of an area to be audited by considering factors such as the number of auditors and audit location. (See Annex 4.1.3)
- Significance** is related to how significantly a program/activity will contribute to the organization's goal. (Annex 4.1.4)
- Subject to auditor professional judgment. The audit team may choose one or more potential key areas to be audited. The decision takes into account the available audit resources.
- Scoring Scale:** – High: 3; Medium: 2; Low: 1

Note: In the tables on the following pages, the blank spaces in this example are normally meant to be filled out. Also, the factors included in each table are subject to the auditor's professional judgment.

### ANNEX 4.1.1 – RISK

No	Potential key areas to be audited	RISK FACTORS																Average Score
		A		B		C		D		E		F		G		H		
		Score	Desc.	Score	Desc.	Score	Desc.	Score	Desc.	Score	Desc.	Score	Desc.	Score	Desc.	Score	Desc.	
1	Design of Performance-Based Budgeting	2	By design, budgeting is prepared based on the performance of the previous 2 years	3		3		2		3		2		1		1		2,13
2	Planning and Budgeting	2		3	The performance targets listed in the Work Plan were not achieved significantly	2		3		3		3		2		2		2,50
3	Budget Execution	3		3		3	No changes were made to address the overspending of personnel spending	2		2		3		2		2		2,50
4	Monitoring and Evaluation	2		1		2		2		3	Multiple government agencies involved	3		2		3		2,25

#### RISK FACTORS

- A. Significant under/over budget spending
- B. Not achieving the goals that have been set
- C. Management does not react to weaknesses found
- D. Sudden program expansion
- E. Relationships of responsibilities that are overlapping, unclear or confusing
- F. Activities that are complex in an environment full of uncertainty
- G. Lack of security of electronic data and/or information systems
- H. Indication of Non-compliance Audit Finding



## ANNEX 4.1.2: IMPACT OF AUDIT

No	Potential key areas to be audited	IMPACT OF AUDIT FACTORS												Average Score
		A		B		C		D		E		F		
		Score	Desc.	Score	Desc.	Score	Desc.	Score	Desc.	Score	Desc.	Score	Desc.	
1	Design of Performance-Based Budgeting	3	Improvement in implementation and measurement of achievement	3		3		2		2		2		2,50
2	Planning and Budgeting	3		3	Improvement in standardization of performance indicators, related to the determination of outputs and outcomes	3		2		2		1		2,33
3	Budget Execution	3		3		3	Improve the transparency and accountability of budget execution performance outcomes	3		3		2		2,83
4	Monitoring and Evaluation	3		3		3		3	Encourage the government to use the performance information reported to develop more efficient planning by taking into account past performance achievements	3		1		2,67

### IMPACT OF AUDIT FACTORS

- A. Effectiveness
- B. Improved planning, control, and management
- C. Increased accountability
- D. Efficiency
- E. Economic
- F. Service Quality Improvement

### ANNEX 4.1.3: AUDITABILITY

No.	Potential key areas to be audited	AUDITABILITY FACTORS							Average Score
		A				B	C	D	
		A.1	A.2	A.3	TOTAL				
1	Design of Performance-Based Budgeting	2	2	2	2	1	2	2	1,75
2	Planning and Budgeting	2	2	2	2	1	2	2	1,75
3	Budget Execution	2	2	2	2	1	2	2	1,75
4	Monitoring and Evaluation	2	2	2	2	1	2	2	1,75

### AUDITABILITY FACTORS

- A. Personnel
  - A.1. Auditor skills/expertise
  - A.2. Auditor's experience of the area to be audited
  - A.3. Number of auditors
- B. Time available to conduct the audit
- C. Significant changes to the entity
- D. Audit Location

#### ANNEX 4.1.4: SIGNIFICANCE

No.	Potential key areas to be audited	SIGNIFICANCE FACTOR						Average Score
		Materiality		Critical Limit of Success		Visibility		
		Score	Description	Score	Description	Score	Description	
1	Design of Performance-Based Budgeting	1		2		3	Weaknesses in the design will significantly affect the achievement of the expected outcomes for the public	2,00
2	Planning and Budgeting	1		3	If problems are resolved, will have a significant impact on the overall performance-based budgeting process	3		2,33
3	Budget Execution	2	The budget and realization of the sampled area are material	2		3		2,33
4	Monitoring and Evaluation	1		2		3	Disorderly reporting of monitoring and evaluation results and invalid data will make it difficult to see how far a program or activity has achieved the expected results	2,00

#### SIGNIFICANCE FACTOR

**Financial materiality** is based on the valuation of the assets controlled and the amount of revenue and expenses managed by the audited entity. The higher the level the financial materiality of an activity/program/field, the higher likely to be a key area to be selected as audit scope. Materiality in financial audits and performance audits may vary and the same object can be viewed differently. Therefore, an object/area could be considered as material from the performance audit point of view, but immaterial from the financial audit perspective, and vice versa.

