



Republic of Zambia



# **PUBLIC FINANCIAL MANAGEMENT HANDBOOK**

**for Members of Parliament and Staff**





# Foreword

The National Assembly of Zambia performs four core functions, namely law-making, representation, budget scrutiny and approval, and oversight. Its authority is derived from the Constitution of Zambia (Amendment) Act No. 2, 2016, which states that the representation of the will of the people and the legislative and oversight authority of the Republic are vested in and exercised by Parliament.

While the National Assembly has the formal powers to keep the Executive accountable for its actions and policies, including its management of public financial resources, the challenge is to use this mandate to effectively ensure that the Executive adheres to prudent public financial management principles and fiscal policy targets, including maintaining aggregate fiscal discipline and ensuring that public resources are used equitably, efficiently, effectively and accountably.

The National Assembly has for some time been undertaking reforms in order to strengthen the performance of its constitutional functions, and its present Strategic Plan 2015-2019 sets out strategic objectives for a further strengthening of its capacity within its core functions. As part of this process, the National Assembly is implementing the European Union's Support to the National Assembly of Zambia Project, which aims at strengthening the ability of the National Assembly of Zambia to perform its role as the apex of public financial management and budget accountability processes.

The purpose of this Handbook, developed under the auspices of the European Union Project, is to provide a toolkit for the strengthening of the National Assembly in the performance of its mandate in public financial management. It provides a comprehensive introduction to the concept, objectives and scope of public financial management and serves as a reference and self-training manual for Members of Parliament and Staff of the National Assembly on issues relevant to their specific functions. Moreover, the Handbook serves as a framework for the design of future capacity building interventions initiated by the National Assembly for both Members and staff.

This Handbook does not represent an assessment of the effectiveness of the country's current financial management setup nor operational performance. Any financial management system is undergoing periodic reviews overtime to improve its effectiveness. The Zambian PFM system is no exception. Some parts of the system works better than others. However, the National Assembly recognises that Government has embarked on series of reforms aiming at improving the efficiency, effectiveness, transparency and accountability of the current system. The ongoing implementation of the Treasury Single Account; the Integrated Financial Management Information System; Output-Based Budgeting; the expected planning and budgeting legislation and the revisions to the Public Finance Act are examples of the reforms.

Let me take this opportunity to thank all the stakeholders - the academia, governmental and non-governmental think tanks, national public financial management experts and practitioners and National Assembly staff members - for their valuable contributions and lively participation during the course of developing the Handbook. Let me also take this opportunity to thank the Ministry of Finance for taking time to provide input and for supporting the publishing of the document.

Finally, I extend my gratitude to the European Union without whose support this Handbook would have been a challenge to write and publish.

It is my hope that Members and Staff of Parliament will employ the Handbook as an essential aid in public financial management oversight.



**Rt. Hon. Justice Dr. Patrick Matibini, SC., MP**  
Speaker of the National Assembly of Zambia

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# Acronyms

<b>ABB</b>	Activity-Based Budgeting	<b>MoF</b>	Ministry of Finance
<b>AGO</b>	Accountant General's Office	<b>MOU</b>	Memorandum of Understanding
<b>BOP</b>	Balance of Payment	<b>MPSAs</b>	Ministries, Provinces and Spending Agencies
<b>BOZ</b>	Bank of Zambia	<b>MTEF</b>	Medium-Term Expenditure Framework
<b>CAADP</b>	Comprehensive Africa Agriculture Development Programme	<b>NGO</b>	Non-Governmental Organisation
<b>CACG</b>	Commonwealth Association of Corporate Governance	<b>OBB</b>	Output-Based Budgeting
<b>CF</b>	Consolidated Fund	<b>OECD</b>	Organisation for Economic Cooperation and Development
<b>COFOG</b>	Classification of Functions of Government	<b>PACRA</b>	Patents and Company Registration Agency
<b>COMESA</b>	Common Market for Eastern & Southern Africa	<b>PBO</b>	Parliamentary Budget Office
<b>CPIA</b>	Country Policy and Institutional Assessment	<b>PCI</b>	Per Capita Income
<b>CSO</b>	Central Statistical Office	<b>PDDC</b>	Provincial Development Coordinating Committee
<b>CSO</b>	Civil Society Organisation	<b>PEFA</b>	Public Expenditure and Accountability
<b>DDCC</b>	District Development Coordinating Committee	<b>PEMFA</b>	Public Expenditure Management and Financial Accountability Programme
<b>DFID</b>	Department for International Development	<b>PER</b>	Public Expenditure Review
<b>DSA</b>	Debt Sustainability Analysis	<b>PFM</b>	Public Financial Management
<b>EU</b>	European Union	<b>PIM</b>	Public Investment Management
<b>FRA</b>	Food Reserve Agency	<b>PMEC</b>	Payroll Management and Establishment Control
<b>GFSM</b>	Government Finance Statistics Manual	<b>PPP</b>	Public-Private-Partnership
<b>GAAP</b>	Generally Accepted Accounting Practices	<b>PSC</b>	Public Sector Committee
<b>GFS</b>	Government Finance Statistics	<b>PSSD</b>	Department for Payroll Management and Establishment Control Support Services
<b>HR</b>	Human Resource	<b>RATSA</b>	Road Transport and Safety Agency
<b>IBP</b>	International Budget Partnership	<b>SADC</b>	Southern Africa Development Community
<b>ICT</b>	Information and Communication Technology	<b>SME</b>	Small and Medium Enterprise
<b>IDM</b>	Investment and Debt Management Unit	<b>SOEs</b>	State-Owned Enterprises
<b>IFAC</b>	International Federation of Accountants	<b>TSA</b>	Treasury Single Account
<b>IFMIS</b>	Integrated Financial Management Information System	<b>UNCDF</b>	United Nations Capital Development Fund
<b>IMF</b>	International Monetary Fund	<b>VAT</b>	Value Added Tax
<b>IPSAS</b>	International Public Sector Accounting Standard	<b>WB</b>	World Bank
<b>LGEF</b>	Local Government Equalisation Fund	<b>ZMW</b>	Zambian Kwacha
<b>LICs</b>	Low-Income Countries	<b>ZPPA</b>	Zambia Public Procurement Authority
<b>LMIC</b>	Lower Middle Income Country	<b>ZRA</b>	Zambia Revenue Authority

# Introduction

This Handbook on Public Financial Management (PFM) for Members of Parliament and Staff of the National Assembly contains 35 chapters grouped under six modules. While the first two modules concern themselves with topics of a general and crosscutting nature, including a general introduction to the concept of public financial management and the institutional, policy and legal framework for public financial management in Zambia, the other four modules are structured along the budget cycle, encompassing the budget formulation stage, the budget scrutiny and approval stage, the budget execution stage and the post budget implementation stage.

The Handbook provides Members of Parliament, Assembly and constituency office staff with a general introduction to the concepts of public financial management, fiscal decentralisation and good financial governance and guidance on Parliament's role and responsibilities throughout the budget cycle, including *inter alia* the assessment of the Medium-Term Expenditure Framework (MTEF) and the annual budget; budget debate and approval; monitoring and budget follow-up during budget execution and scrutiny of the End-of-Year financial report by the Accountant General; and the consideration of the report of the Auditor-General on the accounts relating to the general revenues of the Republic and expenditure of monies appropriated by Parliament. In this way, the reader will be introduced to aspects of public financial management in a comprehensive and coherent manner with emphasis on Parliament's mandated role during the various stages of the budget cycle.


While the Handbook describes legal and institutional frameworks, as well as systems and procedures in the Zambian context, its purpose is not to assess strengths or weaknesses in the structures, systems or functionality of public financial management in Zambia. Rather, the Handbook explains how the various components of PFM work in a Zambian or international context as deemed relevant, and ways and means to make PFM work better and more effectively.

In keeping with the budget cycle structure, some topics may appear more than once in the Handbook. This, however, does not imply a duplication of the contents as the topics are addressed from different angles depending on the stage in the budget cycle. A few examples illustrate this. While Chapter 5 "The national integrated planning and budgeting framework" in module II explains the structure and various elements of the planning and budgeting system, Chapter 12 "The national budget preparation process" in module III explains how this system works in practice during the process of compiling the medium-term expenditure framework and the annual budget. Then Chapter 16 "Policy and budget analysis as a tool to inform the political debate and decision making" serves to assist Members and Staff during the budget scrutiny and approval stage, while Chapter 32 in module V provides guidance on how to use budget analysis as a monitoring tool during the budget execution stage.

While the Handbook can be used as a standalone document, it may be used to best advantage in conjunction with the support of the key readings listed at the end of each chapter. To assist readers not fully acquainted with public financial management, a glossary explaining the many concepts and terms used in the Handbook is attached in Annex I.







**MODULE 1**  
**INTRODUCTION AND**  
**BACKGROUND TO PUBLIC**  
**FINANCIAL MANAGEMENT**





# CHAPTER 1

## The meaning, objectives and content of public financial management

This chapter introduces and defines Public Financial Management (PFM). It outlines the objectives and shows the importance of PFM, explains the main components and stakeholders and briefly introduces the institutional framework for the Zambian PFM system. The Members of Parliament and Staff of the National Assembly will appreciate the scope and extent of PFM as it relates to the overall management of the economy and the need for Parliamentary fiscal oversight. Additionally, the section gives an overview of ongoing PFM reforms and their purpose.

### 1.1 INTRODUCTION

Governments all over the world have a responsibility to provide goods and services for their citizens in an efficient and effective manner despite having differing ideologies and value systems. The different ideologies and values influence the direction of economic policies on how best to make use of the country's scarce resources. The environment in which economic activity takes place, therefore, depends upon the people, the resources available within the country, and the systems designed to provide for the welfare of the citizens. Public financial management is at the centre of this national socio-economic system.

PFM underlies all government activity and is, therefore, practised in a dynamic environment. It has a lot in common with private financial management, as many

of the principles of budgeting, expenditure and reporting also hold true for private organisations. Whereas the main focus for private financial management is to ensure that investors and owners of businesses receive a profit, the focus of public financial management is the efficient provision of services to citizens and optimum use of public resources. Hence, public financial management concerns itself with achieving aggregate fiscal discipline, allocative efficiency, equity, redistribution of wealth and value for money in a transparent and accountable manner. It is, therefore, important to understand how various PFM functions fit into a broader system of rules and regulations that govern the management of public resources, and what these functions are ultimately intended to achieve as a whole.

The World Bank, International Monetary Fund and donor countries have observed that a strong PFM system is an essential aspect of the institutional framework for an effective state. Effective delivery of public services is closely associated with poverty reduction and economic growth, and as such countries with strong, transparent and accountable PFM systems tend to deliver services more effectively and equitably and also regulate markets more efficiently and fairly. It is universally accepted that good PFM is a necessary condition for achieving sustainable development.

## 1.2 WHAT IS PUBLIC FINANCIAL MANAGEMENT?

According to Lawson (2015)<sup>1</sup> “*public financial management refers to a set of laws, rules, systems and processes used by governments to mobilise revenue, allocate public funds, and undertake public spending, account for funds and audit results.*” It encompasses a broader set of functions than ordinary financial management and is commonly structured as a cycle of six phases, including 1. Policy formulation. 2. Budget formulation. 3. Budget approval. 4. Budget execution. 5. Accounting. 6. External audit and evaluation.

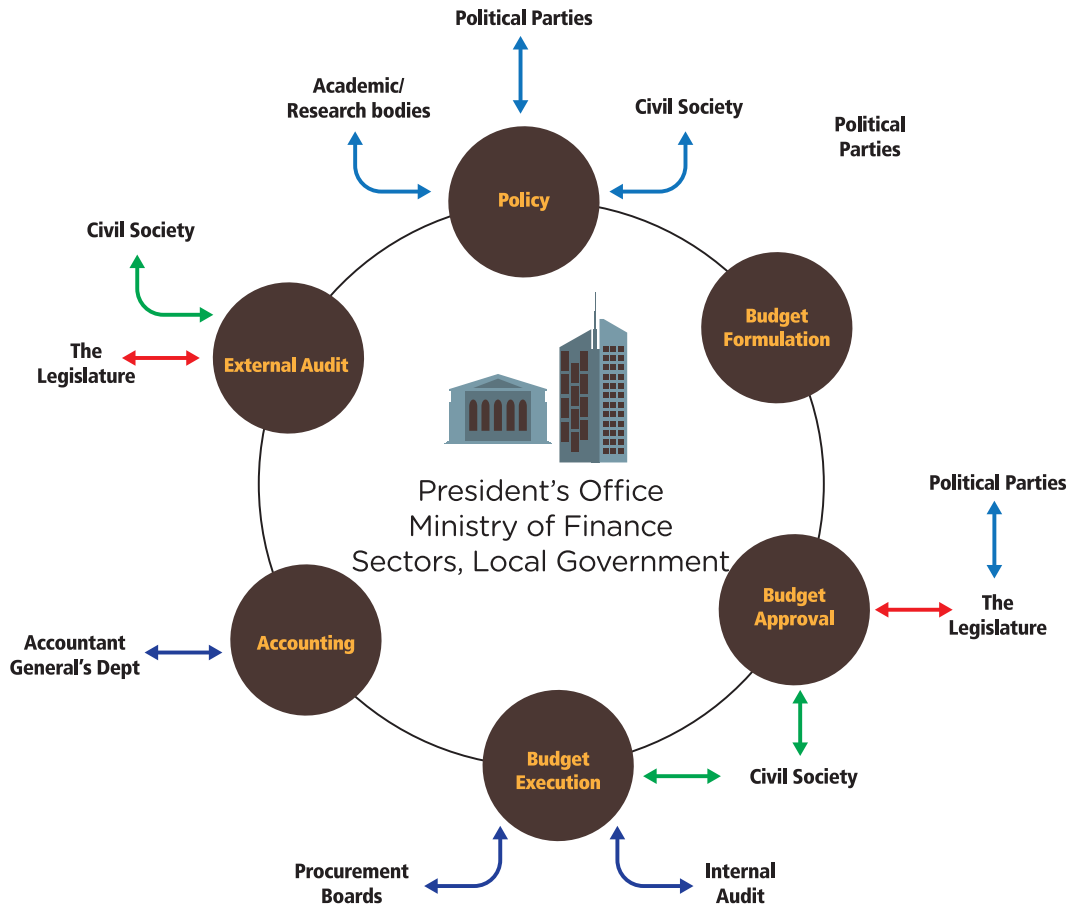
PFM, as practised by most governments, is anchored on legal and institutional frameworks that provide the platform for supervising all phases of the budget cycle, including formulation and preparation of the budget, budget execution and expenditure management, internal controls and audit, procurement, monitoring and reporting arrangements, and external oversight and audit.

The PFM system involves several stakeholders that include state and non-state actors such as the academia, civil society and political parties. These stakeholders are engaged in the PFM cycle to ensure that the system operates effectively and transparently while preserving accountability. It is important to note that these have a variety of interests that can place government in conflict situations. For example, while some interest groups are critical of public spending to avoid increasing the tax burden, others argue for more spending even if this implies an increase in the tax burden. With respect to civil society, it should be understood that this category embraces a variety of interest groups with different missions and views on public spending. For instance, the recipients of a specific service will have a different set of interests from advocacy groups.

<sup>1</sup> Lawson, A. (2015). Public Financial Management. GSDRC Professional Development Reading Pack No. 6. Birmingham, UK: GSDRC, University of Birmingham.

The nature and interface of the stakeholders in the PFM cycle is illustrated in Figure 1.1 below.

Figure 1.1 The PFM cycle and key stakeholders involved



**Source:** Lawson, A. (2015). Public Financial Management. GSDRC Professional Development Reading Pack no. 6.

### 1.3 OBJECTIVES OF PUBLIC FINANCIAL MANAGEMENT

The broad objectives of PFM are to achieve overall fiscal discipline, allocation of resources to priority needs, and efficient and effective delivery of public services. These can be broken down into the following five key objectives against which performance of the system can be measured:

1. Maintenance of aggregate fiscal discipline to ensure that aggregate levels of revenue collection and public spending are consistent with targets for the fiscal balance, and do not generate unsustainable levels of public borrowing.
2. Allocative efficiency to ensure that public resources are allocated in accordance with agreed strategic priorities.
3. Operational efficiency to ensure maximum value for money in the delivery of services.

4. Accountability to avoid leakages and wastage in the use of resources through defined checks and balances.
5. Finally, the system should follow due process and be seen to do so, by being transparent, with information publicly accessible to all stakeholders<sup>2</sup>.

#### 1.4 INSTITUTIONAL FRAMEWORK OF THE ZAMBIAN PFM SYSTEM

The Ministry of Finance (MoF) is the main coordinating body responsible for public financial management. The Ministry is divided into departments with various functions including budget and economic affairs, planning and economic management, investments and debt management, accounting and administration. The Ministry of Finance also oversees statutory bodies that perform other specialised functions, namely Bank of Zambia (for monetary policy management), Zambia Revenue Authority (for tax administration), Zambia Public Procurement Authority (for public procurement regulation) and the Pensions and Insurance Authority (for pensions and insurance regulation), with the exception of the National Pension Scheme Authority, Public Sector Pension Fund and the Local Authorities Superannuation Fund which fall under different legislative arrangements for public pension funds.

The Ministry of National Development Planning prepares the National Development Plan and oversees its implementation, while the Ministry of Local Government oversees the decentralisation process, including fiscal decentralisation.

As part of the evaluation and oversight of the system, the Auditor-General scrutinises the use of financial resources and ensures that government delivers services in an equitable, efficient and effective manner for the benefit of all the citizenry. Parliament performs an oversight role particularly in the scrutiny and legislative approval of the budget as submitted by the Executive. Parliamentary fiscal oversight is paramount in providing checks and balances over public finance management.

The governance system of the country is highly centralised with the Central Government controlling most of the functions through line ministries with little devolution of financial powers to the local authorities. Therefore, the public finance management system is centrally driven with the Ministries, Provinces and Spending Agencies working through deconcentrated<sup>3</sup> structures to undertake most responsibilities of non-tax revenue collection and managing their expenditure with MoF remote supervision. This system has been faced with challenges relating to weak transparency and accountability in government operations, geographic inequality in access to public services and low fiscal capacity of local authorities due to the erosion of their revenue base<sup>4</sup>.

<sup>2</sup> See for example A. Lawson (2015)

<sup>3</sup> It is important to make a distinction between decentralised and deconcentrated structures, as de-concentrated structures refers to Central Government entities located and operating at the Provincial and District levels, whilst decentralised structures refer to entities operating as local government (e.g. District Councils) agents.

<sup>4</sup> For details on service delivery weaknesses in the current PFM setup, see The National Planning and Budgeting Policy – Situation Analysis, p. 5. See also [http://www.mofnp.gov.zm/jdownloads/National%20Budgets/final\\_approved\\_national\\_planning\\_and\\_budgeting\\_policy.pdf](http://www.mofnp.gov.zm/jdownloads/National%20Budgets/final_approved_national_planning_and_budgeting_policy.pdf)

## 1.5 EFFECTIVENESS OF THE PFM SYSTEM

The effectiveness of the PFM system is not easy to assess even when measuring performance against the five specific objectives. For example, measuring allocative and operational efficiency requires special studies including policy and budget analyses. Some more advanced middle income countries undertake these special studies regularly through programme evaluations or value-for-money audits. Some Public Expenditure Reviews (PERs) also address these issues, but, in general, such studies are not common in developing countries and their structure rarely allows for easy international comparison. In Zambia, the introduction of output-based budgeting and reporting<sup>5</sup>; further broadening of the performance auditing<sup>6</sup> performed by the National Audit Office, as well as the consideration of performance audit reports conducted by parliamentary portfolio committees are innovative elements aiming at strengthening Parliament's oversight of PFM effectiveness.

The practical assessment of the public financial management system focuses on the examination of the institutions, rules and procedures to ensure the achievement of the key objectives of the PFM system. This approach provides the conceptual basis for the Public Expenditure and Financial Accountability (PEFA) assessment framework<sup>7</sup>, developed by the International Monetary Fund (IMF) and the World Bank in conjunction with the European Union (EU), United Kingdom – Department for International Development (DFID) and other bilateral donors. It provides a set of high-level indicators used to measure the performance of a public finance management system. Zambia is among the many countries that use this framework whose updated set of PEFA indicators was issued in 2015<sup>8</sup>.

## 1.6 PFM REFORMS IN ZAMBIA

It is worth noting that improving the effectiveness of the public financial management system can generate widespread and long-lasting benefits, and may in turn help to reinforce wider societal shifts towards inclusive institutions that strengthen the nation, reduce poverty, and enhance gender equality and balanced growth.

In its bid to transform the nation and accelerate development, the Government has been undertaking public sector reforms for the last two decades. The PFM system has been a major component of the reforms and their implementation has been an on-going process. From early 2005 to 2012, the PFM reforms were done under the Public Expenditure Management and Financial Accountability (PEMFA) Programme which was a comprehensive PFM reform with initially 13 components. It covered control and financial management systems, integrated financial management and information system (IFMIS) implementation, improved fiscal policy and economic planning, reformed budget preparation and budget execution, improved debt management, improved internal audit, better

5 See chapter 10

6 See chapter 35

7 For more information on PEFA framework, go to <http://www.pefa.org>

8 A PEFA assessment was carried out in 2016, however the result of this assessment has not yet been published.

external finance and coordination, the legal and regulatory framework, strengthened external audit, enhanced parliamentary oversight, accountancy training and regulation, public procurement reform and a centralised computer services department. PEMFA was later extended for two years with emphasis on IFMIS implementation, improved internal audit, revenue administration and public procurement reform. The PEMFA programme was succeeded by the Public Financial Management Reform Strategy for the Government of the Republic of Zambia (2013-15) with a focus on integrated planning and budgeting, debt management, government investments, domestic revenues, fiscal decentralisation, IFMIS and cash management, public procurement, internal audit and control, monitoring and evaluation and restructuring of the Ministry of Finance.

The PFM reform programme's definitive goal is to ensure efficient, effective and accountable use of public resources as a basis for sustained economic development and poverty eradication through improved service delivery. According to the 2015 to 2017 Medium Term Expenditure Framework (MTEF) - a three year rolling financial planning framework setting out policy priorities and programmes<sup>9</sup> - the Government has prioritised the implementation of Public Financial Management (PFM) reforms. This process will include enacting the Planning and Budgeting Bill, reviewing the Public Finance Act, fully operationalising the Treasury Single Account (TSA), implementing a mining sector monitoring systems, restructuring the Zambia Public Procurement Authority (ZPPA) and strengthening internal audit mechanisms. Additionally, a review of the status of all grant-aided institutions is being done with the aim of identifying some for possible abolition or mergers.

According to some recent research and evaluation studies done by researchers at the University of Birmingham in the United Kingdom and also by the World Bank, three critical ingredients are necessary for successful PFM reform as set out below:

- i. **Leadership** – a strong political and technical commitment, clear communication and coordination of reform, and a widening group of reform leaders who manage fears, expectations and differences of opinion.
- ii. **Policy space for developing appropriate reforms** – a thorough understanding of the context, a focus on the functionality of the system and not just the form, and teams and organisations that experiment and take risks, interrogating both the problem and the proposed solutions.
- iii. **Adaptive, iterative and inclusive processes** – where monitoring, learning and adaptation are key<sup>10</sup>.

<sup>9</sup> For a more detailed presentation of the Medium-Term Expenditure Framework, see Chapter 14.

<sup>10</sup> A. Lawson (2015)



## 1.7 CONCLUSION

Well-designed and well-functioning financial management systems are essential prerequisites for effective states and development outcomes. The aims of public financial management are the provision of services to citizens and optimum and sustainable use of public resources through aggregate fiscal discipline, allocative efficiency, equity, redistribution of wealth and value for money in a transparent and accountable way. While a universal, ‘one size fits all’ PFM model does not exist, it is generally recognised that good PFM systems build on a set of key principles, such as

- comprehensive and clear legislative frameworks, rules and procedures;
- effective institutions with clear mandates;
- transparency and accountability in government operations;
- effective coordination of national planning and budgeting functions and processes;
- credible budgeting processes and budgets;
- broad non-governmental involvement throughout the planning and budgeting cycle; and
- effective parliamentary oversight.

In line with these guiding principles, the objectives of the National Planning and Budgeting Policy for Zambia<sup>11</sup> are to:

- a) integrate national planning and annual budgeting processes with a greater results-orientation;
- b) strengthen synergies in the various planning processes;
- c) facilitate more participatory/decentralised development planning and budgeting processes;
- d) enhance budget credibility;
- e) facilitate greater evidence-based decision-making in development planning and budgeting; and
- f) strengthen the oversight function of the legislature.

11 Republic of Zambia, 2014, “National Planning and Budgeting Policy”, p.11

## REFERENCES AND FURTHER READING

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# CHAPTER 2

## Fiscal decentralisation and the fiscal relationship between the Central Government, Parliament and sub-national governments

This chapter explains what fiscal decentralisation is; what it seeks to achieve; the main building blocks and the required legal framework for fiscal decentralisation to thrive. The objective is to make the Members of Parliament and Staff appreciate why the Government has decided to decentralise the Zambian governance system, what the relationship between the central and the local government should be, as well as what role Members of Parliament should play for fiscal decentralisation to work effectively.

### 2.1 INTRODUCTION

The concept of decentralisation, which involves the transfer of power and resources from the Central Government to sub-national governments<sup>12</sup> has been a topical issue in the development agenda for most developing and transition countries in the past decades. This can be attributed to the widely held view that decentralising roles and responsibilities from Central Government to lower levels of government leads to efficiency in the delivery of public services, accountability and responsiveness to citizens' needs.

<sup>12</sup> Eaton, K., Kaiser, K. & Smoke, P., (2010) The political economy of decentralization reforms: implications for aid effectiveness. Washington, D.C.: The World Bank.

The Constitution of Zambia (Amendment) Act No. 2 of 2016 provides for a system of devolved governance under a two tier level of government, which is national and local government. It establishes the autonomy of each level of government and spells out the concurrent and exclusive functions of the national, provincial and local government<sup>13</sup>. Box 2.1 below provides examples of some of the concurrent and exclusive functions of national, provincial and local government.

**Box 2.1**

**Exclusive National Functions**

- (a) Elections
- (b) Foreign and International Affairs
- (c) Defence, security, maintenance of law and order
- (d) Citizenship and immigration

**Exclusive Local Government Functions**

- (a) Pollution Control
- (b) Building regulations
- (c) District planning

**Concurrent National and Provincial Functions**

- (a) Animal Control and Diseases
- (b) Health Services
- (c) Consumer protection
- (d) Administration of Justice
- (e) Health Services

These progressive constitutional provisions are supported by the Local Government Act and the decentralisation policy, which among other things provide for local authorities' financing arrangements and the institutional framework for decentralisation.

## 2.2 WHY FISCAL DECENTRALISATION?

Fiscal decentralisation refers to the devolution of budget functions from the Central Government to sub-national governments<sup>14</sup>. It involves the transfer of expenditure and revenue responsibilities from the Central Government to lower levels of government<sup>15</sup>. The overall objective of fiscal decentralisation is to create an optimal fiscal environment that allows both central and sub-national governments to provide public goods

13 It is important to note that functions under provincial administration are 'deconcentrated' functions of central government hence remain part of central government while functions under local government, are 'devolved' functions. De-concentration, refers to a transfer to lower-level central government authorities, or to other local authorities who are upwardly accountable to the central government (Ribot 2002).

14 In the case of Zambia, the new constitution ACT, 2016, recognises two tiers of government: central and local government. Sub-national government in this context refers to the two lower tiers of government, that is, Provincial and Local Government.

15 Roy, B. (2008), The Pillars of Fiscal Decentralization. <https://www.caf.com/media/3961/200807Bahl.pdf>.

and services in line with the subsidiarity principle, which provides that roles and responsibilities must be assigned to the lowest tier of government that can efficiently and effectively administer them. The assumed benefits of fiscal decentralisation can be summarised as follows:

- improved efficiency by strengthening the links between the mix of services with the citizens' demand and needs, being closer and more responsive to the local preference (matching of local preferences);
- improved financial accountability by bringing the government and decisions closer to the people in terms of options for voice, influence, information exchange, control and monitoring etc.; and
- improved effectiveness by improving the likelihood of strengthening of competition in public service provision, mobilising citizens' contribution, innovation, etc.<sup>16</sup>

### 2.3 BUILDING BLOCKS TO FACILITATE FISCAL DECENTRALISATION

The design of inter-governmental fiscal relations<sup>17</sup> that ensures predictable, stable and fair revenue streams for the performance of sub-national functions, is of vital importance in the entire fiscal decentralisation framework. To this end, a clear set of rules and procedures for the fiscal interrelationship between the central and local governments is required. It must be noted that there is no single perfect model for the design of the fiscal decentralisation architecture. This is because each country has a unique combination of political, historical, institutional and ethnic circumstances, which has a bearing on motivation for decentralisation.

In principle, the design of the inter-governmental fiscal architecture should not undermine the effectiveness of the three fiscal functions of the Government, namely macroeconomic stabilisation, redistribution, and resource allocation for public service provision. There is growing consensus that macroeconomic stabilisation and redistribution should remain a function of the Central Government<sup>18</sup> while allowing appropriate levels of discretion over revenue mobilisation and resource allocation to be devolved to lower levels of government.

**The building blocks of fiscal decentralisation can be categorised into four distinct parts, as set out below:**

#### 1. Assignment of expenditure roles and responsibilities

The first step in designing an effective inter-governmental fiscal relations is the identification of expenditure responsibilities for providing public goods and services to the different levels of government. This step is required to estimate the expenditure needs of the two levels of government. A coherent approach should be based on the subsidiarity principle<sup>19</sup>. This is consistent with the decentralisation theorem which states that “each public service should be provided by the jurisdiction having control over the minimum geographic

16 See for example Steffensen, *Fiscal Decentralisation and Sector Funding Principles and Practices*, 2010

17 In this chapter, “inter-governmental fiscal relations” and the “fiscal decentralisation architecture” are used interchangeably

18 Fedelino, A. & Ter-Minassian, T. (2010). *Making fiscal decentralization work: Cross Country Experiences*. Washington, D.C.: IMF

19 The subsidiarity principle basically states that nothing should be done by a larger and more complex organisation which can be done as well by a smaller and simpler organisation. In other words; any activity which can be performed by a more decentralised entity.

area that would internalise the benefits and costs of such provision.”<sup>20</sup>.

Once the expenditure roles and responsibilities of the public sector are identified, the next steps are to address the following questions:

- What expenditure functions should be exclusive to sub-national governments?
- What expenditure functions should be exclusive to Central Government?
- What expenditure functions should be concurrent i.e. overlapping between central and sub-national government?

For concurrent functions, unambiguous clarity must be given to who is responsible for what aspects of the formulation, financing and execution of a particular expenditure programme. In many cases, central governments want to retain a high level of discretion and control, resulting in a lack of clarity in the discretion that local governments can exercise and unpredictability in the assignment of the expenditure authority that the local government has<sup>21</sup>.

Clarity in the assignment of expenditures is also of crucial importance in ensuring accountability at each tier of government for the effective execution of the function. Ignoring this important aspect in the design of inter-governmental fiscal relations can weaken and undermine the efficiency of public expenditures.

## 2. Revenue Assignment

Once expenditure functions have been assigned, resources must be sourced to match the assigned responsibilities. Local government revenues consist of transfers from Central Government and revenues raised by local governments themselves. This follows the key principle *funds follow functions*. Designing an appropriate mix of revenue assignment is dependent on a number of factors. Fedelino and Ter-Minassian<sup>22</sup> argue that taxes in local authorities can lead to tax competition between local governments in order to attract businesses and affluent tax payers resulting in revenue losses or tax evasion, and ultimately to fiscal imbalances across local authorities. They also argue that ultimately, the assignment of revenue responsibilities should not erode the Central Government’s fiscal role of redistribution and fostering macroeconomic stability. This means that taxes that have significant influence on economic fundamentals (e.g. inflation) should be assigned to the Central Government.

20 Oates, W. (1972) *Fiscal Federalism*. New York: Harcourt Brace Jovanovich, Inc.

21 Norris, E.D. (2006) *Comparative Economic Studies. The Challenge of Fiscal Decentralization in Transition Countries*. [Online] 48, p.100-131. Available from: <http://www.palgrave-journals.com/ces/journal/v48/n1/pdf/8100063a.pdf>

22 Ibid

The literature<sup>23</sup> provides useful rules and guidelines for assigning revenue or tax responsibilities as summarised below:

- Taxes characterised by a large tax base such as income tax must be a function of central government partly because such taxes are suitable for economic stabilisation.
- Natural resource taxes are better left to central government to avert horizontal disparities (disparities across local authorities) in terms of variations in the revenue bases within sub-national government and because sub-national governments may not have the capacity to effectively manage such volatile taxes.
- Tax bases that are distributed highly unequally between jurisdictions should be assigned to central government.
- Generally immobile taxes are better assigned to lower tiers of government (i.e. local government). For this reason, land and property taxes are usually assigned to local authorities.
- Benefit taxes and user charges can be administered by any tier of government that has comparative advantage.

Complexities in the administration of certain taxes can also be used as a reasonable criterion in the revenue assignment framework. For example, taxes that are complex to administer such as Value Added Tax (VAT), are better left for the Central Government.

### 3. Transfers<sup>24</sup>

In most countries and especially those where a large portion of expenditure functions are devolved to lower tiers of governance, inherent financial imbalances across tiers of government are usually common. This is because central governments have taxing and borrowing powers, which local authorities normally do not have. This creates the necessity for transfers from central government to sub-national governments to supplement local revenues for effective service delivery. Transfers can also be used for equalising horizontal fiscal disparities among sub-national governments. These are key aspects that should be considered when designing inter-governmental fiscal transfers.

The design of inter-governmental transfers should also embody inherent incentives for efficient and effective local revenue mobilisation<sup>25</sup>. In a number of developing and middle-income countries, so-called performance-based grant systems have been introduced as an incentive for local governments to improve

23 Fjeldstad, O. (2001) Inter-governmental fiscal relations in developing countries. A review of issues. [Online] Available from: <http://www.cmi.no/publications/file/871-intergovernmental-fiscal-relations-in-developing.pdf>; Alm, J. & Boex, J. (2002) An Overview of Intergovernmental Fiscal Relations and Subnational Public Finance in Nigeria. [Online] Available from: <http://icepp.gsu.edu/files/2015/03/ispwp0201.pdf>

24 The term “transfers” is used in this context to cover a diverse range of financing instruments available to sub-national governments, including but not limited to grants and revenue sharing.

25 Revenue mobilisation in this context refers to all activities involved in securing new and additional revenues for the local authority as well as making use of, and maximising, existing revenues.

local revenue mobilisation, accountability and service delivery<sup>26</sup>. To facilitate effective planning and budgeting at lower tiers of government, transfers from the Central Government must also be designed in a manner that guarantees stability and predictability. This latter feature can be achieved by administering transfers through revenue sharing, as a share of specific national tax types, or a share of the total Central Government taxes, according to a predetermined formula.

Apart from revenue sharing, transfers can also take the form of grants, with the most common ones being:

- i. **Unconditional grants:** These are general-purpose transfers aimed at addressing vertical imbalances.
- ii. **Conditional grants:** These grants are conditional in their utilisation, usually designed to stimulate spending on expenditure items that the central governments considers to be of national priority. While the name of the grant is generally applicable in many countries, the actual conditions vary vastly depending on the motivation.
- iii. **Equalisation grants:** Equalisation grants help address horizontal imbalances (imbalances across local authorities). Through these grants, authorities with greater fiscal needs receive more than those with relatively less fiscal need, hence equalisation. In other words, the grants equalise the capacity of local governments in the provision of public goods and services (e.g. the Local Government Equalisation Fund (LGEF) in Zambia).

Overall the spirit behind inter-governmental fiscal transfers is that sub-national governments need to be granted adequate resources to undertake the expenditure responsibilities assigned to them, whilst upholding principles of accountability.<sup>27</sup>

#### 4. Borrowing

While borrowing can have undisputable development gains, this can be a major source of fiscal risks if sub-national governments are given uncontrolled authority to finance their functions through borrowing. Of particular concern to the Central Government, is the need to ensure macroeconomic stability. A common approach to controlling borrowing by sub-national governments include prudent borrowing contingent on capital markets' willingness to provide financing based on an assessment of the borrower's credit worthiness. This approach precludes Central Government from having control with local authorities' debt. Another approach is to regulate local authorities' borrowing powers by enforcing borrowing limits. This gives the Central Government the leverage to ensure that the aggregate public debt is kept within sustainable limits. For developing countries like Zambia, satisfactory results are more likely to be achieved through the second approach, which is based on Central Government oversight and control. This is on account of reasons including the following:

- The capital market is not fully developed to guarantee prudential lending to local authorities in respect of their ability to pay back.

<sup>26</sup> See for example UNCDF (not dated) Performance-Based Grant Systems – Concept and International Experience

<sup>27</sup> Fjeldstad, 2001.



- Moral hazard<sup>28</sup> questions associated with an easier way of raising financing would arise, at the expense of strengthening local governments' own revenue mobilisation efforts.
- Some forms of debt accumulated by local authorities are not necessarily through direct borrowing, i.e. non-payment of statutory and contractual obligations.
- Central Government's capacity to handle the fiscal risks associated with uncontrolled borrowing by local authorities is limited, or would only be feasible at great cost to the Central Government.

## 2.4 LEGAL AND REGULATORY FRAMEWORK

For fiscal decentralisation to yield desirable quality service delivery and development outcomes, it must be anchored on a strong legal footing. This requires that a comprehensive legal and institutional framework be put in place to prescribe the roles of various actors in a manner that supports a well-defined system of fiscal decentralisation architecture. The legal framework must eliminate ambiguities associated with lack of well-defined criteria in the assignment of functions and powers across regional and local governments.

While the new Constitution may have a proviso on devolved governance, practice has shown that such high-level declarations are only manifest when there is a more detailed framework of governance, practice and transparency to bring it into effect.

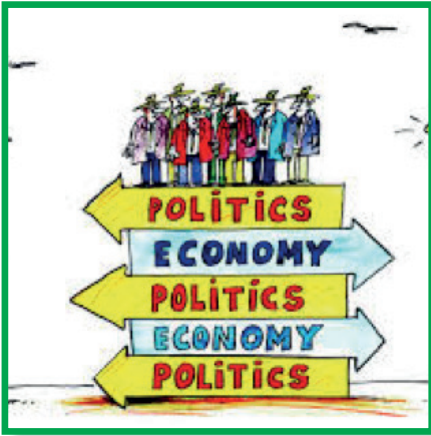
## 2.5 CONCLUSION

Fiscal decentralisation provides a real opportunity for providing public goods and services in a more efficient and effective manner, and strengthening accountability in the utilisation of resources. However, successful fiscal decentralisation requires a robust legal, regulatory and administrative system for central–local government fiscal relations, as well as the existence of good public expenditure management principles at both central and sub-national levels. There are four important building blocks to fiscal decentralisation: (a) assignment of expenditure roles and responsibilities; (b) assignment of revenue roles and responsibilities; (c) inter-governmental fiscal transfers; and (d) sub-national government borrowing. Assigning of revenue responsibilities should always come after the assignment of functions (i.e. funds follow function).

28 The local authorities may take more risk of borrowing beyond their capacities to pay knowing very well that the Central Government would bail them out should they fail to service the debt.

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# CHAPTER 3

## Good financial governance and political economy

This chapter provides Members of Parliament and Staff of the National Assembly with a broad understanding of the tenets and practices of good public financial management. This aims at ensuring that the Members and Staff are able to support the National Assembly to effectively perform its mandates of providing oversight over the Executive's implementation of public programmes and policies, and scrutinising and approving the National Budget.

The chapter describes the two key concepts that are important for providing an understanding about public financial management, namely: good financial governance and political economy. It shows an example from Malawi illustrating the concept of political economy, its application and interplay in practice, as well as its political implications

### 3.1 INTRODUCTION

The National Assembly has a mandate to foster good financial governance in Zambia, giving due consideration to the political economy of public financial management.

The Constitution gives the National Assembly the mandate to:

- Make laws.
- Provide oversight over the Executive's implementation of public programmes and policies.

- Scrutinise and approve the National Budget.
- Represent the people (of Zambia).

In particular, the mandates of making laws, exercising oversight over the Executive in the financial management of public resources for public programmes and policies as well as examining and approving the National Budget are critical building blocks for achieving overall good financial governance. An understanding of these building blocks and how public institutions behave within the political economy context enables Members of Parliament and Staff to determine how and when to influence public financial governance and foster the transparent, accountable, effective and efficient mobilisation and utilisation of public resources on public programmes and policies.

### 3.2 WHAT IS GOOD FINANCIAL GOVERNANCE?

Good financial governance is the sound, transparent, accountable, effective, efficient and equitable planning, mobilisation and utilisation of public financial resources for the benefit of the Zambian people. Good governance entails a healthy interrelationship between responsible and well-informed public institutions, systems and processes.

Good financial governance is about good stewardship over public financial resources. Public resources are monies collected by the Government to finance the implementation of public programmes and policies. The mobilisation of public resources is primarily the purview of the Executive, mainly through the Minister of Finance (Constitution, Cap 1; Public Finance Act 15 of 2004; Minister of Finance (Incorporation) Act), guided by a National Budget Cycle (elaborated in Chapter 12). As such, the lead responsibility to ensure the achievement of good financial governance rests with the Executive.

The key tenets of good financial governance are set out below:

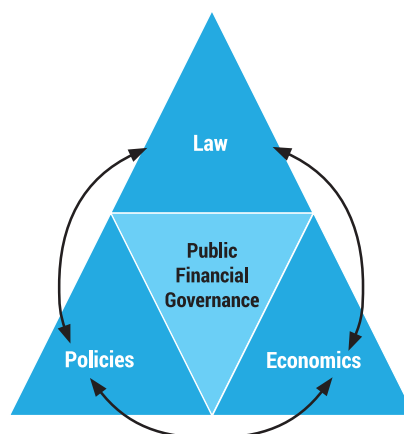
- **Transparency:** This describes an openness and accessibility of the public sector, achieved through a proactive, deliberate, unrestricted and truthful provisioning of financial information and records to the citizenry.
- **Accountability:** This is the establishment of clear responsibilities, the appropriate delegation of authority, systems to hold people in authority to account for the results they achieve, proper stewardship of funds, and consequences for failure to do so.
- **Effectiveness:** This is the ability of the public financial management system to generate and utilise public resources in such a way that the resources ultimately fully reach the intended beneficiaries, the citizens.
- **Efficiency:** This is the ability of the public financial management system to generate and utilise public resources with the least amount of waste or misuse of the resources.
- **Equity:** This is the fair or equitable sharing of public resources for the benefit of all citizens.

The National Assembly has an important role in overseeing effective financial governance as carried out by the Executive. This means through its oversight, scrutiny and power of approval and rejection functions as well as through its law making functions, the National Assembly can exert its influence in order to foster good financial governance outcomes or seek redress in situations where such outcomes are not being achieved. Effective influence of the National Assembly over the Executive is a crucial check and balance with a strong bearing on good governance, socio-economic and political progress and overall development.

### 3.3 WHAT IS THE ROLE OF POLITICAL ECONOMY IN FINANCIAL GOVERNANCE?

In order to support the National Assembly to effectively exercise its oversight of the Executive in an effective manner, Members of Parliament and Staff must understand the interrelationships among public sector institutions as well as the sources and consequences of the institutional behaviours surrounding public financial management. In particular, the political economy of public financial governance is salient. Political economy describes the interplay between the law, economics and politics, and how institutions develop and operate within this space in different social and economic systems (Figure 3.1). The political economy helps to reveal the behaviours of different institutions as they interrelate in formulating and implementing public policies and programmes, underpinned by the law, politics and economics.

**Figure 3.1** Political economy of public financial governance



The National Assembly makes the laws that govern the country's politics and economic activities. In doing so, it takes into consideration important financial management considerations, such as availability of funds, means to deliver the intent of the law and internal capacity such as infrastructure and available funds. It crafts the laws aimed at ensuring the right checks and balances between political and economic interests, particularly given that these interests may sometimes diverge considerably.

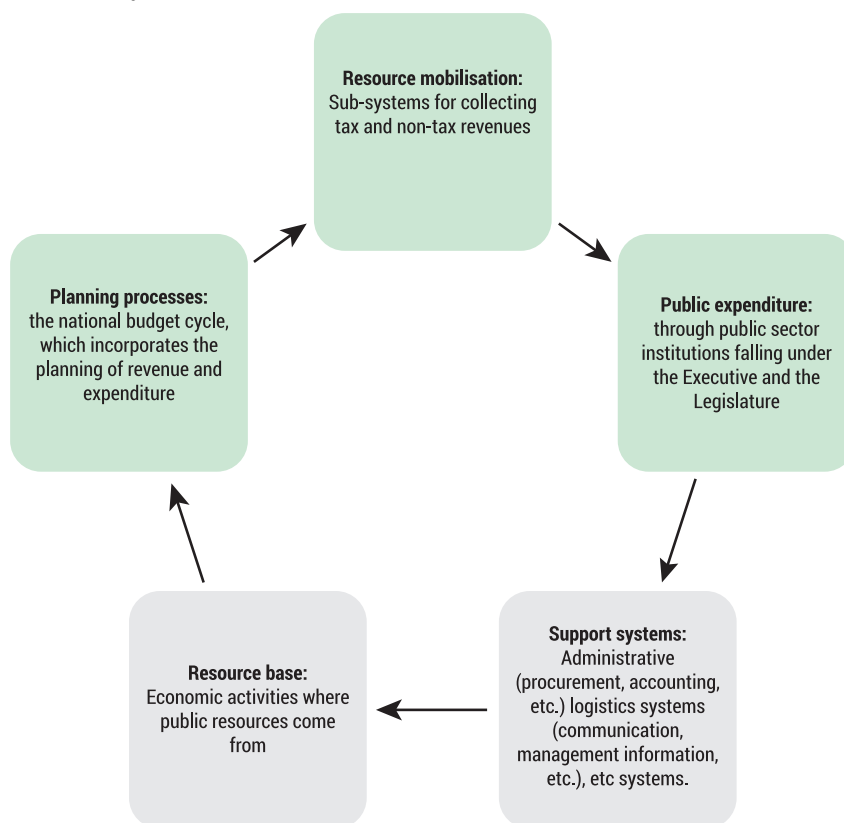
### 3.4 PUBLIC FINANCE SYSTEM IN PRINCIPLE

Inherently, both common and divergent interests emerge as the law, politics and economics interact through different public institutions to foster good financial governance. Often, where common interests exist, it is relatively easy to build consensus about the formulation and implementation of public policies and programmes. As such, chances of achieving positive policy and programmatic outcomes increase. On the other hand, when interests diverge, tensions emerge and prospects of achieving good financial governance diminish.

It is, therefore, important to continuously scrutinise and improve the public finance system that the public sector uses to manage and administer public resources. By implication, Members of Parliament and Staff of the National Assembly must first understand, in broad terms, the public finance system if they are to understand the political economy of financial governance and its relationship to the legislative process, the review of budgets and the oversight of the Executive.

In principle, the public finance system comprises three core elements, namely: planning processes; resource mobilisation functions; and public expenditure functions, as well as two critical support elements, a resource base (or an economy) and support systems (Figure 3.2).

**Figure 3.2** Public finance system principle



The public finance system is what facilitates the interplay of the law, politics and economics towards fostering good financial governance and broader developmental outcomes.

### 3.5 POLITICAL ECONOMY OF FINANCIAL GOVERNANCE: AN EXAMPLE FROM MALAWI

Having broadly understood the public finance system, it is the responsibility of Members of Parliament and Staff of the National Assembly to constantly raise questions regarding the public finance system and its ability to deliver good governance. To assist, they may use the institutional arrangements (e.g. committees), tools (think tanks and research and academic institutions) and the knowledge at their disposal to answer the questions.

Below is a practical illustration from Malawi, showing how the law, politics and economics can interplay and can give rise to questions about good financial governance. It also explains how Members of Parliament can seek and find answers. Malawi is used as an example because of its comparability to Zambia. Malawi has a democratic, multi-party system of government like Zambia with an established constitution since 1995 (five years after Zambia's in 1990). The system of government in Malawi comprises the Executive, the Legislature (National Assembly) and the Judiciary, as in Zambia. The Malawian National Assembly has 193 members compared to 167 members in Zambia. Even the geographic and demographic characteristics of Zambia and Malawi are comparable: both countries are landlocked, located in southern Africa and have similar population sizes (16.2 million and 17.2 million people, respectively). Both countries are members of the Common Market for Eastern and Southern Africa (COMESA) and the Southern African Development Community (SADC).

Malawi signed the Compact under COMESA's Comprehensive Africa Agriculture Development Programme (CAADP) in April 2010 and became the 14<sup>th</sup> COMESA country to join CAADP. In signing the CAADP Compact, the COMESA countries, including Malawi, legally reaffirmed – *inter alia* – their common commitment to the Maputo Declaration (by African Heads of State in 2003) of allocating at least 10 % of the national budget to the sector.

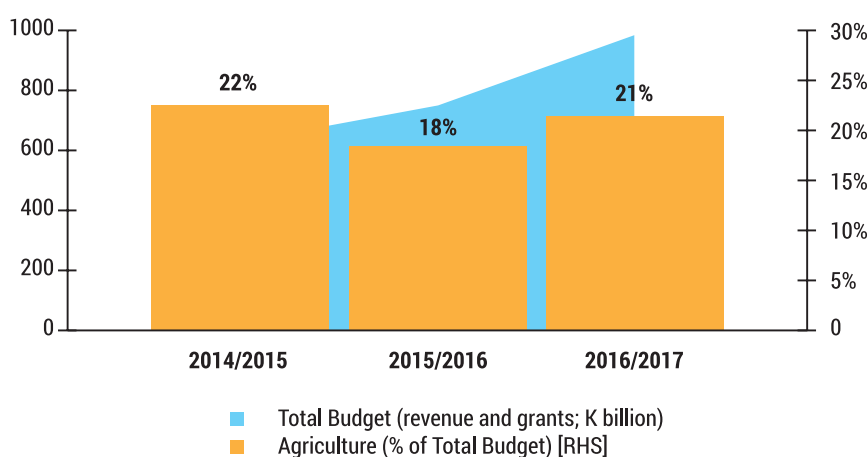
Malawi's political decision to sign the Compact was sanctioned and legal in consonance with the country's Public Financial Management Act (2003). It was also consistent with the legal provisions of the Treaty Establishing the Common Market for Eastern and Southern Africa (COMESA). The decision was taken in view of the economic importance of agriculture to Malawi at a time when the majority of Malawians were dependent on agriculture as their mainstay for earning a livelihood. The interplay of legal, political and economic considerations – or of the political economy – is evident in this example. The different arms of Government had to weigh in on the overall political, economic and legal importance of the policy decision and follow through with the decision.

Given that the decision was ultimately taken, in 2010, the question is then: Did the public financial system deliver on the policy objective, in line with the Maputo Declaration, to allocate at least 10 per cent of national budget to the agriculture sector? If the Members of Parliament and members of staff of

the National Assembly in Malawi could determine that the policy goals were delivered, they might argue that other things being equal, good financial governance was achieved.

A quick evaluation of budgetary allocations to agriculture in Malawi helps to illustrate commitment to the goals. Figure 3.3 presents the total National Budget and the Budget share allocated to agriculture for the fiscal years 2014/2015 to 2016/2017, which represents a three-year period five years after Malawi signed the CAADP Compact. The annual average budgetary allocation to agriculture was 20.1% of the total National Budget over the period. This was significantly (twice) larger than the 10 % allocation target in the Maputo Declaration and the Compact.

**Figure 3.3 National budget and allocations to agriculture**



**Source:** Budget Speeches, Ministry of Finance, Economic Planning and Development

Therefore, in this case, the Members of Parliament and National Assembly Staff would be concluding that, other things being equal, the public finance system delivered on the policy goal to allocate at least 10% of the National Budget to the agricultural sector. As part of its oversight mandate, the National Assembly would thus use its mandate and the legal instruments at its disposal to encourage the Executive to maintain good public financial governance, particularly in view of the critical importance of agriculture to Malawi.

This illustration and the assumed conclusions that the Malawian Members of Parliament might make are overly simplistic and idealistic. Furthermore, in order to establish if good financial governance had indeed been achieved, the National Assembly, being informed that the 10% commitment had been met, could legitimately question this information in a number of ways. It could ask for more information about the actual expenditures to ensure that the funds attributed to agriculture were legitimate. It could ask



for details of the programs through which these had been spent. It could ask for audits and evaluations to ensure that the funds had been effectively spent. It could seek assurances that those eligible for aid actually received it. It could demand further details on any investments such as research, equipment or education.

In reality the political economy of good financial governance is often a lot more complicated with multiple layers of factors to consider. It is often about balancing the social and economic interests with the self-interests of individual Members of Parliament. It has been said that: "...parliaments are political organisations and as such cannot be approached as if they were simply institutions of management and administration. The bureaucratic functions of parliaments are heavily influenced by the fact that parliaments are political environments where people manoeuvre to maximise powers and resources" and also that: "...If the Budget Committee doesn't put its foot down, it is not necessarily because Members don't have the expertise to do so. It is likely to be because to create waves would not be in the political interests of the individuals concerned"<sup>29</sup>. Within the realm of the political economy, good financial governance is therefore about how to transparently, accountably, effectively, efficiently and equitably balance the political, legislative and economic interests of groups and individuals.


### 3.4 CONCLUSION

The effectiveness of the influence of the National Assembly over the Executive is a crucial check and balance, which has a significant bearing on good financial governance, as well as social, economic and political development. Thus, Members of Parliament and staff members of the National Assembly should become fully aware of their important role in supporting the National Assembly, as an institution, to exert its due influence over the Executive and foster good financial governance, within the context of Zambia's political economy. They should also be aware of the possible complementarities and tensions or conflicts between group interest and individual self-interest within the realms of law-making, policy-making and decision-making.

29 Africa All Party Parliamentary Group, 2008, Strengthening Parliaments in Africa, A report by the Africa All Party Parliamentary Group, March 2008, p.43-44

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**MODULE 2**  
**INSTITUTIONAL, POLICY AND**  
**LEGAL FRAMEWORK**





# CHAPTER 4

## Legislative and regulatory framework for managing public finances

This chapter reviews the legal and regulatory framework for managing public finances in Zambia. The objective is to ensure that the Members of Parliament and Staff of the National Assembly have a clear understanding of the current legal and regulatory PFM framework as they play a critical role in legislating the legal framework to support a sound and effective PFM system.

### 4.1 INTRODUCTION

Sound PFM systems are conventionally associated with systems that ensure efficient, effective and accountable generation and use of public financial resources<sup>30</sup>. For a PFM system to work effectively, it must be supported by a strong legal and regulatory framework. Public finances have a number of inherent risks. These include misdirection of funds, failure to account for expenditures, theft and fraud, inaccurate and incomplete financial statements. Sound PFM systems and practices are an important means of mitigating such risk.

### 4.2 REVIEW OF THE CURRENT LEGAL AND REGULATORY FRAMEWORK

The legal framework for managing public finances is comprehensive. The International Monetary Fund (IMF) reports that the country has multiple different

<sup>30</sup> See for example CIPFA, Public Financial Management – A whole system approach, 2009 and Commonwealth Secretariat, Guidelines for Public Financial Management Reform,

pieces of legislation related to public financial management<sup>31</sup>.

Table 4.1 below lists some of the laws and regulations that relate to PFM in Zambia<sup>32</sup>.

**Table 4.1: List of laws and regulations related to public financial management**

1. Constitution of Zambia (Amendment) Act No. 2 of 2016	14. Loans and Guarantees (Authorization) Act, Cap. 366
2. The Bank of Zambia Act, 1996	15. Local Authorities (Financial) Regulations, 1992
3. The Development (United Kingdom Government) Loan Act, Cap. 373	16. Local Government Act, Cap. 281
4. The Development Bond Act, Cap. 379	17. Local Loans (Registered Stock and Securities) Act, Cap. 353
5. The Financial Regulations, 2006	18. Minister of Finance (Incorporation) Act, Cap. 349
6. The General Loans (Guarantee) Act, Cap. 358	19. National Road Fund Act, 2003
7. General Loans (International Bank) Act, Cap. 365	20. Public Audit Act, No. 29 of 2016
8. General Loans (Mediobanca) Act, Cap. 376	21. Public Finance Act, 2004
9. General Loans and Stock Act, Cap. 350	22. Public Procurement Act, 2008
10. Government Securities Act, Cap. 357	23. Public-Private Partnership Act, 2009
11. International Bank Loan (Approval) Act, Cap. 372	24. Treasury Bills Act, Cap. 348
12. International Bank Loan Act, Cap. 375	25. Zambia Development Agency Act, 2006
13. Loans (Authorization) Act, Cap. 355	26. Zambia Revenue Authority Act, Cap. 321

Source: IMF Country Report, August 2015

Of the above listed pieces of legislation governing PFM operations in the country, the active ones are set out in table 4.2 below<sup>33</sup>:

**Table 4.2** Active legislation for PFM in Zambia

LEGISLATION	PURPOSE
Constitution of Zambia (Amendment) Act No. 2 of 2016, specifically Part XVI on Public Finance and Budget	Constitutes overall framework for all PFM related legislation and sets out guiding principles for public financial management in the country as well as Parliament's mandate in PFM.
Loans and Guarantees Act, Cap 366 of the Laws of Zambia	Primary legislation on debt management authority for the Minister of Finance. The Act provides for the raising of loans, the establishment of sinking funds, the giving of guarantees and indemnities and the granting of loans by or on behalf of the Government.

31 IMF Country Report, August 2015.

32 These are the laws identified by IMF in the 2005 Country Report

33 The remaining 17 acts are dormant due to lack of harmonisation with later legislation or policy frameworks (Ibid.)

Minister of Finance (Incorporation) Act, Cap. 349	This is the law that incorporates the Minister of Finance as the sole corporation by that name. It gives the Minister powers to acquire and hold in that name lands, government securities, shares in any company, securities for money, and real and personal property of every description. The Act also gives powers to the Minister to execute deeds, to enter into agreements binding on himself and his successors in office, and to do all other acts necessary or expedient to be done in respect of the above matters or any of them.
National Road Fund Act of 2003	This law established the national road fund for use in the construction, maintenance and care of public roads as well as to manage traffic and safety in the road transport sector.
Public Audit Act, No. 29 of 2016	This law makes certain provisions relating to the duties and powers of the Auditor-General in auditing public institutions.
Public Finance Act of 2004 & Financial Regulations of 2006	Save for the Constitution, this is the main legal instrument for PFM in Zambia. It provides for the control and management of public finances, as well as audit of all public accounts.
Public-Private Partnership Act of 2009	This provides for public-private partnerships for the construction and operation of infrastructure facilities and systems and for the development of general principles of transparency, economy and fairness in the awarding of contracts by public authorities. The Act also provides for rules governing procurement, contracting and management of public-private partnerships.
Public Procurement Act of 2008 & Public Procurement Regulations of 2011	This law provides for transparency and accountability in public procurement and the regulation and control practices relating to public procurement in order to promote the integrity of, fairness of and public confidence in the procurement process.
Zambia Revenue Authority Act, Cap. 321	This law gives powers to the Zambia Revenue Authority to collect, on behalf of the Government, taxes that are levied under the different tax laws.

### 4.3 STRENGTHENING OF LEGAL FRAMEWORKS FOR PFM

IMF recommends a comprehensive legal framework for PFM to include provisions that direct governments to set out fiscal strategy targets and objectives – say three years in line with the medium-term budgetary framework applied in Zambia - in order to ensure that these objectives are reflected in decisions on resource allocation<sup>34</sup>. Moreover, the IMF recommends that the macroeconomic and fiscal framework should be consistent with the government’s medium-term forecasts of economic growth. It must have a fiscal strategy that establishes the principles, targets, and/or rules that help to shape the country’s medium-term development and expenditure plans and the budget. It must also provide arrangements for reporting performance against the strategy and explaining any deviation from the targets<sup>35</sup>.

34 IMF Country Report No. 15/240 of 2015

35 Ibid.

The IMF Country Report No. 15/240 of 2015 proposes the areas set out below for a comprehensive legal framework for macroeconomic and fiscal policy.

#### Principles of prudent and transparent fiscal management

- A borrowing policy which ensures that public debt is sustainable.
- A fiscal policy that achieves and maintains an appropriate fiscal balance.
- Policies to ensure the minimization and/or management of fiscal risks arising from factors such as unexpected changes in the macroeconomic outlook, external economic shocks (e.g., fluctuations in international commodity prices), potential calls on government guarantees, and other contingent liabilities (e.g., public-private partnerships (PPP)).
- A policy for government wages that is sustainable and ensures the hiring and retention of competent staff.
- Policies that ensure a reasonable degree of predictability about the level and stability of tax rates.
- A national budget and budgetary process that promotes transparency, accountability, and effective management of the public sector.
- Policies that facilitate the achievement of value for money in the use of public resources, especially with regard to capital investment projects.
- Policies that promote the prudent management of natural resources and revenues arising from their extraction.
- An appropriate balance between the powers of the executive and legislative branches in regard to decision-making on fiscal policy, information sharing and the management of the budget.
- A provision that the Minister is responsible for ensuring that the principles of prudent fiscal management are taken into account in reporting to the legislature on all matters relating to the PFM laws.

#### Fiscal objectives and targets

- In accordance with the principles of prudent fiscal management described above, the Government should set out medium-term fiscal objectives and targets for the next three years or more. Such provisions might take the form, for example, of a procedural rule that allows the Government to set numerical targets (sometimes called “fiscal rules”) on macro-fiscal indicators such as the level of debt, borrowing and overall public spending in an annual fiscal strategy statement.
- Once the fiscal targets have been set—for example, at the beginning of the term of a new government—performance in achieving them should be monitored regularly, e.g., in the annual fiscal strategy statement or in the budget documents, or both.
- The law should define the format and content of the fiscal strategy statement which should be submitted to the legislature for scrutiny and endorsement of the assumptions and objectives.
- The law should define procedures and timelines for translating the objectives and policies outlined in the fiscal strategy statement into the expenditure projections contained in the Medium-Term Budget Paper (MTBP)/MTEF and subsequently into the annual budget estimates.

#### Deviations from fiscal objectives and targets

- In many countries, fiscal laws allow the government to deviate from its fiscal objectives and targets on a temporary basis in exceptional circumstances (e.g., where there is a major commodity price shock or natural disaster). Such laws typically require the Minister to submit a report to the Legislature that explains the reasons for such a deviation, the period the deviation is expected to last, and a plan to correct the deviation to be approved by the legislature.

#### Macroeconomic and fiscal forecasts

- Modern public finance laws usually require the Government to prepare and make public medium-term projections of GDP, inflation, the rate of employment and unemployment, the exchange rate, interest rates, and other macroeconomic indicators; together with projections of revenues, expenditures, the fiscal deficit, public debt, and other fiscal indicators; and in addition, the Government is often required to explain the methodologies and assumptions used in preparing these projections, taking account of domestic and international economic conditions, including the commodity markets.



However, the current legal framework for public finance management in Zambia, besides being fragmented and mostly outdated, lacks many of these key provisions. For example, the Public Finance Act, 2004, which is the main act for public finance management, along with other public finance management laws, are silent on issues related to macroeconomic and fiscal strategy and macroeconomic forecasting.

#### 4.4 LEGAL REFORMS IN ZAMBIA

In the public finance management reform programme currently being implemented, the government has prioritised the revision of the existing legal framework for public finance management and national development planning. In addition, the new Constitution calls for a revision of existing pieces of legislation related to the management of public finances. For example, Article 198 of the Constitution provides the following as the guiding principles of public finance:

- a) Transparency and accountability in the development or formulation of macro-economic frameworks, socioeconomic plans and the budget;
- b) Promotion of a public finance system that ensures that the burden of taxation is shared fairly, revenue raised nationally is shared equitably among the different levels of government, and that expenditure promotes the equitable development of the country;
- c) Sustainable public borrowing to ensure inter-generational equity; and
- d) Prudent and responsible use of public resources.

The new Constitution incorporates many important provisions on public finance and budgeting including macroeconomic and fiscal policy, financial management and the regulation of public funds. It also provides for the preparation of medium and long-term financing frameworks and development plans, the budget preparation process, public participation in the formulation of development plans and annual budgets, content of the Government's financial statements and control and disbursement of appropriated funds.

In addition, the Constitution has provided for decentralisation where the governance system will be devolved to local authorities. When implemented, this will substantially increase the autonomy of and the amount of fiscal transfers to local governments. These reforms will require the establishment of legal provisions for enhancing intergovernmental fiscal relations, including the Central Government's oversight of local government fiscal operations as well as harmonisation of the Local Government Act with the Public Finance Act.

Government has furthermore proposed a two-track approach to revising the public finance legislation. The first track comprises the enactment of the Integrated Planning and Budgeting Bill already drafted, but not yet laid before Parliament<sup>36</sup>. The Integrated Planning and Budget Bill

<sup>36</sup> The Bill was drafted and was supposed to be presented to Parliament in 2015. However, the Ministry of Finance could not present it to Parliament as they waited for the new Constitution to be enacted.

broadly covers the preparation of the national development plan (NDP) and the budget. The second track will comprise the preparation of the revised Public Finance Act and other specific public financial management related laws, including laws on debt management, state-owned enterprises (SOE), and local government finance.

#### 4.5 CONCLUSION

This section has shown that the legal framework for public finance management in Zambia is divided among several different laws and regulations, many of which are outdated and poorly harmonised. Hence, to strengthen public financial management, Government is in the process of developing a new legal framework for managing public finances, which sets out Government's medium-term fiscal strategy, targets, and objectives, and the policies and procedures for ensuring that these objectives are reflected in decisions on resource allocation.

Government has adopted a two-track approach in revising the legal framework. The first comprises the Planning and Budgeting Act, while the second will comprise the revision of the Public Finance Act.

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# CHAPTER 5.

## The national integrated planning and budgeting framework

The national integrated planning and budgeting framework makes up the overall framework within which Ministries, Provinces and Spending Agencies (MPSAs) must develop their medium-term and annual plans and associated multi-year and annual budget estimates. Hence, a successful implementation of the national development plan depends on MPSAs' ability to develop plans and budgets that contribute to the realisation of the goals and objectives set out in the national framework. This chapter aims to enhance Members of Parliament and National Assembly Staffs' appreciation of the linkages between the national policy and strategic planning framework and the budgeting process, including MTEF and the annual budget.

### 5.1 INTRODUCTION

In Zambia, like most other countries, multi-year and annual budgets take place within long-term national and medium-term sectoral development planning frameworks. To link long and medium-term development plans and policies to the budgeting process, most countries apply medium-term expenditure frameworks, which in turn form the basis for annual budgets. Therefore, as an important part of Parliament's budget oversight role, Members and Staff should carefully examine the extent to which annual budgets indeed reflect national and medium-term sector plans and policies, and ensure that the Executive is implementing policies, strategies and programmes as agreed in the vision, as well as long and medium-term national planning frameworks.

## 5.2 NATIONAL PLANNING

In most countries, governments prepare national development plans in consultation with the citizens, the private sector, non-governmental organisations and other stakeholders. The objective is to come up with clear strategies based on the perceived needs and priorities of their citizens. The plans provide strategic policy direction and objectives, key national result areas and national outcomes for a multi-year time horizon – typically 5 years<sup>37</sup>. The plans define desired development outcomes to be achieved, build consensus on the obstacles to and opportunities for achieving those outcomes, define the role and contribution of different sectors and stakeholders in achieving the outcomes, and provide a strategic framework within which more detailed planning and budgeting can take place at regular intervals.

## 5.3 BUDGETING

The national budget is Parliament's legal authorisation of the Executive's power to collect revenues, incur expenditures and borrow money for the coming year. It is a means of allocating resources to achieving the objectives of the Government as outlined in the national development plan. It is a mechanism for undertaking national economic and fiscal planning, and a means of controlling and monitoring the use of funds to ensure they meet the stated objectives.

Therefore, affordability must influence policy making and planning at the point when the decision is made. Where adjustment is required to deal with changing macroeconomic conditions and changed priorities, adjustment needs to take place through policy change to be sustainable.

## 5.4 MEDIUM TERM EXPENDITURE FRAMEWORK (MTEF)

The medium-term budget planning approach, explained in detail in Chapter 14, encompasses forecasts of all revenues and expenditures and links the national plans and medium-term sector plans with the medium-term budgetary framework, which in turn forms the basis for the annual budget. The result is better control of expenditure and greater efficiency and effectiveness in implementing policies, programmes and projects.

## 5.5 INTEGRATED PLANNING AND BUDGETING FRAMEWORK IN ZAMBIA

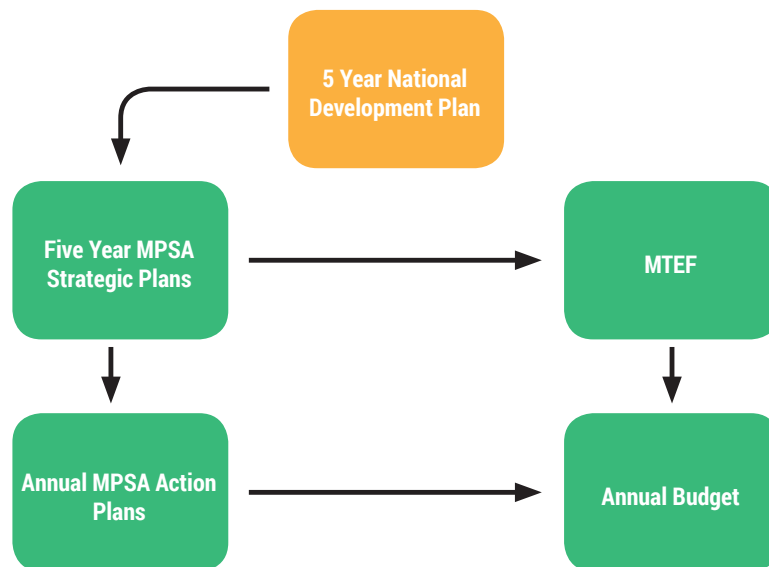
The integrated planning and budgeting processes incorporate the procedures used to prepare socio-economic and physical (spatial) plans and link these to annual budgets at the national, provincial and

<sup>37</sup> In Zambia, the national development plans have a time horizon of 5 years, whilst the medium-term expenditure framework has a three-year horizon.

district levels. Top-down planning and budgeting processes comprise structures at the national and sector level which will provide estimates of available resources and offer policy guidance to lower levels of government structures. The bottom-up process comprises sub-districts, districts and provincial levels that make assessments of their prevailing circumstances in order to develop their own development plans. Institutions at all levels are mandated to develop strategic plans and annual work plans, which in turn form the basis for their budgets which enable the implementation of national, provincial and district development plans.

The Zambian integrated planning and budgeting framework is illustrated in the figure below.

**Figure 5.1.** The integrated planning and budgeting framework in Zambia



The Government of the Republic of Zambia launched the national planning and budgeting policy in 2014. The policy is intended to strengthen accountability, oversight and participation mechanisms in national planning and budgeting in order to enhance responsiveness, openness and results orientation.

**The objectives of the policy are to:**

- integrate national planning and budgeting processes with greater results orientation;
- strengthen synergies in the various planning processes;
- facilitate more participatory and decentralised development planning and budgeting processes;
- enhance budget credibility;
- facilitate greater evidence based decision making in development planning and budgeting; and
- strengthen the oversight function of the Legislature.

While the Ministry of Finance is responsible for the preparation of the MTEF and annual national budget, the responsibility for preparation, implementation, monitoring and evaluation of the National Development Plan rests with the Ministry of National Development Planning. The MTEF is key in linking planning and budgeting. The objective is to ensure the national budget is an effective tool in implementing the plans to reach the objectives as stated in the national development plan, sector strategies and district development plans.

The integrated national planning and budgeting process is designed to enhance the linkages between result-oriented plans and the output-based budgets derived from them in order to improve development outcomes and the delivery of public services. The process encompasses long-term, medium-term and short-term plans. Long-term plans consists of national long-term visions and the integrated district development (spatial) of districts. For the medium term, five year national, provincial and district development plans are developed to operationalise these long-term plans, adjusted when necessary for changes in the macroeconomic and financial circumstances and the development priorities of the nation. All MPSAs prepare five year institutional strategic plans from which three year rolling budgets (MTEF) and annual work plans and output-based budgets are prepared annually.

## 5.6 CONCLUSION

National planning is deficient when it is disconnected from the budget and from the provision of public services. Having separate processes opens the door to inconsistent plans and budgets. It is, therefore, necessary to encourage consistency by integrating plans and budgets. In this way, the budgets should be informed by national plans in order to bring about development in a country.

The national planning system in Zambia provides the mechanism for making the decisions on the following issues: Identifying development objectives, developing strategies and programmes to achieve objectives, assessing resource availability and prioritising between objectives and expenditure plans in order to match expenditures to available resources.

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[www.uganda-sds.org](http://www.uganda-sds.org) (Integrated Planning and Budgeting benefits districts)  
[www.unpei.org](http://www.unpei.org) (mainstreaming into national planning process)



# CHAPTER 6.

## Purpose and structure of public budgets

The examination and passing of the annual national budget is one of the most important functions of Parliament during the budget cycle and it is, therefore, important that Members of Parliament and National Assembly Staff understand the concept, purpose, and the main structure of public budgets to adequately perform this function. This chapter sets out the key features, purpose and structures of public budgets. While the chapter looks into the general structure of budgets, Chapter 15 focuses on the detailed coverage and classification system applied in the national budget document, the Yellow Book.

### 6.1 INTRODUCTION

A budget is a financial plan of action for a specified future period, usually a fiscal year. It shows how the Government intends to spend forecasted revenues within the fiscal year in order to deliver public goods and services to the people or community it serves in the most efficient and effective way.

A government's budget is its most essential policy tool, providing a statement of the priorities of a nation or an entity thereof (for example province, state, city, region or district). Government budgets are normally divided into two separate budgets, namely a recurrent or operational budget and a capital or investment budget. The recurrent budget covers revenues and expenditures and is a combination of public expenditure plans and revenue and tax legislation for the coming year. The capital or investment budget on the other hand is made up of expenditures related to capital formation such as infrastructure development

and acquisition of other assets. Governments acquire revenue to finance their expenditures through different methods including taxation, sale of goods and services, domestic loans and loans from other countries, grants from development partners, etc.

A government's budget is also a tool for balancing competing demands for scarce resources. Public resources are inevitably limited and the process of developing a budget is used to assess competing claims on available resources from various sectors such as ministries, political parties, regions and states and segments in society and to facilitate necessary trade-offs.

An essential feature of modern government budgets is that they provide a system of accountability and controls over the spending of public funds by government officials, ministries, departments and sub-national governments. In democratic societies, parliaments are at the apex of this accountability system. Consequently, it is essential that parliamentarians have a clear understanding of what a budget is in order to exercise appropriate control.

## 6.2 PURPOSE OF PUBLIC BUDGETS

A public budget serves at least five main purposes as set out hereunder:

- i. As a **democratic** tool, it shows the public how the Government intends to utilise public resources against which Government will be held responsible.
- ii. As a **political** tool, a budget is an expression of the Government's ideological commitment, political philosophy and policy platform on how a country should move forward.
- iii. As an **economic** tool, government budgets serve to shape the economic priorities of a country or entity. A budget is normally the most important document on policy for the year. In a modern economy the influence of government on the economy as a whole is immense as it is often the biggest employer, the biggest spender and the biggest single claimant on the country's resources. A government can influence the economy in numerous ways, but its own revenues, borrowing and spending are the major macro-economic factors.  
A budget can influence the direction of investment, for example by lowering taxes for certain sectors of the economy, promote employment, and influence the redistribution of income between various parts of the society.
- iv. As a **legal** tool, the budget has to be in line with constitutional requirements, relevant legislation and the spirit of participatory democracy. The point to keep in mind is that governments can only spend money after they have been authorised to do so by parliaments.
- v. As a **management** tool, the budget directs the administration in its daily operations and spending.



### 6.3 STRUCTURE OF PUBLIC BUDGETS

The main structure of public budgets is generally standard with two main components: A revenue side and an expenditure side. The expenditure side of the budget is normally further sub-divided into a recurrent (operational) budget and a capital (development) budget although capital budgets are increasingly integrated into overall budgets as accrual budgeting is introduced. In the case of Zambia, the introduction of activity-based budgeting (ABB) led to the amalgamation of the capital and recurrent budgets into the same document - the Yellow Book. This makes a segregation of the two a rather technical exercise requiring access to the ABB software and produce of special reports. However, with the roll out of output-based budgeting, capital expenditures will feature as a separate budget line in the budget document, which - alongside a table showing the location of infrastructure projects - will enable Members of Parliament better track capital investments and their geographic location.

#### Revenues

There are four major sources of revenues and financing for the national budget. These are tax revenues, non-tax revenues, foreign grants and domestic and foreign financing as shown in Table 6.1, the resource side of the 2016 Budget. Tax revenues are made up of income taxes, Value Added Tax (VAT) and customs and excise duties. Income taxes are composed of company tax (taxes paid by companies on their profits and other income), Pay As You Earn (payroll tax paid by workers in formal employment), and withholding tax and other income tax (tax paid by individuals and tax withheld on certain payments, such as rentals). As for VAT, there is domestic VAT (consumption tax paid on domestically produced goods and services) and import VAT (payable on imported goods). Customs and excise duties constitutes the other type of tax revenues with customs duties being tariffs payable on imported goods while excise duties are chargeable on eligible imported and locally produced goods and services.

Other (non-tax) revenues include fees and fines (charged and collected by MPSAs for providing certain services and fines paid for certain offences committed by citizens), exceptional revenue (revenue collected in exceptional circumstances and may not be regular), mineral royalty (i.e. resource levy paid by mining companies for extracting minerals from underground), and the insurance premium levy (a charge on insurance premiums transactions).

Grants are non-repayable moneys from foreign governments and international organisations to help finance the national budget. Total financing is split into two: Domestic financing where Government borrows from the domestic financial market to support the budget, and foreign financing where Government borrows from the international capital market, multilateral institutions and other international institutions to finance projects and other key programmes in the budget. It should be noted that financing is not part of the revenues, but is there to balance the resource side and the expenditure side of the budget in cases where revenues are insufficient to meet expenditures.

**Table 6.1** Revenues and financing, 2016 in millions of Kwacha (K'million)

	K'million		
<b>1. Total Tax Revenues</b>			<b>30,366.3</b>
1.1 Income Taxes			
Company Income Tax	3,239.1		
Pay As You Earn	7,934.4		
Withholding Tax and Other	3,166.8	14,304.3	
1.2 Value Added Tax (VAT)			
Domestic VAT	1,503.4		
Import VAT	8,390.1	9,893.5	
1.3 Customs and Excises			
Customs Duties	2,488.9		
Excise Duties	3,643.6		
of which - Fuel Levy	991.2	6,132.5	
<b>2. Other (Non-Tax) Revenues</b>			
2.1 Fees and Fines		7,645.3	
2.2 Exceptional Revenue		1,164.4	
2.3 Mineral Royalties		2,889.1	
2.4 Insurance Premium Levy		44.0	<b>11,742.9</b>
<b>3. Grants</b>			<b>545.8</b>
<b>TOTAL REVENUES</b>			<b>42,655.0</b>
<b>4. Total Financing</b>			<b>10,480.8</b>
4.1 Domestic Financing		2,509.5	
4.2 Foreign Financing			
Programme Loans	3,954.3		
Project Loans	4,017.0	7,971.3	
<b>TOTAL REVENUES AND FINANCING</b>			<b>53,135.8</b>

**Source:** Ministry of Finance - 2016 Budget Speech.

### Expenditures

Expenditures fall under two classifications: *functional* and *economic*<sup>38</sup>. The functional classification of expenses is the system used to identify the socio-economic objectives of current transactions, capital outlays and acquisition of financial assets by general government and its sub-sectors. The economic classification shows the budget appropriations, by line-item, to the various programmes in terms of input categories, such as expenditures for goods and services, wages and salaries, transfers and subsidies and capital expenditure.

The functional classification, which has ten functions, is explained by Table 6.2 below. These

<sup>38</sup> Details on the economic classification can be obtained from the Government Finance Statistics Manual 2014 (IMF 2014). The standardised chart of accounts and the budget structure in the Yellow Book is also explained in further detail in Chapter 15.

represent the expenditure side of the 2016 Budget. This classification outlines the expenditure by functions performed by Government institutions rather than the allocations or expenditures by each institution as detailed in the Yellow Book. The Yellow Book shows budget allocations for each institution while Table 6.2 indicates the budget allocations to each of the ten functions and sub-functions. The structure of the expenditure side in the Yellow Book is further explained in Chapter 15. The functional categories used by the Zambian Government are:

- The *General Public Services* function is made up of expenses relating to the organisation and operation of Government such as those related to Parliament, conduct of elections, the collection of taxes and the management of public funds and public debt, contributions to international organisations and the operations of the foreign missions. In addition, local government equalisation fund, external and domestic debt service, tripartite elections and referendum, compensation and award, and other services not mentioned are part of the general public services and the function cuts across various institutions.
- The *Defence* function covers the services provided by the Ministry of Defence including the defence wings (Zambia Army, Zambia Airforce and Zambia National Service) and foreign military assistance to Zambia.
- The *Public Order and Safety* function includes services provided by institutions such as the Zambia Police Service, the Judiciary, fire protection services, prisons services, and others.
- The *Economic Affairs* function covers services provided by all economic ministries and institutions and includes general economic, commercial and labour affairs, transport, communication, agriculture, etc. Empowerment funds, the Fisheries Development Fund, the Farmer Input Support Programme, the Food Reserve Agency, the Rural Electrification Fund and roads infrastructure are part of the economic affairs function.
- The *Environmental Protection* function relates to services involving waste management, pollution abatement and other environmental protection services. The Ministry of Local Government and Housing, the Ministry of Lands and local authorities are key players in this area.
- The *Housing and Community Amenities* function is about water supply and sanitation, housing and community development, street lighting, and other services. Again the Ministry of Local Government and Housing and its apex institutions are vital in this domain.
- The *Health* function refers to health services as provided by the Ministry of Health, the Ministry of Community Development, Mother and Child Health (partly), the Ministry of Defence (the military hospital) and the Zambia Police (medical services in clinics run by the institution). The services also include drugs and other medical supplies, infrastructure and equipment.

- The *Recreation, Culture and Religion* function is all about recreation, sports and cultural services, broadcasting and publishing and other services. The Ministry of Youth and Sport; and the Ministry of Information and Broadcasting Services are at the centre of this function.
- Similarly, the *Education* function covers services relating to pre-primary and primary education, secondary and post-secondary education, tertiary education, school and university infrastructure and other education services. Here, services would cut across two ministries, i.e. the Ministry of General Education and the Ministry of Higher Education.
- The *Social Protection* function includes services for retirees (Public Service Pension Fund), disabled and aged people, as well as social cash transfer and food security packs for the most vulnerable in society. The Ministry of Labour and Social Security and the Ministry of Community Development, Mother and Child Health (partly) are in charge of this function.

**Table 6.2: Expenditure by functional classification in millions of Kwacha (K'million)**

	K'million	
<b>1. General Public Services</b>		
o/w Local Government Equalisation Fund	717.0	
Tripartite Elections/Referendum	727.9	
Public Affairs and Summit	82.6	
External Debt Interest	3,615.6	
Domestic Debt Interest	3,549.3	
Sinking Funds	536.2	
Awards and Compensation	100.0	<b>19,171.7</b>
<b>2. Defence</b>		<b>3,145.8</b>
<b>3. Public Order and Safety</b>		<b>1,840.6</b>
<b>4. Economic Affairs</b>		
o/w Empowerment Funds	373.3	
Fisheries Development Funds	5.0	
Framer Input Support Programme	1,000.4	
Food Reserve Agency	750.0	
Rural Electrification Fund	118.2	
Roads Infrastructure	6,629.9	<b>13,247.2</b>
<b>5. Environmental Protection</b>		<b>151.4</b>
<b>6. Housing and Community Amenities</b>		
o/w Water Supply and Sanitation	283.6	<b>468.7</b>
<b>7. Health</b>		
o/w Drugs and Medical Supplies	754.0	
Medical Infrastructure and Equipment	387.0	<b>4,431.8</b>
<b>8. Recreation, Culture and Religion</b>		<b>261.6</b>

<b>9. Education</b>		
o/w School Infrastructure	637.3	
University infrastructure	390.0	
Student Loans and Bursaries	310.9	<b>9,143.2</b>
<b>10. Social Protection</b>		
o/w Public Service Pension Fund	805.0	
Social Cash Transfer	302.0	
Food security Pack	20.0	<b>1,273.8</b>
<b>TOTAL EXPENDITURE</b>		<b>53,135.8</b>

**Source:** Ministry of Finance - 2016 Budget Speech.

## 6.4 CONCLUSION

Public budgets have a standard structure made up of the resource or revenue side and the expenditure side. The two must balance each other. Used as democratic, political, economic, legal and management tools, public budgets are aimed at advancing the development agenda and achieving efficient public service delivery for the benefit of the communities.

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# CHAPTER 7

## Government accounting and reporting standards and practices

Good accounting and reporting standards and policies provide the basis for the effective internal and external controls that safeguard the usage of public resources. The objective of this chapter is to explain the principles and policies of government accounting and reporting standards, as well as the importance of adhering to internationally accepted standards and principles in upholding transparency and accountability in the receipt and usage of public resources.

### 7.1 INTRODUCTION

The Government of Zambia, through the Ministry of Finance, gives instructions to all government Ministries, Provinces and Spending Agencies (MPSAs) on the adoption of the standards and policies for the purpose of uniformity in recording financial transactions across the Government. The uniformity is ensured through adherence to the Public Finance Act, 2004 and the Financial Regulations, 2006 and a number of circulars issued by the Ministry of Finance.

The following sections give a brief background of the standard-setting bodies and highlight the different standards applicable to the different bases of accounting, from cash-basis accounting through to full accrual accounting. Furthermore, the sections highlight the necessary qualitative characteristics for resultant financial information of good accounting standards and policies, and the importance of timeliness of the financial information for decision-making purposes.

## 7.2 GOVERNMENT ACCOUNTING STANDARDS AND PRINCIPLES

*“Accounting standards are authoritative standards for financial accounting and reporting developed through an organised standard-setting process and issued by a recognised standard-setting body. Accounting standards specify how transactions and other events are to be recognised, measured, presented and disclosed in a public sector entity’s financial statements. The objective of such standards is to meet the needs of users of financial statements by providing the information needed for accountability and decision making”*<sup>39</sup>. In this way, Government accounting standards ensure that the qualitative characteristics of financial information have the attributes that make the information provided in financial statements useful to users. They are applicable to financial statements, regardless of the basis of accounting used to prepare the financial statements. The principal qualitative characteristics of the financial information are outlined below.

### Understandability

Information is understandable when users might be expected to reasonably comprehend its meaning. For this purpose, users are assumed to have a reasonable knowledge of the Government entity’s activities and the environment in which it operates, and to be willing to study the information. However, the principle of understandability does not equate to simplicity, especially for public sector financial reporting. Hence, information about complex matters should not be excluded from the financial statements merely on the grounds that it may be too difficult for certain users to understand.

### Relevance

Information is relevant to users if it can be used to assist in evaluating past, present or future events or in confirming, or correcting, past evaluations. In order to be relevant, information must also be timely. The relevance of information is affected by its nature and materiality.

Information is material if its omission or misstatement can influence the decisions of users or assessments made on the basis of the financial statement. Materiality depends on the nature or size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful. Materiality is not simply a matter of the monetary value of the reporting item, but also its importance to the user. Therefore, reporting on certain important expenditures, even though they are low, may be necessary to understand the most important elements of the financial report.

### Reliability

Reliable information is free from material error and bias, and can be depended on by users to represent faithfully that which it purports to represent or can reasonably be expected to represent.

If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that the latter are accounted for and presented in accordance with their substance and economic reality.

39 Financial Reporting & Assurance Standards Canada, <http://www.frascanada.ca/public-sector-accounting-board/what-we-do/about-psab/item55777.aspx>



Information is neutral if it is free from bias. Financial statements are not neutral if the information they contain has been selected or presented in a manner designed to influence the making of a decision or judgment in order to achieve a predetermined result or outcome. It should, however, be noted that complete neutrality of information is very difficult. Therefore, in the preparation of financial reports, in order for them to provide reliable information, known biases or factors that might affect how the information is interpreted, must be fairly presented in notes to the statements.

### Prudence

Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or revenue are not overstated and liabilities or expenses are not understated.

The information in financial statements should be complete within the bounds of materiality and cost to acquire this information to provide a reasonable level of confidence.

### Comparability

Information in financial statements is comparable when users are able to identify similarities and differences between that information and information in other reports.

Comparability applies to the:

- comparison of financial statements of different entities; and
- comparison of the financial statements of the same entity over periods of time.

An important implication of the characteristic of comparability is that users need to be informed of the policies employed in the preparation of financial statements, changes to those policies and the effects of those changes. Such policies should be reported in the notes to the financial statements. Because users wish to compare the performance of an entity over time, it is important that the financial statements show corresponding information for preceding periods<sup>40</sup>.

## 7.3 GOVERNMENT FINANCIAL REPORTING STANDARDS AND PRACTICES

**Financial accounting**, which is the branch of government accounting concerned with the recording of financial transactions and events, is regulated by rules to ensure the quality of both the inputs and outputs of the accounts of governments. The concern for credible and comparable financial information led to the development of accounting standards to promote uniformity in accounting practices. The standards, called Generally Accepted Accounting Practices (GAAP) (in the United

<sup>40</sup> The notes to the financial statement and the extra information including accounting policies and the general information about the reporting entity is covered in Chapter 33.

Kingdom) or Principles (in the United States of America), are used by supreme audit institutions to evaluate the quality of annual financial representations by the respective treasuries of the governments. Based on these standards, the supreme audit institutions will express their views as to the ‘true and fair view’ or ‘fairness’ of the financial reports of governments or institutions in their presentations of financial information to stakeholders. Thus accounting standards are GAAP only if they are developed by sufficiently independent organisations recognised by the national associations of independent auditors (e.g., Certified Public Accountants in the United States of America, and Chartered Accountants in some other English-speaking countries).

This is key to ensuring the neutrality of accounting standards and increases confidence in the way the information is reported by the user. However, as always, such standards does not mean that all the information as reported is completely accurate.

**Cash Accounting** is an accounting method in which receipts are recorded during the period they are received, and expenses are recorded in the period in which they are actually paid. On the other hand, **Accrual Accounting** is a method that records revenues and expenses when they are incurred, regardless of when cash is exchanged. The term ‘*accrual*’ refers to any individual entry recording revenue or expense in the absence of a cash transaction. This, therefore, means that revenues and expenditures are recognised and reported in the period they relate to regardless of when the revenue is actually received and/or when the expenditure is actually incurred.

In practice, a distinction is normally made between four main bases of accounting: cash basis, modified cash basis, full accruals basis and modified accruals basis.

The *cash basis* of accounting measures cash flows at the time those flows actually take place, while the *modified cash basis* of accounting allows a short period of time after the year-end for settling liabilities of the year just ended (and treats this expenditure as occurring in the year just ended). On the other hand, the *full accrual basis* of accounting records expenditures and revenues when they fall due (i.e. in many cases before the associated cash-flows take place). It records assets and liabilities and is, therefore, associated with the production of balance sheets (or statement of affairs). It also recognises and records depreciation on assets with finite lives, something that cash accounting cannot accommodate. The *modified accruals basis* of accounting is similar to the full accruals basis, but it is simpler because it does not involve the capitalisation of fixed assets (nor the provision of depreciation of fixed assets).

The basis of accounting determines the extent of information that an accounting system needs to collect and report. A pure, cash-based system can only report on cash balances and cash flows (inward and outward), but cash payment or receipt is usually only a small element in the whole system of a transaction. For example, a purchase transaction (going through stages: commitment of funds, local purchase order, receipt of goods/services, payment and de-commitment of excess funds) could generate different accounting information depending on the accounting basis being used.

With pure cash accounting, the transaction will only be reported when the payment is made while

with accrual accounting, a liability will have to be recognised when the obligation to pay has been established. Thus pure cash accounting does not provide useful information for managing payables and receivables. An accrual accounting system provides a systematic method of recording and managing receipts and payments due, something that many governments are lacking.

Since the late 1980s, a variety of approaches, termed New Public Management, have been considered international best practice. These have emphasised the importance of efficiency and claimed that this will be increased if governments work more like business<sup>41</sup>. Alongside a range of other public management reforms, such as contracting out and the creation of agencies, business style, accrual accounting has been advocated as the best model for governments to report on their finances<sup>42</sup>. Accrual accounting represents the actual financial conditions of the Government in terms of debts, other long-term liabilities and capital assets<sup>43</sup>. However, while the accrual base can offer much more information about the financial condition of a government, it is also much more complex, requiring more resources to maintain and challenges users in terms of complexity and the concept of recognition and depreciation.

While accrual accounting forms the basis for the generation of sophisticated information required by for-profit business enterprises, it should be borne in mind that governments are fundamentally different from private business in several important ways. They have different purposes, processes of generating revenues, stakeholders, budgetary obligations, and propensity for longevity. These differences require separate accounting and financial reporting standards in order to provide information to meet the needs of stakeholders to assess government accountability and to make political, social, and economic decisions.

Regardless of the accounting principles adopted, a fundamental objective of the financial statements for any public sector organisation is to fulfil the stewardship function by providing an audited comparison of the actual use of resources with the agreed budget. A government's financial accountability arises from the budget-setting process during which it gains agreement to the levels of taxation that will be levied and to the funding which will be allocated to the various services, which it intends to provide. Thus the budget out-turn report and the associated report of the Auditor-General are the prime documents by which the Government is held to account by Parliament for the regularity and probity of its financial management.

Regardless of whether the cash or accrual basis of accounting is used, accounting standards exist for both. A number of governments across the globe have adopted International Public Sector Accounting Standards (IPSAS). The Public Sector Committee (PSC) of the International Federation of Accountants (IFAC) formulates IPSAS. IPSAS does not over-ride statutory or other official national requirements, but the PSC encourages governments and national standard-setters to adopt IPSAS.

41 Hood 1991; Pollitt & Bouckaert 2000

42 Guthrie, Humphrey, Jones & Olson 2005; Smullen 2009

43 In September 2009, the IMF reported that the following countries had adopted the full accrual basis of accounting: Australia, Canada, Colombia, France, New Zealand, UK, US (source: [https://en.wikipedia.org/wiki/International\\_Public\\_Sector\\_Accounting\\_Standards](https://en.wikipedia.org/wiki/International_Public_Sector_Accounting_Standards))

Accounting records are kept for a wide variety of administrative entities of Governments: Ministries, Provinces and Spending Agencies (MPSAs) (including hospitals, research centres, colleges, schools, police stations, defence establishments). Government accounting entities are spread throughout the country, from the capital city to the remotest corners of the country. Given such a spread, the capacity of accounting entities and of their staff is bound to vary considerably. In order to ensure adequate accounting from such a wide range of entities, a government accounting system has to be relatively uniform, well documented, simple to learn and operate, and easy to consolidate.

A number of developing countries have adopted the Cash Basis IPSAS (Zambia included) or modified cash basis, which is meant to record only transactions without prepayments and accruals, while some developed countries have migrated from the cash basis to full accrual IPSAS with some in the middle (modified cash or modified accrual). IPSAS aims to improve the quality of general-purpose reporting by public sector entities, leading to better-informed assessments of the resource allocation decisions made by Government, thereby increasing transparency and accountability.

#### **7.4 CASH BASIS AND MODIFIED CASH BASIS OF ACCOUNTING**

Cash Basis IPSAS prescribes the manner in which general purpose financial statements should be presented when prepared using the cash basis or modified cash basis of accounting. Information about the cash receipts, cash payments and cash balances are necessary for accountability purposes. It also provides input useful for the assessment of the ability to generate adequate cash in the future and the likely resources and uses of cash. In making and evaluating decisions about the allocation of cash resources and sustainability of the entities' activities, users require an understanding of the timing and certainty of the cash receipts and payments.

Compliance with the requirements and recommendations of the IPSAS standard ensures comprehensive and transparent financial reporting of cash receipts, cash payments and cash balances of the Government. It also enhances comparability with the country's own financial statements and with those of other countries using the cash basis of accounting.

Cash Basis IPSAS is less complex and resource demanding to manage than Accrual Basis IPSAS. They are well adapted to the needs of budgetary control that assumes payment is definite and strict budget control can be exercised by comparing sums authorised with those actually spent. The Cash Basis IPSAS is relatively easy to understand and verify, and is generally compatible with statutory requirement in many countries.

In most governments the cash basis is used in conjunction with the commitment system for budgetary control purposes. Under the commitment system, planned and approved expenditures that have not yet been made but will be in the reporting period are first entered into the accounting system as commitments. Authorised expenditure (or available budget) is reduced by commitments that have not been liquidated (i.e. not been followed by a cash payment). However, when the cash

payment occurs, the sum committed is then recognised as expenditure. A commitment system is an important tool in budgetary control in a cash-based accounting system.

Financial statements prepared under the Cash Basis IPSAS, as cited from the Standard, must include the components listed below.

- (a) A statement of cash receipts and payments, which:
  - (i) Recognises all cash receipts, cash payments and cash balances controlled by the entity.
  - (ii) Separately identifies payments made by third parties on behalf of the entity.
- (b) Total payments made by third parties, which are not part of the economic entity to which the reporting entity belongs.
- (c) Accounting policies and explanatory notes.
- (d) When the entity makes publicly available its approved budget, a comparison of budget and actual amounts. The comparison of budget and actual amounts should be presented separately for each level of legislative oversight:
  - (i) the original and final budget amounts;
  - (ii) the actual amounts on a comparable basis; and
  - (iii) by way of note disclosure, an explanation of material differences between the budget for which the entity is held publicly accountable and actual amounts, unless such explanation is included in other public documents issued in conjunction with the financial statements, and a cross reference to those documents is made in the notes.<sup>44</sup>

## 7.5 ACCRUAL AND MODIFIED ACCRUAL BASIS OF ACCOUNTING

The purpose of the preparation of accounts under the accrual basis is to identify the full costs of services provided at the time provided so that taxpayers receiving those services pay for them rather than pass them on to future generations (Intergeneration Equity), and permit preparation of the financial statements for the whole of Government, which reflect the actual financial condition regardless of whether the goods or services have been paid for, or cash has been received.

A number of IPSAS standards are available for the preparation of financial statements using the Accrual Basis IPSAS. IPSAS 1 – Presentation of Financial Statements requires that a complete set of financial statements prepared under the accrual accounting standard should comprise:

- a. statement of financial position;
- b. statement of financial performance;
- c. statement of changes in net assets/equity – cash flow statement;

44 International Public Sector Accounting Standard (IPSAS): Financial Reporting Under the Cash Basis of Accounting. Issued January 2003.

- d. When the entity makes its approved budget publicly available, a comparison of budget and accrual amounts; and
- e. Notes, comprising a summary of significant accounting policies and other explanatory notes.

Before moving from cash basis to full accrual accounting, the following considerations are relevant:

- accrual accounting information is more difficult and more costly to produce and to use, than cash-based accounting information;
- part of the cost of using accrual-based data is the cost of understanding it (to understand accrual-based data a significant amount of capacity building, including for parliamentarians is needed);
- the adoption of full accrual accounting is more complex and more costly than the simple cash basis (asset valuation is an example of complexity and cost);
- poor countries usually lack accounting skills, and therefore have few trained people who can either produce complex accounting information or use it; and
- the accounting systems of many developing countries suffer from a range of serious defects even though they employ the simplest cash accounting basis.

## 7.6 CONCLUSION

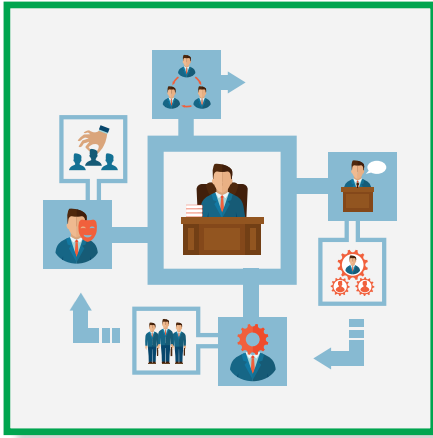
The transparency and accountability of governments' financial management is facilitated with the provision of reliable and relevant information that is provided on a timely basis. Whichever standards are adopted, through the financial management legal framework or regular instructions to the respective government levels, they should have the attributes highlighted in this chapter.

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# CHAPTER 8

## Key players and their roles and responsibilities in PFM

Public Financial Management involves a number of key players with different responsibilities and different roles to play at the various stages of the budget cycle. It is important for Parliament's oversight and monitoring of PFM processes and performance that Members of Parliament and Staff of the National Assembly have a clear understanding of the division of roles and responsibilities between these players. This chapter aims to explain who the players are and how the various players complement each other. Moreover, the chapter identifies the players responsible for optimum use of public resources and for taking remedial action in cases of non-compliance with the legal and regulatory framework, abuse of public resources or financial mismanagement.

### 8.1 INTRODUCTION

The primary and foremost stakeholders in an effective system of accountability are the citizens of a country. They look to their legislative bodies to hold the Executive accountable for the collection of revenue, management of public debt and expenditure on public programmes. At the operational level, the ministers as head of ministries and departments hold the senior civil servants accountable, who in turn hold junior levels accountable for proper execution of programmes and achievement of results. Within the public sector, the supreme audit institutions, internal audit departments, the ombudsman, anti-corruption agencies and other investigating organisations involved in enforcing conduct and discipline have an interest in a properly functioning system of accountability. Besides, the Non-Governmental Organisations operating in a country remain alert to the accountability information published by the Government departments and

agencies. Local and internal media also have a stake in the proper functioning of the accountability mechanism.

The following sections will look at the players identified in the regulatory framework, as well as other stakeholders who include civil society, the cooperating partners and Parliament.

## 8.2 MINISTRY OF FINANCE

The Ministry of Finance is responsible for the formulation of economic development policies, and the economic management of the affairs of Government in order to achieve faster and sustainable economic development. The Ministry is also the principal actor in policy formulation in respect of public finance and as such responsible for the financial soundness of Government's economic policies and for the proper control of revenue and expenditure. The Secretary to the Treasury has the responsibility to ensure that the functions of the Ministry are carried out economically, efficiently and effectively, and its objectives duly achieved.

## 8.3 CONTROLLING OFFICER

As provided for in the current regulatory framework, the Controlling Officer is the Chief Accounting Officer in respect of all public moneys collected, received and disbursed on behalf of a ministry or department. Controlling Officers play a key role in public financial management and are charged with the duty of planning and controlling the expenditure of public funds.

The duties of controlling officers include the following:

- a) maintenance of an effective, efficient and transparent system of financial and risk management and internal control;
- b) maintenance of a system of internal audit under the control and direction of an audit committee complying with and operating in accordance with the Public Finance Act;
- c) maintenance of an appropriate procurement and provisioning system in accordance with the *Zambia Public Procurement Act*;
- d) maintenance of a system for properly evaluating capital projects;
- e) ensuring effective, efficient, economical and transparent use of the resources under their control;
- f) preventing unauthorised, irregular and wasteful expenditures and losses resulting from negligence and criminal conduct;
- g) immediately reporting, in writing, particulars of the expenditure to the Secretary to the Treasury on discovering any unauthorised, irregular or wasteful expenditure, referred to in (f);

- h) taking immediate, effective and appropriate disciplinary steps against any officer in the Ministry or department who contravenes or fails to comply with the provisions of the Act; and
- i) not committing Government to expenditures in excess of money appropriated by Parliament.

#### 8.4 ACCOUNTING OFFICER

An Accounting Officer has the following responsibilities as stipulated by the Public Finance Act:

- a) propriety and regularity of the public finances for which the Accounting Officer is answerable;
- b) performance in the delivery of outputs, taking into account the performance indicators in the Estimates;
- c) economic, efficient and effective use of resources available to the Accounting Officer;
- d) exercising reasonable care to prevent and detect unauthorised, irregular and nugatory expenditure, and for this purpose implementing effective, efficient and transparent processes of financial and risk management;
- e) putting in place a sound system of internal control over the Department's activities, including the receipt, disbursement of and accounting for public funds and ensuring that the system is working efficiently and effectively;
- f) keeping and maintaining departmental accounts and financial records including data on outputs and performance in accordance with the regulations and procedures contained in the Accounting manual;
- g) ensuring that financial transactions pertaining to the Department are duly processed through the Treasury Single Account (TSA) and that outputs and performance are reported on time;
- h) responding to internal audit management letters and reference sheets and taking remedial action on weaknesses and shortcomings identified; and
- i) preparing financial statements and corporate governance report by statutory bodies.

#### 8.5 ACCOUNTANT GENERAL

The Accountant General has the responsibility to advise the Secretary to the Treasury and other Accounting Officers on matters relating to:

- (a) Government accounting;
- (b) the management of Government cash flows;
- (c) the opening and operation of bank accounts.

In respect of government accounts, the Accountant General has to:

- (a) ensure the adequacy and reliability of the central computerised Treasury Single Account System (TSA) for the processing and recording of Government transactions and for the preparation of financial and non-financial reports including performance reports;
- (b) ensure that adequate controls exist to safeguard the integrity and security of financial data stored in the TSA;
- (c) prepare and submit to the Auditor General the annual statutory financial statements;
- (d) maintain an updated Chart of Accounts and ensure that financial data is recorded in conformity with the Chart of Accounts; and
- (e) exercise control over the dissemination of financial and other information by officers of the Treasury.

In respect of cash management, the Accountant General is responsible for:

- (a) determining the Government's cash requirements and ensuring that sufficient funds are available to meet the payment obligations of the Government as they fall due;
- (b) ensuring that proper cash management systems are in place in all departments for the efficient and effective use of cash resources;
- (c) maintaining Government's main bank account with the Central Bank and to monitor bank balances of Ministries, Provinces and Spending Agencies (MPSAs); and
- (d) authorising the opening of bank accounts by MPSAs.