**Critical Limit of Success:** The critical aspect of success limits shows the importance of an area in determining the success of an entity. If improvements significantly impact the entity's operations, the significance will be high. For a job that is routine and improves the performance of an object, but does not have a broad impact on the performance of the entity, the level of significance is relatively low.

**Visibility:** The visibility or clarity of an area is closely related to the external impact of an activity/program/field. This relates to the social, economic, and environmental aspects of the activities/programs/fields and the importance of these activities to government or community programs. For example, performance audit in the area of land service management at a land office.

## ANNEX 4.2. Draft audit design matrix (ADM) to assess the performance of expenditure management – an example from Indonesia

**Audit Objective:** To assess the effectiveness of expenditure management by the central government in the framework of performance-based budgeting

**Audited Entities:** Ministry of Finance (MoF), Ministry of National Development Planning (MoNDP), Ministry of Health (MoH)

**Overall Audit Question (Level 1):** Has the management of central government expenditure been effective – within a performance-based budgeting framework?

- **Audit Question (Level 2):** 1.1. Are activities and expenditures of Government Ministries planned and budgeted in a measurable manner and as needed?
  - **Audit Question (Level 3):** 1.1.1 Is the budgeting of expenditure consistent with the planning of activities?

Audit Criteria	Criteria References	Audit Evidence	The Sources of the Audit Evidence	Audit Evidence Acquisition Method	Audit Procedure	Audit Risk / Limitation / Constraint	Mitigation of Audit Risk / Limitation / Constraint	Potential Audit Finding	Potential Audit Conclusion (level 3)	Potential Audit Conclusion (level 2)	Potential Audit Conclusion (level 1)	Potential Audit Recommendation	Expected Added Value/ Benefits
Type and volume of activity output stipulated in the planning document/ Work Plan is in accordance with what is stated in the budget document	1 Act no 25 (2004) Chapter 2; 2 Government Regulation No. 17, (2017) Chapter 23 3 Research Study of ...	1 Work Plan 2 Budget document (Country-specific).	1 MoNDP 2 MoF 3 Government Agency (sample).	1 Inspection 2 Analyzing the procedure 3 Query/ Interview.	1 Inspect the Work Plan and Budget Document to know whether the type and volume of activity output specified in the Work Plan are the same as those outlined in the Budget document.  2 If there are differences and the budget is approved by the parliament, ensure that the MoNDP approves the intended change and has accommodated it in the changes to Work Plan  3 If the budget hasn't been approved by the parliament, make sure the budget document is given a special note/mark;	1 Documents are restricted  2 Poor Documentation.	1 Prepare documents requests well in advance (spare enough time)  2 Prepare a high-level official meeting if needed	There is a discrepancy between the type and volume of activity output stipulated in the planning document and that set forth in the budget document.	The budgeting of expenditure is not consistent with the planning of activities	Activities and expenditures of Government Ministries have not been budgeted as needed	The management of central government quality expenditure in the budgeting activities has not been effective	Build and develop an information system to enhance the synchronization and alignment of planning and budgeting processes.	Improvement in the alignment of planning and budgeting processes to ensure the achievement of National Priority targets that has been planned by the government.

Audit Criteria	Criteria References	Audit Evidence	The Sources of the Audit Evidence	Audit Evidence Acquisition Method	Audit Procedure	Audit Risk / Limitation / Constraint	Mitigation of Audit Risk / Limitation / Constraint	Potential Audit Finding	Potential Audit Conclusion (level 3)	Potential Audit Conclusion (level 2)	Potential Audit Conclusion (level 1)	Potential Audit Recommendation	Expected Added Value/ Benefits
					<p>4 Ensure that there is approval for the differences in budget documents from the MoF.</p> <p>5 Analyze the impact of the differences on the achievement of the planned targets.</p>								
<p>Other criteria could include, for example:</p> <p>1.1.2: Type and volume of activity output of new initiatives/ policies as outlined in the budget document are referenced in the National Work Plan;</p> <p>1.1.3: Classification and naming of programs and targets of program/activity/output in the Budget Document are consistent with the Work Plan;</p> <p>1.1.4: All changes to the formulation of programs and/or activities arising from the reorganization have been accommodated in changes to the Work Plan and Budget Document</p>													

**Notes:**

- Overall Audit Question (level 1) is designed to answer the audit objective.
- Based on the overall audit questions (level 1), the Auditor breaks down the question into several sub-questions (level 2). There can be more than one level 2 question to support and answer the level 1 question. Normally, the level 2 questions are in line with the key area to be audited.
- Based on the level 2 audit questions, the auditor breaks down the question into several sub-sub questions (level 3). There can be more than one level 3 question for each level 2 question.
- In designing the hierarchy of audit questions, auditors must ensure that sub-audit questions at the lowest level will be answered by carrying out certain audit procedures. Sub-audit questions at the lowest level will also refer to specific criteria which will be used, and at the same time become the basis for collecting audit evidence. Audit criteria are designed based on the audit question at the lowest level (level 3). The audit criteria should consider several characteristics which are relevant, understandable, complete, reliable, objectives, and auditable.

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