## 8.6 INTERNAL AUDITOR

The regulatory framework provides the following responsibilities for the internal auditors in all MPSAs:

- (a) reviewing the compliance with the existing Government financial regulations, instructions and procedures;
- (b) evaluating the effectiveness of internal control systems;
- (c) appraising the economy and effectiveness with which financial and other resources are being used;
- (d) reviewing the reliability and integrity of record keeping and reporting on financial and operating information systems;
- (e) pre-auditing of payments documents and of all the documents used in initiating commitments, as well as contract agreements;
- (f) verifying and certifying periodical financial returns such as expenditure returns, revenue returns, staff returns and vehicle returns;
- (g) reviewing and pre-auditing annual appropriation accounts, fund accounts and other accounting statements to ensure that accurate accounts are prepared to required standards;
- (h) investigating irregularities identified or reported and reporting on cases leading to wastage

- of resources or cases of general misuse or misappropriation of financial resources and Government property;
- (i) ensuring that revenues and other receipts due to the government are collected promptly, banked immediately and are fully accounted for;
  - (j) carrying out spot checks on areas such as revenue and receipt collection points, project supply and delivery sites, to ensure compliance with procedure and regulations;
  - (k) reviewing budgetary controls on issuance of warrants, commitments, expenditures, revenues and accounting from time to time;
  - (l) ensuring that the Government's physical assets are appropriately recorded and are kept under safe custody; and
  - (m) reviewing the budgetary allocation process to ensure legislative and administrative compliance and advising when commitments are entered without budgetary provision or adequate cash.

## 8.7 PARLIAMENT

The budget is the most important economic policy tool of a government and provides a comprehensive statement of the priorities of a nation. As the representative institution of the people, Parliament is the appropriate place to ensure that the budget optimally matches a nation's needs with available resources. Effective parliamentary participation in the budget process establishes checks and balances that are crucial for transparent and accountable government and ensures efficient delivery of public services.

Budget scrutiny is a task that Parliament is required to undertake when asked to consider the annual revenue and expenditure proposals of the Government.

As argued by Wehner<sup>45</sup>, the influence of legislative bodies on budget policy has declined in many industrialised countries. This may be due to several factors, such as greater complexity, inadequate skills and/or time to review documents of an, often, technical nature, government tendency to want to move quickly, and overall growth in depth and extent of budget statements. It now appears, however, that many legislatures are rethinking their role in the budget process and reasserting themselves as more active players. Factors like recognition of the central nature of budgets, decline in public confidence in government spending, resistance of the public and politicians to increased taxation, more media focus on spending scandals and demands for more legislative scrutiny may explain why this is the case.

The Constitution of Zambia requires taxation and public spending to be approved by Parliament. Therefore, the role of the Legislature is to scrutinise and authorise revenues and expenditures, and to ensure proper budget implementation, as set out below.

45 Joachim Wehner, *Back from the sidelines?*, World Bank Institute (not dated)

**Parliamentary approval of the budget:** One of the key tasks of Parliament in PFM is to examine and pass the draft budget tabled by the Executive for the upcoming fiscal period.

**Parliament and the audit of public accounts:** Parliament does not only approve the budget, but also assesses the integrity of budget execution through involvement in the execution and audit process. This is done through committees such as the Budget Committee and the Public Accounts Committees.

### 8.8 SUPREME AUDIT INSTITUTIONS (in Zambia the National Audit Office)<sup>46</sup>

There is growing recognition of the importance that supreme audit institutions play in ensuring accountability and good governance<sup>47</sup>. Significant support to the strengthening of supreme audit institutions in a number of developing or middle-income countries, including Zambia, by development partners bear witness to this. The Constitution of Zambia provides that the National Audit Office will audit the accounts of all institutions financed from the public funds. The supreme audit institution will conduct financial and performance (value for money) audits<sup>48</sup>, including forensic audits and other types of audits in respect of projects that involve the use of public funds. The Auditor-General will ascertain that money appropriated by Parliament or raised by the Government has been applied for the purpose for which it was appropriated, expended in conformity with the authority that governs it, and expended economically, efficiently and effectively.

### 8.9 COOPERATING PARTNERS AND CIVIL SOCIETY ORGANISATIONS

International financial institutions and donor agencies play a powerful role in the public financial management of poor countries with particularly high levels of foreign debt. The international financial institutions and donors often attach stringent conditions to loans and/or grants to developing countries. To be supportive of sound budget practices, donor funding needs to be transparent and predictable, and full information on such funding should be given in the budget. Increasingly, the negotiations around debt and new financing involve a wider range of state and non-state actors. Consultative Group Meetings have become important opportunities for the private sector and civil society groups to make their voices heard on economic and budget policy issues. Civil society groups are involved in public sector financial management, as non-state actors, at different levels from national development plans through to budget expenditure tracking. They are mostly consulted on a number of government issues and at other times, they partner with the Government to deliver a service.

<sup>46</sup> The Public Audit Act No. 29 changed the Office of the Auditor General to the National Audit Office

<sup>47</sup> [www.parliamentarystrengthening.org](http://www.parliamentarystrengthening.org)

<sup>48</sup> For a detailed explanation of the concept of performance or value-for-money audit see Chapter 35.

## 8.10 CONCLUSION

Accountability at all levels in the Public Services is key to public service delivery. Clear roles enable public officers to exercise their responsibility to deliver with judgment, intuition and innovation. Accountability is an obligation to ensure that work has been conducted economically, efficiently and effectively in compliance with agreed rules and standards.

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# CHAPTER 9

## Parliament's role during the budget cycle

While most legislatures have formal powers to keep the Executive accountable for its actions and policies, including the preparation and implementation of the annual budget, there is considerable variation in the way parliaments execute their 'powers of the purse'. The challenge is for parliaments to use their financial oversight responsibilities to ensure that the needs of the citizens, including the poor and other vulnerable groups, are not only heard, but also attended to through the delivery of well-designed Government programmes and services while at the same time ensuring that the Executive adheres to prudent PFM and fiscal policy targets. This chapter explains Parliament's role throughout the budget cycle, including the early stages of planning and budget preparation, budget scrutiny and approval, monitoring of budget implementation, and examination of end-of-year financial statements and the Auditor-General's annual report.

### 9.1 INTRODUCTION

Parliament has a key role to play in public financial management, as the passing of the national budget and the Appropriation Bill every year forms the basis for the Executive's spending of public funds in the ensuing financial year. Without Parliament's approval of the annual budget, the Government can neither incur spending nor collect taxes. Parliament's overall role in public financial management is provided for in Part XVI: *Public Finance and Budget of the*

*Constitution of Zambia as amended.* Part XVI is reinforced by *Article 63 of the Constitution of Zambia as amended*<sup>49</sup>.

There are different schools of thought regarding the role of Parliament in the budget process. While some argue that parliamentary involvement in the budget process ensures Executive accountability, leading to the judicious use of public funds, others are of the view that parliamentary involvement may obstruct the Executive in the fulfilment of its promises to the citizenry. Yet another school suggests that parliamentary involvement in the budget process may result in increasing the size of the budget without corresponding resources and, therefore, should not be encouraged. Such divergent views are inevitable and part of the democratic process. There will always be pressure from programme activities – the spenders – and those advocating restraint – the guardians. However, it is important that the actions of the Executive are kept in check by parliament.

The involvement of Parliament in the important stages of the budget cycle beyond examination and approval of the annual budget and oversight of its implementation and the Executive's general financial management performance, will be enhanced by the forthcoming Budget and Planning legislation, which will provide for Parliament's oversight role through earlier and broader involvement in the budget cycle. Examples of the enhanced oversight role envisaged in the Act include ex-ante approval of supplementary appropriations and borrowing, involvement of portfolio committees in the examination of sector budget proposals, review of the Green Paper and earlier review of the annual budget proposal<sup>50</sup>. The Constitution of Zambia as amended provides for the approval of expenditure by Parliament where there is urgent need to incur such expenditure. It is anticipated that this provision will be operationalised through the proposed legislation, including borrowing, involvement of portfolio committees in the examination of sector budget proposals, review of the MTEF/Green Paper and earlier review of the annual budget proposal<sup>51</sup>.

49 Article 63. (1) Parliament shall enact legislation through Bills passed by the National Assembly and assented to by the President. (2) The National Assembly shall oversee the performance of executive functions by– (a) ensuring equity in the distribution of national resources amongst the people of Zambia; (b) appropriating funds for expenditure by State organs, State institutions, provincial administration, local authorities and other bodies; (c) scrutinising public expenditure, including defence, constitutional and special expenditure; (d) approving public debt before it is contracted; and (e) approving international agreements and treaties before these are acceded to or ratified.

50 See Article 205 of the Constitution.

51 See Article 205 of the Constitution.

## 9.2 THE BUDGET CYCLE AND THE ROLE OF PARLIAMENT

The budget cycle in Zambia is a year-round affair running from January through to December as demonstrated in the diagram below.

Table 9.1 The budget cycle

Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Finalisation of review processes using mid-term evaluations and progress reports on district plans			Budget preparation						Budget approval by the National Assembly		
			<ul style="list-style-type: none"> <li>■ Preparation of the macro-economic and fiscal framework</li> <li>■ Annual budget &amp; MTEF</li> <li>■ Concept note</li> <li>■ Publishing of the MTEF/Green Paper</li> <li>■ Tax policy review &amp; budget preparation by the MPSAs</li> <li>■ Budget consolidation &amp; preparation of Bills</li> </ul>								
Budget implementation/execution											
Budget monitoring and post budget implementation audit											

The role of Parliament during the different stages of the budget cycle can be summarised as follows:

### 1. Budget preparation stage

The budget preparation stage precedes the presentation of the budget to Parliament highlighted in yellow in Table 9.1. At this stage the Ministry of Finance asks for input on the Medium-Term Expenditure Framework/Green Paper from various stakeholders, including Members of Parliament through the Budget Committee. The MTEF is normally finalised in August to provide the framework for the annual budget estimates to be finalised in September. Despite this process not being supported by law, it is an important exercise because it gives Parliament an opportunity to ascertain if the budget proposal corresponds to the three-year budgetary forecasts in the MTEF.

Members of Parliament also participate in the budget drafting stage through budget hearings in Districts and Provinces in their individual capacities at district and provincial levels.

In order for the Members of Parliament to effectively interrogate the Budget, they need to be assisted to understand the often complex technical budget issues and processes to be able to play a substantive role in the process. The Parliamentary Budget Office (PBO), an independent, nonpartisan source of budget information established at the National Assembly would serve this purpose.

### 2. Budget approval stage

After having completed the consultations, the Executive consolidates the budgetary inputs into the national budget proposal. The budget proposal is then presented to Parliament by the Minister of Finance for examination, debate and approval. The Minister is by virtue of Article 202 (1) of the

Constitution as amended responsible for presenting estimates of revenue and expenditure for the next financial year to Parliament not later than ninety days before the commencement of the next financial year. This means that the Budget Statement is likely to be presented to Parliament in the second half of September.

The approval process in Parliament consists of six major events:

1. presentation of the Estimates of Budget Speech by the Minister responsible for finance;
2. referral of the Budget for scrutiny to the Expanded Budget Committee;
3. general policy debate of the budget statement;
4. consideration and approval by Head/Department of the Budget (Committee of Supply);
5. approval of the Money Bills (Committee of Ways and Means); and
6. approval of the Appropriation Bill.

In parallel with the debate on policy issues of the budget in the House, the budget proposal is subject to a more detailed examination by the Expanded Budget Committee. The Expanded Budget Committee is an ad-hoc committee, which consists of the Budget Committee, all chairpersons of portfolio and general-purpose committees, and the Chairperson of the Reforms and Modernisation Committee. The Committee, by virtue of the Standing Orders 83 (3), is given a maximum of 10 days to study the budget proposal and prepare a report to be presented to the House.

The Chairperson of the Budget Committee serves as Chair Person of the Expanded Budget Committee. The Expanded Budget Committee invites various stakeholders to assist with the consideration and unpacking of the national budget. This process is meant to broaden the consultative process with key stakeholders on the budget and also to promote the participation of citizens in the legislative process. The report by the Expanded Budget Committee is not adopted, but merely serves to inform the budget debate on the floor of the House.

The Money Bills presented to the House by the Minister of Finance are referred to the Budget Committee or any other relevant committees. Article 65 (1) of the Constitution empowers a Minister to introduce a Money Bill. Article 65 (2) further states that a Money Bill is a Bill that provides for, among other matters:

- a. the imposition, repeal, remission, alteration or regulation of taxes;
- b. the imposition of charges on the Consolidated Fund or any other public fund; or the variation or repeal of any of those charges;
- c. the appropriation, receipt, custody, investment, issue or audit of accounts of public monies;
- d. the grant of public money to a person or authority or the variation or revocation of such grant;
- e. the raising or guaranteeing of a loan or the repayment of it; or
- f. matters incidental to matters specified above.

Standing Order 81 (5) provides that the Budget Committee or the committee to which the taxation proposal has been referred be required to present a report to the House within the period determined by the House Business Committee. If the Committee requires more time to conclude its business, the Speaker may extend the period. The extension provision is meant to take care of sittings when there is overwhelming response from the general public to participate in the consideration of the Bill.

Like the report on the budget proposal, the reports on Money Bills are also not adopted by the House, but serve to assist Members in their debate on the floor of the House.

Once the Expanded Budget Committee has submitted its report on the budget and the Minister of Finance winds up debate, the motion moved by the Minister of Finance for the House to resolve into the Committee of Supply is put and adopted. The resolution of the House into Committee on Supply signals the beginning of the consideration of the estimates by individual Heads of Expenditure. The approval of each Head is preceded by a policy statement by the responsible Minister. A policy statement by a Minister is basically a justification of how the Ministry intends to use the resources.

The presentation of the Appropriation Bill by the Minister of Finance is the culmination of the various stages of the approval process of the budget. The Bill is a summary of the total amounts voted to each Head, including the sub-heads of the budget for the ensuing financial year. The enactment of this Bill authorises expenditure from the general revenues of the Republic of the monies required for the services of the Republic during the financial year.

The approval of the budget is one of the core functions of Parliament. While Parliament cannot amend the total amounts of estimates of revenue and expenditure in the proposed budget, it can vary the estimates of revenue and expenditure within the budget (Article 202 (4) of the Constitution). This means that Parliament has power to alter the Executive's priorities and programmes and make reallocations across or within sector budgets.

### 3. Budget implementation stage

Parliament's role during the implementation stage is provided for in *Article 203 of the Constitution; the Standing Orders of the National Assembly and the Public Finance Act, 2004*.

Two provisions in the amended Constitution are of particular interest to Parliament, namely Article 203, clauses 2 – 7. Thus, clause (2) provides that “*the Minister responsible for finance shall, where the amount appropriated for a financial year is insufficient to meet expenditure in that financial year, lay before the National Assembly for approval a supplementary estimate for expenditure.*”

Article 203, clause (3) provides that following Parliament's approval of the supplementary estimate for expenditure, “*the Minister responsible for finance shall lay before the National Assembly for enactment, a Supplementary Appropriation Bill in respect of the approved supplementary estimate of expenditure.*”

Article 203, clause (4) further provides that “*where there is an urgent need to incur expenditure for a purpose that has not been appropriated under the Appropriation Act for that financial year and it would not be in the public interest to delay the appropriation of the expenditure until a supplementary estimate is approved by the National Assembly...the President may...issue a warrant authorising the expenditure and withdrawal from the Consolidated Fund.*” However, the Minister of Finance shall present the warrant .....to the relevant parliamentary committee for approval (clause (5). Clause (6) provides that the committee will have forty-eight hours to consider the warrant, whilst clause (7) provides that “*where expenditure is incurred in accordance with clause (4), the Minister responsible for finance shall, in that financial year, lay an Excess Expenditure Appropriation Bill before the National Assembly for enactment.*”

The legal provisions for Parliament’s role in budget follow-up are laid out in the Public Finance Act, 2004, Article 3, section 2 (b), which provides that the Minister (the Minister responsible for Finance) “*shall be responsible for presenting, half yearly, budget performance reports to the National Assembly.*” These reports are important not only for Parliament’s monitoring of the implementation of the current budget, but also for Parliament’s examination of the Executive’s budget proposal for the next financial year presented to Parliament in October. Furthermore, the half yearly performance reports should form the basis for Parliament’s examination of the Executive proposals for supplementary appropriations.

Parliament’s role in the monitoring of budget implementation is further provided for in the National Assembly Standing Order No. 156, which empowers the Budget Committee to carry out regular examination and scrutiny of the budget estimates, and conduct budget hearings and on-the-spot checks of project implementation. Relevant portfolio committees of Parliament may make selective periodic monitoring and outreach visits to project or programme areas to ascertain at first hand the status of implementation.

#### 4. Post-budget implementation scrutiny

Parliament’s role during the post implementation stage can be explained by Article 211, Clause (3) in the Constitution, which provides that “*the Minister responsible for finance shall, within one month after the receipt of the Auditor-General’s opinion, lay the financial report, with the Auditor-General’s opinion, before the National Assembly*”. This financial report is important for Parliament’s assessment of Government’s past financial performance as it provides information on:

- (a) all revenues received and money spent during the previous financial year;
- (b) debt repayments;
- (c) payments made in the previous financial year for purposes other than expenditure; and
- (d) the financial position of the republic at the end of the previous financial year and other information as prescribed.

It is important to observe that the Constitution includes provision for Parliament to consider additional information that will assist the National Assembly’s scrutiny and give it a complete overview of budget implementation.

Article 212 of the Constitution further provides that *“the Auditor-General shall, not later than nine months after the end of the financial year, submit an audit report to the President and the National Assembly, on the accounts of the Republic audited in respect of the preceding financial year.”*

The Public Accounts Committee is charged with the responsibility of scrutinising the Auditor-General's Report. In considering the report, the Committee invites submissions from Controlling Officers from various Ministries, Provinces and Spending Agencies whose institutions have been cited in the Report or any other relevant party. These stakeholders assist the Committee in considering the Report. The Committee prepares a report on the findings in the Report, which is adopted on the Floor of the House for onward transmission to the Government for corrective action. The powers of the Committee end at making recommendations.

While the financial audit reports are being considered by the Public Accounts Committee, portfolio committees examine special audit reports such as performance audit reports, as well as forensic and information and communication technology (ICT) audits in order to identify fiscal and non-fiscal risks, which can serve as a guide for the legislature in its scrutiny of budget proposals.

Two newly established portfolio committees, namely the Committee on Parastatal Bodies and the Committee on Local Government Accounts, are responsible for scrutinising audit reports related to the accounts of parastatal bodies (State Owned Enterprises) and local authorities.

In order of sequence, Parliament receives MPSA annual reports, the financial report and finally the audit report.

### 9.3 STRENGTHENING OF PARLIAMENT'S ROLE IN ALL STAGES OF THE CYCLE

Experiences worldwide suggest that parliamentarians can contribute to good financial governance by expanding their oversight role throughout the budget cycle. Parliaments approve the annual budget and oversee Government spending. Through these ex-ante and ex-post budget reviews, they hold the Executive accountable for the use of public funds. This role can be accomplished through the work of parliamentary committees or through oversight by individual Members. Involving Parliament more in the budget cycle can create a greater sense of public ownership of economic policies and spending priorities and at the same time enhance Members' insights in budget processes and accountability measures. This could strengthen Parliament's oversight performance and lead to greater transparency and accountability in Government's financial operations. International experience shows, however, that this involves enhanced technical support to the Members by highly qualified and motivated staff.

Independent and dedicated budget offices and research departments within the parliamentary structures have proven to be an effective way to build this capacity.

## 9.4 CONCLUSION

This chapter has shown that Parliament plays an important role during all stages of the budget cycle and that Members of Parliament can contribute to good financial governance by expanding their oversight role and by engaging themselves in planning and budgeting processes at the grass-root level. The chapter suggests, however, that to be able to effectively execute the parliamentary mandate in the budget cycle, Members need help in understanding complex budget issues and processes. Independent, well-staffed Parliamentary Budget Offices and research units have proven to be useful means to achieve this.

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**MODULE 3**  
**BUDGET FORMULATION STAGE**





# CHAPTER 10

## Choice of budget method

While the choice of budget methods may sound like a decision of a purely technical nature, budget methods have a significant impact on the level of involvement of decision-makers in the budgeting process and their access to information essential for the political debate, prioritisation, decision-making and Parliament's approval of the annual budget. The aim of this chapter is to demonstrate to Members and Staff that methods of budgeting have changed over time in response to politicians' dissatisfaction with budgeting processes and budget formats, and the public's general demand for more open, participatory and transparent budgeting processes and easily accessible budget documents.

### 10.1 INTRODUCTION

Changes in budgeting processes and budget formats have mainly been initiated by decision-makers and pressure groups outside governments in response to non-participative and un-transparent budgeting processes, lack of budget background information and largely inaccessible budget documents. For many years, both the entire process of compiling budget estimates and the budget document were seen as technical matters and, as such, not meant for public participation nor active involvement of the political leadership, including that of Members of Parliament. This state of affairs has changed, and over the past thirty years or so, budget methods have changed significantly towards bottom-up participatory budget processes; increased time for political negotiations; prioritisation and examination of budget background papers; better and more accessible budget information and budget documents; better links between policies, budgets and

results; and - in many countries – publishing of citizens’ versions of the annual national budget to enhance insight and ownership.

In Zambia, the most recent budget reform, namely the introduction of Output-Based Budgeting in 2014, is seen as a response to the politicians’ complaints about the bulkiness of the Activity-Based Budget format and the weak or non-existing links to policy objectives and sector programmes.

The most significant differences in budget methods are between incremental or marginal budgeting on the one hand and the multiplicity of performance related methods on the other. The sections below will briefly explain the key features of incremental budgeting, applied by the Government of the Republic of Zambia up to 2003 and the key features of some of the dominant performance oriented budget methods applied by governments worldwide over the last three to four decades, including Zero-Based, Programme-Based, Activity-Based (introduced in Zambia in 2003 and practised till today), Output-Based (introduced in Zambia in 2004 as a pilot) and Performance-Based Budgeting methods.

## 10.2 INCREMENTAL BUDGETING

Incremental budgeting refers to a budget method primarily focusing on sector (ministries and spending agencies) needs and wishes rather than resource availability and prioritisation between competing needs. Incremental budgeting is based on the current budget or previous year’s spending<sup>52</sup> carried forward for the next fiscal year adjusted for factors such as additional resources, service standard developments, anticipated price change, wage inflation and new activities and spending priorities. This process is mainly concerned with the incremental or marginal upward adjustments of current budget lines as it provides little incentive or likelihood that budgets would be voluntarily reduced, except where major budget restrictions are applied or a programme actually ends. A key feature of this approach is the aspect of negotiation in order to maximise the institution’s or sector’s share of the available resource envelope without prioritisation between old and new activities or between different expenditure options.

Incremental budgeting is usually seen to be straight-forward and easy to understand. The system allows time for policy makers and senior officials to focus on new activities rather than numerous, detailed budget estimates in the budget document. This system is also considered to be stable as changes are effected gradually. However, the system assumes that revenue sources are not under strain, that there is little change in Government programme outputs and outcomes and that a stable fiscal framework is in place.

While the incremental budget method allows sectors to express their needs and demands and to exert influence on the outcome of the budgeting process, the disadvantages often offset the benefits. Notably, the method lacks focus on existing activities, thus making prioritisation between new and

<sup>52</sup> The current budget or the previous year’s actual spending would form the basis for the budget preparation depending on the timing of the finalisation of the end-of-year financial accounts.

old activities difficult. This tends to cause proliferation of new programmes and activities, over-budgeting and ineffective utilisation of scarce public resources.

### 10.3 MODELS OF PERFORMANCE-BASED BUDGETING

There is not just one model of performance budgeting, but a range of different models. All link funding and results, but in different ways. Performance budgeting systems differ to some extent in their focus and objectives. Some aim principally at improving expenditure prioritisation and cost effectiveness, while others focus on improving service effectiveness and efficiency. Reflecting the different forms of linkage between results and funding which they seek to build, performance budgeting systems also differ in respect to the type of performance information upon which they primarily rely. This applies both to the type of performance measures they use; whether they make use of evaluation, and the type of indicators used to assess budget success, e.g. outputs, outcomes, and broad social and economic indicators. However, irrespective of choice, all forms of performance budgeting have in common the idea of greater managerial freedom focusing on results while at the same time giving due prominence to inputs as these are key contributors to results.

#### Programme Budgeting

The most basic form of performance budgeting is that which uses performance information systematically in the preparation of the budget. A common tool used for this purpose is programme budgeting, in which expenditure is classified in the budget by objectives (outcomes and outputs), rather than solely economic input categories (such as salaries, supplies and communication costs) and organisational entities (e.g. ministry or department within the ministry). The primary objective of programme budgeting is improved expenditure prioritisation and the strengthening of the linkages between budgets and results.

#### Zero-Based Budgeting

Unlike incremental budgeting, Zero-Based Budgeting does not start from the previous year's spending level or the current budget. Instead, every activity or programme must be considered afresh and must be justified in order to be continued. As a result, each institution's budget must start from zero and the programmes and activities must be well articulated or described and costed at different levels of output or service. For instance, plans to achieve set goals and the benefits to be derived must be clear. Any consequences for not approving or including the programmes or activities in the budget must be explained. This planning process requires officials to check and update their plans and consider the best alternative ways to attain their objectives.

Zero-Based Budgeting is considered to be a more efficient method when balancing the resource envelope with competing demands and needs, as it raises questions about the status quo and forces technocrats and decision-makers to focus on objectives and outcomes. The method is assumed to facilitate better resource allocation and prioritisation under changing circumstances. Drawbacks with Zero-Based Budgeting emanate from the fact that it requires more time than incremental

budgeting. The method is also bureaucratic and skills demanding. Moreover, given that a large part of governmental budgets are non-discretionary and, therefore, not subject to political prioritisation, it has proven futile to propose to the political leadership to scrutinise each and every change to a budget line.

### Activity-Based Budgeting

Activity-Based Budgeting is an approach that involves the creation of an activity-based structure for government activity and then the costing of those activities. The Activity-Based Budgeting method differs from incremental budgeting as it uses the volume of a particular activity instead of historical expenses. As such, Activity-Based Budgeting provides a way of linking costs (inputs) to outputs, which, in turn, should lead to improved allocative efficiency.

Activity-Based Budgeting was introduced in Zambia in 2003, as a successor to incremental budgeting with the aim of improving allocative efficiency and cost control. While the Activity-Based Budgeting in the Zambian context has proven to be a useful tool in controlling costs, the numerous programmes and activities have led to a mammoth budget document with numerous numbers, but without information on expected results (outputs) and geographic location of the spending - information that is important for the political prioritisation and decision-making process. Moreover, a mix of programmes with economic classifications and weak links to mandated functions of MPSAs has created challenges in terms of budget management, analysis and reporting.

### Output-Based Budgeting

The Output-Based Budgeting system, which was introduced in Zambia in 2014 for the 2015 budget on a pilot basis (only for the Education budget) is a variant of programme budgeting and a front-runner for a fully-fledged performance budgeting system.

While the Activity-Based Budgeting method places emphasis on inputs, Output-Based Budgeting focuses on the delivery of outputs or results linked to policy objectives. The basic idea is that the budget of government agencies is approved and funded on the basis of delivery of planned and actual outputs and outcomes (achievement of objectives). The key question is what should be delivered by each agency rather than how much the agency should be given. Each output is then costed and the budget allocation for the agency is the quantity of outputs to be delivered multiplied by the price payable per unit. However, this budgeting system requires that there are in place appropriate measurable objectives, defined output targets and indicators for both outcomes (achievement of objectives) and outputs.

The shift from Activity-Based to Output-Based Budgeting entails a re-engineered focus on budget formulation processes and procedures. Among other things, resource allocation criteria will no longer be based on MPSA's organisational structure and past allocations and performance, but on their mandated functions, set objectives and output targets. The focus on results will enhance the informative quality of progress reports as these will show outputs achieved against the money spent and not only money spent against approved budget estimates.

The output-based budgeting system will gradually replace the activity-based one. While the latter served its purpose, namely to show the costs of activities and facilitate tighter expenditure control, the resulting budget document – the Yellow Book - has become too bulky and too distanced from MPSA's mandated functions to enable effective oversight of the policy function of the budget.

It is important to note, however, that Output-Based Budgeting does not replace the costing of inputs or activities. While the focus is on budgeting for results, inputs to achieve these still need to be costed. The challenge in budgeting is to provide both enough output-based information to meet the link to planning and enough activity based line-item information to meet the need for information on inputs.

### Performance-Based Budgeting

Performance-Based Budgeting aims to improve the effectiveness and efficiency of public expenditure by linking the budget or funding of public sector organisations to the results they are expected to produce. The model, in its pure form, refers to the 'purchaser-provider model' adopted by, for example, New Zealand, Australia and the United Kingdom as key elements of the New Public Management reforms implemented in the nineteen eighties and nineties. Most countries have adopted less sophisticated variants in line with Zambia's Output-Based Budgeting model. While the purchaser-provider model aims to link services (outputs) to the actual price of delivering these outputs (for example treatment of hip fractures in the health sector), the adapted model aims to link funding to broader defined outputs and outcomes. In Output-Based Budgeting, funding is also linked to specific activities and outputs, but the real cost of delivering these activities can only be partly captured due to limitations in most countries' accounting and budgeting systems. Furthermore, the capturing of the real cost of delivering a given service/output would require detailed time measurement of working processes the cost of which often offsets the benefits.

## 10.4 CONCLUSION

Budgeting methods in Zambia have moved from incremental budgeting to Activity-Based Budgeting and the country is now transitioning to output-based budgeting. These changes have been driven by the need to address budgeting shortcomings associated with the earlier budgeting techniques and to respond to leadership and public requirements. While Activity-Based Budgeting puts emphasis on the costing of inputs to ensure more consistent and accurate budget estimates across sectors, Output-Based Budgeting puts an emphasis on the costing of results. It is, however, important to note that accurate costing of inputs is a pre-requisite for successful output-based budgets.

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# CHAPTER 11

## The role of communities in the planning and budgeting process, including project identification at community and constituency levels and MPs' role in the process

With the National Planning and Budgeting Policy and the amended Constitution, active involvement of citizens in public planning and budgeting processes has become a right rather than a privilege. Thus, the National Planning and Budgeting Policy states as one of its objectives that more participatory and decentralised planning and budgeting processes should be facilitated through the strengthening of the existing structures for state and non-state actor participation. Article 89 (1) of the Constitution provides that the National Assembly shall facilitate public involvement in the legislative process, whilst Article 205 (d) provides for “public participation, at all levels of Government, in the formulation of financing frameworks, development plans and preparation of annual budgets”. The aim of this chapter is to strengthen the appreciation of Members and Staff of the importance of involving citizens in the planning and budgeting process to ensure ownership of both process and budgetary outcome, as well as to ensure that planning and budgeting inputs respond to development needs at the community level. Moreover, it aims at enhancing the understanding of the unique role Members of Parliament play in this process, including the identification and prioritisation of projects at community and constituency levels.

## 11.1 INTRODUCTION

Community participation in the budgetary process has been an increasing trend in democracies the world over for a long time. Participation can be seen as a right, and as such a goal in itself, but it is also being advocated as one of the checks and balances necessary for good governance and a valuable tool in locally relevant decision-making and development. For instance, the ‘Participatory Budgeting in Africa’ handbook by UN Habitat and Municipal Development Partnership Eastern and Southern Africa concludes the main lesson learnt from participatory budgeting experiences as follows:

*“... as a tool for enhancing social accountability, good governance and decentralised governance, participatory budgeting has resulted in unprecedented political, social, economic and institutional achievements wherever it has been successfully implemented.”*

Citizen participation in the planning and budgeting process can take many forms<sup>53</sup>. It can be direct, as when informed citizens meet and debate fiscal priorities, and forward their resolutions and plans to decision-makers. It can be indirect, when citizens elect Members of Parliament, who meet to debate the budget. Protests, lobbying, and other forms of voice are also examples of participation. This chapter looks at the roles of communities and Members of Parliament in the planning and budgeting process at community and constituency levels, as well as ways and means to make the participation real and not only a ritual to comply with formal requirements.

## 11.2 ROLE OF THE COMMUNITIES AND PURPOSE OF COMMUNITY PARTICIPATION

### Participation

There are many definitions of public participation, but generally speaking the concept can be summarised as the involvement of the public in decision-making on issues that affect their lives. The concept further refers to all community members irrespective of age, sex, political, ethnic and religious affiliation, or physical disability.

The most basic form of public participation in a representative democracy is voting for one’s elected representative. However, whereas general elections take place only every five years<sup>54</sup>, effective public participation means involving the public in the government’s decision-making processes beyond elections. The public can be involved in all decisions that affect them. The most common example is the planning of a development project to uplift a specific community, but the public can also be involved in activities with a much wider scope, such as the district budgeting process or the development of a broad national policy. Furthermore, participation does not have to be restricted to the planning stage, but it can as well be applied at the implementation and monitoring and evaluation stages.

53 Brautigam D. (2004). The People’s Budget? Politics, Participation and Pro-poor Policy, Citizen Participation: Legitimizing Performance Measurement as a Decision Tool. Government Finance Review, GFOA, April 2002. Development Policy Review, 2004, 22 (6): 653-668.

54 From Articles 63 and 105 of the Constitution of Zambia (Amendment) Act No. 2 of 2016

Participation is a central element of democracy and, increasingly, citizen participation in economic policy is advocated as a way of making Government spending more 'pro-poor'. People's budgets, alternative budgets, women's budgets, and participatory budgeting have raised hopes and expectations that greater participation by ordinary citizens, NGOs, and other civil society organisations in spending and revenue generation can lead to better outcomes for the poor. Community participation can have other benefits such as increases in information, while greater transparency may make it easier to put pressure on and embarrass a government that is not pro-poor. Participation in budgeting and planning is provided for in Article 205 (d) of the Constitution.

### Platforms for participation

Constituency Offices are in place in all the constituencies in the country in order to provide meeting places for Members of Parliament and their constituents on various issues affecting them. Professional Assistants in these offices are staff of the National Assembly. They do a lot of work for and with the Members and the Communities. Among others, the Constituency Offices produce monitoring and evaluation reports on constituency projects, which may form basis for questions raised by Members to the Ministers in Parliament.

### Approaches to eliciting community participation

Public engagement allows real dialogue to take place between the Government, the public and community organisations, allowing them to work together to find solutions to complex problems<sup>55</sup>. Engagement activities also create a sense of community pride in planning for development. There is no single, universally applied, method of public participation<sup>56</sup>. Each community engages in participation differently. One of the common methods of public participation is public dialogue whereby local councillors and Members of Parliament create platforms or forums for interaction with community members. This can take place during planning and budgeting processes and during implementation and evaluation of community projects or other activities which affects peoples' lives. It is an effective way of involving the communities because it offers an opportunity, in a structured format, to interact and voice their concerns. It is important that dialogue platforms are used proactively throughout the budget cycle and not only during the early planning and budgeting phase. Structured and systematic dialogue between elected leaders and the communities is equally important to monitor budget implementation and in the evaluation of development outcomes.

### Timing and approaches to community participation

Timing and approaches are related because approaches that work in one phase of planning, budgeting, and performance management may not be effective in other phases. There are various topologies of participation among which are functional and consultative. For example, a community goal-setting session would be very appropriate in assisting a government to establish priorities in developing a strategic plan or in the early stages of the budget process.

The identification of community preferences and satisfaction levels or testing of ideas and

55 Lenihan, Don (2012), *Rescuing Policy* – the case for public engagement, Public Policy Forum, 2012

56 Davis T. S. (2002), *Brownfields, A Comprehensive Guide to Redeveloping*, American Bar Association, 2002

approaches should take place before a decision is made. Governments may solicit information for general purposes, such as strategic planning, or may solicit targeted information as input for specific projects, plans, or initiatives. Unless there is a compelling reason to target only certain segments, public involvement approaches should encourage all citizens to participate. In addition, governments should make involvement opportunities accessible to all citizens and hold meetings at various times to provide maximum participation. Common methods for soliciting information include the following: (i) surveys, either in person or via mail, phone, or Internet; (ii) focus group discussions; (iii) interviews; (iv) public meetings, such as public hearings; and (v) interactive priority setting tools.

### Providing information to the community

This approach is appropriate at all stages and may include newsletters, public notices in community media, community hearings, public reports, such as budgets-in-brief, annual financial reports, or performance reports, web sites, individual or group emails, phone calls, and personal contact.

### Provision of feedback to the community

Governments should systematically collect, maintain, monitor, and analyse information gained from public involvement activities, maintain contact information on individuals and groups that wish to be kept informed, and use multiple communication mechanisms to ensure that those involved or interested in the process are notified of opportunities for additional feedback and of decisions made based on the public involvement process. Most importantly, governments should explain to the public how the public involvement has impacted on plans, budgets and performance.

## 11.3 CITIZEN INVOLVEMENT IN THE PROJECT CYCLE

The project cycle include the following three basic stages<sup>57</sup>:

1. *Preparation phase*, consisting of six main activities: (i) problem analysis; (ii) project identification and selection; (iii) forming of project organisation, including team and project coordinator; (iv) project formulation and design; (v) development of work plan, including activities, milestones and time frames and; (vi) costing of project.
2. *Implementation phase*, consisting of six main activities: (i) establish organisational arrangements for the project; (ii) determine administration and management control; (iii) execute project activities; (iv) conduct project monitoring and keep record of all activities; (v) provide feedback; (vi) make necessary changes and adaptations.
3. *Evaluation phase*, including (i) evaluation of the project against set standards and the original plan; (ii) measure the achievements against objectives and out milestones; (iii) identify lessons to be applied to future projects; (iv) determine whether the project should be continued, changed or stopped.

<sup>57</sup> See for example *Regenesys (2007), Project Management Training*, Ministry of Regional and Local Government, Housing and Rural Development, 2007, and European Commission (2004), *Project Cycle Management Guidelines*, Volume 1, EC, 2004

### Preparation phase

For any project to succeed, Members, councillors, members of the public and community groups must be involved in all stages of this cycle. It is the responsibility and right of every Zambian to ensure that public financial resources are well allocated and spent by being informed, participating in project meetings in their location and constituency, supporting projects, monitoring projects, and reporting any cases of abuse. A Member of Parliament, as a people's representative, has a very important role to play in the community in terms of planning, budgeting, project identification, implementation, monitoring and evaluation. The role can be summarised as participation and facilitation. A Member can participate in and/or facilitate consultative meetings about planning, budgeting and project identification, implementation and evaluation in his/her constituency. For these activities to happen, Members must hold regular meetings (surgeries) in their constituencies together with Councillors who are in-charge of Wards (sub-district structure).

Information for situation analysis and problem definition should be collected with the involvement of the community members using several techniques. This is to ensure valid, reliable and comprehensive information about the community and its problems. Some of the following techniques can be used: Documents review; surveys; discussions with individuals, specific groups and the community as a whole; interviews; observations; listening to people; brainstorming; informal conversations; and the problem tree. Situation analysis is very important before any attempts to solve the problem because it provides an opportunity to understand the dynamics of the community, and helps to clarify social, economic, cultural and political conditions.

The Ward Development Committees are sub-district local government structures established to facilitate community participation in decision-making and development planning processes at the ward level. They are the linkages between the District and communities and are involved in resource mobilisation and project prioritisation for inclusion in district strategic development plans. The Council should be openly communicating with the communities and their representatives when it is time to submit project proposals for constituency development funds. This is usually done through open meetings; posters in popular locations, such as the notice boards of schools, clinics and churches; as well as letters to chiefs, village headmen, and the Area Development Committees. The community together with the Area Development Committee then identifies projects that meet local needs. However there is no stipulated process for how this ought to take place. After prioritising projects, the Area Development Committee send the project proposals to the Constituency Development Committee. The latter is the central management authority of the Constituency Development Fund. It consists of nine members: One Area Member of Parliament, two Councillors nominated by all Councillors in the Constituency, one Chiefs' representative nominated by all chiefs in the Constituency, one Director of Works in the case of District Council or Director of Engineering Services in the case of Municipal Council and City Councils, four community leaders from Civil Society and NGOs churches, and Community-Based Organisations identified by the Area Members of Parliament and Councillors in the Constituency.

### Implementation phase

Implementation is the stage where all the planned activities are put into action. Before the

implementation of a project, the implementers should undertake a risk analysis by identifying their strengths and weaknesses (internal forces), opportunities and threats (external forces). There is a close and mutually reinforcing relationship between planning, implementation and monitoring. One of the three cannot be done in isolation from the other two, and when doing one of the three, the planners and implementers have to cater for the others. The community, as a major beneficiary, must be fully involved in the monitoring of the projects. A Member of Parliament needs to be fully involved in monitoring, mobilisation and organisation of the community as is articulated in the Constituency Development Fund Guidelines.

The Constituency Development Fund was approved by Parliament in 1995, to finance micro-community based projects that contribute to infrastructure development at constituency level. The specific objectives of the Fund are to provide community participation in decision making during project identification, support community driven projects, support planning and management of the Fund at the constituency levels, and provide resources that ensure development investments responding to the priority needs of the constituency. Under the Constituency Development Fund guidelines, a Member of Parliament is a member of the Constituency Development Fund Committee. The Member plays an important role in influencing the distribution of and application for centrally allocated funds.

### **Evaluation phase**

Project monitoring is an on-going process while evaluation is periodical and aims at addressing the relevance, effectiveness and impact of projects. Monitoring and evaluation of projects is fundamental if the project objectives and success are to be achieved. Monitoring and evaluation of project improves overall efficiency of project planning, management and implementation.

## **11.6 CONCLUSION**

Participation in the planning and budgeting process is a central element of democracy and, increasingly, citizen participation in economic policy is advocated as a way of making Government spending more ‘pro-poor’. People’s budgets, alternative budgets, women’s budgets, and participatory budgeting have raised hopes and expectations that greater participation by ordinary citizens in the communities, NGOs, and other civil society organisations in spending and revenue generation can lead to better outcomes for the poor. Budgets are important Government documents, crucial to a nation’s development. Efforts must, therefore, be stepped up to ensure that the process is participatory and effective in translating government plans into tangible and long term development benefits for the people. Therefore, Members must be involved in the planning, monitoring and evaluation of development projects in their constituencies.

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# CHAPTER 12

## The national budget preparation process

An understanding of the national budgeting process is important for Members of Parliament and National Assembly staff as the procedures adopted by the Executive determine the level of involvement of Parliament during the budget formulation process. As closed and non-transparent budgeting procedures negatively impact the effectiveness of parliamentary oversight and heightens the risk of Parliament passing budgets, the implications of which are largely unknown, Parliament should ensure that the Executive complies with good financial governance principles, including openness and transparency in the budget preparation process. This chapter emphasises the importance of open and participatory budgeting processes to promote public ownership of the national budget and effective Parliamentary oversight. Moreover, the chapter explains the steps in the budget preparation process; the linkages between the policy and strategic planning framework and the budgeting process, including the Medium-Term Expenditure Framework and the annual budget; the role and functions of various stakeholders in the process, including MPSAs and non-state actors; the political prioritisation process and Parliament's role in the process<sup>58</sup>.

### 12.1 INTRODUCTION

Whereas the national budget is a plan for the spending of a given amount of money on selected activities within the financial year presented in the national budget document – the “Yellow Book” - budgeting involves the process of

<sup>58</sup> For a more detailed presentation of the Medium-Term Expenditure Framework (the Green Paper) see also Chapter 14.

analysing and developing the macro economic and fiscal frameworks, projecting revenues, costing of programmes and activities and compilation of expenditure estimates. The process also entails the prioritisation between competing expenditure needs within the constraint of the estimated resource envelope. While Parliament's role in the technical stages of the budget preparation process is limited<sup>59</sup>, there is, nevertheless, a need for Members and Staff to familiarise themselves with the process and to acquire a comprehensive understanding of the various steps, expected outputs, stakeholders involved, information required, macro-economic and fiscal forecasting and compilation and presentation of estimates. Moreover, Members and Staff should be able to engage themselves in the process, including compiling budget information and other information required to conduct initial analyses and briefing papers for their committees.

## 12.2 THE INSTITUTIONAL AND LEGAL FRAMEWORKS

The principles guiding the budget process are contained in Article 198 of the Constitution of Zambia. These are:

- a. transparency and accountability in the development or formulation of macro-economic frameworks, socio- economic plans and the budget;
- b. promotion of a public finance system that ensures that—
  - i. the burden of taxation is shared fairly;
  - ii. revenue raised nationally is shared equitably among the different levels of government;
  - iii. expenditure promotes the equitable development of the country;
- c. sustainable public borrowing to ensure inter-generational equity; and
- d. prudent and responsible use of public resources.

Matters relating to public finance and the budget are contained in Part XVI of the amended Constitution of Zambia. Specifically, Article 202 (1) and (3) gives the Minister of Finance the mandate to prepare and present the National Budget (estimates of revenue and expenditure) before the National Assembly in each financial year (a) not later than ninety days prior to the commencement of the next financial year, for Parliamentary approval on or before 31<sup>st</sup> December; or (b) within ninety days after the swearing in of the President, in an election year.

The budget preparation process in Zambia is also guided by the Planning and Budgeting Policy of 2014. The policy framework provides for an integrated planning and budgeting process in order to achieve policy coherence, enhance budget credibility and strengthen Parliamentary oversight. The Ministry of Finance is an important institution in coordinating the entire process while the MPSAs are responsible for the preparation of their respective institutional budgets.

<sup>59</sup> During the period May to August most work is of a technical nature primarily performed by the MoF and MPSAs (see Table 12.1)

### 12.3 THE NATIONAL BUDGET PREPARATION PROCESS – STEP-BY-STEP

The preparation of the national budget is the responsibility of the Executive. It involves a number of stages and players or stakeholders. Prior to the 1980s, the budgeting process was very secretive and all the information was within the domain of the civil service and Cabinet. Since that time, budget reforms have been undertaken and the process is now more open or transparent, consultative, more informative and predictable. A number of stakeholders are now more involved in the budgeting process and these include the Parliament, various elements of civil society or Non-Governmental Organisations (NGOs), the private sector, the cooperating partners, and individual Zambians. It is a long process encompassing a series of sequenced activities involving a number of players and interested parties. Table 12.1 below shows the budget preparation process at different stages and timing. The detailed process is explained below.

**Table 12.1** Stages of the national budgeting process

Period	Process/Steps	Actors	Outcome	Parliamentary Outlook
May - June	Development of the Macro and Fiscal Frameworks.	Ministry of Finance, Bank of Zambia, Zambia Revenue Authority, Central Statistics Office, MPSAs and Co-operating Partners.	Macroeconomic variables and the resource envelope and expenditure levels are projected.	This is a very technical stage of the budget preparation and one would expect technical engagement from the National Assembly, essentially through the Parliamentary Budget Office to appreciate how macro-economic numbers are generated.
July - August	Preparation and approval of Concept Paper, the draft MTEF and Annual Budget.	Cabinet, Ministry of Finance, Cabinet Office, and MPSAs.	Approval of Concept Paper, the MTEF and Annual Budget by Cabinet.	Members of Parliament are expected to have provided inputs in district, provincial and ministerial budgets in line with priorities contained in the district and provincial plans.
August	Issuance of "Green Paper"; "Call Circular", Ceilings and Budget Preparation.	Ministry of Finance, MPSAs, National Assembly, Civil Societies or NGOs, Co-operating Partners.	Draft MTEF and Annual Budget prepared by MPSAs and received by Ministry of Finance. Consultations made with various stakeholders.	The "Green Paper" and draft MTEF and Annual Budget is submitted to the National Assembly (relevant committee). However, this is usually for its information as there is not much input from it.
August - September	Budget Hearings and Consolidation of MTEF and Annual Budget.	Ministry of Finance, and MPSAs.	Draft MTEF and Annual Budget with accompanying measures finalised. Draft Estimates of Revenue and Expenditure printed for use by Cabinet.	At this stage, any inputs from the National Assembly could be accommodated by the Executive but this is not usually the case.

September	Draft MTEF and Annual Budget submitted to Cabinet for approval.	Cabinet, Ministry of Finance, and Cabinet Office.	MTEF and Annual Budget approved by Cabinet.	No National Assembly role at this stage.
September - October	Printing of the Annual Budget Documents.	Ministry of Finance, Cabinet Office, PSMD and Min. of Works and Supply (Government Printers).	Printed copies of "Yellow Book", Budget Speech, Bills, Establishment Registers, and Citizen Budget (done later) are done.	No National Assembly role at this stage.
October	Annual Budget presented to the National Assembly.	Cabinet, Minister of Finance, Ministry of Finance, Cabinet Office, and National Assembly.	The National Budget read or presented before the National Assembly with accompanying documents.	The Members of Parliament must study the Budget Speech and other accompanying measures in readiness for the policy debate.

### Step One - Development of macroeconomic and fiscal frameworks

The first step in the budget process is the development of the macro economic and fiscal frameworks covering a period of three years. The macro-framework contains projected macro-economic variables, which include the Gross Domestic Product (GDP) growth rates, inflation targets, fiscal deficit levels, international reserves, etc., based on a review of developments in the current fiscal year. Using the macro-economic framework, the fiscal framework is then computed to indicate projected total resources (revenues, grants & loans) available on one side and the cost of Central Government operations (expenditures) on the other. While the two frameworks are being developed, a series of meetings take place with MPSAs to review the past budget and planning period and to analyse new policy pronouncements. The outcome of these meetings will be included in the budget. Co-operating Partners are also consulted so that their financial support to the budget can be secured.

### Step Two - Preparation and Approval of the Concept Paper, Draft MTEF and Budget

This step involves the preparation of the Concept Paper for the consideration of Cabinet. The Concept Paper is a brief Cabinet Memorandum containing proposed strategic areas of focus in the upcoming budget and MTEF with no budget allocations. Once approved, the document is used as guidance in the preparation of the MTEF and annual Budget.

After the approval of the Concept Paper, the draft MTEF and annual budget are then prepared. They contain macroeconomic targets as well as revenue and expenditure projections including ceilings for MPSAs in the medium term with priority areas in terms of focus and resource allocations. In addition, the documents briefly highlight growth, revenue and expenditure strategies for the forthcoming period. For Members of Parliament, it is expected that their input will come through the district, provincial and ministerial budgets in line with priorities contained in the district and provincial plans

### **Step Three - Issuance of Green Paper<sup>60</sup>, Call Circular, Ceilings and Budget Preparation.**

After approval by Cabinet, the Green Paper or the draft MTEF and annual budget are issued to the public and various stakeholders including the National Assembly, non-state actors, co-operating partners, the private sector and individual citizens for consultation purposes. At the same time, the Call Circular (instructional document or guidelines on budget preparation) is issued in line with Section 52 (2) (f) of the *Public Finance Act*. Budget ceilings or budgetary allocations are released to MPSAs to enable them to start the preparation or finalisation of the MTEF and annual budget. MPSAs also conduct performance reviews of the previous budget and plan period as they prepare their budgets.

### **Step Four - Budget hearings and consolidation of MTEF and annual budget.**

At this stage, MPSAs must have finished the preparation of their budgets. They are then called for the budget hearing meetings in order to present their Budget Framework Papers (with relevant and supporting budget estimates) to the Treasury. Any budgets outside the ceilings provided are sent back to MPSAs for adjustments to bring them within the given ceilings. In the meantime, revenue proposals are also considered by an inter-ministerial committee called the Tax Policy Review Committee for possible inclusion in the final and draft MTEF and annual budget. In the end, the fiscal framework is finalised and consolidated taking into consideration the final impact of revenue measures. Then the draft estimates of revenue and expenditure are prepared for submission to Cabinet. Any suggestions or comments from stakeholders such as NGOs, the private sector, individuals or co-operating partners could find their way into the budget at this stage. While the Green Paper is shared with the National Assembly for information purposes, the Assembly is not formally required nor expected to provide comments to the Executive.

### **Step Five - Draft MTEF & annual budget submitted to Cabinet for approval.**

The consolidated draft and final MTEF and the annual budget showing the total resource envelope (revenues, grants and borrowing), expenditure allocations to MPSAs (draft Yellow Book) with accompanying revenue and expenditure measures, macroeconomic targets, key strategic policy focus/interventions and other supporting documents are then submitted to Cabinet for final approval. A day before the budget presentation to the National Assembly, the Minister of Finance also submits to Cabinet a Budget Address or Speech for its approval.

### **Step Six - Printing of the annual budget and other accompanying documents.**

The following documents are printed in readiness for the presentation of the annual budget to the National Assembly: (a) the Estimates of Revenue and Expenditure or “Yellow Book”; (b) the budget legislation in relation to tax and non-tax measures (c) the Budget Speech; (d) the Citizen Budget (this usually comes later), and (e) the Establishment Registers (Prepared by Public Service Management Division).

### **Step Seven - Annual budget presentation to the National Assembly.**

Finally, the Minister of Finance presents the National Budget to the National Assembly by reading the Budget Address or Speech before the House on the second Friday of October or ninety days after a President has been sworn in during the presidential election year.

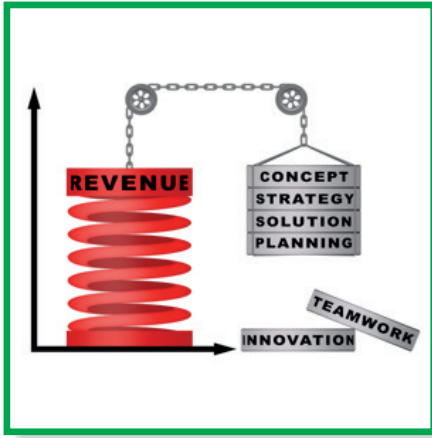
60 The Green Paper is a consultative document drawn from the macroeconomic and fiscal frameworks, and based on the existing NDP, outlines Government’s fiscal intentions and socio-economic strategies over the next three years.

## 12.4 CONCLUSION

The budget preparation and approval process involves several steps and procedures within the Executive. The process also includes consultations with several stakeholders to ensure ownership. Reforms have enhanced Parliamentary oversight and this is important to ensure transparency and accountability.

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# CHAPTER 13

## Resource mobilisation and design of revenue systems

This chapter seeks to enhance the understanding of Members and Staff of the relative merits of different revenue sources, including tax and non-tax revenues and factors to be considered when designing revenue regimes aimed at broadening and deepening the tax base. The chapter, furthermore, aims to share experiences of revenue reform designs and the implementation thereof, including efficiency, effectiveness and fairness of various taxes and non-tax revenues.

### 13.1 INTRODUCTION

Resource mobilisation refers to all activities involved in securing new and additional resources for the Government. It also involves making better and maximum use of existing resources. The need to strengthen revenue generation and the administration thereof continues to be an essential – and challenging – area of focus for most developing countries in their quest to finance the implementation of various Government functions. According to the IMF, many lower income countries still have potential to increase their tax ratios by two to four percent of Gross Domestic Product (IMF, 2011). A supportive environment such as sustained political commitment, a supportive legal framework and an experienced and capable administration must exist if meaningful and desirable results in this important PFM area are to be achieved.

### 13.2 WHY DOES THE GOVERNMENT MOBILISE RESOURCES?

The Government has an inexorable obligation to foster development and provide essential public services. This requires that sufficient resources are generated to support and facilitate implementation of the overarching development and service delivery programmes. For example, the Government has to generate sufficient resources to support its service delivery role in key sectors such as education, health, agriculture, energy, roads, water supply and sanitation.

One of the major development challenges and a real impediment to economic development in Zambia is poor and inadequate physical infrastructure, especially roads, railways and energy. It is, therefore, critical that the Government raises enough of its own resources to be able to undertake these massive investments.

### 13.3 HOW DOES THE GOVERNMENT MOBILISE RESOURCES?

Government mobilises resources from domestic and external sources. The domestic revenue sources include the types as stated hereunder.

#### Tax revenues

Taxes are compulsory monetary contribution to the state's revenue, assessed and imposed by a government on activities, income, property, etc. of individuals and organisations. Table 13.1 below summarises the tax categories currently collected in Zambia.

**Table 13.1.** Tax category, legal framework and tax type collected

Tax category	Tax Law	Type of tax
Income taxes	The Income Tax Act, Chapter 323 of the Laws of Zambia	Company Income Tax; Pay As You Earn (PAYE); Withholding tax; Presumptive Tax; Turnover Tax; and Base Tax
Property taxes	Property Transfer Tax, Cap 340 of the Laws of Zambia	Property Transfer Tax
Value Added Tax	Value Added Tax Act, Chapter 331 of the Laws of Zambia	Import Value Added Tax; and Domestic VAT
Customs, Excise and other duties	Customs and Excise Act	Customs Duty; Excise Duty; Export Duty; and Carbon Emission Surtax

Source: ZRA



In terms of contribution to the budget, Table 13.2 below shows the relative value of the different sources of revenues.

**Table 13.2: Revenue contribution to the Budget (% of Total Budget), 2010 - 2015**

	2010	2011	2012	2013	2014	2015	Annual Average
Domestic Revenues	77%	82%	84%	72%	76%	63%	76%
Tax Revenues	70%	76%	76%	62%	65%	49%	66%
Non Tax Revenues	7%	6%	7%	9%	11%	14%	9%
Grants	8%	3%	3%	1%	1%	1%	3%
Loans	15%	15%	13%	27%	23%	36%	22%

**Source:** Ministry of Finance

As can be seen from the table above, tax revenues are the major source of Government revenues accounting for about 66 % of the total revenues.

### Non-Tax Revenues

Non-tax revenues are broadly made up of payments to Government in the form of fees such as motor vehicle licensing fees, fines such as settlements arising from judicial processes, forfeits, dividends from Government's investment and sales of existing goods. It also includes Mineral Royalties<sup>61</sup> which are collected by Zambia Revenue Authority (ZRA) as provided for under Section 88 of the *Mines and Minerals Act*. The contribution of this revenue category to the budget makes up around 9 % of the budget<sup>62</sup>.

### Domestic borrowing

Section 3 of the *Loans and Guarantees (Authorisation) Act*, Cap 366 permits the Minister responsible for Finance to raise from time to time, in the Republic and elsewhere, on behalf of the Government such loans as the Minister may deem desirable. The Government borrows by using Government debt instruments such as treasury bills and government bonds.

61 In some literature, mineral royalties are treated as a tax and sometimes referred to as mineral royalty tax (MRT). This is because Part VII of the Mines and Minerals Act of 2015, which provides for the collection of the mineral royalties empowers the Commissioner General of the Zambia Revenue Authority to collect royalties and also provides that the Income Tax Act shall apply to the collection, assessment, enforcement of, and right of appeal with respect to, any mineral royalty imposed under this Part.

62 Ibid.

**External resource mobilisation includes:****Grants**

Grants are financial contributions from other governments or from international organisations. In Zambia, the main categories of grants are:

- *General Budget Support*: This consists of financial contributions from foreign countries and international organisations to support programmes and activities in the national budget through the Ministry of Finance. Bilateral budget support grants have in the past been received from countries such as Germany, Norway and Finland and the United Kingdom while multilateral grants have been received from the European Union;
- *Sector Budget Support*: This consists of financial contributions from cooperating partners for specific interventions in, and directly to, sectors such as Education;
- *Project Grants*: These are financial contributions in the form of bilateral and multilateral support from cooperating partners for implementation of specific projects.

**External Loans**

Using the same provisions of Section 3 of the *Loans Guarantee and Authorisation Act*, the Minister of Finance raises resources through external loans. The Minister contracts loans on concessional terms<sup>63</sup> mainly from cooperating partners such as the African Development Bank (AfDB), the World Bank, the International Monetary Fund or on market terms such as the recent Eurobonds that the Government raised on the international capital market.

**13.4 GUIDING PRINCIPLES IN DESIGNING A GOOD TAX SYSTEMS**

In many developing countries, including Zambia, where governments have to cope with less revenue, increasing expenditures and resulting fiscal constraints, raising revenue remains the most important function of which taxes constitute the main source. While ensuring that the desired level of revenue is collected, which depends on the broader economic and fiscal policies of a country, there is a number of broad tax policy considerations that have traditionally guided the development of good taxation systems. The box below gives a summary of the broad tax policy consideration that the Organisation for Economic Co-operation and Development (OECD) has identified (OECD 2014).

63 Concessional loans are loans that are extended on terms substantially more generous than market loans.

## Box 13.1

**Tax Policy Consideration identified by the OECD that have traditionally guided the development of good tax systems are:**

- **Neutrality:** Taxation should seek to be neutral and equitable between forms of business activities. A neutral tax will contribute to efficiency by ensuring that optimal allocation of the means of production is achieved;
- **Equity:** Taxpayers in a similar situation should be taxed similarly. This includes horizontal equity (taxpayers with equal ability to pay should pay the same amount of taxes) and vertical equity (taxpayers with a greater ability to pay should pay more taxes);
- **Certainty:** Tax rules should clearly specify when and how a tax is to be paid and how the amount will be determined. Certainty may be viewed as the level of confidence a person has that a tax is being calculated correctly;
- **Efficiency:** This simply means that compliance costs to business and administration costs for governments should be minimised as far as possible;
- **Effectiveness and fairness:** Taxation should produce the right amount of tax at the right time, while avoiding both double taxation and unintentional non-taxation. In addition, the potential for evasion and avoidance should be minimised;
- **Flexibility:** It is important that a tax system be dynamic and flexible enough to meet the current revenue needs of governments while adapting to changing needs on an ongoing basis; and
- **Simplicity:** Taxpayers should be able to understand the rules and comply with them correctly and in a cost-efficient manner.

In practice, however, balancing these principles while at the same time meeting development objectives is a challenging task for most countries.

### 13.5 ADMINISTRATION OF GOVERNMENT RESOURCES

In terms of administration, most countries have separate institutions responsible for administering Government resources. In Zambia, until 1994, all Government resources were administered by the Minister of Finance. Taxes were administered by the Departments of Taxes and Customs and Excise<sup>64</sup>. The non-tax revenues were administered by different Government revenue collecting departments on behalf of the Minister of Finance who is mandated to mobilise Government resources under the *Minister of Finance Incorporation Act*. Grants were administered by the External Resource Mobilisation Department while loans and Government investments were administered by the Investment and Debt Management Department.

In the context of declining tax collections from a peak of 30 % of GDP in the early 1970 to just 13% of GDP in the early 1990s, the Zambian Government launched a tax reform in 1992. In addition

<sup>64</sup> Income taxes were administered by the Department of Taxes while customs duties, excise tax and sales tax were administered by the Department of Customs and Excise. On creation of Zambia Revenue Authority (ZRA), these departments were transferred to ZRA and sales tax was abolished and replaced by Value Added Tax.

to other policy initiatives, the reform programme included a major overhaul of tax administration that culminated in the establishment of the Zambia Revenue Authority (ZRA) in 1994, charged with the responsibility of tax administration, while the tax policy function remained - and still is - with the Ministry of Finance<sup>65</sup>. ZRA operates as a semi-autonomous institution funded from general revenues of the Republic. It administers taxation on behalf of the Government in line with government tax policy as may be prescribed by the Government through tax legislation. The objective is to increase domestic resource mobilization to meet the growing expenditure demands of the Government. In doing so, ZRA follows the main principles of taxation to ensure that the taxation system is efficient, effective and fair.

The other resources, non-tax revenues, grants and loans are still being administered by the Minister of Finance, with the fees and fines component under the non-tax revenues being administered by the non-tax collecting institutions on behalf of the Minister of Finance, while dividends (Government Investment) will now be administered by the Industrial Development Corporation (IDC) on behalf of the Minister<sup>66</sup>.

### 13.6 CHALLENGES IN TAX ADMINISTRATION

Even though tax revenues as a share of GDP started to improve following the establishment of ZRA as an autonomous body to efficiently and effectively administer taxes, Government in its policy and development documents acknowledges that there is still scope to raise more resources. For example, domestic revenue as a share of GDP has remained fairly constant for the past five to ten years relative to the strong economic growth of above 5% over the same period. This raises concerns signalling existence of large tax gaps<sup>67</sup>.

According to the IMF, Zambia like many other developing countries still has potential to increase her tax ratios by two to four percent of Gross Domestic Product (IMF, 2011). The country however faces some challenges in tax administration, including among others:

- high level of cash transactions and related poor recordkeeping especially among small and medium sized enterprises (SMEs), making it very difficult to have any audit trail;
- policy inconsistency; especially in the mining sector, where tax policy changes have been frequent; thereby affecting not only the tax revenue collection, but also the investment environment in the sector;
- Wide geographical distribution of taxpayers and varying levels of infrastructure development (e.g., banking services)<sup>68</sup>;
- Low public perception of the benefits of paying tax; and

65 For the specific role of ZRA during the budget execution phase, see Chapter 24, Revenue Collection

66 The transfer of State-Owned Enterprises is still under way with some companies already transferred to the Industrial Development Corporation (IDC)

67 Tax gap here is used to mean the difference between potential tax collections and actual tax collections.

68 Zambia currently has 107 districts out of which 20 are unbanked, while ZRA has offices in 47 districts only.

- Social/political conflict of taxation versus poverty reduction, particularly for the SMEs. A large portion of the population/electorate is employed in the informal sector. Whereas the Government's policy is to broaden the tax base by bringing into the tax net the informal sector, there is little or no political will to implement this policy.

In order to overcome these challenges, there is need for a supportive environment such as sustained political commitment, and well-entrenched administrative reforms must exist if meaningful and desirable results are to be achieved. This means that more still needs to be done in domestic resource mobilisation efforts so that the existing potential and opportunities can be fully exploited. There is also a need for clear laws and regulations to guide the principles to be followed in taxation. Any gaps in the legal framework pose major risks of an unstable and unpredictable environment.

In terms of borrowing, the country stands to benefit from the principles of transparency and accountability if the regulatory framework places emphasis on the oversight role of the National Assembly in areas such as approving debt limits/thresholds and reporting.

### 13.7 CONCLUSION

Resource mobilisation is key to the development agenda of countries, especially in developing countries where more resources are required to facilitate overarching infrastructure development and service delivery programmes. Government financial resources are generally made up of tax and non-tax revenue, donor support in the form of grants and borrowing from both domestic and external markets. In order to make a tax system effective, the system must be fair, transparent, accepted and not too complicated to administer and to be understood by the taxpayers. Hence, designing a tax system that yields enough money for Government to do business and deliver services without over-taxing the taxpayers is often a daunting task.

In Zambia, Government and non-governmental think tanks and research institutes suggest that despite some improvement in tax revenue collections since the establishment of the ZRA, there is still scope for improved tax collection through widening of the tax net to include the informal sector, further tightening of loopholes in the legal framework and more efficient tax collection.

However, a supportive environment in terms of sustained political commitment and well-entrenched administrative reforms are important if meaningful and desirable results are to be achieved in enhancing domestic resource mobilisation.

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# CHAPTER 14

## Understanding the Green Paper (Medium-Term Expenditure Framework)

The purpose of this chapter is to explain the concept of Medium-Term Expenditure Framework (MTEF) and the process involved in developing the Green Paper. The section provides a detailed background for the introduction of the system and how it is prepared by the Ministry of Finance (MOF). This will assist Members and Staff to countercheck the Green Paper and investigate if it is in line with the vision of the Government and the national development plan. An understanding of the Green Paper will assist Members of Parliament and Staff in their assessment of policy relevance, credibility and comprehensiveness of the annual budget proposal<sup>69</sup>.

### 14.1 INTRODUCTION

A common challenge in national planning and budgetary frameworks is the missing connection between plans and budgets. Policy and planning frameworks may be well developed, but governments fail to implement them due to the passing of budgets without clear linkages to either policies or plans<sup>70</sup>. To address this weakness in the financial management system, most countries have introduced multi-year budgetary frameworks – often in connection with

69 For the role of the Green Paper in the budget preparation process see also Chapter 12, The National Budget Preparation Process.

70 For example, the situation analysis in the National Planning and Budgeting Policy (Republic of Zambia, 2014) concluded that the National Development Plans (NDPs) “were not adequately integrated into the annual budget process such that the actual allocation of public resources through the annual budget did not reflect the development programmes and priorities they contained”, p.3.

sophisticated integrated strategic planning and performance management systems.

In 2004, the Zambian government introduced a three-year rolling expenditure planning framework in an attempt to correct the many deficiencies of the incremental system of budgeting deployed by the Government at the time. In the incremental line item budget, the recurrent budgets were presented on a line item basis showing the types of expenditures (i.e. salaries and wages, fuel, oil and lubricants, stationery, etc.), while the capital budget was presented by project. The difficulty with this type of budgeting was that the budget documents did not present any further information on budget allocations, neither on the links to programmes and expected results nor geographic location. The major deficiency of such type of budgeting was the excess optimism of annual budgets in relation to resource availability and implementation capacity. Furthermore, the goals, objectives, outputs and allocations in national planning documents were not adequately considered in the annual budgeting and implementation cycle. Lack of effective prioritisation of programmes and expenditures related to prioritised goals and objectives in planning documents also led to wide gaps between plans and actual achievement.

## 14.2 OBJECTIVE OF MTEF

The MTEF is intended to facilitate a number of important outcomes, such as: “*greater macroeconomic balance, improved transparency within and between sectoral resource allocations, greater budgetary predictability for line ministries, and more efficient use of public monies*” (World Bank, 1998).

The MTEF’s aim is to improve resource allocation by effectively prioritising all expenditures on the basis of the Government’s socio-economic programmes and dedicating resources only to the most important ones.

*“A further objective of the MTEF is greater budgetary predictability, which is expected as a result of a commitment to more credible sectoral budget ceilings. The MTEF also endeavours to make public expenditures more efficient and effective, essentially by allowing the ministries greater flexibility in managing their budgets in the context of hard budget constraints and agreed upon policies and programmes”* (World Bank, 1998).

Therefore, MTEF is a structured, coherent and integrated (institutionalised) process of policy making, planning and budgeting. It involves the sector stakeholders in an iterative decision making process that: (a) ensures that national goals and targets (set in national policies and plans) are reached through appropriate medium-term programmes; and (b) reconciles the resource levels (in particular financial resources) required to reach the medium-term targets with the resources likely to be available. Contrary to long-term plans, for which estimates of likely available financial resources can only be very tentative, planning for a medium-term period of three years takes place under much more realistic conditions since the likely levels of financial resources can be estimated with a high degree



of probability. Typical of the MTEF process is the interplay between top-down and bottom-up approaches. At certain points in the process, the central level hands down decisions. This is the case for example when the Ministry of Finance indicates the draft budget ceiling for Ministries, Provinces and Spending Agencies (MPSAs). At other points in the process, decisions and information move up, namely when MPSAs decide on their draft sector programmes and submit the same to the Ministry of Finance.

The preparation of the MTEF has four major elements:

1. a macro-fiscal framework that estimates the impact of macroeconomic developments on government revenues and expenditures, and provides a medium-term projection of revenues, expenditures, the budget deficit and its financing;
2. analysis of key budget planning and management issues which, in recent years, have included public service reforms, the wage bill, investment management and financing of local government budgets, etc.;
3. an analysis of spending priorities that looks at how the government's strategic policy and programme priorities should influence resource allocations between and within sectors; and
4. expenditure plans that provide three-year sector and ministry-level resource ceilings and identify the key spending priorities at programme level.

### 14.3 MTEF PROCESS IN ZAMBIA

In Zambia, the Medium-Term Expenditure Framework (MTEF) is called the Green Paper. The Green Paper is a consultative document drawn from the macroeconomic and fiscal frameworks. It is based on the existing vision and National Development Plan and outlines Government's fiscal intentions and socio-economic strategies over a period of three years. In this way, the Green Paper serves as a pre-budget consultation document.

#### Macroeconomic framework

The process of designing the MTEF starts with Ministry of Finance. This is a top down approach. The Ministry of Finance develops the macroeconomic framework, which covers a period of three years and involves estimation of gross domestic product growth, balance of payments, inflation, fiscal deficit and international reserves. The framework takes into account fiscal policy objectives and their impact on the economy. Indicative available statistical data are produced for a medium term of three years.

#### Fiscal framework

Using the macroeconomic variables agreed in the macroeconomic framework, the Ministry of Finance comes up with the fiscal framework. The fiscal framework indicates the total revenue and expenditure estimates for the three-year period. Revenue estimates (mainly taxes, non-tax revenues, and grants from cooperating partners) are projected in line with the macroeconomic framework. A deficit target is set at an appropriate level taking into account the current macroeconomic situation.

### **Aligning policies and objectives**

When the macroeconomic and fiscal frameworks have been developed, the Ministry of Finance holds policy meetings with key spending institutions to accommodate any new policies and any other pronouncements made by the Government since the last budget or any economic changes that have taken place.

### **Concept Paper**

After the policy meetings, the Ministry of Finance prepares a concept paper, which is a brief Cabinet Memorandum containing proposed strategies on which the Government should focus in the next annual budget and MTEF period. The concept paper does not contain any budget allocations. After Cabinet consideration and approval, a Green Paper is then prepared.

### **Draft MTEF**

The draft MTEF contains the macroeconomic targets, total revenues and expenditure projections in summary form for the medium term. It also contains priority areas in terms of focus and resource allocations. In addition, strategies in growing the economy, mobilising resources and spending focus are briefly explained.

### **Cabinet approval of draft MTEF**

After Cabinet approval of the draft MTEF and annual budget, a Green Paper is issued to the public and various stakeholders for comments and any ideas that individuals may want the Government to focus on.

### **Green Paper Circulation**

The Green Paper is a consultative document drawn from the macroeconomic and fiscal frameworks and based on the existing National Vision and National Development Plan, outlining the Government's fiscal intentions and economic strategies over the next three years. The Green Paper also contains proposed ceilings or budgetary allocations to MPSAs. Once the Government has issued the Green Paper, consultative meetings are held with various stakeholders including civil society organisations and co-operating partners. The general public is encouraged to make submissions to the Government as well. The Green Paper is published in the print media and also placed on the Ministry of Finance's website. The Green Paper is shared with the National Assembly, where it is subject to a technical review by the Parliamentary Budget Office. The review will be shared with the Expanded Budget Committee in the form of a Policy Brief informing the Committee's scrutiny of the budget proposal. In the meantime, a separate technical committee is set up at the Ministry of Finance that deals with tax and non-tax proposals for inclusion in the annual budget. Comments are invited from stakeholders regarding tax policy by placing advertisements in the print media.

### **Call Circular**

The Ministry of Finance issues a Call Circular to MPSAs to guide them on the various issues to handle when finalising their budgets. The Call Circular will contain guidelines and instructions on how MPSAs must prepare their budgets or estimates of revenue and expenditure.

### Bottom up budgeting

Budget hearings follow with all MPSAs. This is the platform for MPSAs to present their budget framework papers with all relevant and supporting documents. The fiscal framework is then finalised taking into account the comments the Ministry of Finance has received from the stakeholders. This then is consolidated by taking into consideration the final impact on revenues.

## 14.4 CONCLUSION

The Green Paper, as indicated, is a consultative document that is used as a platform for the Government to solicit views or inputs on the stated intentions of the Government before the MTEF and the annual budget are finalised and approved by Cabinet. Stakeholders (Parliament, individual citizens, civil society organisations, co-operating partners, etc.) are invited to scrutinise the document vis-à-vis policies, strategies, priority programmes, resource envelope, macro-targets and risks to the budget.

In addition to these requirements, the MTEF offers a number of advantages. Introducing the MTEF generates awareness of the need to look beyond the immediate urgencies. It helps improve the link between policy and budget transparency. With its implicit emphasis on results of the expenditure, the MTEF can generate greater attention to efficiency and effectiveness of public spending. It fosters an improvement in line ministries' capacity, and their eventual empowerment and accountability.

The MTEF can overcome the tension between long term planning and incremental, short-term budgeting driven by fiscal pressure and also encourage investment by making taxation and Government spending more predictable whilst improving transparency and facilitating evaluation. It can ensure fiscal discipline by developing a consistent and realistic resource framework and improve the allocation of resources to strategic priorities among and within sectors. Finally, the MTEF can provide incentives for efficient and effective use of funds and ensure much stronger links between policy making, planning, and budgeting. The MTEF cannot result in improved spending and service delivery in isolation; it needs to be integrated with and complemented by improvements in other public policy and management processes.

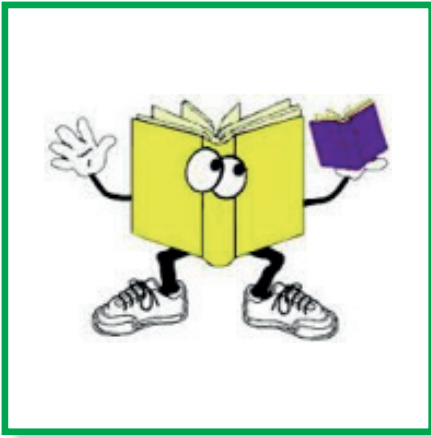
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**MODULE 4**  
**BUDGET SCRUTINY AND**  
**APPROVAL STAGE**





# CHAPTER 15

## The coverage and classification of the budget (understanding the structure and contents of the Yellow Book)

This chapter explains the budget classification system used in Zambia with a view to guiding Members and Staff of Parliament in the active use of the national budget document – the Yellow Book<sup>71</sup>. A thorough understanding of the structure and contents of the Yellow Book is important in order to strengthen Parliament’s oversight function in general, and to enable Members to carry out their own analysis of the budget proposals’ responsiveness to national policies and priority programmes in particular.

### 15.1 INTRODUCTION

To be able to track Government spending and to compare spending over time and across governments, it is important to establish standard classifications for reporting revenues and expenditures, as well as rules for the structure and contents of budgets. A comprehensive classification system allows the tracking of spending within the following dimensions: *administrative* (identifies the Government institution responsible for managing the public funds concerned); *economic* (identifies budget input categories, such as goods, services, wages,

<sup>71</sup> It is important to note that the Yellow Book, Volume I, is activity based and still the dominant budget document as it covers all MPSAs except the Ministry of Education. The Ministries of General Education and Higher Education, respectively are presented in Volume II of the Yellow Book which is output based. While the principle of the output-based budget in Volume II will be mentioned, the chapter primarily aims at explaining the classification structure of Volume I.

subsidies, interest and capital expenditure); *functional* (identifies categories of expenditure according to the purposes and objectives for which they are intended) and *programme* (identifies sets of interconnected activities aiming at achieving specific outputs, for example ‘capacity building’).

The international standard for classification systems is the Government Finance Statistics (GFS), which provides the framework for economic and functional classification of transactions. Under the United Nations-supported Classification of Functions of Government (COFOG) - the functional classification applied in GFS - there are ten main functions at the highest level and 69 functions at the second (sub-functional level).

In this chapter, the budget classification system used in Zambia is presented with a view to guiding Members and Staff in the active use of the national budget document – the Yellow Book (notably Volume I). A thorough understanding of the structure and contents of the Yellow Book, Volume I, is important in order to strengthen Parliament’s oversight function in general, and to enable Members carry out their own analysis of the responsiveness of budget proposals to national policies and priority programmes in particular.

## 15.2 RELEVANCE OF THE CHART OF ACCOUNTS TO THE BUDGET CLASSIFICATION

To make sense of the economic implications of the national budget it is important to have an understanding of the economic, functional, administrative, and programme classifications. To this effect, the use of the Government Finance Statistics (GFS) in budget classification is befitting. The economic classification is shown in the two boxes below.



**Box 15.1 GFS Economic Classification - Revenue**

<b>11 Taxes</b> 111 Taxes on income, profits and capital gains 112 Taxes on payroll and workforce 113 Taxes on property 114 Taxes on goods and services 115 Taxes on international trade and transactions 116 Other taxes	<b>12 Social contributions</b> 121 Social security contributions 122 Other social contributions	<b>13 Grants</b> 131 From foreign governments 132 From international organisations 133 From other central government units	<b>14 Other revenue</b> 141 Property income 142 Sales of goods and services 143 Fines, penalties and forfeits 144 Voluntary transfers other than grants 145 Miscellaneous and unidentified revenue
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**Source:** International Monetary Fund (2014). Government Finance Statistics Manual. Washington: International Monetary Fund.

**Box 15.2 GFS Economic Classification - Expenditure**

<b>21 Compensation of employees</b> 211 Wages and salaries 212 Social contributions	general Government 243 To other general Government units	<b>27 Social benefits</b> 271 Social security benefits 272 Social assistance benefits 273 Employer social benefits
<b>22 Use of goods and services</b>	<b>25 Subsidies</b> 251 To public corporations 252 To private enterprises	<b>28 Other expense</b> 281 Property expense other than interest 282 Other miscellaneous expense
<b>23 Consumption of fixed capital</b>	<b>26 Grants</b> 261 To foreign governments 262 To international organisations 263 To other general Government units	
<b>24 Interest</b> 241 To non-residents 242 To residents other than		

**Source:** International Monetary Fund (2014). Government Finance Statistics Manual. Washington: International Monetary Fund.

In Zambia, as in many other countries, the economic classification is aligned with the Chart of Accounts in order to be able to track actual spending against the budget. In this harmonised system, assets and liabilities are captured. The Government Chart of Accounts is a means of classifying revenues and expenditures in a consistent fashion to permit comparison and ensure proper placement in financial statements, budgets and allocations.

The structure of the Chart of Accounts is presented below.

### 1 Revenue

- 11 Revenue collected by the Zambia Revenue Authority
- 12 Revenue collected by Ministries, Provinces and Spending Agencies (MPSAs)
- 14 Grants
- 16 Funding

### 2 Expenses

- 21 Personal Emoluments
- 22 Use of Goods and Services
- 24 Financial Charges
- 25 Social Benefits
- 26 Grants and Other Payments
- 27 Subsidies
- 29 Legal Costs

### 3 Assets

- 31 Non-Financial Assets
- 32 Financial Assets

### 6 Gains/Losses and Miscellaneous

- 62 Unrealised Gains/Losses

The Zambian Government Chart of Accounts is a component of the Government's Integrated Financial Management Information System (IFMIS). Most of the items in the Chart of Accounts are easily aligned to those of GFS, as shown in box 15.1 and 15.2 above.

## 15.3 COVERAGE OF THE BUDGET

Coverage of the budgets presented in the Yellow Book for each Government entity is at two levels where it is practically possible, i.e. national and provincial. Otherwise, for most government entities the budget is aggregated at the national level.

## 15.4 CLASSIFICATION OF REVENUES

The Government of the Republic of Zambia uses the IMF Government Finance Statistics Manual (GFSM), 2001, framework of classifying revenues. In this framework, revenue is classified

according to the following categories: (1) taxes; (2) social contributions; (3) grants; and (4) other revenues<sup>72</sup>. This form of classification is seen in the Zambian Government budget shown in Table 15.1 below, where the various types of revenue by their unique code are recorded under the Head that collects them.

**Table 15.1:** Structure of Revenues in the Activity Based Budget for the Year 1<sup>st</sup> January, 2016 to 31<sup>st</sup> December, 2016

**DETAILS OF ESTIMATED REVENUE, GRANTS AND FINANCING**

	2014 Actual (ZMW)	2015 Estimates (ZMW)	2015 Revised (ZMW)	2016 Estimates (ZMW)
<b>A. RECURRENT REVENUE AND GRANTS</b>				
14 Ministry of Mines and Minerals Development Programme: 2021 Non- Tax Revenues (MPSAs)				
Activity: 101 Licences				
122050 Mining Licence				
Activity Total				
Activity:				
Activity Total				
Programme Total				
<b>Head Total</b>				
17 Ministry of Foreign Affairs				
37 Ministry of Finance				
Programme: 2011 Tax Revenues				
Activity : 101 Corporate Income Tax				
111110 Company Tax				
Programme: 2031 Grants				
Programme: 2042 Financing				
44 Ministry of Labour and Social Security				
<b>Head Total</b>				
Category Total				
<b>B. FINANCING</b>				
37 Ministry of Finance				
Programme: 2042 Financing				
Activity: 103 Domestic Financing – Long Term Non-Bank				
143020 Carryover Funds				
Activity Total				
Activity:				
Activity Total				
Programme Total				
<b>Head Total</b>				
Category Total				
<b>GRAND TOTAL</b>				

**Source:** Government of Zambia, Estimates of Revenue and Expenditure (Activity Based Budget) Volume 1 – For the Year 1st January, 2016 to 31st December, 2016

72 Jacobs, et al. 2009.

## 15.5 ADMINISTRATIVE CLASSIFICATION

In the budget, it is important that the institutions handling resources are identified for accountability purposes. This administrative classification identifies the entity responsible for managing the public funds concerned, such as the Ministry of Education or Health or, at a lower level, schools and hospitals. In the Yellow Book this information is structured as follows:

1. **Head** (such as a Ministry, a Commission, Province, or a major expenditure group such as Loans and Investments of the Ministry of Local Government and that of the Ministry of Finance, Constitutional and Statutory Expenditure, and the National Assembly);
2. **Sub-Head** (Department or Unit or a large institution such as a hospital or college). A combination of District programmes budgeted under a Head is shown in the Yellow Book as a Unit.

In this regard, a Head in the Yellow Book is an agglomeration of Government-defined programmes of expenditure and revenue under a government institution. Each government institution has a specific mandate to undertake related to government functions. A Head is subdivided into Departments (where necessary) and these are further subdivided into units. The expenditures and revenues of the Head are accounted for by a Controlling Officer appointed by the Ministry of Finance every year. The Controlling Officer is either the executive head of the institution or another very senior officer in the institution.

## 15.6 ECONOMIC CLASSIFICATION

Economic classification, as explained earlier in Chapter 6 and above in this chapter, identifies the type of expenditure incurred, for example, salaries, goods and services, transfers and interest payments, or capital spending (such as on infrastructure). According to instructions by the Ministry of Finance, some of these items in the Chart of Accounts are listed as activities in the Yellow Book, e.g. salaries, parking fees, and utility bills. Every item in the Chart of Accounts has a numerical code. However, when a chart of accounts item is listed as an activity in the Yellow Book, at that point it is also given an activity numerical code according to the way all other activities are coded. The numerical code of an activity in the Yellow Book is its serial number in a programme. Instructions on how to number activities are provided in the Call Circular, which is issued by the Ministry of Finance at the beginning of the budgeting cycle every year.

Since the capital budget is integrated as part of the Activity-Based Budget in the Yellow Book, Volume I, it is difficult to isolate recurrent expenditures from the total budget. There is no summary table in the Yellow Book on budget allocations by economic classification from which, for example, the total share of personal emoluments from the total budget can be seen. However, as an improvement on this situation, in the Output-Based Budget<sup>73</sup>, a table on budget allocation by economic classification is provided and it contains the following items: (1) Personal Emoluments; (2) Goods and Services; (3) Transfers and Other Payments; (4) Capital Expenditure; and (5) Liabilities. Users of budget information will have an interest in both types of information.

<sup>73</sup> As mentioned earlier, output-based budgeting is currently being piloted in the two ministries of General Education and Higher Education, respectively. The output-based budget is presented in Volume II of the Yellow Book. Volume I of the Yellow Book, which covers all other MPSAs, is activity-based.

### 15.7 FUNCTIONAL CLASSIFICATION

The coding of programmes in the Yellow Book provides for a functional classification. This classification categorises expenditure according to the purposes and objectives for which they are intended. For example, Programme; 5024: Health Service Delivery in Shiwangandu District under the Ministry of Health has a first digit (5) which stands for social sectors and 024 denotes that it is a 24<sup>th</sup> programme under the Health Management in Shiwangandu District.

### 15.8 CLASSIFICATION BY GEOGRAPHICAL LOCATION

In order for the budget to show where geographically the Government resources are allocated, a limited classification by geographic location is also applied in the Yellow Book. In accordance with this type of classification, only programmes under a provincial Head, such as Lusaka Province, have a numerical coding that has (6) as its first digit in a four-digit code. The other three digit spaces are for its serial number in a Department.

### 15.9 PROGRAMME CLASSIFICATION

Every programme in the Yellow Book has a four-digit code. Each code starts with a digit that identifies it to a functional classification. In this regard, the Ministry of Finance has adopted the Classification of Functions of Government (COFOG) functional classification with five functional areas numbered as follows: 1) Economic; 2) Revenue; 3) Administrative; 4) Law and Order; and 5) Social. The programmes under a provincial Head are treated as an exception in this situation, as the first digit in their code is (6), as a way of showing that they fall under a provincial budget. Programmes that are applicable to all MPSAs have a standard code, such as, “Programme; 3003: Capacity Building”.

A set of activities that meets specific policy objectives, such as achieving a selected Sustainable Development Goal agreed to at the United Nations, is a programme. Two purposes are served by classifying expenditures by programmes, namely:

1. Identifying and clarifying the goals and objectives of government spending, and
2. Monitoring operational performance through performance indicators, which may relate to the inputs, outputs, or outcomes of a particular programme.

The programmes in the current activity-based Yellow Book (Volume I) do not reflect these two purposes. Some entities labelled as programmes are merely meant for the easy management of the government machinery, such as the “Personal Emoluments” programme. This programme is a standardised inclusion for every MPSA, and yet in economic classification, salaries and wages are

an expenditure item that can be a component of any other programme. Since all personnel costs of staff of a Head (if the Head is small in terms of the number of staff) or Department are aggregated into this programme, the personnel costs of staff implementing a programme cannot be used as a performance indicator to ascertain the value for money of the staff employed on a programme. This ambiguity has been addressed in the Output-Based Budget (Volume II of the Yellow Book). In the Output-Based Budget, programmes are broken down into a set of related activities connected to outputs. The estimated costs of achieving an output equals the aggregate input-costs of carrying out the activities related to the output.

The inputs into an activity are selected as defined from the chart of accounts.

### 15.10 STRUCTURE OF EXPENDITURES IN THE YELLOW BOOK

Essentially, the expenditure side of the Yellow Book is structured in a similar way to the revenue side (see Table 15.1), in that, the highest sub-agglomeration of budget values is called a Head (e.g., Ministry of Mines and Minerals Development), and it has a serial number preceding its title name. Under a Head, there are Departments which, on the expenditure side, are written on the same line as the title of the Head on top of a Yellow Book page, and its serial number is separated from the Head serial number by a slash, for example, “HEAD 02/01 OFFICE OF THE VICE PRESIDENT – HUMAN RESOURCE AND ADMINISTRATION” and “HEAD 02/03 OFFICE OF THE VICE PRESIDENT – RESETTLEMENT DEPARTMENT”, as shown in Table 15.2. Further, under Departments are units with programmes, and programmes are sub-divided into activities. On each activity line, there are three columns of an expenditure amount in the pre-budget year and one column for the budget year. The headings of these columns are shown in Table 15.2.

**Table 15.2** Structure of Expenditures in the Activity Based Budget

<b>HEAD 02/01 OFFICE OF THE VICE PRESIDENT – HUMAN RESOURCE AND ADMINISTRATION</b>				
	2015			2016
	Approved Estimates	Supplementary Estimates or Savings Declared	Total Authorised	
	ZMW	ZMW	ZMW	ZMW
01 Human Resources and Administration Unit Programme: 3000 Personal Emoluments Activities: 001 Salaries Division I 002 Salaries Division II 003 Salaries Division III 005 Other Emoluments				
<b>Programme Total</b>				
Programme: 3001 General Administration Activities: 003 Office Administration 007 Operations of the Vice President's Bureau 011 Utility Bills				
<b>Programme Total</b>				
<b>Unit Total</b>				
<b>Department Total</b>				
<b>HEAD 02/03 OFFICE OF THE VICE PRESIDENT – RESETTLEMENT DEPARTMENT</b>				
01 Human Resources and Administration Unit Programme: 3000 Personal Emoluments Activities: 001 Salaries Division I 002 Salaries Division II 003 Salaries Division III				
<b>Programme Total</b>				
Programme: 3001 General Administration Activities: 003 Office Administration 011 Utility Bills				
(programmes continue)				
<b>Programme Total</b>				
<b>Unit Total</b>				
02 Resettlement Schemes Development Unit Programme: 3011 Management Information Systems Activities: 004 Data Collection (activities continue)				
<b>Programme Total</b>				
<b>Unit Total</b>				
<b>Department Total</b>				
<b>Head Total</b>	-	-	-	-
<b>GRAND TOTAL</b>	-	-	-	-

**Source:** Government of Zambia, Estimates of Revenue and Expenditure (Activity Based Budget) Volume 1 – For the Year 1st January, 2016 to 31st December, 2016

The first column shows the expenditure amount Parliament originally approved. The second column shows an amount of expenditure that was added to the approved amount through supplementary appropriations or the savings declared if an expenditure unit had not managed to spend what it had been funded for the activity. The third column shows the amount which was authorised as expenditure i.e. the total amount that was funded and expended on a particular activity. The fourth column shows the proposed amount for the budget year. For all the activities in a programme, a total amount is provided. It also follows that programme totals make up Unit totals, and Unit totals make up Department totals. Subsequently, Department totals make up Head totals, and finally Head totals make up the Total Budget.

In the Yellow Book, Volume I, immediately after the table of “Details of Estimated Revenue, Grants and Financing”, there is a table called “Appropriation-in-Aid”. Ministries, Provinces and Spending Agencies that collect non-tax revenue above a sum of one million Kwacha, qualifies to retain a proportion of the revenues collected. The funds to be retained by an MPSA are budgeted by that MPSA as part of its expenditure budget and these funds are spent on items that facilitate the collection of revenue. These are the funds that are referred to as “Appropriation-in-Aid” as shown in table 15.3. In the table, a total operational budget of each Department of a given Head is shown in three columns, of which the first one is the estimate in the two years before the budget year, the next one is what was the revised estimate (after factoring in supplementary estimates, if there were any) for the year before the budget year, and the third one is the current budget estimate. Following the same format for the total operational budget of each Department, the extract from it titled “Appropriation-in-Aid Funding” is also given below it. A grand total of Appropriation-in-Aid is given at the end of the table, which is a sum of all the MPSAs that collect non-tax revenue. It is important to note that the amounts given in this table do not affect the computations of either the revenue table or the expenditure table because the amounts in this Appropriation-in-Aid table are extracts from the expenditure table.

**Table 15.3** Structure of the Appropriation-in-Aid table in the Activity-Based Budget for the Year 1st January, 2016 to 31st December, 2016

<b>APPROPRIATION-IN-AID</b>			
	2014 Estimate	2015 Revised Estimate	2016 Estimate
11 Zambia Police			
1 Headquarters			
Operational Budget	143,224,790	143,224,790	125,198,273
Appropriation-in-Aid Funding	22,708,303	22,708,303	24,311,669
(Heads and Departments continue)			
<b>Grand Total Appropriation-in-Aid</b>	<b>565,547,239</b>	<b>565,547,239</b>	<b>526,637,023</b>

**Source:** Government of Zambia, Estimates of Revenue and Expenditure (Activity-Based Budget) Volume 1 – For the Year 1st January, 2016 to 31st December, 2016



### **15.11 USE OF BUDGET CLASSIFICATIONS TO TRACK POVERTY-REDUCING EXPENDITURES**

When Zambia was implementing the Poverty Reduction Strategy Paper (PRSP) in the early 2000, PRSP programmes were tagged as a way of showing poverty-reducing expenditures. However, these no longer appear in the Yellow Book because the Medium Term Expenditure Framework (MTEF) - the Green Paper - designates some whole sector expenditures as poverty-reducing.

### **15.12 BUDGET CLASSIFICATIONS IN ACTIVITY-BASED BUDGETING AND OUTPUT-BASED BUDGETING**

The Activity-Based Budgeting system acts as the costing basis for Output-Based Budgeting. As discussed above, the initial costing of the budget using the Chart of Accounts starts with activities, which are the bedrock of the programmes, and which determine the monetary value of the outputs of programmes. However, given the shortcomings of the present Yellow Book format in Volume I to the extent that programmes contained in it do not reflect an output-based prioritisation of government functions, the Yellow Book is just largely a listing of numerical data with very limited or no text to adequately inform the users of purpose, objectives, or results to be achieved. In order to improve on this situation, the Government has started piloting the Output-Based Budgeting in the Ministries of General Education and Higher Education. Hence, these two ministries are only using the Activity-Based Budget to cost inputs to programme activities. The structure of an output matrix of the Ministry of Higher Education alongside the accompanying budget allocation table are shown in Tables 15.4(a) and (b).

**Table 15.4(a):** Structure of the Output Matrix for the Ministry of Higher Education in the 2016 Output-Based Budget (Volume II of the Yellow Book)

Programme	Key Output(s)				
	Output Indicator(s)		2015		2016
			Target	Actual	Target
<b>5504: University Education</b>	1	Number of school leavers entering tertiary/ higher education.	43,000	NA	44,000
	2	Number of New Bed Spaces Created in Existing Universities and Colleges.	9,600	NA	9,600
<b>5506: Skills Development</b>	1	Number of Learners in TEVET <sup>74</sup> institutions	40,000	36,124	45,000
	2	Completion Rate in TEVET programmes.	70%	NA	80%
	3	Number of trainers trained in pedagogical skills.	536	575	575
	4	Number of new trades training institutes construction.	3	2	2

**Table 15.4(b):** Structure of the accompanying budget allocation table

	Programme	2015 Approved Budget	Releases as at 30 Sept. 2015	2016 Budget Estimate
5504	University Education	1,183,502,640	880,078,178	939,723,144
5506	Skills Development	153,335,054	123,575,479	121,296,339

**Source:** Government of Zambia, Estimates of Revenue and Expenditure (Output Based Budget), Volume 2 For the Year 1st January 2016 to 31st December 2016

In this example, the costs of achieving the targeted intake of 43,000 school leavers and creation of new bed spaces in 2015 were estimated at K 1.2 billion, while a target of 44,000 school leavers in 2016 and the creation of the same number of bed spaces have been estimated at K 940 million. It can further be derived from the information in the OBB document that the estimated amount in 2015 included K 650 million for infrastructure development (capital investment), whilst 330 million were allocated for capital investment in the 2016 estimate. The costs of the targeted outputs under programme 5506 Skills Development in 2015 were estimated at K 153.3 million, out of which capital expenditure amounted to K 80 million. The cost of achieving the output targets for 2016 were estimated at a total of K 121 million, including 50 million for infrastructure development.

### 15.13 CONCLUSION

This chapter has outlined the structure of budgetary information found in the Yellow Book, notably Volume I. It has shown that the coverage of the Yellow Book is confined to national and provincial

74 Technical Education, Vocational and Entrepreneurship Training.

budgets. The chapter has also shown that the informative value of the Yellow Book Volume I is limited as its programmes are delinked from mandated functions of the relevant departments and units and intended results. This makes meaningful analysis of the linkages between estimates and policies and priorities very difficult. The introduction of Output-Based Budgeting, Volume II of the Yellow Book is, however, intended to address the identified weaknesses in the current Activity-Based Budget format.

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# CHAPTER 16

## Policy and budget analysis as a tool to inform the political debate and decision making

This chapter defines and explains the purpose of policy and budget analyses and shows their relevance in informing political debate and decision-making. The section will help the Members and Staff of Parliament to understand the tools for evidence-based political debate and decision-making to enhance budget oversight. They will also appreciate the link between policies and resource allocation in the planning and budgeting process in the short and medium terms.

### 16.1 INTRODUCTION

According to the Republic of Zambia Cabinet Handbook<sup>75</sup> 3rd edition (2010), a policy refers to a statement of goals, objectives and courses of action outlined by the Government to provide guidance for its intended actions. In this way, a policy is simply a guideline for action. Policies, on the other hand, are an expression of values and beliefs. These values and beliefs are often used as routes to decision-making. Ideally, policy decisions should be reflected in resource allocations to ensure that policies are being implemented efficiently and effectively.

The process of determining resource allocation for the best outcomes of a given

<sup>75</sup> Government of the Republic of Zambia, Zambia Cabinet Handbook, 3rd edition (2010)

policy is referred to as policy analysis. Policy analysis can be described as a tool to inform the political debate and decision-making. Policy analysis defines the problem and the goals, examines the arguments and analyses the implications of various policy options and recommendations. It plays a dynamic role in the policy making process by ensuring that sector objectives, constraints and policies remain consistent, and it can be a dynamic tool to guide patterns of growth and technical change (e.g. fertiliser improvement). Policy analysis helps the prioritisation or re-prioritisation of resources to key areas since resources are limited, and it helps identify efficient options from non-efficient ones. Finally, it helps guide the debate on policy choice and budget implications, e.g. fertiliser input support versus irrigation investment<sup>76</sup>.

Policy analysis deals with both the process of assessing policies or programmes and the product of that analysis. Policy analysis can be divided into two major fields:

1. Analysis of an existing policy, which being analytical and descriptive, attempts to explain policies and their development in their current state.
2. Analysis of a new policy, which is prescriptive, involves formulating policies and proposals in a future state.

Policy analysis uses both qualitative and quantitative methods, including case studies, surveys, research, statistical analysis and scenario building. The process of analysis starts with defining the problem and evaluation criteria, identifying and evaluating alternatives and rejecting or recommending policy for decision-making.

Policy analysis has its roots in systems analysis. Due to the nature of the public sector, emphasis is laid on public service oriented delivery systems. The specific discipline focused on the public sector is referred to as public policy analysis. Public policy analysis is the discipline that considers what actions would best serve the public interest in a given situation, and how those actions can best be implemented effectively. Policy analysis helps to establish a link between policy considerations and resource allocation during planning and budgeting. However, it is important to note that policy analysis in and of itself is of little value without due consideration of how a specific policy would be implemented and what it would cost. In government, there is no such thing as a pure policy analysis as there is a constant pressure on a number of policy fronts for scarce resources. Therefore, the adoption of an ideal policy without regard to implementation and cost is impossible and misleading.

## 16.2 BUDGET ANALYSIS

In order to undertake budget analysis, it is necessary to understand the budget and the accompanying processes of policy and planning. While a public budget is a plan for the mobilisation of resources and spending of a given amount of money on a variety of activities and programmes within a

<sup>76</sup> Mphuka, C. (2015), Policy linked budget implementation and reporting indicators, PP presentation prepared for the National Assembly of Zambia, 2015

given period of time, normally a year, budgeting refers to the process of planning, computing and compiling budget estimates and preparing the budget proposal to be tabled in Parliament for scrutiny and approval<sup>77</sup>. Understanding the budget and the budgeting process is therefore a prerequisite in budget analysis.

Budget analysis is the process of ascertaining the efficiency, effectiveness, equity and timeliness of budgeting and its outcomes. It involves analytical work aimed at scrutinising public budgets to ensure that there is transparency and accountability in the mobilisation and allocation of public funds. The International Budget Partnership (IBP) defines budget analysis broadly as a tool for understanding the intent and possible impact of governments' plans for raising and spending public resources. According to the IBP, public budgets can be analysed from various perspectives including:

- looking at budget trends over time;
- comparing spending for one sector, like health, to its share of the overall budget or to proposed spending for another sector, like defence; and
- assessing how a budget addresses the needs of a particular group, such as women, children, those with disabilities, and the poor; or how it affects the overall economy.<sup>78</sup>

Budget analysis uses a set of tools to manage, monitor and evaluate the budget. It is used in assessing a planned budget before approval and implementation. It is used to control and monitor the budget as it is being executed. And, it is used retrospectively to evaluate outcomes, proper use of funds and link to the intended policy outcomes.

It is the main tool for assessing whether the objectives of the budget are achieved. Like policy analysis, it also uses both qualitative and quantitative methods, including case studies, survey, research, statistical analysis and forecasting models. Analysis of budget policies focuses on the implications of budgets. Analyses can be divided into analyses that focus on executive budget proposals, sector-specific analyses, analyses of effects of budgets on diverse population groups, analyses of effects on economic and social rights, analyses that focus on the economy in general and analyses that focus on budget revenue. The broad coverage of issues analysed makes budget analyses a relevant influence in the political discourse and decision-making.

### 16.3 POLICY AND BUDGET ANALYSES IN POLITICAL DEBATE

Political debate focuses, among other things, on the potential impact of laws and policy. Policy and budget analyses are commonly used to inform political debate and decision-making in the context of resource allocations. Political debate is a contest of ideas that are argued by opposing sides for

<sup>77</sup> For more detailed presentation of the budget concept and the process of preparing the budget see chapter 6, which explains the purpose and structure of public budgets.

<sup>78</sup> [www.ibo.org](http://www.ibo.org)

possible consideration, while decision-making is the process of evaluating propositions resulting in the selection of one course of action among several alternative possibilities. Political debate and decision-making revolve around the consideration of values and norms. The value assumptions are closely linked to ideology and political philosophy. These considerations have an influence on policy and decision-making by individuals and governments. However, policy and budget analyses, when applied effectively, are important tools for informing the political debate and decision-making.

Policy-makers have at their command two broad classes of policies with which to affect the economy. The first is monetary policy controlled by the Central Bank, whose instruments are changes in stock of money, changes in interest rates and some control over the banking system. The second is fiscal policy under the control of the Legislature but initiated and implemented by the Executive. The instruments of fiscal policy are tax rates and government spending, which are actively used to stabilise the economy through the public financial management system, including notably the budget.

These two broad types of policy are the major focus of political debate as they are at the centre of directing the economy and providing for the wider needs of society. Policy pronouncements are analysed in terms of what, how and when expectations are to be delivered and at what cost. Budget analysis addresses issues of whether the deliverables have been made as planned over a given time in the desired fashion. This approach of looking at policy and the budget shows the complementarity of the two analyses in making informed arguments and influencing the consideration of choices among alternative propositions. The role of analysis is limited to providing a tool to help focus debate and shape the considerations in decision-making.

The politics of the budget process essentially means examining the ways in which the distribution of power within that process affects the subsequent distribution of public resources. The process of allocation of resources to different institutions and purposes is essentially a political, rather than a purely technocratic one. Any attempt to address the contents of budget allocation without looking at political process is therefore unlikely to produce the desired results.

#### 16.4 DEMANDS FOR SOCIAL ACCOUNTABILITY<sup>79</sup>

The demand for political commitment to values such as equity, equality, adequacy, efficiency, and constitutional rights is influencing political thinking in pursuit of social accountability. Measures aimed at strengthening legislative oversight and links between parliamentarians, citizens and civil society organisations are important ways to enhance social accountability.

<sup>79</sup> Social accountability refers to “an approach towards building accountability that relies on civic engagement, i.e., in which it is ordinary citizens and/or civil society organisations who participate directly or indirectly in “exacting accountability” (World Bank, 2004) or “the broad range of actions and mechanisms that citizens can use to hold the state to account as well as actions on the part of government, civil society, media and other actors that promote or facilitate these efforts” (World Bank, 2006)



The World Bank in its Social Accountability framework<sup>80</sup> has identified budget analysis as one of the critical tools for social accountability on the basis of the following beneficial outcomes:

- *Increase efficiency in budget allocation:* Brings the demand side closer to budget planning.
- *Improve accountability and management:* Demystify, improve coordination, and financial management.
- *Improve information sharing and public understanding of the budget:* Demystify the technical language and increase transparency in the budgetary process.
- *Influence budget allocations:* Inform citizens on the impact of allocations and to mobilise public opinion to pressure for greater equity in allocations.
- *Improve targeting of funds for vulnerable groups, including women and children:* Help empower vulnerable groups by giving voice to their concerns
- *Initiate debates on sector specific implications of budget allocations:* Help improve effectiveness and efficiency of public spending to optimise the use of resources.
- *Influence revenue policies:* By analysing the impact of taxes and tax reform on different groups to ensure greater equity in revenue collection.

The foregoing signifies the need for applying policy and budget analyses to enable Parliament to execute its oversight mandate in an effective way. Collaboration with non-state actors like civil society and think tanks may also be able to augment Parliament's oversight capacity and enhance public appreciation of legislative representation.

### 16.5 LINKAGE BETWEEN POLICIES AND RESOURCE ALLOCATION

All policy represents the distribution of power and resources. Therefore linking policy objectives and resources is essential. However, in many cases it may be difficult to establish direct linkages between policy objectives and resource allocation to deliver services in support of the objectives. This is due to the structure of budgets that may not easily accommodate increasingly complex policy objectives. It must be noted that most policies require a series of linked and complementary actions to achieve objectives. This can take several forms. In many instances, more than one ministry or agency will be involved in implementation. Therefore, the budgets of those organisations will reflect part of a policy intent, but not necessarily all. In another instance, time will be a factor. These actions may roll over periods and therefore have cost implications for several years during the implementation phase. This requires a deliberate linkage to cover the overlaps in the provided time of execution. Therefore, as a specific policy is considered, it must be linked to the overall budget process.

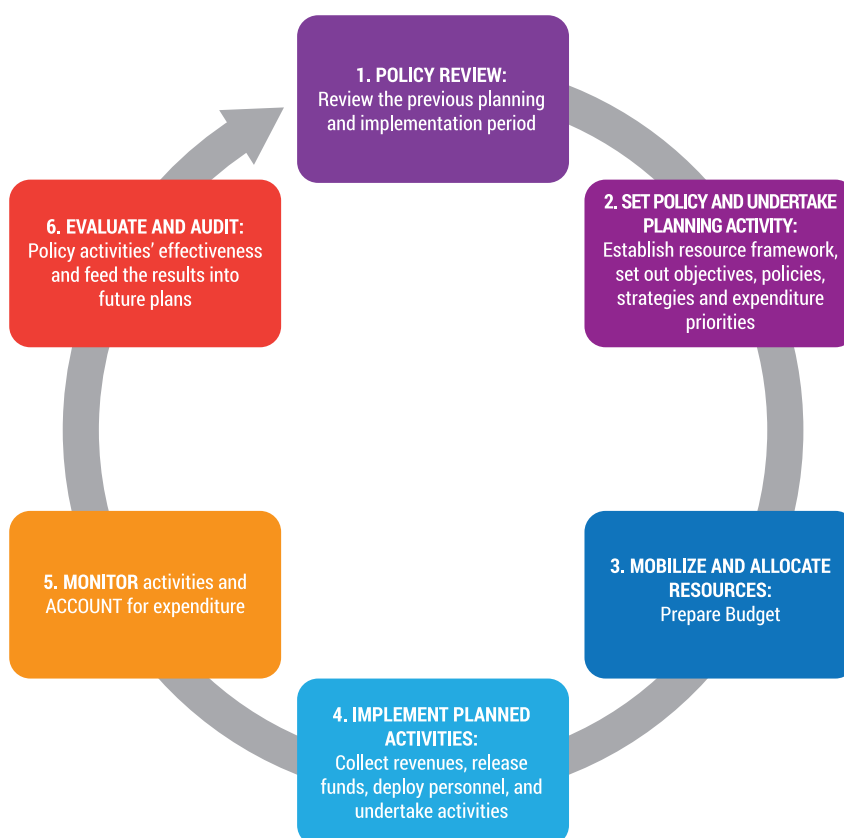
A medium-term approach as adopted by the Zambian Government<sup>81</sup> provides such a linking

80 Social Accountability Sourcebook. Chapter 3, Methods and Tools: <http://info.worldbank.org/etools/docs/library/96829/overview.htm>

81 See Chapters 5, 12 and 14

framework and facilitates the management of considerations between policy and budget realities to reduce pressure throughout the whole budget cycle as illustrated in Figure 16.1.

**Figure 16.1.** Linking policy, planning and budgeting in resource management cycle.



**Adapted:** Public Expenditure Management Handbook, (The World Bank, 1998)

As observed in Figure 16.1 above, an integrated policy, planning and budgeting approach is fundamentally about having expenditure programmes that are driven by policy priorities and disciplined by budget realities. Future resource allocations based on a specific policy mix become more predictable where a medium-term framework enforces discipline. Predictability allows line departments to plan and manage resources more efficiently within the time frame of the annual budget cycle and over the longer term. The result is better control of expenditure and greater efficiency and effectiveness in implementing policies, programmes and projects (See also Chapter 14, Understanding the Green Paper, which provides a detailed description of the Medium-Term Expenditure Framework used in Zambia).

## 16.6 CONCLUSION

The linkage between policy and resource allocation is important in creating a cohesive and effective public service delivery system. Strategic resource allocation moves policy, planning and budgeting into the centre of politics and administration. An important factor in ensuring that policy, planning and budgeting are linked is an effective system at the centre of government to make strategic decisions on the basis of budget realities. Through the provision of a realistic, hard-budget constraint, and effective political engagement, the MTEF and the budget process legitimise policy choices, leading to greater credibility of resource ceilings and budget allocations, and to predictability of funding.

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# CHAPTER 17

## Analysis of the linkages between revenues, sector policies and budget allocations, and between economic growth and poverty reduction

One of the most challenging political tasks in the budgeting process is to ensure that government revenues – taxes, non-tax revenues and loans – are allocated in accordance with the objectives set out in national development plans and thus contributing to poverty reduction and economic growth. This chapter defines and describes a few key concepts, namely fiscal resources, budget allocation, sector composition and policies, economic growth, poverty reduction and inclusive development. It briefly discusses how fiscal revenue, budget allocation, economic growth, sector policies, sector performance, and poverty reduction are interlinked in principle and in practice. Finally, it explores some of the practical challenges facing the public sector as it tries to foster development using the interplay of fiscal and sector policies to enhance economic growth, reduce poverty and achieve development.

### 17.1 INTRODUCTION

Fiscal policy encompasses policies on revenue mobilisation, expenditure and the overall budget (or fiscal) balance. Essentially, this means that fiscal policy is concerned with how the public sector mobilises fiscal resources, how it chooses to allocate and spend those resources on public programmes and projects, and how it balances the budget when marked deviations between revenue and expenditure occur.

This chapter amplifies the linkages between revenues, budget allocations, sector policies, economic growth and poverty reduction. It also draws on practical examples to demonstrate how aspects to do with the national budget and fiscal policy relate to economic performance in the different sectors of the economy, and how, in turn, sectoral performance is linked to overall economic growth, poverty reduction and inclusive development.

## 17.2 DEFINING THE CONCEPTS UNDERPINNING INCLUSIVE DEVELOPMENT

Fiscal policy, sector policies, economic growth and poverty reduction are all elements of what might be summed up as *inclusive development*. A number of definitions of inclusive development exist. Perhaps the simplest is that inclusive development entails improving the wellbeing of all citizens in a given society while safeguarding the wellbeing of that society's future generations. It encompasses long-term or inter-generational human progress that carries along all the members of a country while taking full account of the wellbeing of future generations. Each society is responsible for making its own political economy choices about what constitutes *human progress* or *wellbeing*.

In Zambia, the historical evolution and interactions of the law, economics and politics (or the political economy) has led to what might be termed as a *constitutional, democratic and liberalised socio-economic system*. This system is essentially a collective of individuals and households, companies and the Government, all domiciled and operating in the geographic territory known as Zambia. The system is responsible for defining its collective goals on human progress or development.

The Government is the custodian of the Zambian economy. The economy, governed by the Executive and the Legislature, has therefore defined short- and long-term developmental aspirations. The country draws its long-term inspiration from the Vision 2030<sup>82</sup>, which envisions that Zambia will become a prosperous middle-income country by 2030. Within the framework of Vision 2030, the country's Revised National Development Plan for the period 2011-2015 focused on *People Centred Economic Growth and Development* (MOF, 2014<sup>83</sup>). This thematic focus covers the following key elements: (i) *economic growth*, which means sustained improvement in the quality and quantum of material wealth generated from economic activity, reflecting material prosperity, (ii) a *people-centred* focus, implying a balanced economic growth path that creates decent and inclusive livelihood opportunities for all citizens, accompanied by broad-based poverty reduction and (iii) *development*, which entails true human progress or wellbeing, including access to "political freedoms, economic facilities, social opportunities, transparency guarantees, and protective security" (Sen, 1999:19)<sup>84</sup> all carried across multiple generations. Basically, this defines or epitomises *inclusive development*.

In the short-term, the governance and management systems of the economy utilise a range of policy instruments ranging from macroeconomic (fiscal, monetary and the external sector, including trade) policies to microeconomic or sectoral policies. It is therefore worthwhile to offer an itemised description of some of the key concepts that are inherent in inclusive development.

82 Republic of Zambia, 2006, Vision 2030 – A Prosperous Middle-Income Nation by 2030

83 MOF (2014), Revised Sixth National Development Plan 2013-2016, Lusaka, Republic of Zambia, Ministry of Finance

84 Sen, A. (1999). *Development as Freedom*, Alfred A. Knopf, New York.

## Fiscal revenue

*Fiscal revenue* describes the money mobilised by the Government in a given fiscal year. Table 17.1 illustrates what Zambia anticipated as revenue for 2015, as estimated in the 2015 Yellow Book. Among other things, it demonstrates that in 2015, Zambia expected to raise 96.6% of its total revenue (excluding *financing*) from domestic sources, anticipating that this would mainly come as income tax revenue making up 33.3% of revenue and grants.

**Table 17.1:** Fiscal Revenue for Zambia (excluding Financing), 2015

Central Government Operations	2015 Budget (K)	% of Revenue and Grants	% of GDP
<b>Revenue and Grants (I + II)</b>	<b>35,363,792</b>	<b>100.0%</b>	<b>19.2%</b>
<b>I Domestic Revenue (1 + 2)</b>	<b>34,150,200</b>	<b>96.6%</b>	<b>18.6%</b>
1. Tax Revenue (a + b + c + d)	25,344,781	71.7%	13.8%
a. Income tax	11,793,248	33.3%	6.4%
b. Value Added Tax (VAT)	6,576,732	18.6%	3.6%
c. Customs and Excise Duties	6,944,213	19.6%	3.8%
d. Export Duties	30,589	0.1%	0.0%
2. Non-Tax Revenue (e + f + g + h + i + j)	8,805,419	24.9%	4.8%
e. Total user fees, fines and charges	1,552,278	4.4%	0.8%
f. Dividends and interest	270,365	0.8%	0.1%
g. Mineral royalty	5,936,882	16.8%	3.2%
h. FISP recoveries	420,678	1.2%	0.2%
i. FRA-proceeds from crop sales	625,216	1.8%	0.3%
j. Other revenues	-	0.0%	0.0%
<b>II Grants (3 + 4)</b>	<b>1,213,592</b>	<b>3.4%</b>	<b>0.7%</b>
3. Direct Budget Support	-	0.0%	0.0%
4. Project Support	1,213,592	3.4%	0.7%
<b>Nominal GDP (est.)</b>	<b>183,790,000</b>		

Source: MOF (2016)<sup>85</sup>, with modifications

An important point about fiscal resources is that the public sector, anticipating a budget deficit or shortfall, can plan to borrow additional funds - an approach usually referred to as *deficit financing*. This amount will exceed the total anticipated revenue. Thus Zambia's National Budget often specifies "Total Revenue and Financing", which reflects the total amount of available public resources (including borrowed public funds). The 2015 budget planned for domestic borrowing of 3.8 billion Zambian Kwacha (ZMW), Earmarked Bond proceeds

85 Ministry of Finance (2016). 2015 Annual Economic Report. Republic of Zambia, 2016

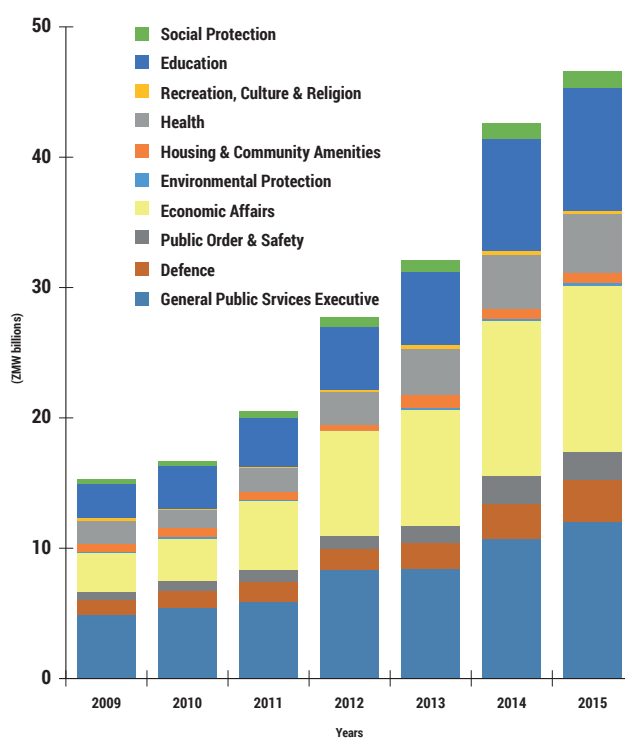
of ZMW 2.4 billion, and foreign finance programme and project loans amounting to ZMW 4.2 billion. The sum total financing exceeded the revenue and grants reflected in Table 17.1. As such, the total national budget (revenue and financing) was ZMW 46.7 billion, underpinned by an estimated fiscal deficit financing outlay of ZMW 10.3 billion or 5.6% of GDP. Members of Parliament and National Assembly staff need to appreciate that there is a variety of financing options that must be balanced to arrive at the revenues needed. Budgetary augmentations such as deficit financing have significant bearing on whether or not the country will have sufficient public resources to run its programmes and projects. They also have a significant bearing on the total size of the debt stock future generations will be burdened with.

### Budget allocation

The national budget is a management and planning tool that estimates revenues and expenditures for a specific period of time and assists in the allocation of resources across competing demands and uses. Thus, a *budget allocation* is the amount of funding designated to each expenditure line in the budget. In practice, budget allocations can be organised according to a number of different classifications such as by function, by programme and activity, by Central Government Operations or by economic activity/sector.

Figure 17.1 presents Zambia’s budget allocations by function during the period 2009 to 2015. In each year the budget was allocated to 10 functional classifications. The nominal value of the annual budget grew from ZMW 15.3 billion in 2009 to ZMW 46.7 billion in 2015.

**Figure 17.1:** Budget allocation by function, 2009-2015 (ZMW billions)



Source: Constructed from Budget Addresses and Yellow Books (various)



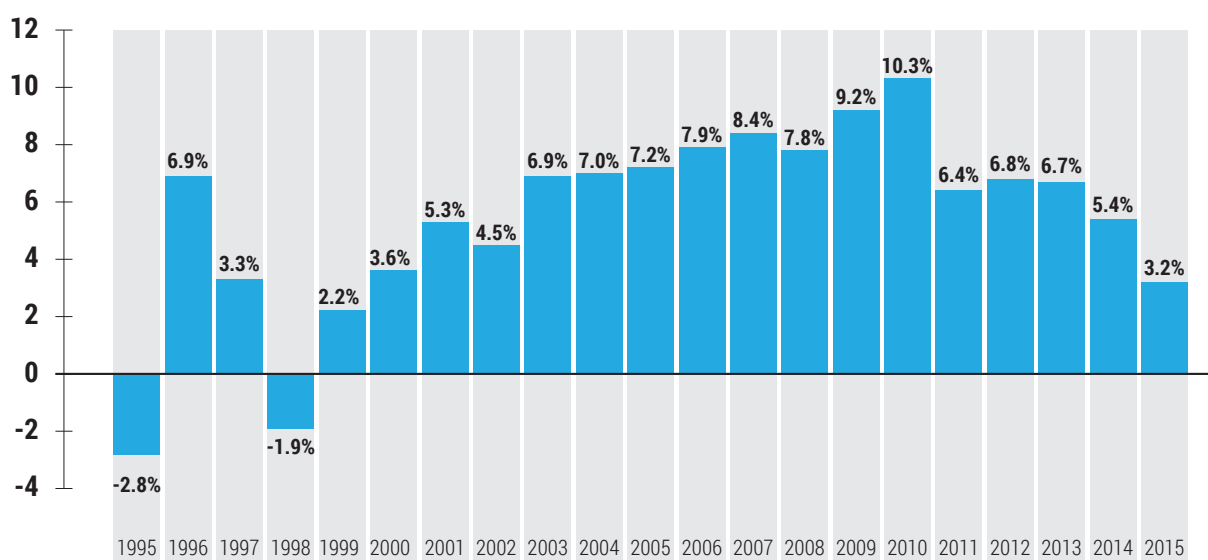
Out of the 10 functions, the allocation to *Economic Affairs* was the largest expenditure line in 2015, accounting for 27.3% of the budget. This was followed by *General Public Services Executive and Education*, which respectively accounted for 25.8% and 20.2% of the budget.

### Economic growth

A question that often seems obvious but is nonetheless worth considering is: What is *economic growth* and where does it come from? Very simply put, economic growth is the increase in the total amount of goods and services produced by an economy over a given period of time, usually one calendar year. It represents the total efforts or economic activity of individuals, households, private sector firms and the public sector in generating material wealth (goods and services) in a year. Economic activity is conventionally measured as Gross Domestic Product (GDP) using various survey approaches to collect data on economic activity and employing various statistical techniques to aggregate the data. Zambia's Central Statistical Office (CSO) is responsible for the calculation of the country's (nominal and real) GDP and GDP growth rate. The percentage rate of increase in the GDP from one year to the next is therefore termed the *GDP growth rate*. It measures the change in the level of economic activity from period to period. Growth can be calculated in *real* or *constant terms*, which reflect a measure that is adjusted for inflation (or general price increases) or it can be calculated in *nominal* or *current terms* that do not make any inflation adjustments.

Figure 17.2 shows Zambia's real GDP growth rate between 1995 and 2015. The economy recorded sustained growth from 1999 through 2015, with the rate of growth steadily increasing from 2.2% in 1999 to a peak of 10.3% in 2010 before declining to 3.2% in 2015.

**Figure 17.2: Real GDP growth rates**



**Source:** Constructed from the Central Statistical Office (CSO) (2014)<sup>86</sup> and the Ministry of Finance (MOF) (2016)

86 Central Statistical Office (2014). Gross Domestic Product 2010 Benchmark Estimates Summary Report. Lusaka, Republic of Zambia. Central Statistical Office (CSO), March 2014.

The real GDP growth rates in Figure 17.2 provide an aggregate indication about the performance of the Zambian economy over the past decade. It shows that growth has remained positive throughout although it has slowed down in recent times.

The real GDP indicator does not however show where this positive performance comes from. What were the main specific economic activities or sectors responsible for the growth? To get a better sense of these issues it is necessary to look at the sectoral composition or structure of the Zambian economy and identify some of the policies that may have influenced the changing composition of the economy.

### Sectoral composition, sector policies and performance

The *sectoral composition* of an economy describes the principal underpinnings of its economic structure. It describes how private firms and households as well as the public sector are organised in the undertaking of their respective economic activities. In order to conceptually understand the economy slightly better and support an organised and systematic administration of public policies, reference is normally made to an international classification that helps to group economic activities and sectors based on similarities of the underpinning production activities. At the most aggregate level, the economy can be categorised into four sectors, namely the agriculture sector, the (natural) resource extractive sector, the manufacturing sector, and the services sector.

In Zambia, the CSO uses a variant of the international classification, categorising economic activities into primary, secondary and tertiary sectors. According to the 2015 Annual Economic Report (Ministry of Finance, 2016), the Zambian economy is structured as two *primary sectors* (agriculture and mining and quarrying), *four secondary sectors* (a combination of manufacturing and selected services) and *14 service sectors* (see Box 17.1).

In order to show the transformation of the Zambian economic structure at an aggregate level, it is instructive to categorise the sectors and activities according to the standard international classification. Thus, the broad economic sectors of the standard international classification are defined as follows for Zambia:

- The agriculture sector, including *agriculture, forestry and fishing*.
- The resource extractive sector, including *mining and quarrying*.
- The *manufacturing* sector.
- The *services* sector, aggregating all *services* including those listed under the secondary sector in Box 17.1.

Based on this broad classification, Figure 17.3(a) presents the structure of the Zambian economy at two points in time, 1995 and 2015, reflecting the structural evolution of the economy over a decade. The main structural change was that services, which were already dominant, contributing 51% to total GDP in 1995 captured an increasingly larger share of economic activity over time, reaching 70% of GDP in 2015. The declining sectors during the structural transformation were mining,

whose contribution to GDP declined from 19% in 1995 to 10% in 2015 and agriculture, which declined from 14% of GDP in 1995 to 8% in 2015. The manufacturing sector remained relatively small in contributing to GDP, accounting for 9% and 8% of GDP, respectively in 1995 and 2015.

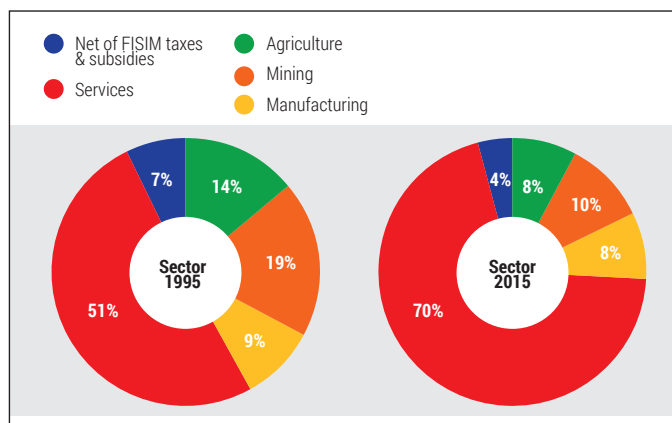
**BOX 17.1: Overview of Zambia's classification of Economic Sectors and Activities**

<b>KIND OF ECONOMIC ACTIVITY</b>	
<b>PRIMARY SECTOR</b>	
A	Agriculture, forestry and fishing
B	Mining and quarrying
<b>SECONDARY SECTOR</b>	
C	Manufacturing
D	Electricity, gas, steam and air conditioning supply
E	Water supply; sewerage, waste management and remediation activities
F	Construction
<b>TERTIARY SECTOR/SERVICE SECTORS</b>	
G	Wholesale and retail trade; repair of motor vehicles and motorcycles
H	Transportation and storage
I	Accommodation and food service activities
J	Information and communication
K	Financial and insurance activities
L	Real estate activities
M	Professional, scientific and technical activities
N	Administrative and support service activities
O	Public administration and defense; compulsory social security
P	Education
Q	Human health and social work activities
R	Arts, entertainment and recreation
S	Other service activities
T	Activities of households as employers; undifferentiated goods- and services-producing activities of households for own use
	Financial intermediation services indirectly measured
	Gross Domestic Product (GDP) at basic prices
	Taxes less subsidies on products
	Gross Domestic Product (GDP) at purchasers prices

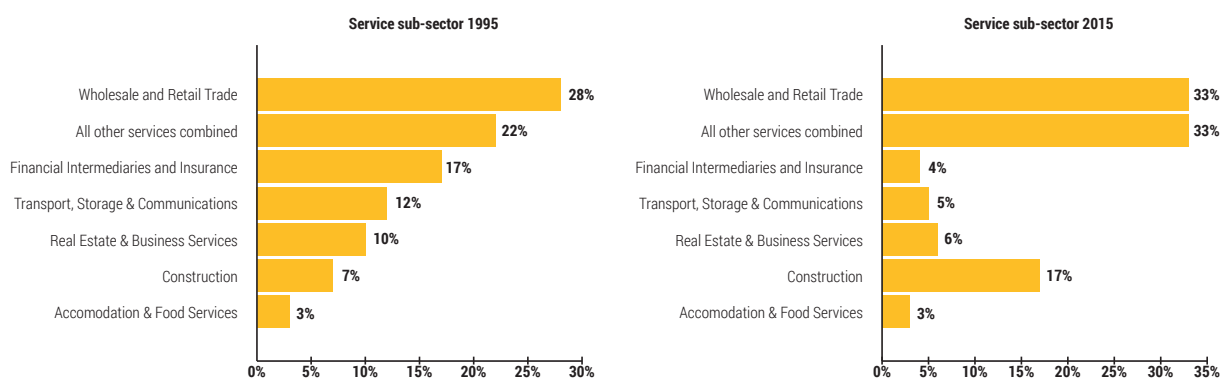
Thus, the main driver of economic growth in Zambia during 1995-2015 was the services sector. A disaggregation of the sector into its sub-sectors is therefore informative (Figure 17.3b). The most significant services in Zambia in 1995 were wholesale and retail trade services, accounting for nearly 28% of all services. This services sub-sector had increased to 33% of total services by 2015. Another dominant group of services was *all other services combined*, which combines education, public administration services, health, social work, households as employer services, and a host of others. This sub-group increased from 22% of total services in 1995 to 33% in 2015. A third sub-sector that grew considerably was construction, which moved from 7% of total services in 1995 to 17% in 2015. Financial intermediaries and insurance, transport, storage and communications, and real estate and business services all lost ground in terms of their relative contributions to total services between 1995 and 2015. This suggests that the Zambia economy’s growth was largely driven by wholesale and retail trade services, other services (notably education, public administration services, health, social work, households as employer services, and others) and construction services.

It is important to understand that fiscal and sectoral policies have a significant influence on the structure of the economy. For example, as shown earlier, sizable portions of the budget allocation between 2009 and 2015 (Figure 17.1) went to education services, health service, road infrastructure services (not directly presented in Figure 17.1) under economic affairs and public administration services (also not directly shown in Figure 17.1) under general public services. The accompanying fiscal spending on these budget lines contributed to the relative share increases of the respective services sectors in overall GDP value-added. In this way the public sector is able to influence economic restructuring through targeted or sectoral public spending policies. Figure 17.3 (a) below shows how general public services as a percentage of GDP has grown between 1995 and 2015 at the expense of, notably, agriculture and mining, and, to a lesser degree, manufacturing. Figure 17.3 (b) shows an increase in sub-sectors such as wholesale and retail trade, construction and all other services combined, whereas sub-sectors such as financial intermediaries and insurance, transport and communication, and real estate and business services have declined.

**Figure 17.3 (a)** Sectoral composition of GDP 1995 and 2015



Source: Adopted from the Ministry of Finance, 2016

**Figure 17.3 (b)** Sectoral composition of GDP 1995 and 2015

Source: Adopted from the Ministry of Finance, 2016

The sectoral policies are derived from the priority setting in the short-term, medium-term and long-term plans and strategies. For instance, Zambia's national budget, as a short-term (annual) fiscal policy instrument, determines the allocation or distribution of public resources across the sectors and sub-sectors of the economy. In turn, the budget is informed in the medium term by the Medium Term Expenditure Framework (MTEF) or Green Paper, which, in principle sets out the medium-term fiscal spending priorities over a three-year rolling time horizon. In principle, the MTEF is informed by the National Development Plan (NDP), which takes a longer-term developmental perspective, covering five years. It should be noted that whilst these are the envisaged linkages between the short-term, medium-term and long-term fiscal and sectoral policies, in practice, capacity constraints, coordination challenges, and conflict of interests may limit or even reverse the would-be effectiveness of these policies. These challenges will be discussed later in the chapter.

### Poverty Reduction

The concept of poverty can be evasive and complicated. However, abstracting from the usual complexities, this chapter focuses on the simple concept of *income poverty*, which describes a situation where a family or household's monthly income or consumption expenditure fails to meet a nationally-established monetary threshold. The Central Statistical Office has adopted the material wellbeing measure of poverty in which the poor are defined as those members of society who are unable to afford minimum basic human needs, comprising food and non-food items, given all their total income (CSO, 2012: 175)<sup>87</sup>. The CSO therefore computes absolute poverty lines or thresholds, which specify the amount of money that is required to meet a minimum standard of living, such as basic nutrition and essential non-food necessities (basic clothing, housing, etc.). Any family with a monthly income or expenditure level that is too low to afford the minimum living standard is said to

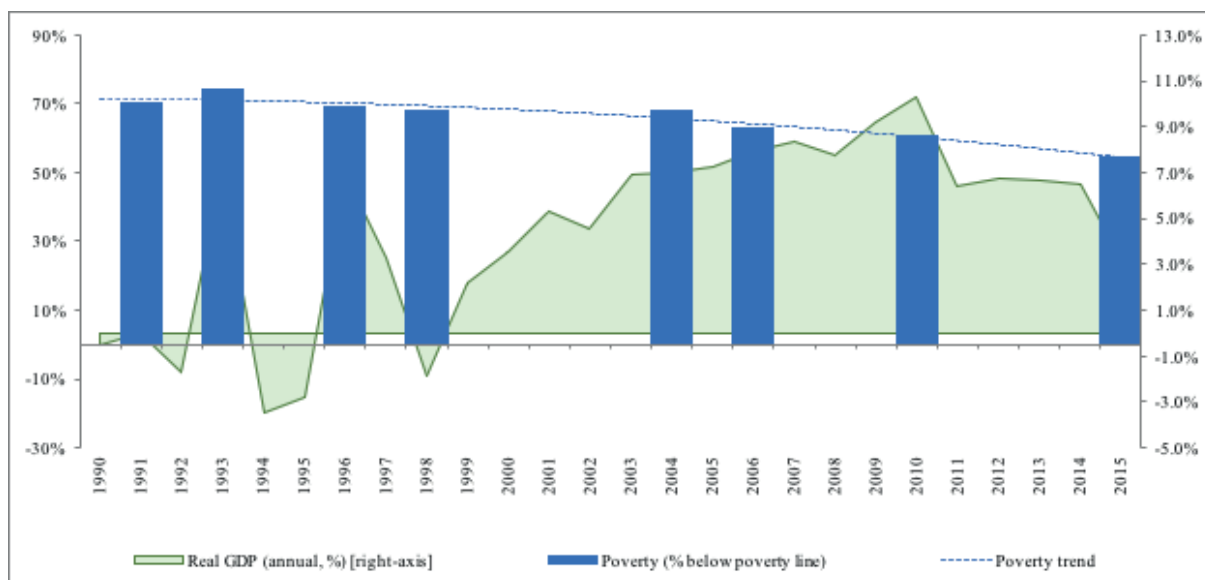
87 Central Statistical Office (2012). Living Conditions Monitoring Survey 2006 and 2010 Report. Lusaka, Republic of Zambia, Central Statistical Office (CSO), March 2012.

be income-poor. The national count of all such low-income or poor families, taken as a proportion of all households in Zambia, gives an estimate of the national *poverty headcount*.

A key objective of macroeconomic and microeconomic (sectoral) policies is to ensure that no one is left behind in the process of economic growth. That is, the benefits of growth and prosperity should be distributed fairly across the population, reflected in a general reduction in poverty levels.

The Zambian economy has struggled to achieve the poverty reduction policy and developmental goal. Over the two and a half decades between 1991 and 2015, which mark Zambia’s post-liberalisation era, the economy achieved macroeconomic stability towards the end of the 1990s. It then recorded sustained positive real growth from around 1999, with the annual averaged real GDP growth rate at 6.5% per year between 1999 and 2015, an impressive outcome by any global standard (see Figure 17.4).

**Figure 17.4** Real GDP growth rates and poverty levels in Zambia



**Source:** Constructed from Central Statistical Office data

However, despite the constant growth, poverty remained persistently high throughout the period. Overall poverty declined by only 16 percentage points over 25 years (from 70% in 1991 to 54% in 2015), implying a reduction of about 0.7% per year over the period. Despite the period of sustained positive growth (1999-2015), poverty levels declined only marginally, falling by 14% or about 0.6% per year. This suggests that the renewed real economic growth from 1999 onward made a meagre contribution to overall poverty reduction.

### 17.3 CONCLUSION

From the foregoing, clearly a number of critical developmental challenges still remain for Zambia. For one, while the linkages between fiscal policy (including fiscal revenue and budget allocation policies) and sectoral policies contributed to the economy's stabilisation, structural transformation, and real and sustained economic growth, the ensuing growth did not result in any meaningful poverty reduction. As such, the fact that inclusive development remains evasive is a source of serious concern for the country.

A significant challenge that can sometimes be a binding constraint is that while on the one hand the public sector can only mobilise a finite amount of resources in the form of tax, non-tax revenues, donations (grants) and loans from abroad, foreign investments and so on, on the other hand, the expectations of citizens in terms of wants and even just basic needs are almost infinite. In the face of the multiplicity of needs and wants competing for limited resources, contradictions, conflicting interests, and coordination challenges often emerge. For instance, Members of Parliament would often find themselves caught between two opposing worlds: On the one hand, they would be called upon to influence the effective allocation and utilisation of public resources towards equitable, sustainable and inclusive economic growth for all and. On the other hand, they would have to steer public resources towards activities that maximise political power and individual self-interest. This dichotomy inevitably requires that challenging trade-offs and compromises be made, sometimes leading to sub-optimal policy formulation and implementation outcomes.

As a result, even the most advanced, well-designed and well-meaning (or benevolent) of economic governance systems in the world may fail to achieve all their developmental aspirations. For Zambia the persistence of relatively high poverty levels with little meaningful poverty reduction is one illustration that in a complex, multidimensional world the challenges of competing and contradicting demands can get in the way of inclusive development.

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# CHAPTER 18

## Analysis of the relationship between fiscal and economic policies and variables

Fiscal policy is meant to achieve economic goals such as economic growth, income distribution and development. However, there are other economic policies such as monetary policy, debt policy and trade policy that can be directly affected or may be conducted in response to fiscal policy. This chapter explains the meaning of fiscal policy and how fiscal policies impact on economic and fiscal variables such as public and private demand for goods and services, taxes and public expenditures. An understanding of these linkages is important for analysis by Members and National Assembly Staff of Government's fiscal direction as presented in the annual national budget.

### 18.1 INTRODUCTION

Fiscal policy encompasses overall budget balance, tax and expenditure policies. This is executed through the national budget, which is presented every year to Parliament by the Minister of Finance and approved by Parliament in order to effect both the expenditure and revenue measures. To establish government's fiscal direction, one can learn a great deal from the national budget - the Yellow Book - which shows government expenditure and revenue estimates and the annual Financial Report (also known as the Blue Book), which shows actual releases by the Treasury and amounts spent by Ministries, Provinces and Spending Agencies (MPSAs).

The aim of fiscal policy is to achieve economic and social goals such as economic growth, income distribution and development. However, there are other economic policies such as monetary policy, debt policy and trade policy that can be directly affected or may respond to fiscal policy. In general, fiscal policy is used to stimulate demand for goods and services. Increased demand for goods and services ultimately increases national economic output and hence economic growth. Therefore, when national demand for goods and services is low, the Government can increase its spending and/or reduce taxes to stimulate demand. For example when the Government decides to build more roads or build more schools, enterprises contracted will in turn buy goods and services and may employ people who are in turn paid wages that are used to purchase goods and services. In short, increasing government expenditure and/or reducing taxes may, if properly executed, increase national output and employment.

There are many taxes that government charges. These include direct taxes such as Pay-As-You-Earn, corporate tax, withholding tax, turnover tax etc., and indirect taxes such as Value Added Tax (VAT), import duty and Excise tax<sup>88</sup>. Notwithstanding the type of tax, the effect of reducing any of these taxes means that individuals or companies that get reduced tax can use the extra money at their disposal to spend on goods and services or save. The amount saved at commercial banks is borrowed and re-invested by companies thereby - in a perfect world - growing the economy<sup>89</sup>. However, the latter part is true only when Government is not offering high interest and low risk Treasury bills which may crowd out private lending by commercial banks. It is however, important to note that this expansionary fiscal policy has an effect only when coupled with expansion in the supply of money.

Besides, the capacity to use fiscal policy to manage the total national demand, including by households, Government and firms for goods and services in order to moderate economic cycles, is compromised because of the long time it takes for fiscal policy to take effect.

## 18.2 WHAT IS MONETARY POLICY?

Monetary policy relates to the supply of money. The organ of Government in charge of monetary policy is the Bank of Zambia. As in other countries, it is also referred to as the Central Bank. The main objective of monetary policy is to control inflation. Inflation is usually defined as the sustained rise in the general level of prices. Inflation is bad because it erodes people's savings and purchasing power. Perhaps the most devastating effect of inflation is that it is an extra burden on the poor most of whom cannot adjust their earnings in the face of inflation.

<sup>88</sup> See also chapter 13, Resource mobilisation and design of revenue systems and chapter 24, Revenue collection.

<sup>89</sup> In a real world companies do not reinvest, hire more people or save. They often engage in unproductive risky economic activity or raise executive salaries, which is highly inefficient in redistributive terms.

### 18.3 HOW IS MONETARY POLICY CONDUCTED?

If inflation is high, the Government may aim to bring it down to lower levels. To do so, the Bank of Zambia must reduce the amount of money available. How does Bank of Zambia do this? The Bank has at its disposal several instruments that it uses to do so. In the first place, the Central Bank can increase the policy rate. Doing so signals to commercial banks to increase their interest rates. In the end, the demand for credit is reduced. Ultimately, this reduces the demand for goods and services by firms.

Further, the Bank may increase the required reserve ratio. The required reserve ratio is the proportion of every kwacha deposited at the commercial bank that the commercial bank will not be allowed to lend out and must hold in reserve. For instance, if one deposits 100 kwacha at the commercial bank and the required reserve ratio is 14 %, it means that 14 kwacha of that K100 kwacha cannot be loaned out. This reduces the ability of commercial banks to lend to a bigger base of borrowers and limits the amount of money available to the borrowing public thereby dampening demand for goods and services, and, ultimately, prices. Therefore, a high required reserve ratio acts as a cost for commercial banks to hold deposits.

To reduce inflation, Bank of Zambia can also rely on what it calls open market operations. Under open market operations, Bank of Zambia buys and sells promissory notes - for example treasury bills - to reduce or inject available cash into the economy. Therefore in trying to control inflation, Bank of Zambia may issue treasury bills to commercial banks. This process reduces excess money from the commercial banks and the public thereby reducing demand for goods and services and prices. But this is only effective if the Government does not borrow that money and then increase its own spending with it.

In general we can say that when Bank of Zambia wants to control inflation, it resorts to tight monetary policy. On the other hand, when it wants to stimulate economic growth it may implement expansionary monetary policy.

### 18.4 RELATIONSHIP BETWEEN FISCAL POLICY AND MONETARY POLICY

If inflation is high, the Government should reduce its spending and/or increase taxes. When the Government is running a large budget deficit where expenditures exceed revenues, this leads to pressure to borrow domestically or externally (from other countries) to finance the deficit. Suppose the Government chooses to borrow domestically, then it will, through Bank of Zambia, issue treasury bills or bonds which will make the money available to finance the gap between revenues and expenditures. This creates pressure on prices because even though money is mopped up from the commercial banks which put their money in treasury bills, the same money will not stay unused at the Bank of Zambia. Instead it becomes available to companies and households through government expenditure thereby increasing demand for goods and services and hence inflation.

Therefore, achieving reduced inflation when government is running budget deficits becomes increasingly difficult. In the end, this is a balancing act that takes into account the government's policy aspiration, the amount of risk it is prepared to accept in terms of inflation and the political judgement of the best balance.

Although, the Treasury might be running a deficit, it is possible for the central bank to contain inflation through other instruments such as increasing the required reserve ratios and policy rates. However, this may come at another cost by preventing the private sector from borrowing because of high interest.

### 18.5 FISCAL POLICY, BALANCE OF PAYMENTS AND EXCHANGE RATE POLICY

Fiscal policy has implications for the balance of payments and exchange rate stability of a country. To understand the link between fiscal policy, balance of payments and exchange rates, this section starts by explaining the balance of payments and the significance of maintaining stability in the exchange rate and equilibrium in the balance of payments.

The balance of payments is a method of recording all economic and financial transactions between a country and the rest of the world over a specified period of time. Economic transactions include trade in goods and services and capital movement crossing national borders while financial transactions include short-term investments which are normally with a tenure of less than a year e.g., foreign direct investments, stocks and bonds that cross borders. In the balance of payments, currency inflows are treated as credits while currency outflows are debits. Examples of currency inflows are exports, income received from investments abroad, aid from foreign governments, receipts from tourists, insurance offered to foreign residents, transport receipts from foreigners, etc. On the other hand, currency outflows include imports of goods, aid by the Zambian governments to other countries, payments made by Zambian citizens and companies abroad for services such as tourism, dividends, and payments to foreign workers, gifts to foreigners, etc. Below is an overview of the Balance of Payments (BOP) of Zambia.

BOP OVERVIEW	
Current Account	Capital Account
<b>Merchant trade</b>	<b>Changes in Zambian assets abroad, net</b>
exports	other Zambian govt assets
imports	Zambian private assets
Trade Balance	All changes, net
<b>Services</b>	<b>Changes in foreign assets in the Zambian, net</b>
military trans, (net)	<b>foreign private assets</b>
other services net	All changes, net
Service Balance	
<b>Balance on goods &amp; services</b>	
<b>Investment income, net</b>	
<b>Unilateral transfers</b>	<b>Changes in holdings of official international reserves, net</b>
Zambian government grants	
Zambian govt. pensions & other transfers	
Private remittances and other transfers	<b>Statistical discrepancy</b>
All transfers, net	
<b>Balance on current account</b>	<b>Balance on capital account</b>

Source: Mphuka, Chrispin (2015)

The current account balance plus the capital account balance is called the official settlement balance. When this is equal to zero, then the balance of payment is said to be in equilibrium. If the official settlement balance is negative, it means there is a balance of payment deficit and when it is positive it means there is a balance of payment surplus. It is economically a problem to have a persistently huge deficit in the balance of payment. This implies that the country may not be able to honour all its external payment obligations.

## 18.6 FISCAL POLICY VERSUS MONETARY POLICY TO RESOLVE BALANCE OF PAYMENT DEFICITS

It has been found that running fiscal deficits may usually precede a balance of payment crisis. Running huge budget deficits may signal investors that a country may not be able to pay its external debt obligations, especially when the country has accrued huge external debts that seem to be unsustainable. However, a fiscal deficit may not be the only cause of balance of payment deficits. In some cases, the deficit may be caused by low export performance or an increase in the importation of high-value capital goods. Moreover, overreliance on imports combined with high levels of currency outflow due to paying dividends to foreigners or relying on foreign suppliers for a range of goods and services may also be causes of balance of payment deficit.

When there is a balance of payment deficit and the exchange rate is determined by the forces of demand and supply, the exchange rate will depreciate. The depreciation makes exports cheaper and imports more expensive. This may result in increased exports and reduced imports and ultimately a reduction in the balance of payment deficit.

On the other hand, fiscal policy is the main economic tool to correct a balance of payment deficit.

The short-term effect of fiscal policy on balance of payment deficit is through the income channel. Government has the option to increase taxes or reduce its expenditures. Whether the Government reduces expenditure or increases taxes the effect is the same. An increase in government taxes will reduce the income of households and firms, which will cause these economic agents to reduce their demand for imports and/or switch to domestic production of goods and services. This reduces the trade deficit between imports and exports. Hence, it helps reduce the balance of payment deficit. Two means to do this are increased tariffs and quotas on imports. This reduces imports directly but may not be feasible where the country is in regional trade agreements and WTO rules which bind the country to a certain tariff structure.

In most African countries the productive capacity of local enterprises is weak and limited. This means huge development projects may be contracted to foreign firms. As these foreign firms take the money made out of the country, pressure is created on the exchange rate and balance of payment deficit.

Persistent balance of payment deficits may increase external borrowing. To stem this debt accumulation process, there is a need for governments to implement fiscal reforms. These reforms require a reduction in government expenditure while at the same time increasing taxes. This may include measures such as removal of government subsidies, a freeze on government wages or employment or reduction of the civil service, or a tax increase. Usually, implementing such measures is met with political resistance by various interest groups such as workers' unions. These are short-term measures, often in the face of an emergency situation. Therefore, there is a need for governments to have a medium-term fiscal adjustment programme aimed at eliminating deficits over a period of three to five years. To implement a fiscal adjustment programme over time calls for credibility and consistency in the programme. Ambiguous or contradictory pronouncements by authorities may be interpreted, by investors, as signalling a lack of commitment to correct the fiscal and external deficit. In a related issue, transparent and timely budget reporting improves credibility of fiscal policy. Over time, implementing credible policies creates a reputation, which helps the Government to achieve lower deficits with less costs such as the cost of borrowing at higher interest rates. Government can also improve fiscal policy consistency and credibility by adopting rules that are simple and transparent. For example, the Government may commit to primary expenditures that will not grow more than the growth in real gross domestic product. Monitoring such rules would help avoid huge fiscal deficits in future.

### 18.7 FISCAL POLICY AND INCOME DISTRIBUTION

Fiscal policy is a powerful tool to achieve income distribution goals. Although Zambia has experienced sustained economic growth since the year 2000, poverty and income inequality have remained high. Government expenditures and taxes can be used to redistribute income in order to achieve greater equity in incomes and reduce overall poverty. Lower income inequality is desirable for achieving greater opportunities of access to economic, social and political resources. Some

view the current income inequality as an outcome of unfair access to resources and so detrimental to social cohesion.

The question often raised is how pro-poor government expenditure is. Pro-poor expenditure means that the poor people benefit proportionately more than the rich from any government expenditure. Government expenditures are normally assessed on benefits obtained by income groups such as the poorest 20 % of the population compared to the richest 20 %. Government expenditures that would improve the distribution of income include transfers to the poor such as social cash transfers, food security packs, old-age pension transfers etc. If such government expenditures are properly targeted they help in reducing inequality. Beyond transfers, it is important for parliamentarians to demand that government expenditures on education, health, water, sanitation, etc. benefit the poor more proportionately.

The other tool that government uses to redistribute income is taxes. Direct taxes such as pay-as-you-earn can be used to ensure that the poor pay less compared to the rich. When this is the case, the tax structure is progressive. For Pay-As-You-Earn (PAYE), this is achieved by ensuring that the tax bands are wide enough and the tax rates are differentiated sufficiently to ensure the poor bear less tax burden. In most progressive systems, the poorest are generally exempt from income tax. However, it is difficult to ensure a progressive taxation with direct taxes such as Value Added Tax, import duties, etc., which apply equally to all, regardless of income status. In this case, the tax burden is relatively heavier on the poor or regressive. Sometimes, exemptions are put in place to make such taxes have less effect on the poor. But this does not have the same effect on inequality as direct taxes.

The redistributive effect of fiscal policy in developing countries is restricted by lower overall levels of both taxes and transfers. While tax revenues for developed countries exceed 30 % of GDP, the ratios for developing countries is generally between 15 to 20 % of GDP. As a result, spending on transfers to the poor is also limited in these countries.

Fiscal consolidation, which is a set of measures government takes to reduce deficits and debt accumulation, affects income inequality in two ways. First, consolidation reduces output and increases unemployment in the short run. This has typically been associated with declining wage share. The declining wage share tends to increase inequality, given the higher wage share in the total income of lower income groups. Increasing unemployment also tends to widen wage inequality. Second, both the level and composition of tax and spending can be affected by fiscal consolidation. Income inequality will tend to increase, the more fiscal adjustment relies on increasing regressive taxes (such as VAT) or on cut-backs on progressive spending such as social cash transfers. In developing countries, large fiscal adjustments have had relatively significant impacts on the real economy and unemployment. Thus to minimise the effect of fiscal consolidation on inequality it is important to protect social expenditures such as social cash transfers so that these do not reduce during fiscal consolidation. Also taxes to be increased must be those that aim for equity, such as PAYE.

## 18.8 CONCLUSION

Fiscal policy promotes growth through many channels. It plays a critical role in ensuring macroeconomic stability, which includes low inflation, low interest rates and stable exchange rate. Macroeconomic stability is an important prerequisite for achieving and maintaining growth. Large fiscal deficits reduce aggregate savings in the economy and may lead to inflation, high interest rates and balance of payment pressures with negative results for economic growth. Moreover, macroeconomic instability creates uncertainty of return on investments.

At the micro level, fiscal policy promotes economic growth through well-designed tax and spending policies that can promote employment, investment and productivity. This is achieved through:

- Lowering taxes and improving the design of tax to increase employment.
- Reforming capital income taxes to tax rents encourages private investments, while well-targeted tax incentives can stimulate private investments and enhance research and development.
- More equitable access to education and health care contributes to human capital accumulation, which is important for growth.
- Efficient public investment especially in infrastructure can raise the economy's productive capacity.

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# CHAPTER 19

## Liabilities and assets management

This chapter explains the concept of public asset and liability management the key elements of which are embedded in the Public Finance Act, no. 15 of 2004. This Act gives legislative backing for the public asset and liability strategies and targets for the general public sector. The chapter aims to enable Members of Parliament and Staff of the National Assembly to appreciate major assets and liabilities of the public sector and the management thereof in general, and by the Government of Zambia in particular.

### 19.1 INTRODUCTION

An asset is a resource with economic value that an individual, corporation or country owns or controls with the expectation that it will provide future benefit. Thus assets are those over which the general government has ownership rights, and from which it may derive economic benefits by holding or using them over a period of time.

*Assets must have the following characteristics:*

- They must have economic value and future economic benefits, which will be derived by owners through holding them or using them over a period of time;
- Ownership rights may be enforced;
- They must be capable of being expressed in monetary terms.

*They are divided into two main components:*

*Financial assets* consisting of financial claims, monetary gold and Special Drawing Rights. Financial claims are assets that entitle one unit, the owner of the asset to receive one or more payments from the debtor. Examples are cash deposits, loans, bonds, financial derivatives and debtors.

*Non-financial assets* cover all assets other than financial assets, such as fixed assets, stocks and valuables. Fixed assets are produced assets that are used repeatedly or continuously in processes of production for more than one year.

*Liabilities* are obligations to transfer future economic benefits to other parties. Thus liabilities are obligations to other institutional units or individuals. Examples are creditors, loans, treasury bills, government bonds, and staff creditors.

They are classified between current (payable within one year) and long term (payable for more than one year).

*Liabilities are further classified into financial and non-financial liabilities. Financial liabilities include:*

- i. Deposits held** - holdings of cash balances or deposits from other public or private sector bodies including trust accounts held on behalf of private bodies (e.g. judicial clients' accounts), public financial entities, or non-financial public companies.
- ii. Advances Received** - loans received from non-financial government authorities for policy purposes rather than income generation/liquidity management. They exclude loans from all financial authorities, grants and non-repayable funds received.
- iii. Borrowing comprises**
  - Foreign debts (external debt) from multilateral and bilateral institutions, and through open international markets;
  - Finance leases - lease arrangements in which most of the risks and benefits of ownership rest with the lessee, including all leases defined as finance leases, and excluding operating leases;
  - Domestic borrowing - bank overdrafts, long and short-term loans in local currency, deferred payment schemes (re-purchase agreements);
  - Borrowing from the financial institutions - securities maturing in less than one year and later, including promissory notes, bills of exchange, certificates of deposit, fixed term deposits, Treasury notes and bonds, debentures, long term notes, other derivatives in a net liability position.
- iv. Unfunded liability for employee entitlements** – include employers' liability to pay future

benefits to employees less amounts paid into separately constituted funds not able to be used by government and established to pay these benefits as they arise. This includes liability for superannuation (measured as present value of future benefit payments discounted by an appropriate rate), sick leave paid on resignation or retirement, recreation leave, long service leave, workers' compensation (where benefits are paid by an employer and not a separate insurer) and accrued wages and salaries.

Non-financial liabilities on the other hand include contingent liabilities. This is a potential but material fiscal obligation contingent on the occurrence of particular events actually happening. A contingent liability exists if the Government has guaranteed a loan or established that, in certain circumstances, it will pay out money, e.g. in the event of a natural disaster. However, a bank failure, unless the assets of the bank are guaranteed by Government (which is most unusual) would not trigger a contingent liability.

Whether a government is obligated by law or simply forced by circumstances to provide public financing to cover such contingencies, its contingent liabilities can lead to large increases in public debt.

Contingent items on a government's accounts, if based on the accrual method, might include significant and highly likely court settlements where a government has been sued (contingent liabilities) or has sued (contingent assets) for monetary compensations, yet to be decided on by the courts of law. Prudent financial management dictates that only contingent liabilities are recognized and reported by the Government.

## 19.2 ASSET AND LIABILITY MANAGEMENT

Public sector balance sheets comprise a number of sizable assets and liability items. The government balance sheets can be highly diversified, as public economic agents involve themselves in plentiful activities, ranging from infrastructure investments to reserve management.

The management of both the assets and liabilities of the public sector is generally guided by law and regulations that flow from the law. This is because both assets and liabilities have the potential to expose governments to fiscal as well as sovereign risks. The relevant regulations detailing the acquisition, management and disposal of public assets, both financial and non-financial, and the acquisition of debts (financial and non-financial liabilities) are created within the context of the Constitution of Zambia and the respective laws.

### Financial/non-financial assets held by Government

One of the main assets of a government is usually the flow of tax and non-tax revenues over

several years. Other important assets include foreign exchange reserves, cash reserves and State Owned Enterprises (SOEs). Other major financial assets on the Government's balance sheet are international reserves, cash balances and other sovereign funds. The management of these assets is provided for under the Bank of Zambia Act, 1996. Naturally, while international reserves are mostly invested in safe and high-quality liquid assets in foreign currencies, cash reserves are kept primarily in local currencies. Sovereign funds on the other hand, with higher risk tolerance, can be invested in a wide range of asset classes including government bonds, asset-backed securities, corporate bonds, equities, real estate and foreign direct investment. Since the Government tends to invest the assets abroad in order to reduce inflationary pressures, as well as to avoid excessive appreciation of the currency, the assets are mostly in foreign currencies.

Other financial assets such as the cash in various commercial banks, petty cash balances, advances and imprest accounts are regulated through the provisions of the Public Finance Act, 2004 and the Financial Regulations, 2006. The Minister of Finance is authorised by the Constitution to approve the use of public funds to invest in readily marketable securities and deposits or other secure investments with a financial institution.

The second category on the asset side is non-financial assets, which refers to the assets that cannot be readily converted to cash. They usually have a long-term use and are often capital in nature. In terms of the Government, the major non-financial assets are the net worth of the state owned enterprises (SOEs) and infrastructure investments. Typically, these assets do not create cash flows and usually lack explicit financial features that are required for asset recognition in the commercial sector. One of the main characteristics of non-financial assets that can be simply identified is that these are usually long-lived assets like lands and buildings. Usually, these assets are maintained at book value in the assets register of Government. The Ministry of Works and Supply prescribes procedures for their acquisition, maintenance and disposal of such assets. The other form of non-financial assets are the moveable assets. These are also acquired, maintained and disposed of under the policy guidance of the Ministry responsible for Government Works and Supply.

### **Financial/non-financial liabilities**

On the liability side, government debt, which consists of foreign and local debts, and securities, is the largest financial item. Debt instruments differ in terms of currency denomination, maturity and interest rate structure. Debt management is largely driven by cost-risk objectives. As a result, borrowing strategies are set up with a goal of cost minimisation over the medium to long term, subject to a prudent degree of risk.

The Constitution authorises the government to raise loans or grants, foreign or local, on behalf of itself, other government institutions or other organisations, and to provide guarantee on loans on behalf of other government institutions or other organisations. The law also allows the Government to enter into agreements to give loans or grants out of public funds. However, the constitution requires that the National Assembly approve such loans, grants or guarantees before they are extended. The authority to borrow internationally or local is vested in the Ministry of Finance.

Also, being one of the major sources of sovereign risk, contingent liabilities are treated as and recognised as debt of Government. Since they represent potential claims against the Government, which have not yet materialised, contingent liabilities such as government guarantees fall under this category. The Public Finance Act requires the approval of the Treasury for a government ministry or department to access short-term overdraft or loans from the commercial banks.

### 19.3 CONCLUSION

Governments in general do not produce full balance sheets. As for fiscal reports, while every government issues a budget as a quantified financial plan, only a few construct a sovereign balance sheet highlighting government assets and liabilities. A government budget largely measures cash flows of revenues and expenditures for an accounting period. Thus, the budget, which is a mere financial plan, cannot capture stock values of sovereign assets and liabilities. This is currently one of the key challenges being faced in most developing countries<sup>90</sup>.

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90 For more details related to Governments balance sheets, see also Chapter 7, Government accounting and reporting standards and practices





# CHAPTER 20

## Checklist for political scrutiny of the Green Paper and the Yellow Book

The assessment of past revenue performance vis-à-vis expenditure forecast, political pronouncements, charters and declarations linking budget allocations to political commitments and spending to sector performance forms part of Parliament's oversight role during the budget scrutiny and approval stage. In order to guide Members of Parliament and National Assembly Staff, this chapter provides a checklist for scrutinising budget frameworks and budget proposals to ensure that the budget proposal is realistic and that the objectives and contents of the budget mirror the development priorities contained in strategic policy documents such as the National Development Plans<sup>91</sup>.

### 20.1 INTRODUCTION

The national budget is a strategic document that, once approved by Parliament, becomes budget law that permits Government to raise resources and incur expenditures in order to deliver public services and pursue set development objectives (Norton & Elson, 2002). The budget plays a fundamental role in controlling public resources and forward planning in terms of resource allocation and the management of national resources. Through these broad functions, a national budget acts as an instrument that facilitates the implementation of the Government's political, economic, social and administrative functions.

<sup>91</sup> The formulation of strategic policy documents such as the National Development Plans is participatory, a culmination of broad based consensus with various stakeholders, to the extent that it mirrors the development aspirations of the general citizenry.

It operationalises the development aspirations of the country including electoral promises of successive governments. This strategic nature of the national budget requires that its formulation process be participatory, involving various stakeholders, especially politicians like Members of Parliament who represent the aspirations of the electorate. Politicians are therefore supposed to participate in the budget process by scrutinising documents such as the Green Paper, the budget speech and the Yellow Book to ensure that the objectives and contents of the budget mirror the overarching development and service delivery aspirations of the people.

## 20.2 THE GREEN PAPER<sup>92</sup>

The Green Paper is a consultative document, drawn from the macroeconomic and fiscal frameworks, outlining Government's focus and proposed policy interventions over a three-year horizon. It is used as a platform through which government consults and gets feedback from stakeholders for onward incorporation into the document before it is finalised (i.e. the White Paper)<sup>93</sup>. Most of the planned interventions espoused in the Green Paper are based on the following:

- The macroeconomic framework, indicating macroeconomic objectives and indicators for the medium term (three-year period) such as GDP growth targets, strategies for inflation and domestic borrowing; and
- The fiscal framework, indicating the total resources (revenue, grants, and borrowing if any) available for Central Government Operations (expenditure) over a three-year period.

### Macroeconomic Framework

In terms of the macroeconomic framework, Members of Parliament are expected to assess the macroeconomic indicators<sup>94</sup>, how feasible and realistic these are in relation to the specific macroeconomic objectives espoused in the Green Paper. Whereas assessing how realistic these objectives are may be a daunting task, Members of Parliament could use other value judgment approaches such as assessing how these indicators compare with previous performance. For example, a macroeconomic objective to maintain average real Gross Domestic Product (GDP) growth for the next three years at 9% per year would call for further probing if the same real GDP growth rate for the previous three years only averaged 3%. This would require justifications from the Executive on how they plan to grow the economy from 3% to 9% of GDP per annum (i.e. will there be huge investments in some of the sectors, such as mining and agriculture?).

The inclusion of macroeconomic indicators for previous years in the Green Paper also provides a good opportunity for interrogating past performance. For example major deviations between the

92 While chapter 14 contains a detailed description of the Green Paper as an integrated part of the Executives budget preparation during the Budget Formulation Stage (Module III), the purpose of section 20.2 is to provide Members and assembly staff with operational guidance on how to assess the Medium-Term Expenditure Framework as part of the parliamentary Budget Scrutiny and Approval Stage.

93 The green colour denotes consultative, while white denotes final. However, no white paper has been produced in Zambia in the recent past.

94 Targets for GDP growth, inflation, fiscal deficit, domestic borrowing and Gross International Reserves among others.



projections for the previous year and the actuals after end year, requires further explanation from the Executive arm of government. This can be seen in the wider context of accountability, premised on the notion that where decisions, assumptions and assertions are not challenged, discipline declines.

It is also important to look at the macroeconomic indicators and how they compare with targets in the National Development Plan.

### Fiscal Framework

Apart from the macroeconomic framework, the Green Paper also has important information related to the fiscal framework. Under this section of the document, Members of Parliament are expected to seek answers from the Executive on the assumptions underpinning the projected resources. For domestic revenues (tax and non-tax), effort must be made to assess how the projected domestic resources compare with previous performance and the revenue mobilisation potential for the country. It is a favourable platform to interrogate the revenue measures that will lead to the attainment of the projected domestic resources and to share ideas on possible options for enhancing domestic revenue.

Under financing<sup>95</sup>, particular attention must be paid to the implications of the proposed borrowing on the domestic economy and how this borrowing would benefit the country. For example, economic theory indicates that huge and continued borrowing from the domestic market may crowd out the private sector by redirecting the much needed financing for private sector investments to the government. More importantly, Members of Parliament are supposed to inquire about the implications of programmed borrowing for the debt ceiling of both domestic and external borrowing. In terms of how programmed borrowing would benefit the country, Members should seek explanations on how the Executive plans to utilise the programmed loans (i.e. whether it is for investments or consumption).

In terms of broad expenditure projections, Members of Parliament should get a more informed view of the appropriateness of the allocations by looking at the following:

- a. The component of the non-discretionary expenditures such as constitutional and statutory obligations (i.e. debt payments) and contractual obligations (i.e. personal emoluments) and how this relates to the projected total domestic resources. This would provide Members of Parliament with important information on the actual resources available for the implementation of various government development and service delivery programmes, and how this compares with the planned interventions for the medium term.
- b. The stock of liabilities to suppliers of goods and services and how this compares with the projected allocations under liabilities.
- c. Expenditure performance for the previous year(s) in terms of planned and actual, and how this compares with projections for the following year(s).
- d. Strategic focus for national development such as priorities in the national development plan

95 Financing in this context refers to domestic and/or external borrowing.

including new policy pronouncements and how these compare with the broad spending priorities for the medium term.

### Budget Speech

The Budget Speech provides a summary of the Government's development objectives for the following year as contained in the budget and provides background information upon which these development objectives were premised such as previous performance in both the domestic and external sector. It also crystallises the revenue measures and spending priorities adopted by government and reflected in the estimates in the Yellow Book.

Once the Budget Speech has been presented by the Minister of Finance, Members of Parliament are given time<sup>96</sup> to debate the Speech. The debate on the Budget Speech provides a platform for Members to establish a link between priorities in strategic policy documents such as the national development plan and new policy pronouncements, such as those contained in the presidential speech to Parliament on the occasion of the official opening of the National Assembly. At this stage, Members of Parliament can also reflect on how well their contributions during the initial engagement, through the Green Paper, were incorporated, and can also engage the Minister of Finance on the possibility of accommodating any other pressing needs that may not have been adequately provided for in the budget proposal.

### Yellow Book

The Yellow Book comprises estimates of revenue and expenditure for the ensuing year. It also provides the expenditure estimates at different levels and classifications including aggregations upon which appropriations by Parliament are made. Some of the pertinent issues to look out for when scrutinising the Yellow Book are:

- a. the extent to which the allocations reflect prioritisation in line ministries vis-à-vis spending priorities espoused in the Green Paper and the Budget Speech;
- b. how realistic the estimates are in relation to the activities to be undertaken; and
- c. clarifications on any notable variances between the previous year's allocations and the ensuing year.

In addition to the above, the Constitution, under Article 203, provides for two other forms of budgeting on the *execution* side of the budget. These are Excess and Supplementary Budgets meant to cater for unforeseen and unavoidable expenditures. Excess expenditure is meant for expenditures of an urgent nature, for which any delays in facilitating such expenditures would not be in the public interest, hence can be approved through a presidential warrant which is later considered by the Estimates Committee (clause 4, 7 and 8 of Article 203 of the Constitution). On the other hand, Supplementary Estimates of Expenditure are meant for expenditure items that are not supported by the amounts appropriated in the Budget, and requires National Assembly approval before any expenditure can be incurred (clause 2 and 3 of Article 203 of the Constitution).

Approving the excess or supplementary estimates of expenditure implies adjusting the original

96 Usually one to two weeks

budget either upwards in the event that extra resources (i.e. through borrowing or additional revenues) are sourced, or reducing some of the existing expenditures in the approved budget to accommodate the supplementary expenditures. Excess and supplementary budgets may have far reaching implications on the budget and its objectives. For this reason, scrutiny by Parliament is imperative, particularly on the following:

- **Justification for the supplementary budgets:** Clear justifications must be provided on why the supplementary budgets must be approved i.e. are there compelling reasons why the supplementary budget cannot be deferred to the following year so that the same is included in the subsequent MPSA's budget(s)?
- **Sources of financing for the proposed supplementary budget:** In the absence of extra resources, financing of excess or supplementary budgets entails reallocating funds from other programmes in the approved budget. Explanations must therefore be sought on the sources of financing and associated implications.

In addition to supplementary budgets, the assessment should include an examination of variation of funds between programmes with a view to establishing the extent to which the variations made affect the achievement of set political objectives and targets.

### 20.3 CONCLUSION

The strategic nature of the national budget requires that its formulation process is participatory, involving various stakeholders especially politicians like Members of Parliament who represent the aspirations of their electorates. Pre-budget documents, the Green Paper, the Budget Speech and the Yellow Book, provide Members of Parliament with an opportunity to scrutinise the Executive's budget proposals in terms of fiscal policies, assumptions and assertions. Most importantly, Members should be in a position to establish if the budget proposal reflects national development goals, such as poverty reduction and economic growth.

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# **MODULE 5**

## **BUDGET EXECUTION**





# CHAPTER 21

## Public Procurement

Government's procurement of works, supplies (goods) and services through tendering is not an end in itself. It is a management means to ensure that government institutions acquire high quality works, supplies and services at the lowest reasonable prices through competitive tendering in order to achieve specific public policy purposes.

Open, competitive and transparent procurement operations are seen as a prerequisite for good financial governance in general and effective budget implementation in particular. While open tendering is the default method of public procurement in Zambia, the reports of the Auditor General and assessments of the country's financial management performance<sup>97</sup> indicate that there is room for improvement in procurement operations and strengthening of Parliamentary oversight of the procurement operations of Ministries, Provinces and Spending Agencies (MPSAs).

This chapter aims to strengthen Members of Parliaments and Staffs appreciation of the legal, institutional and procedural framework for public procurement, challenges encountered and ongoing reforms to improve the current state of affairs.

### 21.1 INTRODUCTION

Public procurement concerns itself with the spending of public moneys on the acquisition of goods, services<sup>98</sup> and construction works by the government

97 For example the most recent Public Expenditure and Financial Accountability (PEFA) assessment of 2012.

98 Services are made up of 'consulting services' such as feasibility studies, project management, engineering services, finance and accounting services, training and capacity building, etc.', whilst 'non-consulting services' include equipment maintenance and repair, operation and maintenance services, utility management, installation and maintenance services.

and other public entities to support their operations in the provision of public goods, works and services. The objective of public procurement is to acquire goods, services and works in the best and cheapest way through a competitive bidding process that meet programme and operational objectives of government policy. To prevent waste of public resources, the procurement process must be transparent, cost-effective, timely and within the law.

A good procurement system is vital for the development of any nation because a substantial portion of the country's total public spending involves public procurement. When the public procurement system is efficient and rules and procedures are strictly followed, it leads to a number of benefits such as reduced corruption, financial savings, value-for-money and economic empowerment.

## 21.2 THE LEGAL AND INSTITUTIONAL FRAMEWORK

Public procurement in Zambia is administered under the *Public Procurement Act (No. 12 of 2008)* and its subsidiary legislation (*the Public Procurement Regulations, 2011- Statutory Instrument No. 63 of 2011*). This law repealed and replaced the *Zambia National Tender Board Act, of 1982*. Some of the objectives of the law are (a) to ensure transparency and accountability in public procurement and (b) to manage and regulate public procurement in order to promote the integrity of, fairness and public confidence in, the procurement process. The Act has also provided for the decentralisation of public procurement by turning MPSAs and other public institutions into procuring entities responsible for their own procurements.

In terms of institutional arrangements, the *Public Procurement Act* has provided for the establishment of the Zambia Public Procurement Authority (ZPPA), replacing the Zambia National Tender Board. The new body has now become a public procurement regulatory institution responsible<sup>99</sup> for policy, standard setting, compliance and performance monitoring, professional development and information management and dissemination.

Following the decentralisation of public procurement, each procuring entity is required to constitute a Procurement Committee, which is supposed to be the highest approvals authority. The Procurement Unit must also be set up to assume the role of Secretariat.

## 21.3 PRINCIPLES OF PUBLIC PROCUREMENT

Public procurement is guided by the following set of universal principles and a code of conduct, which, along with relevant legislation, make up the framework for the management of public procurement.

<sup>99</sup> The functions of the ZPPA are elaborated in Section 6 (2) of the Public Procurement Act.



- **Transparency** - This principle requires that information about the public procurement process is accessible to all bidders and stakeholders except for confidential information.
- **Integrity** - This refers to the reliability of bidding information provided by the procuring entity to all bidders and other stakeholders. It is all about public confidence.
- **Economy** - This principle is about efficiency, value for money, fair price and managing public resources with due care and diligence so that money spent represents good value.
- **Openness** - Public procurement requirements must not be kept in secret but should be open to all those qualified to participate in the bidding and the public, except for confidential information.
- **Fairness** - It means treating all bidders in the same way and without bias. For instance, no preferential treatment should be given to certain bidders compared to the rest.
- **Competition** - There should be no hindrance to participation in procurement and all tender requirements must be proportionate to the subject of the contract.
- **Accountability** - This requires that individuals are responsible for their actions and decisions. Everyone involved must be accountable and must be sanctioned when they err against the rules.

## 21.4 METHODS OF PUBLIC PROCUREMENT

The *Public Procurement Act* prescribes different applicable procurement methods. The choice of a particular method is influenced by the estimated value of the procurement, the nature of the procurement and the circumstances. The following are the methods of public procurement<sup>100</sup>:

### Open bidding or selection

Open bidding or/and selection is generally for high-value procurements and is applicable above a certain threshold for goods, works and services. Open bidding/selection ensures maximum competition and uses formal procedure with detailed invitation-to-bid documents. Open bidding or selection is the preferred method as it enhances competition and value for money, and ensures transparency. The only problem is that it is slow and formal stages have to be followed. It is not suited for emergency situations and can be expensive to conduct.

### Limited bidding or selection

This procurement method is also applicable above a certain threshold for goods, works and services and it works well where open bidding or open selection is not appropriate. Usually, few bids or proposals are invited to participate in the tender. This method is appropriate where the requirement is of a specialised nature, where public safety or public security considerations have to be taken into account and where open bidding or selection have failed to produce an award of contract. This method could also be suitable for urgent procurement or if bidders are few.

### Direct bidding or single sourcing

Direct bidding or single sourcing applies to both high and low value procurements and a sole or

<sup>100</sup> See for example [http://tenderszambia.com/zambia\\_public\\_procurement\\_agency.php](http://tenderszambia.com/zambia_public_procurement_agency.php)

single source is identified and invited to submit an offer. No public notice for tender and no public bid opening is required. The evaluation is conducted appropriately and negotiations may be required with the bidder before contract award and no standstill period is needed. This procurement method is appropriate where there is only one source, in an emergency, or the need for compatibility, standardisation, and extension of an existing contract.

### **Simplified bidding and/or selection**

As the name shows, this method of public procurement is less complicated and is used for low value procurements of goods, works and services and what needs to be procured must be readily available off-the-shelf goods. There is no requirement to publish in the Government Gazette or newspapers, and a minimum of three quotations must be obtained from the bidders.

### **Force account**

Force account is construction by the use of the procurement entity's own personnel and equipment. This method is an option if it is the only practical way to carry out public works. This could be justified where quantities of work involved cannot be defined in advance; works are small and scattered or in remote areas and as such makes it difficult to attract competitive bidders; works need to be carried out without disruption of operations; and emergencies needing prompt attention.

### **Community Participation**

This procurement method is used in situations where the government wants to achieve particular social objectives or wants a certain programme to support the objective to involve communities or non-governmental organisations in such targeted projects. Where local expertise or materials need to be used, this method could fit in perfectly.

## **21.5 PUBLIC PROCUREMENT PLANNING**

All procuring entities are obliged to plan their procurement and the procurement plan should be in line with approved budget programmes. Similar goods, works and services must be grouped together where possible to reduce costs. All annual procurement plans should be submitted to the Zambia Public Procurement Authority (ZPPA) and the same should be published. By planning procurement, emergency procurements and use of wrong methods could be avoided. With procurement planning, implementation of capital and other critical programmes could be more effective thereby improving service delivery.

## 21.6 THE PUBLIC PROCUREMENT PROCESS

The process of public procurement encompasses a number of steps and these have been highlighted in the Public Procurement Act and its regulations. In brief, the steps involved are:

- 1. Initiation of procurement requirements** (Section 41)  
Every procuring entity is obligated to document all procurement requirements for goods, works and services before starting any procurement proceedings with an estimated value. The documents shall include availability of funds and approval by the relevant authority.
- 2. Choice of procurement method** (Section 43)  
For each procurement, the method to be used must be indicated taking into account the estimated value, the type of the procurement (goods, works or services), the special circumstances (urgency), and whether or not the procurement is national or international. No procurement shall be split up in order to avoid a particular method of procurement.
- 3. Statement of procurements** (Section 44)  
According to Section 44 of the Public Procurement Act, a statement of procurement requirements with an accurate and complete description of what is to be procured will have to be included in the solicitation document, in the evaluation process and in the contract. This will ensure that fair and open competition prevails and that goods of the required standard are procured.
- 4. Solicitation document** (Section 45)  
The Solicitation Document used should have the appropriate standard document and should contain clear instructions on management of the procurement process and rules. Good examples could be the statement of requirements and the proposed form of contract.
- 5. Selection of Bidders** (Section 46)  
Depending on the procurement method used, it shall determine how the bidders must be selected. For instance, a short list of bidders is prepared in the case of limited or simplified bidding while a notice of expressions of interest is published in order to develop a shortlist of bidders for an open selection. In the case of direct bidding, only one bidder is targeted.
- 6. Invitation of bids** (Section 47)  
Procuring entities are required to keep records of all bidders who have been issued with the solicitation documents. The documents should be issued at the same time to all bidders. Bidders may be required to submit bids in a prescribed manner as the law may state.
- 7. Receipt of bids** (Section 48)  
In line with the requirements contained in the solicitation document, receipts of bids must close at a particular stated date and time. Procuring entities must arrange how bids shall be received. All bids received must be kept confidential.

8. **Opening of bids** (Section 49)  
A public bid opening must be conducted by procuring entities when it involves open bidding, limited bidding and/or an open selection process as required by law.
9. **Evaluation of bids** (Section 50)  
The methodology and criteria to be used in bid evaluation will be dictated by the type, value and complexity of the procurement and must be in line with the law as contained in the solicitation document. Clarifications are allowed provided the substance of the bid is not changed. A report must be prepared and submitted for approval by the appropriate approvals authority.
10. **Negotiations** (Section 51)  
Any negotiation during the tendering process must be carried out in accordance with the conditions and procedure stipulated in the law. Negotiation shall not relate to price except in direct bidding or any exceptional circumstance.
11. **Publication of best evaluated bidder** (Section 53)  
A notice of *best evaluated bidder* shall be prepared by procuring entities within seven days of the decision to award, indicating the value of the proposed contract. The notice should be published and sent to all bidders. Within a period of ten working days after decision to award, no award should be made except for simplified bidding, direct and limited.
12. **Award of contract** (Section 54)  
A written contract document or letter of bid acceptance shall be made available in accordance with the procedure in the solicitation document. Non-adherence to certain provisions of the Act may render a contract, purchase order or letter of bid acceptance null and void. Any contract must use a standard document, and a contract manager should be appointed for the same.

## 21.7 CHALLENGES IN PUBLIC PROCUREMENT

In most countries, public procurement, just like any public financial management area, is not free of problems. The following are some of those encountered in the Zambian case:

- **Political expediency:** There can be pressure to undertake procurements not planned for and undue influence to change tender awards.
- **Lack of confidentiality:** Leakages of information on the tendering process for personal gain to third parties have been reported and this is contrary to the law.
- **Lack of capacity or expertise:** A number of procurements have been handled poorly, and wrong procurement decisions have been made. Some tenders have ended up being awarded to unqualified bidders, leading to poor outcome. This reflects the inadequate capacity of the decision-makers in assessing the qualifications of the bidders. This can be overcome by use of outside expertise.

- **Lack of robust procedures:** Procurement manuals or handbooks may not be available in procuring entities to help staff in acquainting themselves with procurement rules and guidelines.
- **Lack of procurement planning:** Most procuring entities fail to prepare procurement plans. Hence, they end up making emergency procurements and using wrong procurement methods.
- **Poor records management:** There is a need to invest in training of staff, and to provide a conducive office environment, etc.
- **Negative perception of procurement:** Because of the tedious procedures, public procurement is seen as a hindrance to programme implementation, while many see it as a source of corruption.
- **Poor management of contracts:** There is lack of proper supervision in the implementation of projects and less qualified members of staff usually manage contracts.
- **Poor staff retention:** Procuring entities find it difficult to retain qualified and experienced staff, who usually leave for greener pastures.

**Table 21.1** Indicators for assessing integrity of public procurement

- Are efforts being made to streamline public procurement?
- Are all major procurements advertised in ways that bring them to the attention of bidders?
- Is the process as a whole transparent and are procurement decisions made public?
- Are integrity tests conducted on officers in sensitive positions?
- Are assets, incomes and life-styles of officers in sensitive positions monitored?
- Are public procurement rules laid down in documents available to the public?
- Are procurement decisions made by the Central Tender Board or by individual procuring entity?
- Does the process allow for appeal by an aggrieved bidder over tender outcome?
- Can politicians overrule the decisions of technical experts? If so, do they?
- What happens when the Auditor-General or a regulator (Zambia Public Procurement Authority) questions procurement decisions? Does the report go to Parliament? If so, what happens there?

Source: TI Source Book 2000

## 21.8 CONCLUSION

Public procurement is a very important component of public financial management as it involves the management of public resources. This chapter has highlighted the key preconditions for an effective and well managed public procurement system, which, in turn, would safeguard the acquisition of goods, works and services in the best and cheapest way. Since public procurement precedes budget execution, efficient and effective procurement operations are the main contributors to the successful implementation of the national budget and the achievement of the nation's development objectives.

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# CHAPTER 22

## Public investment management

Public investments in physical assets are assumed to provide economic and social returns contributing to job creation, economic growth and poverty reduction. A typical public investment process goes through the four phases of project appraisal, selection, implementation and evaluation. Successful investment depends on a country's capacity to perform each of these steps efficiently and effectively. This chapter aims at enhancing Members of Parliament and Staff's understanding of the steps in public investment planning and execution; the importance of effective Parliamentary oversight of the nature and size of capital investment projects; efficiency in implementation; and the impact of the investments on economic growth and poverty reduction.

### 22.1 INTRODUCTION

Public investment supports the delivery of key public services through the construction of schools, hospitals, public housing and other social infrastructure. Public investment also connects citizens and businesses to economic opportunities through the provision of economic infrastructure, such as airports, seaports, and networks supporting telecommunications, transport and power supply. Through the provision of both social and economic infrastructure, public investment can serve as an important catalyst for economic growth.

A significant body of theoretical and empirical research underscores the positive relationship between investment in public infrastructure and economy-wide productivity. For example, the International Monetary Fund found<sup>101</sup> that for a sample of advanced economies, a 1 percentage point of GDP increase in

101 IMF, October 2014, World Economic Outlook

investment spending would increase output by about 0.4 % in the same year and by 1.5 % after four years. The effect would be even higher in developing economies.

However, the economic and social impact of public investment critically depends on their relevance and implementation efficiency. Another study by the International Monetary Fund<sup>102</sup> suggests that around 30 % of the potential benefits of public investment are lost due to inefficiencies in the investment process. The size of the efficiency gap shrinks as income rises, with developing economies facing a gap of over 40 %, emerging markets facing a gap of 27 % and advanced economies facing a gap of 13 % on average. The study concludes that improvements in public investment management (PIM), including strengthening of the key institutions, which shape the planning, allocation and implementation of public investments, could close up to two-thirds of the public investment inefficiency gap. This is so because countries with stronger PIM institutions have more predictable, credible, efficient and productive investments.

In particular three parameters determine the level of efficiency in public investment:

- Proper *planning* to ensure that investments across the public sector are sustainable;
- Prudent *allocation* to ensure that investments are directed towards the right sectors and projects; and
- Timely *implementation* of projects and within the budget.

## 22.2 PUBLIC INVESTMENT MANAGEMENT

While a universally applied standard process for public investment management does not exist, the following four phases and eight steps encapsulate the most important elements in the process from the early screening of projects to ex-post evaluation of completed projects:

### Phase I. Project appraisal

#### Step 1: Investment guidance and preliminary screening.

During this first phase of the process, project proposals are screened to ensure that they meet the minimum criteria of consistency with the strategic objectives of government. In a Zambian context, projects must be consistent with the policies and objectives set out in the five year national development plan. Thus, the Revised Sixth National Development Plan 2013-2016 focuses on public capital investments that have a bias toward rural development and job creation so as to achieve inclusive growth. The main investment areas are skills development, science and technology, agriculture, livestock and fisheries, energy and infrastructure development, water and sanitation, education and health.

<sup>102</sup> IMF, 2015, Make public investment more efficient



**Step 2: Formal project appraisal**

Projects or programmes that meet the first screening test should undergo more rigorous scrutiny of their cost benefit or cost effectiveness. The project selection process needs to ensure that projects proposed for financing have been evaluated for their social and economic value. Many countries with sound public investment strategies have cut-off economic rates of return established for projects in both economic and social sectors. The quality of ex-ante project evaluation depends very much on the quality of the analysis, which in turn depends on the capacity of staff with project evaluation skills.

**Step 3: Independent review of appraisal**

Where departments and ministries - other than the Ministry of Finance - undertake the appraisal, an independent peer review might be necessary in order to check any subjective self-serving bias in the evaluation.

**Phase II. Project selection****Step 4: Project selection and budgeting**

Technically, project selection involves prioritisation of projects based on their expected economic rates of return. Budgetary resources are then allocated based on the ranking of the economic rates of return of projects until the total capital investment budget is exhausted.

The process of appraising and selecting public investment projects should be appropriately linked to the budget cycle even if the project evaluation cycle runs on a different timetable.

**Phase III. Project implementation****Step 5: Project implementation**

Project designs should include clear organisational arrangements and a realistic timetable to ensure the capacity to implement the project.

**Step 6: Project adjustment**

The funding review process should have some flexibility to allow changes in the disbursement profile to take account of changes in project circumstances. Each funding request should be accompanied by an updated cost benefit analysis and a reminder to project sponsors of their accountability for the delivery of the benefits.

**Step 7: Facility operation**

Asset registers should be maintained and asset values recorded. Ideally, countries should require their operating agencies to compile balance sheets on which the value of assets created through new fixed capital expenditure would be maintained.

## Phase IV. Project evaluation

### Step 8: Ex-post project evaluation

Ex-post project evaluation of completed projects should focus on the comparison of the project's outputs and outcomes with the established objectives in the project design. Good practice suggests that the project design should build in the evaluation criteria and that learning from such ex-post evaluations is used to improve future project design and implementation.

## 22.3 USE OF PUBLIC PRIVATE PARTNERSHIPS (PPP) IN PUBLIC INVESTMENT

When used effectively, PPPs can deliver substantial savings relative to purely public provision of goods and services. Under a typical PPP, a firm may finance, design, build, operate, and maintain an asset in exchange for a combination of user fees and/or periodic payments by the government over the life of the contract. Many PPPs encompass some of these phases, most notably the finance, design and build option. PPPs can offer significant advantages over traditional public procurement in terms of mobilising private financial resources and know-how, promoting the efficient use of public funds, and improving service quality. Although private financing is typically more expensive than government borrowing, a well-designed PPP contract can generate efficiencies that more than offset the higher cost of private capital by bundling the design, construction, and operation of an asset to incentivise the efficient, timely construction of high-quality assets, and the maintenance of and cost recovery from those assets over time.

However, not all investment projects can be effectively delivered using a PPP. The benefits of PPPs mainly arise from the Government's ability to allocate risks efficiently between public and private parties to ensure the right incentives and reduce overall project costs. To do so, the outputs and the quality of services must be predictable and measurable for the duration of the project. PPPs in the IT or health sectors can be difficult, as the technological change is simply too rapid in relation to the typical length of a PPP contract. PPPs also require strong legal, policy, appraisal, approval, and monitoring arrangements to negotiate contracts and ensure that private partners meet their obligations.

## 22.4 STRENGTHENING OF PUBLIC INVESTMENT MANAGEMENT IN A GLOBAL PERSPECTIVE

While it is generally acknowledged that the potential gains from improving public investment management are substantial, strategies for the improvement differ from country to country. It is, however, possible to identify seven widely accepted measures, namely:

1. Strengthening of medium-term fiscal and budgetary frameworks to improve investment planning and coordination across levels of government.
2. Making investment flows less pro-cyclical and more fiscally sustainable in the longer term.

The use of structural balance limits or investment floors, coupled with firm ceilings on overall indebtedness has proven helpful in some countries.

3. More rigorous and transparent arrangements for investment project appraisal, selection, and management, including development of standardised methodologies and central support functions for project appraisal and risk analysis, as well as publishing of criteria for project selection.
4. During project implementation having in place standardised procedures for project adjustments that are applied systematically and, as needed, allow for a fundamental review of the project's rationale, costs, and expected outputs.
5. Instituting ex-post evaluations of projects to provide lessons for future investment projects;
6. Protecting investment expenditures within ministry and agency budgets by ensuring that project implementation is budgeted for as long as it takes to complete the projects and that resources are released based on a phased implementation plan.
7. Strengthening the management of PPPs based on value-for-money reviews by a dedicated PPP unit guided by clear criteria for choosing between PPPs and traditional financing. PPP commitments should be systematically monitored, with overall limits on the accumulation of PPP liabilities, to minimise related fiscal risks.

### 22.5 PUBLIC INVESTMENT MANAGEMENT IN ZAMBIA

While the responsibility for providing guidance for and monitoring of the public investment process formally rests with the Ministry of Finance, sector ministries have the powers to plan and implement their own sector investment projects<sup>103</sup>. Thus, currently the entire process of screening and appraising project proposals is the exclusive responsibility of Ministries, Provinces and Spending Agencies (MPSAs) without involvement of or guidance by the Planning and Economic Management Division under the Ministry of Finance.

MPSAs' investment plans and projects are in principle guided by the National Development Plan, the Medium Term Expenditure Framework and the annual budget, but the weak vetting system from the top, i.e. the Ministry of Finance, and from within the sectors often leads to projects that are delinked from the national development planning and multi-year budgetary frameworks and often not achieving the desired development outcomes (See, for example, 'Situation Analysis' in the National Planning and Budgeting Policy, 2014). Other challenges relate to the absence of comprehensive principles, procedures and institutional responsibilities for the guiding of more efficient and effective investment management, as well as unpredictable funding for capital projects,

<sup>103</sup> World Bank, 2014, p. 4

which often require multi-year funding due to their very nature. Since the availability of resources determines whether an investment will be made or not many projects are stalled before completion or experience delays.

The Planning and Budgeting Policy and pending legal framework aims at addressing these weaknesses in the planning and budgetary framework by strengthening the institutional framework and human capacities at the Ministry of Finance, as well as integrating the national planning and budgeting process across sectors and at all three operational levels, namely national, provincial and district. Alongside better integration of the planning and budgeting process and the creation of stronger links between the national planning framework and sector plans, the Policy also entails a significant strengthening of the national monitoring and evaluation system.

## 22.6 PARLIAMENTARY MONITORING OF CAPITAL INVESTMENT PROJECTS

Since capital budgets in most developing countries, aside from grants from development partners, are loan-financed, it is important that investment-projects are screened and appraised in order to assess their medium to long-term employment and revenue-generating potential.

Parliaments can play an important role in examining investment plans and proposals during the budget scrutiny and approval stage, in the monitoring of the efficiency in project implementation during the budget execution stage, as well as in the evaluation of project impact on economic growth and revenue generation upon completion.

Parliamentary oversight of the Executive's implementation of the capital budget is important to ensure transparency, accountability and value for money. Hence, many parliaments, through their relevant parliamentary committees, conduct field studies to monitor progress in project implementation and utilisation of appropriated funds. The National Assembly of Zambia is no exception as the example in the following box illustrates.

**Box 22.1 Monitoring of capital investment projects in Zambia**

In 2015, the National Assembly of Zambia, as part of the annual work programme of the Committee on Estimates, undertook a comprehensive tracking study on government's utilisation of the US\$ 750 Million Eurobond issued in 2012 with the objective of

- (a) appreciating the efficiency in the release of funds to respective projects;
- (b) comparing the utilisation against the release of funds;
- (c) appreciating the project cycle of the beneficiary projects;
- (d) appreciating the challenges in the utilisation of the funds; and
- (e) recommending the way forward.

To that end the Committee conducted site inspections to the following eight projects:

- ZESCO Limited Power Distribution Project;
- ZESCO Limited Kafue Gorge Lower Hydro Power Project;
- Zambia Railways Limited Track Rehabilitation & Purchase of Rolling Stock Project;
- National Road Fund Agency: Refinancing of Formula One Road Project;
- National Road Fund Agency: Kitwe-Chingola Dual Carriageway;
- Road Development Agency: Pave Zambia Programme;
- Development Bank of Zambia: Credit Line to SMEs; and
- Ministry of Health: Modernisation of Tertiary Hospitals.

**Source:** Report of the Committee on Estimates, Zambia, 2015

**22.7 CONCLUSION**

This chapter has highlighted the importance of public investment to promote economic growth and poverty reduction. It has further explained the phases and steps in an ideal public investment process from the early planning of investment programmes and projects to the final evaluation of the impact of a given investment. The chapter points out the importance of creating strong institutions with clear delineation of roles and responsibilities and the necessary technical capacity to safeguard effective and efficient public investment management, including effective project appraisal, project selection, implementation and post implementation impact evaluation.

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# CHAPTER 23

## Public sector payroll management

For all countries, irrespective of geography or maturity of the economy, public sector payroll costs are a very significant component of government recurrent expenditures. In Zambia, personal emoluments make up some 50% of total public expenditure and 62 % of total tax revenues, making efficient payroll management one of the cornerstones of public financial management. The objective of this chapter is to strengthen Members and Staff of Parliament's understanding of the importance of effective payroll management and the institutional and legal framework guiding payroll management in Zambia. Parliamentary oversight of the public payroll and the way it is managed is important, in part because ineffective management leads to waste of public resources, in part because effective payroll management tends to attract civil servants who are reliable, diligent and used to meeting tight deadlines.

### 23.1 INTRODUCTION

Over the past 20-30 years, public sector payroll management has undergone radical changes from manually operated, fragmented and segregated systems to integrated systems underpinned by modern IT solutions. Simultaneous with the introduction of new, integrated, software based payroll systems, most countries have decentralised the day-to-day administrative operations from central units – often ministries responsible for finance – to operational units such as sector ministries, deconcentrated units and local governments. In many countries, day-to-day payroll management has been further devolved to service outlets, including schools and hospitals, whilst retaining the overall establishment and payroll control at the centre. In Zambia, staff establishment control and payroll

management was split between the Cabinet Office and the Ministry of Finance up to 2004, when establishment control and payroll management were merged and placed under the Public Service Management Division (Cabinet Office)<sup>104</sup>. While the Public Service Management Division has overall responsibility for payroll management and establishment control, the responsibility for the day-to-day operational administration is devolved to ministries, provinces and district administrations. The financing of the payroll, including budgeting and overall budget control remains the responsibility of the Ministry of Finance.

### 23.2 LEGISLATIVE AND REGULATORY FRAMEWORK

In Zambia, the legislative and regulatory framework for public payroll management is embedded in the *Financial Regulations, 2006*, part VI. Section 72 provides that Ministries, Provinces and Spending Agencies shall maintain the following payroll records:

- (a) Establishment register as approved by the National Assembly;
- (b) Payroll schedules;
- (c) Payslips for the tax year; and
- (d) Individual records on salary progression for all employees.

The framework further provides for modalities for calculation, adjustment and payment of salaries and wages, as well as conditions of payment of salaries and wages for leave and overtime payment.

### 23.3 PAYROLL MANAGEMENT AND ESTABLISHMENT CONTROL

The key to more effective public payroll management worldwide has been the integration of establishment and payroll control and management. In Zambia, the physical integration under the Public Service Management Division alongside the introduction of a computer-based payroll management and establishment control (PMEC) system has led to a more efficient and professional payroll management, which, among other things, has reduced the number of illegal employees on the payroll and curbed the payment of illegal salaries and allowances. The integration of the payroll and the establishment register has further facilitated the provision of more accurate, comprehensive and consolidated management information to support better monitoring and decision-making<sup>105</sup>.

104 The supervision of the integrated payroll management and establishment control (PMEC) system is performed by the Department for Payroll Management & Establishment Control Support Services (PSSD)

105 Source: Payroll Management and Establishment Control (PMEC) System power point presentation made available by the Public Service Management Division



The key functional elements of the P MEC system can be summarised as follows:

- *organisational management*, including creation, abolition and upgrading of organisational units, positions and jobs;
- *personnel cost planning*, which manages personal emolument (PE) budgets based on the establishment register and not people on the payroll;
- *personnel administration*, which manages the administration of the terms and conditions of service on the P MEC system;
- *payroll management*, which manages payments and deductions on the system; and
- *authorisations*, which manages issues of security on the P MEC system (access and data).

Key inputs to the system are the various transactions that end-users feed into the system on behalf of the Controlling Officers and include:

- hiring, transfers and promotions;
- demotions, suspensions and terminations; and
- bank charges, loans, advances, third parties, allowances, etc.

Entries to the P MEC system follow standardised procedures to ensure conformity and accountability across Ministries, Provinces and Spending Agencies (MPSAs). Data entering goes through the following five steps:

1. End-user prepares input in respect of any of the above with relevant supporting documents, for example appointment documents.
2. Controlling Officer approves input.
3. Internal audit performs extra control check.
4. End-user enters input onto the P MEC system.
5. End-user signs off for the input captured.

#### 23.4 STAKEHOLDERS AND THEIR RESPECTIVE ROLES IN PAYROLL MANAGEMENT

The level of efficiency and effectiveness of payroll management depends on the performance of and cooperation between relevant stakeholders. The stakeholders and their assigned roles and responsibilities are presented below.

##### **P MEC Support Services Department (PSSD)<sup>106</sup>**

The Payroll Management and Establishment Control Support Services Department is responsible for managing the Government payroll and establishment. The main objective of the Department is to effectively manage the integrated payroll management and establishment control system in order to monitor and control expenditure on personal emoluments in the public service.

<sup>106</sup> PSSD is a department within the Public Service Management Division under Cabinet Office

The department has the following core functions:

- organisational management, including the management of the organisational structures of ministries, provinces and spending agencies;
- personnel administration, including the administration of terms and conditions of service on the P MEC system;
- personnel cost planning, including management of personal emolument budgets on the P MEC system;
- technical support, including management of technical support and security of the P MEC system;
- accounting, including management of disbursements of salaries through direct debit and clearance to government employees; and
- management of the financial and system audits on the P MEC system.

Major projects undertaken and planned by the PSSD include:

- decentralisation of the P MEC system to all ministries and provincial and district centres;
- payment of salaries through Zambia Postal Services Cooperation;
- integration of the P MEC system with the Integrated Financial Management Information System (IFMIS) (yet to be undertaken); and
- Introduction of electronic payslips (E-payslip) (Yet to be undertaken).

### Ministry of Finance

The role and functions of the various departments and units of Ministry of Finance in government's payroll management include:

- payroll report printing (CCSD);
- accounting for personal emolument expenditure (Accountant General's Office);
- payments by DDAC (Accountant General's Office);
- bank reconciliation (Accountant General's Office);
- treasury funding (Budget Office);
- budget consolidation (Budget Office);
- treasury authority and budget adjustments (Budget Office);
- provision of approved personal emolument budgets (Budget Office);
- system and transaction audit (internal and external auditors); and
- process audit (internal and external auditors).

It is important to note that while Cabinet approves new posts through the Public Service Management Division, new posts only become effective once the Ministry of Finance has approved the additional funding. This means that new government structures first become operational when the Ministry of

Finance has given its green light and the funding has been secured through Parliament's approval of the budget.

### Ministries, Provinces and Spending Agencies

As mentioned earlier, the immediate administration of the payroll is decentralised to Ministries, Provinces and Spending Agencies. To accommodate this all MPSAs are staffed with an accountant and a personnel or human resource (HR) officer. The functions decentralised to the MPSAs include:

- personnel administration (HR);
- leave management (HR);
- payroll inputs capturing (HR);
- recovery of advances, imprests and loans (Accounting Unit);
- bank reconciliation (Accounting Unit);
- performance appraisal (Management);
- recommendations for promotions (Management);
- retirement or end of contract (Management);
- limits for acting or secondment (Management);
- personnel emolument budget control (Management); and
- approval of all entries into the P MEC system.

## 23.5 REPORTS

The Payroll Management and Establishment Control (PMEC) system enables the Payroll Management and Establishment Control Support Services Department (PSSD) to generate a number of reports important for effective and efficient payroll control, including parliamentary oversight. The reports include:

- pay slips;
- bank schedules;
- Third party;
- payroll variance;
- monthly budget tracking – comparison between budget and actuals;
- terminations – officers terminated (relevant for staff turn-over monitoring);
- age analysis – indicates the age of employees (relevant for succession planning, recruitment and training);
- staff assignment – shows positions available, filled and not filled, details of staff occupying the positions and when positions fell vacant; and
- grading control – shows all officers with salary scales different from the salary scale of the position held as per appointment.

## 23.6 CONCLUSION

The combined decentralised-centralised payroll management system in Zambia and elsewhere has made payroll management more efficient and effective through, on the one hand, smaller and manageable payrolls, quicker implementation of decisions, ownership of payroll management and easy system accessibility and, on the other hand, centralised supervision and technical backstopping.

However, while integrated establishment and payroll management and control systems, including the P MEC operated in Zambia, have proven their potential in strengthening personal emolument expenditure control, enhanced accountability and provision of management information for effective monitoring, early warning and intervention and improved decision-making, the effectiveness of the systems - like other PFM systems - depends on the individuals and corporate units operating the system. This applies to individuals entering data into the system, controlling officers and management at all levels. Repeated examples of ghost workers on the payroll and illegal payments point to the importance of dedicated, professional and technically skilled staff. In Zambia like other countries, these risks in the operations of the systems are being addressed through continuous sensitisation, capacity development, technical skills training, stricter controls, intensified internal control and audit and sanctions.

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# CHAPTER 24

## Revenue collection

A government's revenue performance depends on numerous factors, such as level of taxation, size of the tax base, simplicity of the revenue system, fairness in taxation, legislative framework and efficiency in collection. While Chapter 13 focuses on revenue mobilisation in general and the most important principles behind any revenue system design, this chapter looks at the challenges facing the revenue-collecting agencies and ways and means to make the collection and administration of revenues efficient and effective.

### 24.1 INTRODUCTION

A good revenue administration is critical to any well-run government or government institution. It enables Members of Parliament and Staff of the National Assembly to have confidence that the revenues needed to run Government and to meet public sector expenditure will be available for allocation as determined through the budgetary process. Citizens depend on the state to provide crucial services and infrastructure. To a large extent, this depends on the way the collecting agencies, which are tasked with collecting the revenues, manage this function. The main task of collecting agencies is to collect revenue. However they must also promote equity, transparency and good governance. In Zambia, the Zambia Revenue Authority (ZRA) collects both tax and non-tax revenues, while some Government Ministries and Agencies, such as Ministry of Lands, Government Printers, Road Transport and Safety Agency (RATSA) and Patents and Company Registration Agency (PACRA), collect non-tax revenues only.

## 24.2 TAX AND NON-TAX POLICY AND ADMINISTRATION IN ZAMBIA

The responsibility for formulating revenue policy lies with the Ministry of Finance. In the *Zambian Constitution*, (Part XVIII, Section 241), the Minister of Finance has been given powers to impose taxes with the approval of Parliament.

There are choices to be made about how the *Zambian Government* should raise revenue to finance its activities. The strategic issue is what is the best mix of revenue sources for *Government*, including the practical issue, what revenues can actually be collected? Successful revenue policy must recognise administrative capacity.

Tax policy reform and tax administration are strongly linked. When an existing tax is changed, or a new tax is introduced, both taxpayers and government authorities face costs of adapting to the new system.

## 24.3 FRAMEWORK FOR TAX AND NON-TAX ADMINISTRATION IN ZAMBIA

The administration of tax revenues lies with the *Zambia Revenue Authority (ZRA) – ZRA Act of 1994, (Chapter 321 of the Laws of Zambia)*. The legal framework for implementing tax policy is contained in the various tax legislations enacted by Parliament, including

- Income Tax Act, (Chapter 323 of the laws of Zambia)
- Customs and Excise Act, (Chapter 322 of the laws of Zambia)
- Value Added Tax Act, (Chapter 331 of the laws of Zambia)
- Mines and Minerals Development Act, (Part VII, No. 11 of 2015)
- Property Transfer Tax Act, (Chapter 340 of the laws of Zambia).

The ZRA also administers non-tax revenues which include:

- Carbon Emissions Tax
- Fuel Levy
- Fees and Fines
- Mineral royalties

Other *Government Ministries and Agencies*, such as *Ministry of Lands, Government Printers, Road Transport and RATSA and PACRA* also collect various fees and fines.

## 24.4 THE ROLE OF PARLIAMENT

Legislators play a central role in the scrutiny of revenue administration performance by holding their governments to account and scrutinising their decisions.

## 24.5 THE ROLE OF THE ZAMBIA REVENUE AUTHORITY

In Zambia, tax collection is performed by the Zambia Revenue Authority (ZRA), as discussed in Chapter 13. When taxes are not fully paid, the state may impose civil penalties (such as fines or forfeiture) or criminal penalties (such as incarceration) on the non-paying entity or individual.

As previously mentioned in Chapter 13, the Zambia Revenue Authority (ZRA) was established on 1st April 1994. ZRA is charged with the responsibility of collecting revenue on behalf of the Government of the Republic of Zambia under the supervision of the Minister of Finance.

The main responsibilities of ZRA are to:

- properly assess and collect taxes, duties, levies and fees at the right time;
- ensure that all monies collected are properly accounted for and banked;
- properly enforce all relevant legislation and administrative provisions; and
- provide revenue and trade statistics to the Government.

The stakeholders in the operations of ZRA include:

- the Zambian people;
- the Zambian business community and those groups which represent their interests together with their professional advisors;
- banks and other financial institutions;
- taxpayers;
- members of Common Market for Eastern and Southern Africa (COMESA), Southern African Development Community (SADC), World Trade Organization (WTO) and other countries transacting business with Zambia, or transiting goods through Zambia;
- tourists, travellers and traders crossing Zambia's borders;
- the donor community and multilateral agencies;
- the Governing Board, management and staff of ZRA;
- the mass media in general; and
- Non-governmental organisations and other interest groups.

## 24.6 REVENUE COLLECTION.

Since its inception, the ZRA has generally been able to meet the revenue target set by Parliament through the annual national budget. The ZRA, like other collecting agencies, needs to constantly come up with strategies that continue to improve its tax collection performance by tackling non-compliance, while reducing costs and decreasing compliance burdens for tax payers.

It is difficult to create an efficient tax administration without a well-educated, well-trained and motivated staff, when money is lacking to pay good wages to tax officials and to computerise the operations. In addition, tax administrations often have to deal with a population with few skills in records retention to determine their tax level. Further, many of them will operate in the informal economy to avoid such taxes. Finally, more sophisticated citizens may use various forms of legal tax avoidance such as the use of accounting loopholes.

Emerging economies like Zambia are predominantly informal. Modern means of raising revenue, such as income taxes and consumer taxes such as VAT, play a minimal role in these economies, and the possibility of achieving high tax yield levels is a challenge for tax administrations.

Statistical and tax offices have difficulty in generating reliable statistics. This lack of data prevents policymakers from assessing the potential impact of major changes to the tax system.

Income tends to be unevenly distributed within developing countries. Although raising high tax revenues in this situation ideally calls for the rich and large corporations to be taxed more heavily than the poor, the economic and political power of rich taxpayers and large corporations often allows them to prevent fiscal reforms that would increase their tax burdens.

## 24.7 STRATEGIES TO IMPROVE REVENUE COLLECTION.

### Capacity development

Revenue authorities across the world should ensure that progressive and effective human resource policies that address recruiting, training, and retaining employees are in place. Hence, the authorities should continuously review their HR policies and administration to ensure that

- staff numbers are adequate and staff have the right skills through constant training;
- the recruitment practices are transparent and effective so that only the right people are recruited and retained;
- the remuneration of staff is adequate and in line with other industries.

### Information and communication technology (ICT)

Revenue collection can be greatly enhanced by adopting ICT systems. They reduce human error and processing time leading to reduced avoidance and evasion of taxes. ICT systems are however



costly to implement in terms of acquiring the equipment and software, training the staff and training taxpayers. The transition process must also be expertly managed.

The Zambia Revenue Authority (ZRA) embarked on a modernisation programme in 2006 that has seen the transformation of its operations from a manual environment to a computerised environment. This programme is ongoing and has continued to produce tremendous benefits to both ZRA and the taxpayers.

Tax Online and ASYCUDA World<sup>107</sup> cover the administration of domestic and trade taxes, respectively. These systems are web-based thus enabling the taxpayers to access them on a 24-hour basis from any place with internet connectivity. As a result of this, taxpayers are able to conduct all their tax affairs on the e-business platform from e-registration, e-filing of monthly or annual returns, e-declaration, to making electronic payments of their taxes through banks that ZRA has partnered with.

### **Enforcement and compliance**

Across the world, revenue authorities are trying to develop strategies that optimises the yields and minimise the cost of collection. In the case of Zambia, the revenue authority is seeking to widen the tax base especially through the taxation of informal activities where most small and medium businesses operate. Furthermore, the ZRA is focusing on making the taxing of large taxpayers operating in sectors like mining, financial services and manufacturing more effective.

## **24.8 THE ROLE OF INSTITUTIONS COLLECTING NON-TAX REVENUE**

Non-tax revenue collection is performed by various government agencies such as the Road Transport and Safety Agency, the Patents and Company Registration Agency and Government Printers. Ministries like Lands, Energy, Transport and Communications also collect non-tax revenues.

The role of institutions collecting non-tax revenue is to implement government policy that has now been translated into legislation. To ensure accountability for the non-tax revenues collected by these institutions, the Ministry of Finance oversees the revenue collection performed by these agencies.

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<sup>107</sup> ASYCUDA is a computerised customs management system which covers most foreign trade procedures. The system handles manifests and customs declarations, accounting procedures, and transit and suspense procedures. ASYCUDA generates trade data that can be used for statistical economic analysis.

## 24.9 CONCLUSION

Effective revenue administration provides assurance that a country's budget will be adequately financed in a timely and predictable manner. Effective revenue administration also ensures that the allocation of revenue is transparent and efficient.

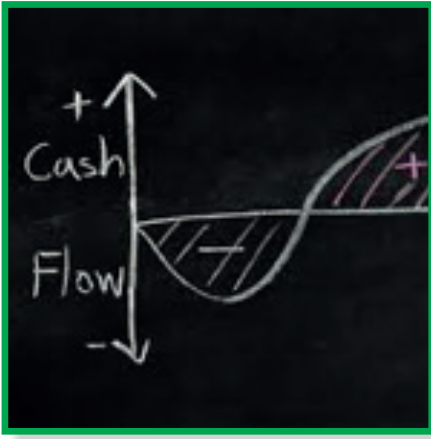
Tax administration is concerned with the effectiveness and efficiency of tax policy. How a tax policy is administered affects the amount of revenue that it generates and the costs of collecting that revenue. There is no point in designing an optimal tax regime if the taxes are not collected because of inadequate tax administration. The converse is also true: an effective tax administration is wasted if some or all taxes are so unpopular that they provoke a tax revolt and people refuse to pay.

Adequate resources will ensure that there is adequate administrative capacity to handle the process of tax collection. Therefore, there is need for any country to allocate sufficient resources to tax administration, but with a demand for accountability.

Tax administration is also at the heart of other aspects of the economy and society – open, honest, efficient tax collection generates a better society than secretive, corrupt and ineffective tax collection. Legislators must be involved in the policy-making process and become champions for progressive revenue policy and administration making.

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# CHAPTER 25

## Cash-flow management, including the Treasury Single Account

Proper cash-flow management is essential to ensure smooth implementation and management of cash within the budgeted expenditure period and within appropriated or authorised budget lines. Effective cash-flow management is also essential to ensure that government can meet its payment obligations in full and on time. The objective of this section is to enhance Members and Staff of Parliament's understanding of Government's cash flow management system and the role of the Treasury Single Account, and the roles of government institutions involved in the management of cash.

### 25.1 INTRODUCTION

Governments seek to increase the confidence of its citizens and investors by improving its public financial management in the area of cash management. This is, among other things, done through implementation of a Treasury Single Account (TSA). The TSA is a unified structure of Government bank accounts under the management of the Ministry of Finance through which Government transacts all its receipts and payments and gets a consolidated view of its cash position at the end of each day.

The TSA replaces an older model of trying to control and manage cash by segregating it in separate bank accounts. The TSA model increases security of cash, liquidity, and interest earned, decreases the need for borrowing and takes better advantage of efficient commercial banking arrangements. This chapter focuses on cash-flow management of the Government as a whole.

## 25.2 CASH FLOW MANAGEMENT AND TREASURY SINGLE ACCOUNT

### Cash Flow Management

Cash-flow management is a term used to describe the practice of balancing expenses to income.

This is achieved through preparation of cash-flow forecasts. Cash-flow forecasts are a key tool for the Treasury to manage government liquidity. The cash flow forecasting process involves estimating the cash that will flow into and out of Treasury Accounts in a given period. The benefits that accrue with the use of an efficient and effective Cash flow Management system include:

- i. The Cash Flow Management system acts as a trigger to alert Government to changes in its cash flow position.
- ii. Ensures that Government obligations are met as they fall due and with spending periods.
- iii. Supports debt management.
- iv. Allows Government to put in place organisational and resource capacity to cope with changes and uncertainties.
- v. Ensures smooth implementation and management of resources within authorised budgets.
- vi. Ensures that revenue inflows are synchronised within spending periods.
- vii. Reallocates resources to meet short term priorities.
- viii. Enables Government to prioritise expenditure.

The end-result, or bottom-line figure, of the cash-flow forecast is the estimated balance in Treasury Accounts at the end of the forecast period. Such tools alert governments to shortfalls or surpluses in their cash requirements.

### Treasury Single Account (TSA)

The primary objective of the TSA is to ensure effective aggregate control over government's cash balances so that governments have sufficient liquidity to carry out their operations. The consolidation of cash resources through a TSA arrangement facilitates government cash management by minimising borrowing costs. In the absence of a TSA, idle balances are maintained in several bank accounts. Effective aggregate control of cash is also a key element in monetary and budget management. Such controls through a consolidated view of cash is also a major risk management and mitigation tool for Government.

The benefits of a TSA are as follows<sup>108</sup>:

- It allows complete and timely information on government cash resources. When supported by an Integrated Financial Management Information System (IFMIS) with adequate interfaces with the banking system operating on a real time basis complete updated balances will be available daily.

<sup>108</sup> See for example Pattanayak, S, Fainboim, I., IMF Working Paper, 2010

- It improves appropriation control. The TSA ensures that the Ministry of Finance has full control over budget allocations, and strengthens the authority of the budget appropriation. When separate bank accounts are maintained, the result is often a fragmented system, where funds provided for budgetary appropriations are augmented by additional cash resources that become available through various creative, often extra budgetary, measures.
- It improves operational control during budget execution. When the Accountant General's Office has full information about cash resources, it can plan and implement budget execution in an efficient, transparent, and reliable manner. The existence of uncertainty regarding whether the Treasury will have sufficient funds to finance programmed expenditures may lead to sub-optimal behaviour by Ministries, Provinces and Spending Agencies, such as exaggerating their estimates for cash needs or channelling expenditures through off-budget arrangements.
- It enables efficient cash management. A TSA facilitates regular monitoring of Government cash balances. It also enables higher quality cash outturn analyses to be undertaken (e.g., identifying causal factors of variances and distinguishing causal factors from random variations in cash balances).
- It reduces bank fees and transaction costs. Reducing the number of bank accounts results in lower administrative costs for the Government for maintaining these accounts, including the cost associated with bank reconciliation, and reduced banking fees.
- It facilitates efficient payment mechanisms. A TSA ensures that there is no ambiguity regarding the volume or the location of the Government funds, and makes it possible to monitor payment mechanisms precisely. It can result in substantially lower transaction costs because of economies of scale in processing payments. The establishment of a TSA is usually combined with the elimination of the "float" in the banking and the payment systems, and the introduction of transparent fee and penalty structures for payment services.
- It improves bank reconciliation and quality of fiscal data. A TSA allows for effective reconciliation between the Government accounting systems and cash flow statements from the banking system. This reduces the risk of errors in reconciliation processes, and improves the timeliness and quality of the fiscal accounts.
- It lowers liquidity reserve needs. A TSA reduces the volatility of cash flows through the Office of the Accountant General, thus allowing it to maintain a lower cash reserve/buffer to meet unexpected fiscal volatility.

### TSA Structure

*The TSA structure is based on a model with the following features:*

- the Consolidated Fund – main GRZ Account;
- revenue Transit Accounts maintained separately as revenue receiving accounts;
- ministries, Provinces and Spending Agencies' (MPSAs') budgetary expenditures (i.e. both recurrent and capital) are financed from a Treasury Single Account at the Bank of Zambia instead of individual Expenditure Clearing Accounts at commercial banks;
- TSA Suspense Account – used to maintain unapplied funds and reconciliations;
- MPSAs extra-budgetary funds are maintained in the Treasury Single Account;
- revenues collected by the Principal Receivers of Revenue may continue to pass through transit Revenue Bank Account and into the Consolidated Fund. Withdrawals from the

- Consolidated Fund to meet MPSAs budgetary expenditure shall be transferred to the TSA;
- MPSAs shall maintain responsibility and authority over their appropriations, executing their budgets with full autonomy and control. MPSAs shall submit their processed and authorised payments for settlement from the TSA through the Integrated Financial Management Information System.

### 25.3 ROLES AND RESPONSIBILITIES UNDER THE TSA FRAMEWORK

The following are responsibilities of key players and institutions in cash-flow management:

#### Accounting Officers

- in relation to the TSA, Accounting Officers shall continue to exercise their mandate in line with the provisions of the Public Finance Act 2004, Financial Regulations 2006 and instructions issued by the Treasury from time to time;
- prepare and submit to the Treasury annual Cash Flow Plan derived from approved work plans, procurement plans and recruitment plans;
- prepare and submit annual cash projections of expenditure to facilitate cash flow programming;
- prepare and submit monthly and quarterly profiles through the IFMIS;
- prioritise and commit government expenditure within cash limits;
- authorise invoices and submit approved payment through the IFMIS for settlement of payment;
- undertake regular bank reconciliations of bank accounts of the TSA Sub-Accounts;
- monitor and account for payments effected from the TSA Sub-Accounts;
- investigate any exceptions on TSA Sub-Accounts in a timely manner, and
- produce financial statements.

#### Treasury Reconciliation and Compliance Unit

- this section will be responsible for the timely reconciliation of all revenues, expenditures and bank accounts held at the BOZ and commercial banks to account for all government financial resources;
- treasury Reconciliation and Compliance Unit will reconcile the bank statements to the IFMIS cashbooks for the same accounts by matching individual transactions using automated bank reconciliation functionality of the IFMIS.

#### Budget Department

- receives and analyses expenditure plans;
- prepares quarterly sector expenditure plans;
- distributes quarterly cash limits; and
- enters cash limits into IFMIS.

#### Accountant General's Office

- approves and regulates the opening and closure of any bank account under the TSA framework;
- issues guidelines for banking, accounting and cash management under this framework;

- configures and manages cash management arrangements on the IFMIS;
- has management responsibility for the Consolidated Fund and the Treasury Cash Holding Accounts;
- monitors sweeping arrangement of sub-TSA accounts and investigates any exceptions in a timely manner;
- maintains external debt data (back office);
- oversees exercise to rationalise number and use of bank accounts;
- has management responsibility for the Government of the Republic of Zambia (GRZ) Chart of Accounts. Any changes to the Chart of Accounts must be made in writing to the Accountant General's Office and, if approved, the IFMIS unit will be responsible for making the change.

### Cash Management Unit (CMU)

- transfer cash releases from the Consolidated Fund to the TSA main account in accordance with instructions issued by the Accountant General;
- formats and transmits payment instructions to the Bank of Zambia (BoZ) for settlement;
- receive and act on payment instruction from MPSAs within the prescribed timeframe;
- advise the Treasury on the daily cash balances on the various accounts operated under the TSA framework;
- does regular reconciliation of the Treasury Cash Holding Account;
- develops and maintains consolidated rolling cash plan covering all bank accounts included in TSA;
- monitors TSA inflows, outflows and balances;
- liaises with agencies to improve cash forecasts;
- issues cash forecasting templates for use by agencies;
- provides training;
- establishes robust cash management models to optimize cash management;
- provides regular reports on performance of cash flows against the annual plan to the AG for proactive management; and
- liaises with the Investment and Debt Management Unit (IDM) and BOZ to determine forecasts for debt settlements and Treasury Bill issuance.

### Investment and Debt Management Unit

- manages and processes domestic and external debt requests;
- maintains sterilisation account, Treasury bills and Bond Accounts in liaison with BOZ.
- updates and implements the debt management strategies;
- coordinates Treasury bills and other borrowing requirements such as bridging loan; and
- manages and maintains the Debt Management and Financial Analysis System.

### Bank of Zambia (BoZ)

*Shall ensure the following in regards to TSA implementation:*

- ensure that no Expenditure bank account of Government is not overdrawn;
- issue daily electronic bank statements for accounts under the TSA framework; and
- issue timely notification of exceptions (Unapplied Electronic Transfers) to Treasury.

### Commercial Banks

- collects tax and non-tax receipts and transfers them to GRZ in accordance with Service Level Agreements;
- operate retail banking and agency services to GRZ in accordance with Service Level Agreements;
- facilitates payments of foreign payments on behalf of government – letters of credit, and
- maintains third party banks accounts on behalf of MPSAs.

### Zambia Revenue Authority (ZRA)

- maintains tax revenue collection accounts;
- ensures regular bank reconciliation of revenue accounts; and
- ensures timely transfer of revenue from the collection accounts to the Consolidated Fund.

### Internal Audit

*As part of the internal audit functions, Internal Auditors are expected to:*

- carry out a quality assurance review of the payment systems, procedures and transactions effected to ensure accuracy, reliability and completeness; and
- provide assurance services to the Accounting Officers with regard to transactions and report on any exceptions in a timely manner.

## 25.4 CONCLUSION

The Treasury's responsibility is to determine and manage the daily cash position. Information about the day's opening cash position is obtained through bank balance reporting systems. The objective of establishing the cash position is to plan the day's borrowing or investment decisions based on whether the closing position is projected to be a shortfall or a surplus. This can only be achieved and effectively managed through implementation of the Treasury Single Account (TSA).

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# CHAPTER 26

## Debt management

Borrowing used to finance investment that earns a rate of return greater than the interest rate is normally a net positive for the economy, but debt can also mean added vulnerabilities if the debt becomes too large relative to income and therefore difficult to service. It is therefore of great importance that Parliaments, as part of the budget scrutiny process and passing of the budget, receive up-to-date and detailed information about the sustainability of a country's current level of debt and its capacity to increase this level without risks of debt distress. The objective of this chapter is to equip Members and Staff of Parliament with an understanding of debt management and the necessary tools for them to effectively perform their monitoring of the management of public resources.

### 26.1 INTRODUCTION

An effective debt management system is an essential part of any country's public finance management system. A well-articulated debt management policy enables Members of Parliament and Staff, and the general public, to have confidence that the procedures and processes necessary to ensure sound debt management are in place and effective and, if they are not, to take corrective action.

### 26.2 WHAT IS PUBLIC DEBT MANAGEMENT?

Public debt can be defined as the total financial obligations of the public sector, i.e. central government and the wider public sector, including financial obligations of parastatals, local governments, and, if guaranteed by Government, to residents

and non-residents. If these obligations are owed to citizens of a country, they are known as domestic debt and if owed to non-citizens, as external debt. Together they are called public debt.

The International Monetary Fund (IMF) defines public debt management as the “*process of establishing and executing a strategy for managing government’s debt in order to raise required amount of funding at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk.*”<sup>109</sup>

In line with this definition, the IMF goes further to state that “*the main objective of public debt management policy is to ensure that the government’s financing needs and its payment obligations are met at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk.*”<sup>110</sup>

### 26.3 LEGAL FRAMEWORK FOR PUBLIC DEBT MANAGEMENT IN ZAMBIA

The law which governs public debt management in Zambia is the Constitution of Zambia (Amendment) 2016 under Part XVI – Public Finance and Budget – Cap. 198 through to Cap. 212, pages 83 to 88. Particular Articles relating to public debt provide for Government to borrow on its behalf, issue guarantees, lend and to state the limits of the proposed borrowing in a particular financial year.

The guiding principles of public finance are in Cap. 198, (c) ‘sustainable public borrowing to ensure inter-generational equity’ (p.83).

Cap. 207 gives power to government to borrow and lend (p.87) and defines public debt as follows:

- The Government may, as prescribed— (a) raise a loan or grant on behalf of itself, a State organ, State institution or other institution; (b) guarantee a loan on behalf of a State organ, State institution or other institution; or (c) enter into an agreement to give a loan or grant out of the Consolidated Fund, other public fund or public account.
- For the purposes of this Article, “public debt” includes the interest on that debt, sinking fund payments in respect of that debt and the costs, charges and expenses incidental to the management of that debt (p.87).

Cap. 202 Part 2 (1) requires the Minister of Finance to ‘specify the maximum limits that the Government intends to borrow or lend in that financial year’. This is done through a Statutory Instrument issued by the Minister of Finance and tabled in Parliament.

<sup>109</sup> International Monetary Fund, 2014, Guidelines for Public Debt Management , p.5

<sup>110</sup> Ibid. p.7

## 26.4 PARLIAMENTARY OVERSIGHT OF PUBLIC DEBT

The Constitution of Zambia (Amendment) also provides for Parliamentary oversight of the Executive in matters relating to public debt. As stated in Cap. 63, Part 2, “*the National Assembly shall oversee the performance of executive functions by... (d) Approving public debt before it is contracted*” (p. 21).

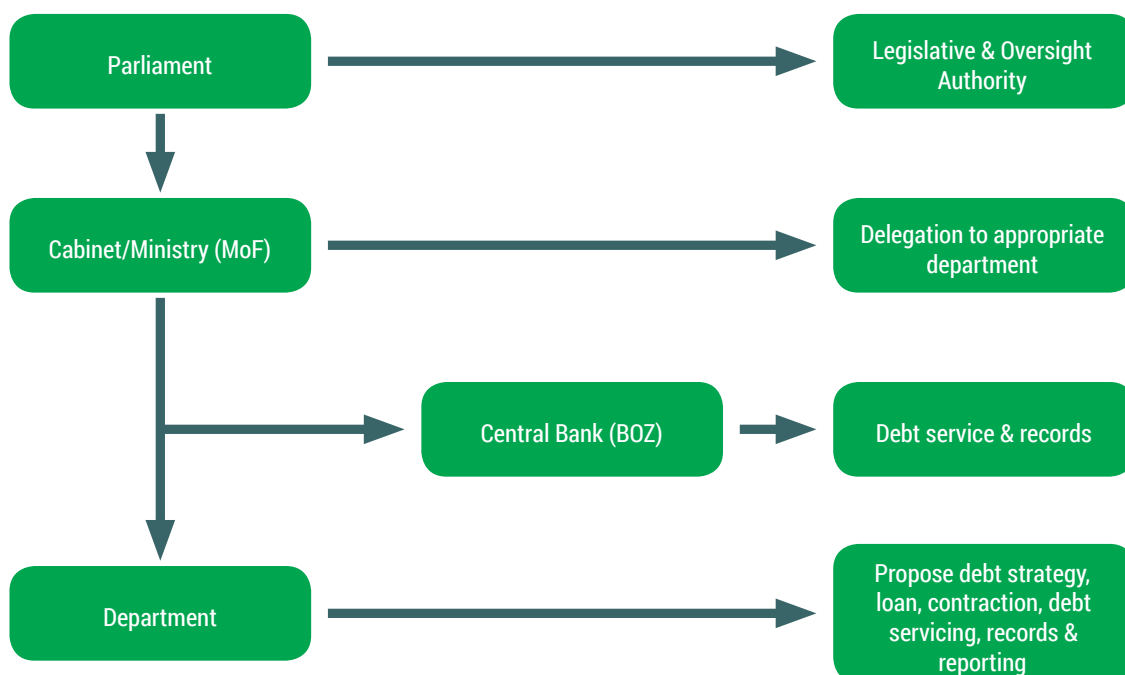
Should the government wish to raise or issue a guarantee on behalf of any entity, Cap. 65 Clause 2 e), authorises the Minister in charge of Finance to present a bill to Parliament for debating and approval on the raising or guaranteeing of a loan or the repayment of it (p.22).

## 26.5 INSTITUTIONAL FRAMEWORK OF PUBLIC DEBT MANAGEMENT IN ZAMBIA

The functions of debt management in Zambia are split between the Ministry of Finance and Bank of Zambia. The Debt Department in the Ministry of Finance is responsible for managing public external debt, public domestic debt, Government-guaranteed debt and Government on-lent funding. The department is also responsible for proposing the country’s debt strategy and conducting debt analysis.

The institutional framework is illustrated below.

**Figure 28.1** Zambia Institutional Debt Management Framework



The Ministry executes payment of all public external and domestic debt, including Government guaranteed debt, through instructions to the Bank of Zambia. In turn, the Bank of Zambia is responsible for managing external debt service payment. The Bank of Zambia is also responsible for managing parastatal and private debt.

The Ministry of Finance provides the broad guidelines of the domestic debt policy while the implementation and management of the policy is executed by the central bank. This arrangement is particularly important in that it facilitates co-ordination between government debt management policy and monetary policy. Additionally, the central bank is better placed in that it has close links with the major primary market participants.

The broad guidelines of domestic debt management policy include:

- meeting the Government's borrowing requirements;
- minimising Government cost of borrowing;
- facilitating the development of the secondary market in government securities;
- facilitating market price formation of credit in the economy; and
- facilitating co-ordination between government debt management and monetary policy management.

As an agent of the Government, the Bank of Zambia performs front office duties in that it undertakes all primary issues of government securities, i.e. Treasury bills and government bonds.

In other words, the Bank of Zambia offers advice in respect of domestic debt policy of the Government. The primary objective of government securities trading is twofold. First, government securities (Treasury bills and government bonds) as a fiscal tool are used by the Government to borrow funds from the general public for the purposes of meeting its financing requirements or rather to finance its budget gaps. Secondly, government securities are used for monetary purposes particularly in managing liquidity in the banking system. The central bank influences the reserves position of commercial banks through the sale and purchase of Treasury bills.

## 26.6 WHAT DETERMINES DEBT CONTRACTING?

A country's borrowing policy should be consistent with its macroeconomic objectives: economic growth, containment of inflation levels, limiting budget deficit to certain levels, keeping credit and money supply under control, and minimising uncertainty among investors by building their confidence.

Debt contracting - or borrowing - is part of the global framework of public finance management and the budgetary process. If a given resource envelope is insufficient to meet all expenditures, a government may want to borrow in order to plug the gap in a particular year or a number of years.

Debt contracting can also be a deliberate policy of raising resources for developmental programmes and projects. This would be under the ambit of the Central Government.

Debt contracting (external) can also be used in order to build up international reserves. Further, it can be used to mobilise capital for the deepening of the domestic capital market. These last two actions would normally be undertaken through the Central Bank.

In Zambia, debt management follows the above principles. Through the 3-year Medium-Term Fiscal Framework (MTEF), the amounts of both domestic and external debt are determined for the period of the MTEF.

In guiding external borrowing during the drawing up of the MTEF, a major tool used is the Debt Strategy. This document is reviewed from time to time.

In the past 25 years or so, Zambia's external debt strategy policy was mainly anchored on the contracting of external loans that were provided under Official Development Assistance (ODA) and on International Development Agency (IDA) IDA-only terms (highly concessional borrowing terms with low interest cost and long maturities with a grant element of 25% or more). Thus, Zambia only borrowed from the soft windows of the international development financial institutions, namely, the African Development Bank (AfDB) Group, the International Monetary Fund (IMF) and the World Bank (WB) Group.

However, following the attainment of a Lower Middle Income Country (LMIC)<sup>111</sup> status, Zambia's debt strategy has included accessing finance on the international bond markets<sup>112</sup> for economically long-term developmental projects.

The Debt Strategy policy document also provides guidelines on the requirement of the country to have in place the Debt Sustainability Analysis (DSA). The DSA is an assessment of a country's ability to meet its obligations in the medium-to-long term. Further, the DSA guides a country's borrowing process on when, for what, how much and from whom to borrow.

Zambia conducts a DSA every year using the Debt Sustainability Framework (DSF) model<sup>113</sup>. The DSF is used by a number of players, namely, a borrowing country, the IMF, the World Bank and other lenders. The borrowing country is guided in its borrowing decisions in a way that balances development goals with preserving debt sustainability. The DSF guides the IMF to set debt limit

111 The World Bank re-classified Zambia as a Lower Middle Income Country in 2011. This implied that Zambia's ability to borrow through the soft windows of the WB and African Development Bank (AfDB) would be reduced as Zambia's per capita income had improved and hence it could access finance at higher borrowing terms i.e. market rates.

112 Three International Bonds have so far been raised (10-year US\$750 million at 5.375% in September 2012, 10-year US\$1.0 billion at 8.5% in April 2014 and 11-year US\$1.25 billion at 9.375% in July 2015).

113 The DSF is an analytical tool developed by the IMF and the World Bank in determining a Low Income Country's (LICs) debt limit policy by the IMF and a LICs concessionality by the World Bank. The LIC's DSF consists of external DSA (includes private sector debt) and public DSA, the assessment of risks is based on the evolution of public and publicly guaranteed (PPG) debt indicators relative to policy-dependent thresholds. The analysis is done on present value-basis under baseline and standard alternative scenarios and risk-of-debt- distress rating based on the analysis of PPG external debt.

policy for a country and the World Bank to set the non-concessional borrowing policy for a country. Donors also use the DSF results in determining grant-allocation decisions.

The DSF uses policy-dependent external debt-burden indicators (external debt and debt service ratios to GDP, exports and government revenue) because the debt levels that low-income countries (LICs) can sustain are influenced by the quality of their policies and institutions.

**Table 28.1** Debt Burden Threshold under the DSF (applying to external public debt)

	NPV <sup>114</sup> of Debt in percent of			Debt Service in percent of	
	Exports	GDP	Revenue	Exports	Revenue
Weak	100	30	200	15	25
Medium	150	40	250	20	30
Strong	200	50	300	25	35

**Source:** IMF & World Bank

These debt-burden thresholds are not to be seen as rigid ceilings but as guideposts for informing debt sustainability assessments. Policy performance is measured by the Country Policy and Institutional Assessment (CPIA) index, compiled annually by the World Bank. It should be understood that these thresholds are mere, but important guidelines as they help to inform and guide policy formulation.

In the case of Zambia, the Minister of Finance in using the DSF analysis will have an informed position as to the extent to which Zambia can go to borrow externally given its outstanding obligations, and the analysis will then form the basis on which to seek Parliament's approval for the particular financial year.

## 26.7 WHAT TO LOOK FOR DURING ASSESSMENT ON DEBT

Parliament as an oversight vehicle of government expenditure should ask for:

1. At Budget Stage, the current approved Debt Strategy and the current Debt Sustainability Analysis (DSA).

It is important that Members of Parliament are provided with copies of the Debt Strategy and the result of the most recent DSF in order for them to understand the implication of borrowing

<sup>114</sup> Net Present Value.

requirements that they are being requested to discuss and approve.

2. At Budget Execution Stage (Approval of all new loans, guarantees, etc.)

It is vital that Members of Parliament are provided with analyses of the implications of the new loans that they are being requested to approve. For instance information on the economic impact or the social benefits should be provided. This should be in addition to information on the impact on current debt.

3. At Post Budget Stage - Evidence of 1 and 2 during the budget cycle under review

## 26.8 CONCLUSION

Debt management is an integral part of macroeconomic management like monetary, fiscal, trade, exchange rate, balance of payment policy, and public debt management is critical to promoting sound economic management. Debt management policy is aimed at ensuring that a country's borrowing is properly managed and borrowed funds are properly channelled to raise economic welfare to higher levels.

And finally, public debt management should not be viewed as a sporadic and inconsistently applied activity but rather a continuous operation.

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# CHAPTER 27

## In-year financial and non-financial reporting

In order for Members of Parliament to perform their oversight role during the budget execution stage effectively, Members need access to relevant, up-to-date and well-presented financial and non-financial information. It is the responsibility of the Ministry of Finance to prepare and present the required information or to make data and other information available to Members and the administration of the National Assembly regularly or on a demand-driven basis. This chapter deals with financial and non-financial reports produced by various government ministries, departments and other spending agencies during the course of the year. These reports may be prepared and produced monthly, quarterly or half yearly. Further, the section will describe the purpose of the reports and the institutions producing them.

### 27.1 INTRODUCTION

The purpose of in-year financial and non-financial reporting is to provide the Government and other stakeholders with a meaningful, comprehensive view of the position and performance of the activities being undertaken in any one budget year. They assist authorities and management to make decisions as regards the implementation of the yearly work plans and the performance of their budgets with respect to meeting objectives, staying within the budget and general control measures. Since Members of Parliament perform the oversight function, it is important to analyse the in-year reports rather than wait for the year-end financial and non-financial reports that are prescribed in the Constitution (Amendment) of the Republic and the Public Finance Act, 2004. These reports will help Members of Parliament to project how the end will be if the situation continues. The reports



also enables the Government and the National Assembly to take corrective action in the case of grave diversions from the budget.

## 27.2 LEGISLATION

Section 3(2) of the Public Finance Act of 2004 requires the Minister of Finance to present half-yearly budget performance reports to the National Assembly. Section (6) of the same Act stipulates that the Secretary to the Treasury shall be responsible for preparing a quarterly review of the performance of the budget and submitting a report thereof to the Minister of Finance. The Standing Orders of the National Assembly, provides that the parliamentary Budget Committee shall “study, inquire into and report on matters related to coordination, control and monitoring of the National Budget” and “conduct budget hearings”<sup>115</sup>. The quarterly performance report by the Ministry of Finance is one of the key sources for the Committee’s regular monitoring of the Executive’s execution of the budget.

## 27.3 WHAT ARE FINANCIAL AND NON-FINANCIAL REPORTS?

A financial report is a formal record of the financial activities and position of a business, person, or other entity<sup>116</sup>. In the present context, financial reports refer to the financial reports produced regularly, i.e. quarterly and biannually, by the Ministry of Finance to take stock of the efficiency of budget implementation against the approved budget.

The key financial information to establish the efficiency of budget implementation, include indicators, such as:

- proportion of budgeted revenues collected;
- proportion of budgeted funds released to the respective MPSAs;
- proportion of released funds received by the respective MPSAs;
- proportion of received funds spent by the respective MPSAs;
- proportion of projects not timely funded.

On the basis of the in-year financial reports, the Ministry of Finance may take corrective action if the needed corrections are within the Ministry’s authority. In the case supplementary appropriations are needed, the corrective measures will be approved by Parliament.

Non-financial reports provide important information about the effectiveness of budget implementation, i.e. about the results achieved against targets and money spent. Hence, they are often called performance reports, which can contain both quantitative and qualitative information.

<sup>115</sup> Standing Orders 2005, Article 156, p.65

<sup>116</sup> [https://en.wikipedia.org/wiki/Financial\\_statement](https://en.wikipedia.org/wiki/Financial_statement)

The non-financial reports make use of performance indicators, such as:

- proportion of projects implemented against monthly or quarterly target or expected end-date (as per the respective MPSA's work plan);
- monthly or quarterly achieved deliverables against targeted deliverables for the period;
- proportion of the projects delayed;
- proportion of the projects' overrun;
- proportion of underperforming projects.

These reports enable Government to have regular data for decision-making as the Ministries, Provinces and Spending Agencies (MPSAs) implement their annual plans. If the institutions execute their budgets without monitoring on a regular basis (monthly or quarterly), they may not know whether they will meet their targets at the end of the year or ensure that they are executing the programmes in the most cost-effective manner.

Government must be responsive to the information needs of a number of different stakeholders, including the National Assembly, non-governmental organisations, the media and the citizens at large. In order to meet these information needs, the Executive – through the Ministry of Finance – must collate, analyse and present financial and non-financial information in an accessible and easy to understand manner. Therefore, the reports must be relevant, reliable and timely for reasonably informed users. They must satisfy diverse information needs, such as short-term financial position and liquidity, budgetary and legal compliance, performance against targets and issues with a long-term focus.

The Treasury is responsible for establishing and maintaining controls to ensure that all government financial transactions are within statutory authority and that the use of public resources is properly recorded. The Treasury also prepares forecasts including economic and fiscal updates as part of the budget.

#### 27.4 TYPES OF IN-YEAR REPORTS

The Ministry of Finance produces monthly, quarterly and biannual financial reports during the financial year. These reports are published on the Ministry's website [www.mofnp.gov.zm/](http://www.mofnp.gov.zm/) and therefore accessible to the Members of Parliament.

The Parliamentary Budget Office, within the National Assembly is responsible for reviewing these reports as part of Parliament's oversight function.

The various reports of importance for Parliament's financial oversight function are presented in the following.

### Mid-Term Economic Review

The Ministry of Finance, in accordance with the *Finance Act of 2004*, Section 3(2), produces a mid-year economic report. This report assesses the performance of the economy in general, covering revenue, expenditure, Gross Domestic Product, balance of payments, etc. The mid-term assessment assists the government to gauge and make adjustments in terms of how they will manage the latter half of the year.

### Budget Performance

The Ministry of Finance reports on all releases of financial resources to MPSAs on a monthly basis. The Ministry equally reports on all revenues that the Government has received on a monthly basis. The data also includes all the financing obtained on a monthly basis.

### Profiles

The Ministry of Finance, at the beginning of the year, requests all the MPSA's to prepare a report on how they have planned the activities and the resources they require month by month throughout the year. The Ministry considers these requests and compares the same with the revenue projections. Based on this assessment, the Ministry will inform the MPSAs of the amount of financial resources they should expect to receive on a quarterly basis.

### Expenditure Reports

Expenditure reports are consolidated by the Accountant General's Office. On a monthly basis, all MPSAs are obligated to forward reports to the Ministry of Finance. These reports show the amounts received by the MPSAs and how they have spent the money received. The reports are produced using the Financial Management System (FMS) and the Integrated Financial Management Information System (IFMIS).

### Budget Execution Report

Ministries, Provinces and Spending Agencies report to the Ministry of Finance all the monies they received and expended on a quarterly basis.

### Statement C Report

The Statement C report is a comparative of authorised provision and actual expenditure by Department. The report provides the detailed budget execution information of Ministries, Provinces and Spending Agencies. It aggregates figures at programme and departmental level. This report is produced on a quarterly basis.

An example of the report is shown in the table below.

**Table 27.1** Statement C Report

MINISTERIAL, DEPARTMENTAL & PROGRAMME PERFORMANCE QUARTER 1 2015 REPORT DashBoard								
	Total*# DISTINCT Progs	Total*# Activities	Total 2015 BUDGET	Total FUNDING FOR QTR 1 2015	Total *FUNDING*	Total *TARGET*	Total *ACTUAL*	Total *PERFORM*
HEAD/ DEPARTMENT/ PROGRAMME								
<b>HEAD01</b>	10	25	10,035,083	2,207,873	22%	27%	26%	93%
<b>DEPT - 01</b>	6	13	3,366,129	412,500	12%	24%	24%	100%
Prog - 3003	1	4	781,554	190,000	24%	9%	9%	100%
Prog - 3008	1	2	1,064,579	162,500	15%	29%	29%	100%
Prog - 3011	1	2	215,000	40,000	19%			
Prog - 3012	1	1	531,995	0	0%	35%	35%	100%
Prog - 3084	1	1	120,000	0	0%	33%	33%	100%
Prog - 3103	1	3	653,000	20,000	3%			
<b>DEPT - 02</b>	5	12	6,668,954	1,795,373	27%	31%	28%	88%
Prog - 3003	1	3	1,765,748	200,000	11%	67%	67%	100%
Prog - 3046	1		568,648	100,000	18%	9%	5%	60%
Prog - 3109	1		1,962,893	1,035,373	53%	100%	100%	100%
Prog - 3110	1		2,146,643	460,000	21%	25%	12%	47%
Prog - 3111	1		225,022	0	0%	33%	33%	100%

### Monthly Economic Indicators

The Ministry of Finance produces economic indicators on a monthly basis. The data includes statistics on monthly inflation, revenues, expenditures, exchange rate trends, interest rates, trends in domestic debt stock and service, exports, imports by major product categories, balance of payments, etc. These reports can be found on the Ministry of Finance data portal on the Ministry's website.

### Non-Financial in-year reports

#### Monitoring reports

The Ministry of Planning receives returns from MPSAs implementing capital projects on a monthly basis. The ministry is able to evaluate the planned schedule of works, funds released by the ministry for that specific project and the project implementation. This allows the ministry to check if the

works are on schedule and, if not, what the possible reasons for the delayed implementation are. With the introduction of output-based budgeting, reporting will become more focused on results and achievements against set targets and objectives.

## 27.5 CONCLUSION

The reports prepared by the Government are meant to provide information to Parliament, Government managers responsible for public finance and budget execution, as well as the private sector and other stakeholders that needs this kind of information to make informed decisions pertaining to their operations. The timely flow of accurate and comprehensive financial and non-financial information also promotes transparency and accountability in Government operations and contributes to parliamentary and public control with the Executive.

Members of Parliament need not wait to the end of the year to be accorded an opportunity to play their oversight role. The availability of monthly, quarterly and biannual key economic and financial information on the Ministry of Finance's website, underpinned by analyses carried out by the Parliament Budget Office at the National Assembly, facilitate democratic oversight of Government financial operations throughout the financial year.

## REFERENCES AND FURTHER READING

Constitution (Amendment 2016) of Zambia.

Public Finance Act, 2004.

[www.gasb.org](http://www.gasb.org) (GASP White Paper on Accounting and Reporting).

[www.mofnp.gov.zm](http://www.mofnp.gov.zm) (Ministry of Finance website).

[www.treasury.gov.za](http://www.treasury.gov.za) (SA Treasury: In Year Management, Monitoring and Reporting).



# CHAPTER 28

## Budget follow-up

Regular monitoring of budget implementation, also called budget follow-up, is a cornerstone of effective financial management. Budget follow-up is important to ensure that appropriated funds are spent in accordance with budget intentions. Budget follow-up forms the basis of necessary in-year supplementary appropriations prompted by unforeseen changes in budget assumptions and forecasts. This chapter seeks to shed light on the role of Parliament in the execution of the national budget, particularly as it relates to follow-up activities such as the review of budget releases against appropriations, expenditure tracking and ensuring value for money in public expenditure. It provides a good starting point to Members of Parliament who need to familiarise themselves with relevant budget follow-up activities and Parliament's particular role in the budget implementation process.

### 28.1 INTRODUCTION

Budgetary checks and balances are necessary if better budgetary outcomes, including development and enhanced service delivery are to be achieved. Useful reference documents for undertaking this follow-up activity include all relevant budget documentation that report on revenue collections, budget releases and actual expenditures against the budget estimates approved by Parliament. The documents described in Chapter 27 can form the basis for obtaining the needed information.

In terms of the significance of parliamentary involvement in budget follow-up activities, the Constitution provides that

- a) the National Assembly shall oversee the performance of the executive functions by scrutinising public expenditure, including defence,

- constitutional and special expenditure (Article 63 (2) (c));
- b) *prudent and responsible use of public resources* shall be one of the main guiding principles of public finance (Article 198 (d));
  - c) the Auditor-General shall, not later than nine months after the end of a financial year, submit an audit report to the President and the National Assembly, on the accounts of the Republic audited in respect of the preceding financial year (Article 202); and
  - d) the Minister responsible for finance shall lay the financial report before the National Assembly together with the Auditor-General's opinion on the financial report being submitted (Article 211 (1) (2) (3)).

The constitutional provisions highlighted above provide the necessary legal foundations for the involvement of Members of Parliament in budget follow-up activities in the spirit of transparency and accountability in the use of public resources.

## 28.2 BUDGET FOLLOW-UP ACTIVITIES

Budget follow-up activities can come in different forms. In the case of Zambia, the relevant follow-up activities can be facilitated through the following:

### Assessment of budget performance

Budget performance reports<sup>117</sup>, financial reports, economic reports, annual progress reports and any other performance reports produced by the executive or as may be prescribed in budget legislation would be useful to Members of Parliament. The frequency with which these reports are presented to the Legislature is subject to supply factors, i.e. legal requirements and demand factors, upon request by Members of Parliament. Under assessment of budget performance, relevant issues to look out for include

- how revenue collections compare with approved estimates;
- how budget authorisations to commit compare with approved appropriations;
- explanations of budget performance;
- performance compared with budget objectives.

***How Revenue Collections and Financing compare with approved estimates:*** The performance of the overall budget is largely dependent on the country's systems and capacities to collect both tax and non-tax revenues and to raise additional financing, i.e. loans from the domestic market and/or externally. If the country's tax and non-tax policy measures are administered in an efficient and effective manner, revenue collections are expected to be at least on target<sup>118</sup>. Where tax administration is strong, it is possible to collect 100% of the realistically projected revenues, sometimes even more.

<sup>117</sup> While Budget Performance Reports (which show actual revenues collected and budget releases against planned collections and releases, respectively, and the explanations for the variance) are produced by the Ministry of Finance on a monthly, quarterly, bi-annual, and annual basis, these are usually for internal use and are therefore not published officially to the Public.

<sup>118</sup> Target refers to the levels approved in the budget.



In most cases, in developing countries such as Zambia where tax and non-tax revenues are insufficient to fully finance budget needs, financing by borrowing is considered as one of the overall budgetary measures. In this regard, Members of Parliament should not only look at how much has been borrowed for the budget but also the sustainability of such debt and the terms and conditions under which such borrowing has occurred. In particular, Members will want to know the accumulated long-term debt, its relationship to fiscal capacity, normally measured as a percentage of GDP and assess its sustainability on that basis.

Revenue and financing performance in this case, shows the effectiveness of the Executive in administering the tax and non-tax policy measures, and managing its exposure to debt risk or indeed the reasonableness of the revenue measures as proposed by the Executive under prevailing economic conditions in the country.

***How budget authorisations compare with approved appropriations:*** As a general rule of thumb, one would expect the mid-year budget performance report to show about 50% authorisation towards approved budget programmes. This is not always the case as some expenditures flow on a seasonal basis or through one-time purchases. It is the responsibility of the Executive to make cash flow projections that enable Members to assess how the government is spending the funds relative to its projections. Members should be aware of such matters. Equally, the end-of-year report is expected to show 100% authorisations towards programmes in the approved budget. The extent to which these budget authorisations deviate from the approved appropriations provides a reasonable indication of the extent to which the original budget remains accurate or as an indicator that circumstances have changed. For example, at the end of the year, a credible budget is expected to show that close to 100% of the appropriation to Ministries, Provinces and Spending Agencies (MPSAs), based on programmes in the approved budget has been authorised for expenditure. Slight deviations (i.e. 5% below or above target) are acceptable and the budget can still be considered credible, while deviations of about 20% or more may be a symptom of problems within the public expenditure management cycle.

***Explanations on budget performance:*** Assessing budget performance by just looking at budget authorisation against appropriations or revenue collections against approved estimates may lead to wrong conclusions about the Executive's performance. While marked deviations may indeed be explained by poor – or overly optimistic - revenue or expenditure forecast, deviations may also be caused by events beyond the control of Government budget analysts and political decision-makers. For example, long spells of drought or international commodity price fluctuations impact negatively on agricultural production and mining outputs, which - in turn - affects Government revenue and hence the fiscal balance.

The need for Members of Parliament to look for explanations where marked variances exist between planned and actual revenue collections or between budget authorisations and actual expenditures is important to inform the political debate and for making well informed recommendations to the Executive.

**Performance on budget objectives:** Each national budget contains a set of macroeconomic objectives. These objectives tend to vary from one year to another depending on prevailing economic circumstances and priorities of the Government. In the case of Zambia, macroeconomic objectives have generally covered areas such as:

- growth projections for gross domestic product;
- inflation target;
- borrowing parameters in terms of the fiscal deficit (now a Constitutional requirement to report in the budget documentation under Article 202 (2) of the Constitution); and
- target on growth of gross international reserves.

Once the annual budget has been executed, it is important for Members of Parliament to assess how the executive fared in the attainment of set macroeconomic objectives. This is important for increased transparency and accountability, but also to inform the formulation of the subsequent budget.

### Mid-Year Review

The Mid-Year Review is undertaken by the Ministry of Finance, with input from the MPSAs, to provide an account of the performance of the economy and implementation of the budget for the first half of the year, against set macroeconomic objectives. During the mid-year review, the Ministry of Finance assesses developments mainly in the following areas:

- real sectors (i.e. Agriculture, Mining, Energy, Transport and Communications);
- budget performance (i.e. performance of revenues, expenditures and fiscal deficit);
- debt parameters;
- monetary and financial sector developments (i.e. monetary, inflation, interest rate, financial and capital developments); and
- external sector developments (i.e. performance on the trade balance).

The above assessments are used to inform decisions for the remaining half of the year. Some of the decisions made from such assessments have led to, inter alia, realignment of economic targets in terms of year-end exchange rates, inflation rate, fiscal deficits, growth prospects and other budget priorities. This assessment also enables the Ministry of Finance to report comprehensively on the fiscal risks and general economic outlook for the remaining half of the year.

During preparation of the Mid-Year Review, MPSAs are involved in a number of ways. The main area of engagement however relates to the submission of relevant sector chapters into the Mid-Year Report for subsequent analysis and review of sector performance.

### Supplementary budget

The Constitution, Article 203, provides for Excess and Supplementary Budgets meant to fund unforeseen and unavoidable expenditures. Specifically, Clauses 2 and 3 of Article 203 set out the normal situation where the Minister is required to lay before the National Assembly a supplementary

estimate of expenditure, which, when approved, should be incorporated into a Supplementary Appropriation Bill for enactment. Thereafter the expenditure can be incurred. On the other hand, Clauses 4, 5 and 6 stipulate that where it is “urgent” to incur expenditure for which no appropriation is made by the National Assembly and “it would not be in the public interest to delay the expenditure until a supplementary estimate is approved by the National Assembly”, the President may issue a warrant authorising the expenditure and a withdrawal from the Consolidated Fund.

In order for the Ministry of Finance to effectively manage and facilitate the supplementary and excess expenditure approval processes in line with the aforementioned constitutional provisions, an administrative procedure has been put in place where all requests for supplementary budgets from MPSAs are submitted through the office of the Secretary to the Treasury for review and onward submission to Cabinet for endorsement before the draft supplementary estimates are tabled for parliamentary approval. Only requests that meet the criteria are submitted for Cabinet endorsement and subsequently parliamentary approval.

Further, virement of funds is permissible to allow for flexibility during budget execution, without compromising on overall fiscal discipline. Virements within approved aggregate expenditure limits – also known as the appropriation level - authorised by Parliament are approved by the Treasury while those exceeding approved aggregate expenditure limits, or appropriation level, are approved by Parliament.

### Expenditure monitoring and tracking

Expenditure<sup>119</sup> monitoring and tracking is primarily done on the basis on the monthly, quarterly and biannual financial reports prepared and published by the Ministry of Finance<sup>120</sup>. In addition to the financial reports produced by MoF, Members of Parliament can monitor the effectiveness of these expenditures through performance audits issued by the Auditor General, monitoring and evaluation (M&E) reports produced by the Ministry of Finance, public expenditure reviews and surveys conducted by various stakeholders, site visits to specific projects by relevant committees of the National Assembly, and by interviewing relevant Government departments.

This exercise is important for a number of reasons, including the following:

- assessing the capacities of MPSAs to spend the moneys appropriated;
- detecting systemic encumbrances in the flow of funds from the Ministry of Finance to the ultimate spending agencies (e.g. delays in the flow of funds);
- strengthening accountability mechanisms;
- assessing progress and efficiencies in the actual implementation of programmes and projects;
- assessing the correlation between public expenditures and their associated impacts on development and service delivery outcomes; and
- promoting optimal utilisation of public resources.

119 Unlike budget releases, expenditure is used to refer to actual spending by spending agencies of government.

120 See Chapter 27, In-Year financial and non-financial reporting.

### Review of audit reports

The National Audit Office conducts financial audits to assess the various departmental accounts, and offers the assurance that such assessments have been conducted free of material misstatements. These audit reports are important to the follow-up activities of Members of Parliament on budgetary matters.

In particular, audit reports enhance parliamentary oversight over budget execution processes by enabling parliamentarians to scrutinise audit reports on how public funds were used by the Executive to inform corrective action through the relevant parliamentary committees such as the Committee on Government Assurances or the Public Accounts Committee.

### Value for Money

The National Audit Office also conducts and produces performance audit reports which provide relevant information for assessing efficiency in the use of public funds. These reports provide an indication of the assessment of sector performance, efficiency and effectiveness with which public resources have been utilised in respective sectors, as well as information on the extent to which value for money is achieved.

There is growing consensus in the literature to define the concept of value for money in terms of cost effectiveness. The notion of value for money can be viewed as a way of thinking that tries to relate how much is spent to what is achieved from such spending. Evidence of value for money can be assessed through presence or absence of an appropriate balance between the three E's: Economy, Efficiency and Effectiveness (Jackson, 2012).

Simply put, value for money in public spending is about achieving the desired results in an effective manner and with the best use of resources (for more details on performance auditing, including the 3 E's, see Chapter 35).

For Members of Parliament, it is important to judge how the costs in various public expenditure programmes undertaken by the Executive relate to the benefits or expected benefits to the country and its citizens. It is also desirable to have an understanding of international benchmarking, e.g. comparison of the cost of a given intervention in Zambia, and the cost of the same intervention in another country whose economic and national characteristics closely resembles those of Zambia.

For example, comparisons in terms of the cost of producing a kilometre of tarred road or the cost of providing education per student in Zambia relative to similar costs in neighbouring countries would raise intriguing value-for-money questions by Members to the Executive. The Budget Office at the National Assembly can be very useful in supporting the role of Members of Parliament in this undertaking.

Finally, Members of Parliament may wish to note that value-for-money does not necessarily mean choosing the cheapest option. This is because the cost of undertaking any government intervention

must be considered in relation to the quality. Hence value for money has to do with the Government implementing priority policies in an efficient manner to achieve the intended objectives without compromising on quality.

### 28.3 CONCLUSION

This chapter has provided a brief synopsis of the involvement of Members of Parliament in Budget follow-up activities and the legal provisions supporting their involvement. The chapter covered four broad areas for parliamentary involvement, which include assessment of budget performance, expenditure monitoring and tracking, reviewing audit reports and ensuring value for money. Review of Audit Reports by Members of Parliament is important in the assessment of the various departmental accounts and performance, and assurance that such assessments have been conducted free of material misstatements. Furthermore, Members are encouraged to assess evidence of value for money in public expenditure to ensure that more, in terms of outputs or benefits to the country and its citizens, is achieved from a given amount of resources, i.e. human and financial resources deployed on a particular programme or activity without compromising on quality.

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# CHAPTER 29

## Internal control and audit

Risks are significant uncertainties of the future that might have an impact on expected results. Risk management refers to the actions taken to assess and manage these uncertainties. While actual risk management is the sole responsibility of management, the internal audit and control function performs the risk control and auditing on the basis of which management undertakes risk analyses and decides on mitigating action as deemed necessary. In this way, the internal audit function serves as the first line of defence in the management of public resources. It evaluates management controls in real time, and plays a critical role in evaluating the effectiveness of preventive, detective and corrective controls. As the findings and reports of the internal auditors often form the basis for and feed into the reports of the Auditor-General, it is important that Members and Staff of Parliament appreciate the role that the function plays in the overall public financial management control and accountability system.

### 29.1 INTRODUCTION

Effective internal audit and internal control systems are essential to any well-run government institution. They enable Members of Parliament and Staff to have the confidence that the procedures and processes necessary to ensure sound public financial management are in place and effective and, if they are not, to take corrective action.

The Chartered Institute of Internal Auditors (2015) defines internal auditing as “an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to the evaluation and improvement of the effectiveness of risk management, control and governance processes”. (p. 6).

The internal audit function of the Public Service is established by the *Public Finance Act of 2004*. Section 10 (1) of the Act provides that “*there shall be a Controller of Internal Audit appointed by the Public Service Commission who shall be the head of Internal Audit and shall, in the performance of duties under this Act be subject to the direction of the Secretary to the Treasury*”.

Internal audit assists management in achieving the objectives of the institution in the most effective, efficient and economical way. By taking a risk-based approach, internal audit addresses the highest risk first, which may be financial or non-financial. Internal audit is pro-active, that is, it highlights problems before they happen.

Internal auditing is guided by *International Standards for the Professional Practice of Internal Auditing (Standards)* as revised in 2012.

## 29.2 INTERNAL CONTROL

Internal controls are operating practices or activities that the Controlling Officer has established, communicated and monitors in order to provide reasonable assurance that the objectives of the Ministries, Provinces and Spending Agencies will be achieved. Internal controls are not limited to financial matters but apply to all operations. The primary objectives of an internal control system are to ensure:

- i. compliance with applicable policies, procedures, plans, laws and regulations;
- ii. reliability and integrity of information;
- iii. economic and efficient use of resources; and
- iv. safeguarding of assets.

Section 7 (3) (a) of the *Public Finance Act No.15 of 2004* requires Controlling Officers to maintain an effective, efficient and transparent system of financial management, risk management and internal control.

Internal controls can be preventive, detective or corrective:

- Preventive controls are controls designed to keep errors or irregularities from occurring in the first place. Preventive controls include segregation of duties, physical control over assets, using passwords to restrict computer access and shredding documents containing confidential information.
- Detective controls are designed to detect errors or irregularities that may have occurred. Detective controls include bank reconciliations, physical count of inventories (stocks) and reviews and comparisons.
- Corrective controls are designed to correct errors or irregularities that have been detected. Corrective controls include recovery of unretired imprest and journal entries to correct errors.



### 29.3 RELATIONSHIP BETWEEN INTERNAL AUDIT AND INTERNAL CONTROL

From the definition of internal auditing, it is clear that internal control is one of the three processes necessary for the success of internal audit. The other two are risk management and governance. Internal control together with risk management techniques must be mastered by internal audit for effective discharge of its mandate.

Internal audit looks at what is happening and compares it to what should be happening (i.e. the internal controls established and communicated by the Controlling Officer).

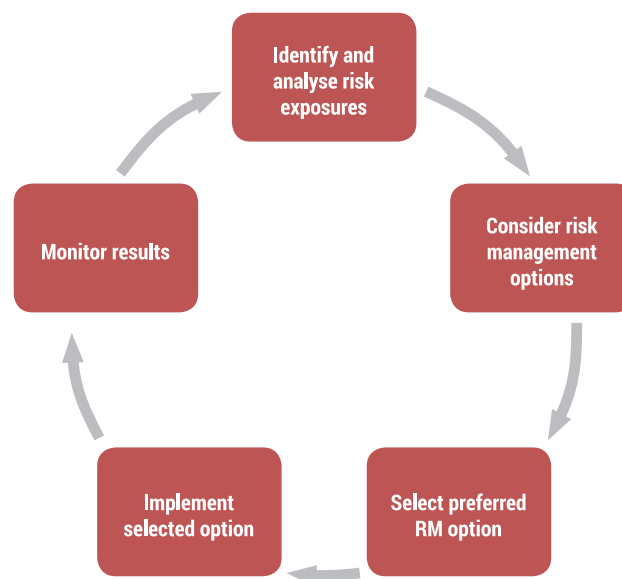
### 29.4 RISK MANAGEMENT

Risk is defined as *the effect of uncertainty on objectives* and is measured in terms of likelihood and impact (ISO 31000, Risk Management)

Risk management is the identification, assessment, and prioritisation of risks followed by coordinated and economical application of resources to minimise, monitor, and control the likelihood and/or impact of unforeseen events or to maximise the realisation of opportunities. The objective of risk management is to assure that uncertainty will not prevent the achievement of objectives.

The risk management process is summarised in Figure 29.1 below.

**Figure 29.1** The Risk Management Process



### 29.5 THE INTERNAL AUDIT PROCESS

The internal audit process is an iterative process, from audit planning to report writing as summarised in Figure 29.2 below.

**Figure 29.2** The Internal Audit Process



### 29.5 AUDIT PLANNING

This is the first step in the internal audit process and can be broken down into two stages, namely annual planning and engagement planning.

Annual planning involves internal auditors deciding what areas will be audited in the up-coming year, based on their assessment of risks and available human and other resources. High-risk areas are scheduled to be audited more frequently compared with low-risk areas.

Engagement planning involves planning the execution of the individual audits in accordance with the timing in the annual plan.

### 29.6 AUDIT EXECUTION

Audit execution involves reviewing business processes or transactions in order to provide assurance that controls are operating as designed and the intended objective of the business process or transaction will be achieved.

Internal auditors collect data through interviews, examination of relevant documents, physical inspections and observation. Data collection is an important part of the internal audit process. Internal auditors support their conclusions about an audit with information gathered using as many different methods as possible. This ensures that the conclusions made are corroborated.

Finally, the data collected is analysed and interpreted. This forms the audit evidence for discussion with the audited department and inclusion in the draft audit report.

### 29.7 AUDIT REPORT

An internal audit report is the tool used by internal auditors to communicate the audit findings to the management of the ministry or agency. Therefore, when writing an audit report, internal auditors consider the audience who will receive and respond to the report. The audit report should be consistent with the terms of reference for that audit so that the audience understands the scope of the audit.

Internal auditors first produce a draft internal audit report and submit it to the audited department for comments on the findings. After receiving the comments, internal auditors drop audit findings which have been addressed and supported by appropriate evidence. The audited department is deemed to agree with all findings if comments to the contrary are not received within the agreed time frame.

Finally, internal auditors issue a final report containing recommendations for addressing the audit findings to the Controlling Officer and the Audit Committee of the Ministry, Province or Spending Agency. The internal audit report is copied to the Secretary to the Treasury and the Auditor-General as required by Section 11 (3) of the *Public Finance Act No. 15 of 2004*.

### 29.8 FOLLOW-UP AUDIT/REVIEW

The final stage of the internal audit process is the follow-up audit. The purpose of the follow-up audit is to review what actions the Controlling Officer has taken to address the audit findings and how effective the actions taken have been. Follow-up audits/reviews also help internal auditors determine the aspects of previous audits to include in future audit plans.

## 29.9 CONCLUSION

Internal audit provides objective assurance on and insight into the effectiveness and efficiency of internal control processes, on a continuous basis. Internal audit is present in all Ministries, Provinces or Spending Agencies (MPSAs). Controlling Officers should use this resource at their disposal to ensure transparency and accountability in the management of public resources.

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# CHAPTER 30

## Oversight of aggregate fiscal risk from other public sector entities, in particular state-owned enterprises (SOEs)

The importance of parastatals' economic and financial performance for the economy and the fiscal risks associated with their operations, including compliance with fiscal rules and regulations, cannot be overstated. This chapter looks at the current systems, procedures and guidelines in place to monitor and regulate the operations of SOEs and other public sector entities, and highlights guiding principles for effective oversight through improved transparency in SOE operations, proper and timely reporting and effective fiscal discipline. Furthermore, the chapter explains Parliament's role vis-à-vis SOEs and other statutory bodies.

### 30.1 INTRODUCTION

The importance of state-owned-enterprises and other semi-autonomous public sector entities' economic and financial performance for the public economy and the fiscal risks associated with these bodies' economic performance, including the servicing of Government guaranteed loans, cannot be overstated. Despite the significant levels of direct and indirect government support to the sector with related high fiscal risks, Parliament's oversight function is confined to the scrutiny of Auditor-General's audit reports, the mandate of which is vested in the newly created Committee on Parastatal Bodies<sup>121</sup>.

121 This oversight mandate was earlier vested in the Public Accounts Committee

## 30.2 WHAT ARE STATE-OWNED ENTERPRISES?

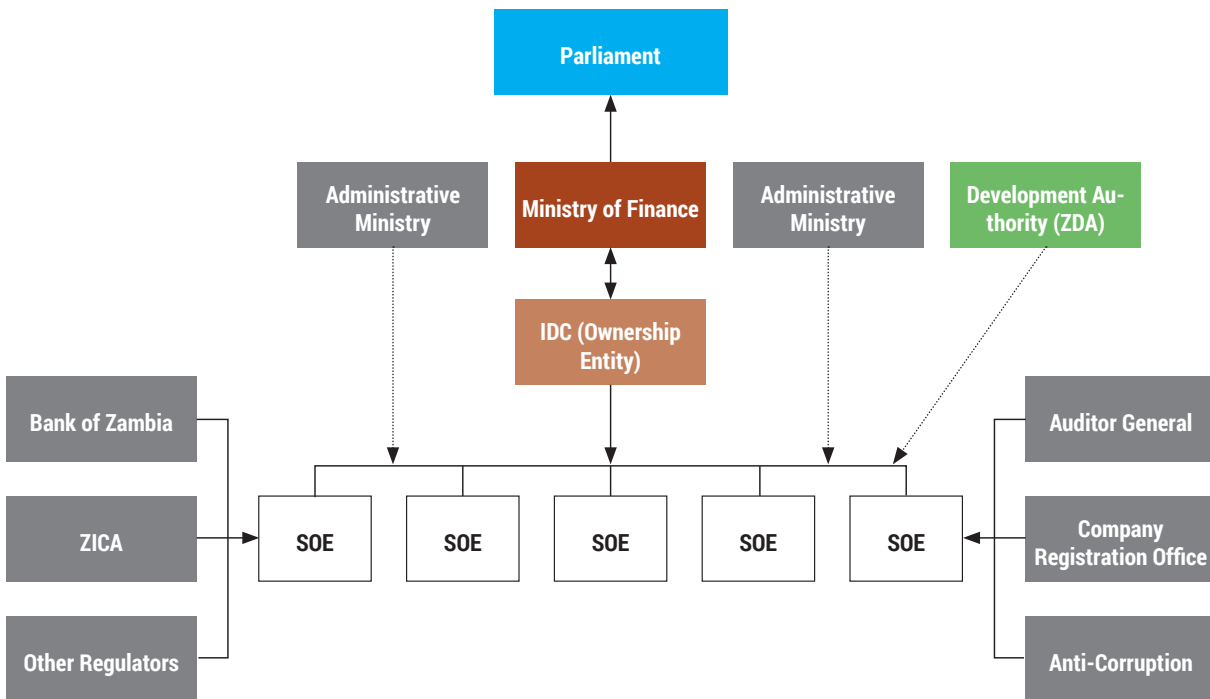
State-owned enterprises (SOEs) in Zambia have two basic legal forms. Most are founded under the Companies Act, and are required to follow the same rules and procedures as other companies formed as limited companies. These include for example Zambia Daily Mail Limited, ZCCM Investments Holdings Plc (ZCCM-IH) and the Industrial Development Corporation Limited. In February 2014, the Government of the Republic of Zambia established the Industrial Development Corporation (IDC). The IDC was incorporated as a company limited by shares under the *Companies Act* and is 100% owned by the Ministry of Finance pursuant to the *Minister of Finance (Incorporation) Act, Cap. 349, of the Laws of Zambia*. Among other things, the IDC serves as an investment holding company for a majority of SOEs (refer to figure 30.1).

Others are statutory corporations established by specific Acts of Parliament. These do not fall under the Companies Act, but are governed by their own founding legislation. For example, ZESCO Limited was formed in 1970 after the *Zambia Electricity Supply Act* was passed in Parliament, Zambia National Broadcasting Corporation was established under Chapter 154 of the *Laws of Zambia*, Road Development Agency was formed under the *Public Roads Act Number 12 of 2002*, National Road Fund Agency was formed under the *National Road Fund Act Number 13 of 2002*, Road Transport and Safety Agency was formed under the *Road Traffic Act Number 11 of 2002* and University of Zambia was formed under the *University Act, 1999*.

SOEs are institutions carrying out business-related activities on behalf of Government in order to enhance public service delivery. They are different from MPSAs, which are part of Government and established under the Constitution, for example, for Ministries under Cap. 92 (2) (a) and Cap. 149 (1) for Provinces.

The regulatory environment for SOEs, shown in figure 30.1 below, incorporates the IDC as an ownership company for some SOEs. The figure shows that SOEs under the IDC report to the IDC, which in turn reports to the Ministry of Finance. Other SOEs, not under the IDC, report to the respective Ministries under which they fall. There are also regulatory bodies that influence the operations of the SOEs, such as the Auditor General and Bank of Zambia. All SOEs, in respect of how they are founded, report to a parent Ministry.

Figure 30.1 Regulatory environment for SOEs



Source: Adapted from World Bank, 2015

### 30.3 FISCAL RISKS EMANATING FROM THE SOE SECTOR

Fiscal risks can be defined as “factors that may cause fiscal outcomes to deviate from expectations or forecasts”<sup>122</sup> or as “the effect of uncertainty on objectives” as used by the ISO 31000 referred to in chapter 29. These developments or events may be outside or within government control. Fiscal risks arise mainly from two sources: 1) macroeconomic shocks and 2) the realisation of contingent liabilities.

Fiscal risks from macroeconomic shocks include various unexpected changes to macroeconomic variables (economic growth, inflation, commodity prices, interest rates, or exchange rates). Fiscal risks from contingent liabilities include calls or realisation of several types of contingent liabilities. Contingent liabilities are obligations triggered by an uncertain event, such as explicit liabilities, i.e. those defined by law or contract (e.g. debt guarantees), and implicit liabilities, i.e. moral or expected obligations for the government, based on public expectations or pressures (e.g. bailouts of banks or public sector entities).

SOEs have often been a significant source of contingent government liabilities, especially as a result of poor governance, mismanagement, or irresponsible borrowing. Recent reports by the Auditor-General<sup>123</sup> have shown that significant fiscal risks relating to, for example, continued loss-making and non-remittance

122 International Monetary Fund, 2016, Analysing and Managing Fiscal Risks – Best Practices

123 See for example “Report of the Auditor General on the Accounts of Parastatal Bodies and other Statutory Institutions, Financial Year Ended 31st December, 2014”, Republic of Zambia, 2016

of statutory contributions constitute a major concern to the Government as these liabilities may lead to Government bailouts. Unfunded and rarely disclosed contractual terminal benefit obligations in many SOEs present a significant source of fiscal risk to the Government.

Overall, sources of contingent fiscal risks from SOEs include foreign loans, payroll obligations for retirees, statutory obligations, trading losses, pension deficits, high cost court cases, government guarantees, letters of comfort and public-private partnerships risks.

### 30.4 INSTITUTIONAL AND LEGAL ARRANGEMENT TO ENSURE TRANSPARENCY IN SOE OPERATIONS AND MANAGEMENT OF FISCAL RISKS FROM SOEs

Successful management of fiscal risks emanating from SOEs involves identification, analysis, mitigation, inclusion in budgets by creating ceilings for contingent liabilities such as guarantees, monitoring and reporting of fiscal risks.

The management of fiscal risks at SOEs is primarily the responsibility of Boards of Directors (KPMG, 2009). The appointment of Boards is provided for in the Companies Act for those SOEs formed under the Companies Act and under the founding Acts of Parliament for those statutory bodies formed under the Acts of Parliament. The Government, through the Ministers of the parent ministries, appoints the Board of Directors of SOEs. For SOEs formed under the Companies Act, the Permanent Secretaries of the parent ministries represent the Government on the boards as members. For statutory SOEs, the composition of the boards is provided for in the founding Acts. For example at ZESCO, the Permanent Secretaries of the Ministry of Finance and National Planning, and the Ministry of Mines, Energy and Water Development represent the Government on the Board.

Boards of Directors of SOEs carry out their stewardship function on behalf of the owners, i.e. the public and the SOEs (KPMG, 2009). The Board of Directors is responsible for the governance of risks including fiscal risk as specified in the Board charter. The Board's risk management responsibilities include developing a documented risk management policy and plan, reviewing the implementation of the risk management plan at least annually, and making public disclosure of the fiscal risks emanating from SOEs.

The Government therefore has appointed Permanent Secretaries to represent it on Boards and to, among other things, manage the fiscal risks at SOEs. These SOEs are required to prepare annual financial statements and to have these accounts audited by external auditors appointed by the Board and/or the Auditor-General. For example, for a statutory SOE like ZNBC, article 24(1) of the *Zambia National Broadcasting Corporation Act* number 154 provides that “As soon as practicable, but not later than six months after such financial year, the Corporation shall submit to the Minister a report concerning its activities during such financial year. (2) The report referred to in subsection (1) shall include information on the financial affairs of the Corporation and there shall be appended thereto: (a) a balance sheet; (b) an audited statement of revenue and expenditure; and (c) such other information as the Minister may require. (3) The Minister shall, not later than seven days after the first sitting of the National Assembly



*next after the receipt of the report referred to in subsection (1), lay it before the National Assembly*”. Thus Parliament has oversight over the statutory SOEs through the reports that are required to be submitted by the parent ministries. For SOEs formed under the Companies Act the annual reports must be presented to the shareholders, the Government, at the annual general meeting.

Within the Ministry of Finance, the Investment and Debt Management Department (IDM) was established in 2002 and drew its mandate from the *Loans and Guarantees Authorization Act*, Cap 366 and Cap 600 of the Laws of Zambia. The IDM, through the Government Investment Unit, is charged with the responsibility of monitoring and evaluating the impact of Government investments, which would include overseeing the Government’s investment in the parastatal sector, the financial performance of the parastatal sector, and on lending and guarantees to the parastatals. The IDM has been reorganised to be part of the Industrial Development Corporation.

### 30.5 PARLIAMENTARY OVERSIGHT AND ROLE OF THE COMMITTEE ON PARASTATAL BODIES

In accordance with the provisions of the Constitution of Zambia, article 121, and the *Public Audit Act No. 29 of 2016*, the Auditor General’s reports on SOEs and other statutory bodies and MPSAs are submitted to the President and the Speaker of the National Assembly simultaneously (article 14). The Committee on Parastatal Bodies examines the reports and presents its findings to the National Assembly. The procedure followed by the Committee on Parastatal Bodies includes obtaining both oral and written submissions from Controlling Officers and Chief Executive Officers of MPSAs and SOEs respectively.

Prior to presenting the final report to the President, the Auditor-General’s draft reports are submitted to the respective Ministries under which the SOEs fall. The Minister then writes to the SOEs for their comments and responses to the observations by the Auditor-General and once the responses are received from the SOE, the Ministry prepares an overall response that is submitted to the Committee on Parastatal Bodies. The responses include an action plan to address the observed weaknesses in the operations of SOEs and reporting on fiscal risks.

Public Accounts Committee reports over the years have recounted a number of weaknesses in the operations of SOEs. Weaknesses range from failure in corporate governance, absence of Boards, failure to hold meetings or exaggerated meeting frequency, failure to produce financial statements and annual reports, budget overruns, unaccounted for spending to non-compliance with governance standards, such as the OECD Guidelines on the Governance of State Owned Enterprises for Southern Africa, the Commonwealth Association of Corporate Governance (CACG) Principles of Corporate Governance and the King III code. These weaknesses imply failures by most Boards of SOEs to exercise their responsibility including fiscal risk management and timely reporting of fiscal risks in particular. However, some SOEs, such as those listed on the Lusaka Stock Exchange like ZCCM-IH Plc and ZANACO Plc, in general, do apply the good corporate governance practices. They publish annual reports, which include full disclosures of risk management policies and amounts provided for in the financial statements in respect of payroll obligations for retirees, statutory obligations, pension deficits, court cases, guarantees and performance bonds.

### 30.6 FISCAL RISK REPORTING AND DISCLOSURE

Public disclosure of fiscal risks helps manage budget vulnerabilities more effectively, improve economic efficiency, and lower debt service costs. Identification of fiscal risks is critical to raising awareness. Ideally, an assessment by SOEs of the scale of fiscal risks and the preparation of statements of fiscal risks for submission to the respective ministries under which they fall during the national budget preparation stage provides an initial and critical input to the public disclosure of fiscal risks. The parent ministries would then submit consolidated statements for all SOEs that fall under them to the Ministry of Finance, which in turn submits them to Parliament to help inform fiscal policy decisions and Parliamentary oversight. However, as indicated above, the failure of the majority of SOEs to produce financial statements and annual reports weakens both Government's and Parliament's control with the operations of SOEs and hence the possibility of timely intervention.

### 30.7 CONCLUSION

The management and reporting of fiscal risks by SOEs is one part of the governance arrangement for SOEs. In order for Government to carry out its ownership functions, reference is being made to private and public sector governance standards, such as, notably, the OECD Guidelines on the Governance of State-Owned Enterprises for Southern Africa, the Commonwealth Association of Corporate Governance (CACG) Principles of Corporate Governance and the King III Report. With regard to risk management and reporting, the OECD (2014) guidelines on SOEs recommends that SOEs should disclose material non-financial information, focussing on areas of significant concern for the state as an owner and the general public. Such information includes any material risk factors and measures taken to manage such risks emanating from SOEs.

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# CHAPTER 31

## Managing extra-budgetary funds

While most countries to varying degrees allow for budgetary transactions outside the approved budget and financial reports, also called unreported government operations, extensive use has the potential of undermining the credibility of the public financial system and creating public distrust in government. The public budget ideally links the taxes the citizens have to pay to the services government has made a commitment to deliver. The objective of this chapter is to explain the nature of extra-budgetary transactions, and why governments make use of them. Furthermore, the chapter sets out to identify the revenues and expenditure that may not be covered in the annual estimates of revenue and expenditure in the Yellow Book or the in-year financial reports produced by the Ministry of Finance, and therefore escaping parliamentary scrutiny.

### 31.1 INTRODUCTION

The term extra-budgetary transactions generally refers to Government transactions, i.e. revenues, expenditures and financing that are not included in the annual budget presentation or financial statements. According to the International Monetary Fund (IMF), extra-budgetary transactions in developing countries are reported to be as high as 40% of the annual budget<sup>123</sup>. Extra-budgetary transactions are resources managed directly or indirectly by administrative branches of Government outside the normal budgetary process. They can be special accounts, segregated from the budget and intended for carrying out a specific activity or to benefit a specific agency. They can also be revenues raised outside the budgetary framework by administrative units and off-budget payments by the Ministry of Finance or any other organisation which has

<sup>123</sup> IMF Technical Notes and Manuals – Extra Budgetary Funds, 2008. This figure includes social security funds, which account for some 35% of total expenditure.

authority over public money. Besides the special funds referred to above, extra-budgetary transactions may comprise surtax, levies, fees, donor funds, other charges and grants to various quasi-government institutions. None of these types of transactions are incorporated into the public accounts, which means that they are not transparent to users of the Government's financial statements. Therefore, this practice produces a distorted view of the Government's financial position.

From a public expenditure management perspective, the most important distinction between budgetary and extra-budgetary transactions is the extent to which resources are captured in the normal budget and accountability process. As the essence of budgeting is to weigh expenditures against one another or against increased revenue in an open and transparent manner, the use of extra-budgetary transactions or unreported government operations may potentially undermine the credibility and democratic function of the budget and hamper parliamentary oversight<sup>124</sup>.

Extra-budgetary accounts are bank accounts into which extra-budgetary revenues are paid in and expenditure paid. Extra-budgetary entities are Government institutions engaged in extra-budgetary transactions, may use extra-budgetary accounts, and may have their own governance structures and, often, a legal status that makes them autonomous or semi-autonomous vis-à-vis Government ministries and departments.

The creation of such entities is common practice around the world. They can serve a good public purpose, especially when they are quasi commercial in scope or must operate with considerable independence. Regardless, they remain part of the public domain and steps need to be taken to ensure transparency in their accounting and budgeting.

### 31.2 WHAT ARE EXTRA-BUDGETARY TRANSACTIONS USED FOR?

The use of extra-budgetary transactions can be attributed to budget system failures and political economy factors. An IMF study<sup>125</sup> has identified the following reasons for use of extra-budgetary funds or transactions, which can be attributed to budget system failures:

- Mismatch of time horizons, where the accumulation and spending of funds spans many years delinked from the annual budget cycle. Examples include special funds established for specified purposes and financed from special taxes or earmarked revenue required usually by law, such as investment funds (e.g. sovereign wealth funds); stabilisation funds (e.g. oil stabilisation funds); saving funds (e.g. oil revenue funds) and social security funds where accumulation and spending of the funds have a long-term horizon delinked from the annual budget process.
- Interference of special interests with the budgeting process.
- Inadequate mechanisms for allocating resources.
- Failure to recognise the needs for local communities in allocating resources, which may lead to alternative means of raising income outside the normal budget process.

<sup>124</sup> The Public Expenditure and Financial Accountability (PEFA) assessment framework considers extra-budgetary expenditure in excess of 10 percent poor financial performance (D score, the lowest score in the framework)

<sup>125</sup> Richard Allen & Dimitar Radar, *Extra-budgetary Funds*, IMF 2010

- Ineffective control and incentive mechanisms for public sector managers.
- Unsatisfactory governance arrangements for accountability and transparency.
- Ineffective mechanisms for addressing donor’s fiduciary requirements.

Use of extra-budgetary transactions for political reasons, include among others:

- Protection of politically sensitive programmes from budget cuts or other short-term considerations in the context of the annual budget cycle.
- Attempts to give an appearance of a smaller budget deficit.
- Generating political support for introducing new taxes, for example through the creation of a special fund financed through a special earmarked tax.
- Insulating donor’s projects in priority sectors at their request.
- Protection of funds from public scrutiny, contrary to generally accepted principles of transparency.<sup>126</sup>

### 31.3 POLICY AND LEGISLATIVE FRAMEWORK IN ZAMBIA

According to the Planning and Budgeting Policy (2014), extra-budgetary funds are defined as “*A fund where public monies are deposited and used in accordance with an enabling statute and may not be reflected, or only partially reflected in the annual budget*”.

The legislation for all Government finances is guided by the Constitution (Amended), Article 200. Clause (1) establishes the consolidated fund to which shall be credited the revenues and other monies accruing to the Treasury. Clause (2) states that clause (1) shall not apply to monies (a) prescribed for a public fund established for a specific purpose; or (b) that a state organ or state institution may retain for the purpose of defraying the expenses of the state organ or state institution, as prescribed.

### 31.4 UNREPORTED GOVERNMENT OPERATIONS

The Zambian budget is confined to Central Government and lacks information on local government expenditures, state enterprises and contingent liabilities. Subsidies to and losses of state-owned enterprises are not reflected in the budget. There are a few enterprises whose activities and losses may have important budgetary implications, such as Nitrogen Chemicals of Zambia and the Food Reserve Agency. With respect to local government, grants to the local authorities are reflected in the budget but not the revenues the councils raise nor the detailed expenditure items. Extra-budgetary transactions financed by Government grants are not covered in the budget. For example, grants to the University of Zambia, Copperbelt University, Mulungushi University, Nitrogen Chemicals of Zambia, etc. are recorded in the budget as block grants with no expenditure details.

<sup>126</sup> Ibid.

### 31.5 CONCLUSION

While the use of extra-budgetary funds and transactions may be justified in exceptional instances, for example in connection with social security funds and sovereign wealth funds, the use of extra-budgetary transactions is inconsistent with effective public financial management and principles of comprehensiveness and transparency in budgeting and budget implementation. Extra-budgetary transactions increase rigidity of resource allocation, which affects policy-makers' ability to fund strategic priorities. Over-use of extra-budgetary transactions lowers the efficiency of service delivery, as it encourages overspending in those areas where earmarked revenue is plenty. Also, the lack of a comprehensive budgetary framework for extra-budgetary transactions can lead to the duplication of expenditure or taxes.

Besides, the complexity of transactions between extra-budgetary transactions and the budgeted funds makes financial management non-transparent. Finally, if the funds are not properly thought out, they can promote inefficient cash management because the idle balances are held in many separate accounts, thereby increasing the borrowing requirements of the Government and the associated interest payments.

Hence, to ensure that the annual budget and the financial reports produced by the Ministry of Finance provide Parliament with an accurate picture of the financial position of the country, the use of extra-budgetary funds and transactions should be kept at a minimum. Where the use of extra-budgeted operations are necessary, for example in connection with off-budget state entities, financial statements from these form part of the financial information flow to Parliament.

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# CHAPTER 32

## Tools for budget analysis

This chapter identifies, defines and shows the various tools for budget analysis and their application. It is intended to equip the Members and Staff of Parliament with basic knowledge in budget analysis. It covers both the qualitative and quantitative approaches used in analysing, tracking and monitoring the allocation and application of resources. The chapter introduces graphic representation of information as a way to quickly communicate messages and simplify the presentation of data. While Chapter 16 deals with budget analysis as a political and technical tool in the budget scrutiny and approval stage, this chapter looks at budget analysis during the budget execution stage. Notably, it aims at enhancing Members and Staff's capacities in the monitoring and interpretation of often complicated financial and non-financial information through the use of infographics.

### 32.1 INTRODUCTION

Budget analysis work is meant to provide information about resource allocation and utilisation. It is therefore expected to be factual, comprehensive and precise in determining the reality of things. This process requires regular and focused monitoring and analysing to ensure that the outcomes are consistent with the set plans. The evaluation process generally involves:

Building skills to understand and analyse the budget and planning documents

Analysis of i) budget allocations and declared policy priorities, ii) trends in budget allocations over time, and iii) allocations to different groups, regions, sectors, using tools such as: benefit incidence analysis or tax incidence analysis etc.

Building coalitions and alliances with other stakeholders in providing checks and balances

There are a number of technical approaches that are used in evaluating the budget though the crucial consideration is the quality of the technical analysis. A balance needs to be maintained between producing exhaustive analyses and getting useful reports that can easily be understood and disseminated for the benefit of different users. The capacity to understand and analyse the budget is a prerequisite for undertaking budget analysis work.

### 32.2 BUDGET TRACKING AND MONITORING

Budget tracking and monitoring looks at the implementation side of the budget, and therefore, the process is undertaken throughout the execution stage. In addition to such tracking by the Executive and Parliament, civil society organisations and think tanks normally track and monitor the budget to verify the application of funds and conformity to policies and programmes spelt out in the budget documents.

Budget tracking and monitoring begins with an analysis of the budget speech. This involves carrying out both an overall and comprehensive assessment of the budget speech when it is released by the Minister of Finance with a follow-up on specific issues for more in-depth analysis using all planning and budgeting documents such as the Green Paper (the Medium-Term Expenditure Framework), economic reports, the Yellow Book and the Auditor General’s report.

### 32.3 TYPES OF BUDGET ANALYSIS TOOLS

Budget analysis tools are used to improve different functions of the public financial management system, from the decision-making processes that are conducted during policy formulation and planning, to accounting of outputs and service provision.

There are two broad approaches to budget analysis, i.e. qualitative and quantitative.



**Qualitative budget analysis** seeks to answer questions about why and how inputs (financial, labour etc) are translating into outputs (goods & services). It provides in-depth information about observed outcomes and assesses the link between policies and resource allocations.



**Quantitative budget analysis** provides evidence by collecting numerical data that are analysed using mathematically based methods. Some methods of calculations include: *component of the budget relative (fraction or percentage) to the whole budget, nominal and real growth rates of the economy*






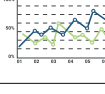
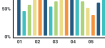
Further, budget analysis looks at the following specific issues:

- Inputs (resources such as money, labour and time used to produce desired results).
- Outputs (results from the utilisation of inputs).
- Outcomes (longer lasting changes in the quality of life of the target population).

When a budget is assessed, the evaluation should not only measure how much is being spent on things (inputs), but also the outputs and outcomes. This is the basis for ascertaining the feasibility of policies and their impact on critical issues such as poverty reduction and population groups or specific needs.

### 32.4 QUANTITATIVE TECHNIQUES

There are a number of statistical techniques available to analyse quantitative data, from simple calculations and graphs to showing the data through tests of correlations between two or more items, to more complex statistical significance calculations. The basics of quantitative budget analysis require knowledge of the budget documents and will include the calculations of:

	Sectors' percentage share of the total budget
	Trends analysis of sectors' share of total budget
	Real and nominal amounts of sector allocations
	Real and nominal growth rates
	Average real growth rates over the medium term

### 32.5 IMPORTANCE OF CALCULATIONS

It is important to analyse the composition of the budget in order to establish how sectors and programmes are prioritised (e.g. education against defence). Other calculations may include:

- one ministry as a share of the country's budget;
- one programme as a share of the total ministry's budget;
- one sub-programme as a share of the total programme;
- wages & salaries as a share of total recurrent expenditures or total domestic revenues;
- administration as a share of total recurrent expenditures;
- capital expenditures as a share of total expenditures.

Analysing trends of the budget allocations and actual expenditures over time can show government's changing priorities in specific items. Such comparisons can be on an annual or quarterly basis to permit more detailed analysis. Further, the graphic display of this data permits a ready understanding of the actual trends. Equally, in situations where inflation is ever changing it becomes critical to calculate the real value of a budget allocation as it determines how much purchasing power the allocation will have at the time of expenditure. Calculating of the real value of an amount, therefore, requires the use of a deflator to determine the value after inflation. The value of the deflator is often given by the Ministry of Finance.

### 32.6 COMMUNICATING RESULTS

Most information on the composition of the official budget is often presented in inaccessible technical language. An important contribution of budget analysis work is to explain the budget in a way in which the layperson can easily understand the implication of budget allocations for different groups or sectors. The presentation of budget analysis results must be done in a simple, user-friendly and easily understandable format. This can be enhanced with visuals when presented as infographics<sup>127</sup>. Infographics are used in various ways for quick but detailed views of data.

They include bar graphs, pie charts, histograms, line charts, tree diagrams, mind maps, Gantt charts, network diagrams and other pictorial images as illustrated in the example below<sup>128</sup>.

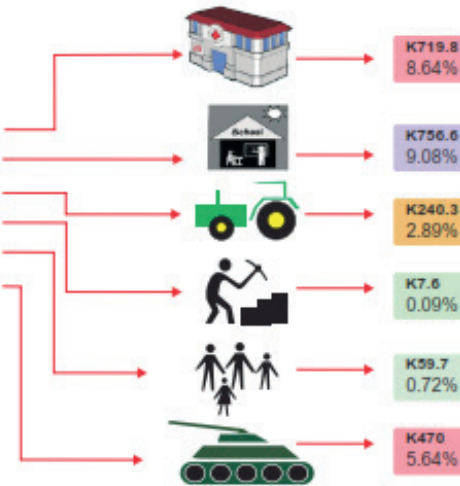
<sup>127</sup> An infographic (information graphic) is a representation of information in a graphic format designed to make the data easily understandable at a glance. Infographics are used to quickly communicate a message, to simplify the presentation of large amounts of data, to see data patterns and relationships, and to monitor changes in variables over time.

<sup>128</sup> It is important to note that infographic information is supplementary and not alternative to the budgetary and financial performance information currently in use, such as the Yellow Book, quarterly and annual financial statements and performance reports, the Blue Book, summary documents and others.

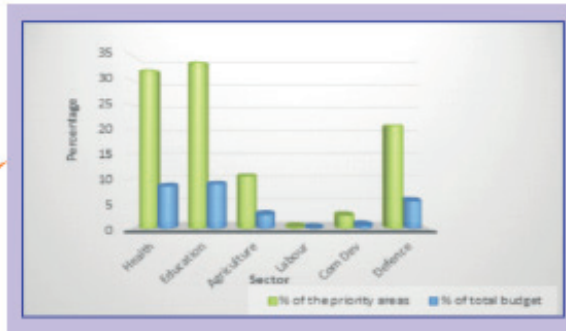
Calculating a Share of the Total Budget (8,328.60)

Sector	Million Kwacha	% of priority area	% of total budget
Health	719.80	31.93	8.64
Education	756.60	33.57	9.08
Agriculture	240.30	10.66	2.89
Labour	7.60	0.34	0.09
Community Development	59.70	2.65	0.72
Defence	470.00	20.85	5.64
	<b>2,254.00</b>		

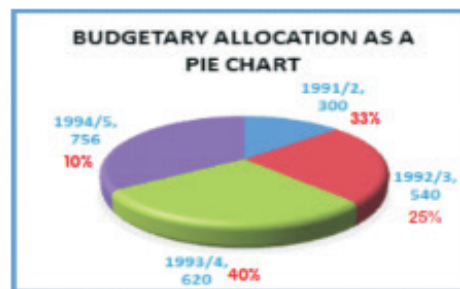
Calculating the share of total budget can show outputs for a ministry, programme or sub-programme.



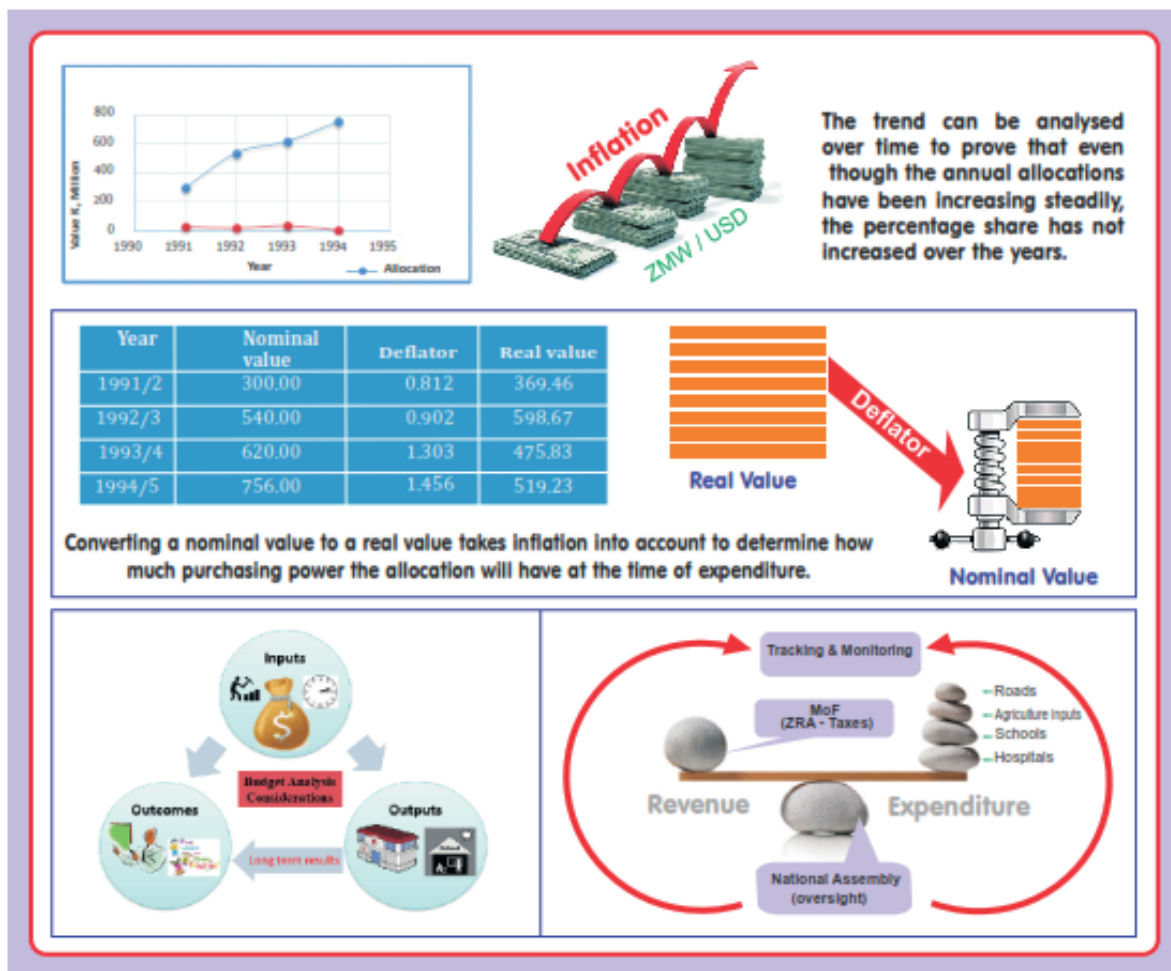
Relative budget shares and priorities become evident when presented in a chart.



Year	Budgetary Allocation	%Share
1991/2	300.00	33
1992/3	540.00	25
1993/4	620.00	40
1994/5	756.00	10



Tracking allocations over a specified period reveals changes in budget amounts and expected outcomes.



### 32.7 CONCLUSION

Budget information can be communicated using infographics to quickly inform parliamentary debates by shedding light on various issues. Parliamentary committees can access detailed budget analysis in graphic format instead of raw data that would normally take a lot of time to read and understand. The infographics above show how data on sector allocations presented in a table can easily be depicted as images in a pictorial format, bar graph and also in a pie chart. The calculations are communicated in various ways to show distribution, time spans, comparisons and prioritisation of resources in budgeting and planning. This mode of communication gives some quick insight into the focus of the policy and that of the decision makers.

Communication and active dissemination of information make greater participation in the budgeting process possible. The information has to be properly framed to draw the attention and interest of the intended audience, whether they are parliamentarians, government officials or the population at large. A graphical representation of the budget provisions makes it easier for the budget reviewer to understand what is represented by the outputs. Simple flow diagrams are recommended for

inclusion with graphic descriptions to enhance the messages conveyed.

The effective use of budget analysis tools and having a well-structured communication strategy has good implications for enhancing the credibility of budget results and overall fiscal oversight.

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**MODULE 6**  
**POST BUDGET**  
**IMPLEMENTATION STAGE**







# CHAPTER 33

## Understanding the structure and contents of the End-of-Year Financial Report ('The Blue Book')

The financial performance in the previous year usually attracts much less political attention than the budget proposal for the next financial year. However, a detailed analysis of the financial results - actual spending against budget estimates and supplementary appropriations during the course of implementing the budget - is of great importance for an informed debate of the credibility of the budget proposal presented by the Executive. It also forms the basis for holding the Executive to account for its performance.

Therefore, the objective of this chapter is to enhance Members and Staff of Parliament's understanding of the structure of and information provided in the End-of-Year Financial Statement also referred to as the Blue Book.

### 33.1 INTRODUCTION

This chapter provides an explanation and interpretation of the structure and contents of the Government's annual financial report known as the Blue Book, which is currently being prepared using the Cash Basis International Public Sector Accounting Standards (IPSAS)<sup>129</sup>. The structures of the financial reports prepared under both the cash basis of accounting (Cash Basis IPSAS<sup>130</sup>) and those prepared under the accrual basis of accounting (Accrual Basis IPSAS) are explained together with the interpretation of each of the statements making up the financial reports under the respective standards.

<sup>129</sup> Government has plans to migrate to the accrual basis.

<sup>130</sup> IPSAS stand for International Public Sector Accounting Standards

### 33.2 STRUCTURE AND CONTENTS OF ANNUAL FINANCIAL REPORTS PREPARED UNDER THE CASH BASIS IPSAS

The Cash Basis IPSAS prescribes the manner in which the general-purpose financial statements are to be presented under the cash basis of accounting<sup>131</sup>.

The Cash Basis IPSAS comprises two parts. The first part, which is mandatory, sets out the requirements that must be complied with by entities that claim to be reporting in accordance with the Cash Basis IPSAS. The second part of the standard is optional and identifies additional accounting policies and disclosures that an entity is encouraged to adopt in order to enhance its financial accountability and the transparency of its financial statements. This second part also includes explanations of alternative methods of presenting certain information.

According to the Cash Basis IPSAS, an entity<sup>132</sup> should prepare and present general-purpose financial statements, which include the following components:

- statement of cash receipts and payments;
- statement of budget execution;
- optional statements;
- accounting policies and explanatory notes.

#### Statement of cash receipts and payments

This statement is mandatory for all entities preparing their financial statements under the cash basis. This statement discloses on its face the cash receipts (taxation, external assistance, other grants and aid, other borrowings, capital receipts, receipts from trading activities), against the cash payments (payments for operations, transfers, capital expenditure, loans and interest payments) for the period.

The statement of cash receipts and payments should include the following information as prescribed by the accounting standard<sup>133</sup>:

- All cash receipts, cash payments and cash balances controlled by the entity.
- Payments made by third parties on behalf of the entity. Third party payments arise where, during a reporting period, a third party directly settles the obligations of an entity or purchases goods and services for the benefit of the entity. The entity should disclose cash receipts and payments in separate columns on the face of the statement :
  - Total payments made by third parties which are part of the economic entity to which the reporting entity belongs, showing separately a sub-classification of the sources and uses of total payments using a classification basis appropriate to the entity's operations; and
  - Total payments made by third parties which are not part of the economic entity to which the reporting entity belongs, showing separately a sub-classification of the sources and

131 See also chapter 7, Government accounting and reporting standards and practices

132 'Entity' in this context refers to Ministries, Provinces and Spending Agencies (MPSAs) and local authorities.

133 <http://www.ipsas.be/ipsas-1-presentation-of-financial-statements.html>

uses of total payments using a classification basis appropriate to the entity's operation. Such disclosure should only be made when during the reporting period the entity has been formally advised by the third party or the recipient that such payment has been made or that the payment has otherwise been verified.

The statement of cash receipts and payments should present the following amounts for the reporting period:

- a) total cash receipts of the entity showing separately a sub-classification of total cash receipts using a classification basis appropriate to the entity's operations;
- b) total cash payments of the entity showing separately a sub-classification of total cash payments using a classification basis appropriate to the entity's operations; and
- c) beginning and closing cash balances of the entity.

Total cash receipts and total cash payments, and cash receipts and cash payments for each sub-classification of cash receipt and payment, should be reported on a gross basis, except that cash receipts and payments may be reported on a net basis when:

- a) they arise from transactions which the entity administers on behalf of other parties and which are recognised in the statement of cash receipts and payments;
- b) they are for items in which the turnover is quick, the amounts are large, and the maturities are short.

### Statement of budget execution

Where the entity makes its budget available to the public, a statement of the budget performance, comparing the budget and actual amounts at the level of legislative approval, is mandatory. The comparison of budget and actual amounts should be presented separately for each level of legislative oversight:

- a) the original and final budget amounts;
- b) the actual amounts on a comparable basis; and
- c) by way of note disclosure, an explanation of material differences between the budget, for which the entity is held publicly accountable and actual amounts, unless such explanation is included in other public documents issued in conjunction with the financial statements. In that case, a cross reference to those documents is made in the notes.

### Optional Statements

The optional additional statements that the International Public-Sector Accounting Standards (IPSAS) encourage entities to include in their respective financial statements include:

- a) statement of cash receipt by fund classification;
- b) proceeds from borrowing;
- c) statement of payments by programme/activities/function of governments.

### Accounting Policies and Explanatory Notes - Structure of the Notes

The notes to the financial statements of an entity should:

- a) present information about the basis of preparation of the financial statements and the specific accounting policies selected and applied for significant transactions and other events; and
- b) provide additional information that is not presented on the face of the financial statements but is necessary for a fair presentation of the entity's cash receipts, cash payments and cash balances.

Notes to the financial statements should be presented in a systematic manner. Each item on the face of the statement of cash receipts and payments and other financial statements should be cross-referenced to any related information in the notes.

### 33.3 STRUCTURE AND CONTENTS OF ANNUAL FINANCIAL REPORTS PREPARED UNDER THE ACCRUAL IPSAS

The preparation of annual financial reports under accrual basis is guided by the International Public-Sector Accounting Standards IPSAS 1- Presentation of Financial Statements. The objective of this Standard is to prescribe the manner in which general- purpose financial statements should be presented to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. To achieve this objective, this Standard sets out overall considerations for the presentation of financial statements, guidance for their structure, and minimum requirements for the content of financial statements prepared under the accrual basis of accounting. The recognition, measurement and disclosure of specific transactions and other events are dealt with in other IPSASs.

A complete set of financial statements prepared under accrual accounting (IPSAS 1.21) comprises:

- Statement of financial position (a "balance sheet").
- Financial performance (an "income statement").
- Statement of changes in net assets/equity.
- Cash flow statement.
- Comparison of budget and actual amounts (in case the entity makes publicly available its approved budget). To be presented as a separate statement or as an additional column in the financial statements.
- Notes, comprising a summary of accounting policies and other explanatory notes.<sup>134</sup>

IPSAS 1 specifies minimum line items to be presented on the face of the statement of financial position, statement of financial performance, and statement of changes in net assets/equity, including guidance for identifying additional line items, headings and subtotals.

Analysis of expenses in the statement of financial performance may be given by administrative, economic or functional classification<sup>135</sup>. Additionally, IPSAS 1 specifies minimum disclosure requirements for the notes.

<sup>134</sup> Ibid.

<sup>135</sup> See chapter 15, The coverage and classification of the budget.

These shall include information about:

- Accounting policies followed.
- The judgments that management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements.
- The key assumptions concerning the future, and other key sources of estimation uncertainty, that have a significant risk of causing a material adjustment to the current amounts of assets and liabilities within the next financial year.
- The domicile and legal form of the entity.
- A description of the nature of the entity's operations.
- A reference to the relevant legislation.
- The name of the controlling entity and the ultimate controlling entity of the economic entity.

Comparison of financial statements prepared under the Cash Basis and those under the Accrual Basis IPSAS:

Cash Basis	Accrual Basis
<p><b>Receipts:</b> Only cash actually received during the reporting period is recorded and reported.</p>	<p>Receivables are recorded and reported when they are earned and not when the cash is actually received. These include amounts not yet received at the end of the reporting period.</p>
<p><b>Payments:</b> Only cash actually paid out during the period of reporting is recorded and reported.</p>	<p>Payments are recorded and reported when they occur and not when they are paid for. Thus include the outstanding payments related to the period of reporting.</p>
<p><b>Use of Capital Goods:</b> Expenditure on Capital goods and services is recorded and reported in the period of procurement.</p>	<p>Expenditure on capital goods is accrued over the useful life of the asset. This means that the expenditure is recorded and reported, proportionately (depending on the depreciation method adopted), over the estimated useful life of the asset</p>
<p><b>Financial Position:</b> Provides only the cash position of the entity without matching the assets and liabilities</p>	<p>Provides a better picture of the financial position of the entity at a moment or point in time.</p>

### 33.4 GENERAL PRESENTATION REQUIREMENTS FOR THE ANNUAL FINANCIAL REPORT

#### Timeliness

The usefulness of the financial statements is impaired if they are not made available to users within a reasonable period after the reporting date. An entity should be in a position to issue its financial statements within six months of the reporting date, although a timeframe of no more than three months is encouraged. Ongoing factors such as the complexity of an entity's operations are not sufficient reason for failing to report on a timely basis. More specific deadlines are dealt with by legislation and regulations in many jurisdictions. Article 211 of the Constitution (Amendment) of Zambia requires that *“the Minister responsible for Finance shall, within three months after the end of each financial year, prepare and submit to the Auditor General the financial report of the Republic in respect of the preceding financial year”*. The Constitution further states *“The Auditor General shall, within two months of receipt of the financial report, examine the financial report and express an opinion on the report”* and *“The Minister responsible for finance shall, within one month after the receipt of the Auditor General's opinion, lay the financial report, with the Auditor General's opinion, before the National Assembly”*. This, therefore means that the financial report must be issued within six months after the end of the financial year.

#### Authorisation date

An entity should disclose the date when the financial statements were authorised for issue as well as who gave that authorisation. If another body has the power to amend the financial statements after issuance, the entity should disclose that fact. The financial reports of Zambia are authorised for issue by the Minister of Finance as provided for by the constitutional provision stated above.

The authorisation date is the date on which the financial statements have received approval from the individual or body with the authority to finalise those statements for issue. It is important for users to know when the financial statements were authorised for issue, because the financial statements do not reflect events after this date. It is also important for users to know of the rare circumstances in which any persons or organisations have the authority to amend the financial statements after issuance. Examples of individuals or bodies that may have the power to amend the financial statements after issuance are Ministers, the Government of which the entity forms part, Parliament or an elected body of representatives. If changes are made, the amended financial statements are a new set of financial statements.

#### Consistency of presentation

The presentation and classification of items in the financial statements should be retained from one period to the next unless, as provided for by the accounting standard:

- (a) A significant change in the nature of the operations of the entity or a review of its financial statements presentation demonstrates that the change will result in a more appropriate presentation of events or transactions, or
- (b) A change in presentation is required by a future amendment to this Standard.

A major restructuring of service delivery arrangements; the creation of a new, or termination of a major existing, government entity; a significant acquisition or disposal; or a review of the overall presentation of the entity's general-purpose financial statements, might suggest that the statement of cash receipts

and payments or other individual financial statements should be presented differently. For example, a government may dispose of a government savings bank that represents one of its most significant controlled entities and the remaining economic entity conducts mainly administrative and policy advice services. In this case, the presentation of the financial statements identifying a financial institution as a principal activity of the government is unlikely to be relevant.

Only if the revised structure is likely to continue, or if the benefit of an alternative presentation is clear, should an entity change the presentation of its financial statements. When such changes in presentation are made, an entity reclassifies its comparative information. It also provides a detailed explanation of the change in the Notes to the financial statements, often providing a cross-walk to show the impact on the statements in the past.

### Comparative Information

Unless a provision of the accounting standard permits or requires otherwise, comparative information should be disclosed in respect of the previous period for all numerical information required by the standard to be disclosed in the financial statements, except in respect of the financial statements for the reporting period to which the accounting standard is first applied. Comparative information should be included in narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.

### Identification of financial statements

The financial statements should be clearly identified and distinguished from other information in the same published document.

The accounting standard applies only to the financial statements, and not to other information presented in an annual report or other document. Therefore, it is important that users are able to distinguish information that is prepared using the standard from other information that may be useful to users but that is not the subject of the accounting standard.

Each component of the financial statements should be clearly identified. In addition, the following information should be prominently displayed and repeated when it is necessary for a proper understanding of the information presented:

- the name of the reporting entity or other means of identification;
- whether the financial statements cover the individual entity or the economic entity;
- the reporting date or the period covered by the financial statements, whichever is appropriate to the related component of the financial statements;
- the reporting currency; and
- the level of precision used in the presentation of figures in the financial statements.

### Correction of Errors

When an error arises in relation to a cash balance reported in the financial statements, the amount of the

error that relates to prior periods should be reported by adjusting the cash at the beginning of the period. Comparative information should be restated, unless it is impracticable to do so.

An entity should disclose in the notes to the financial statements the following:

- the nature of the error;
- the amount of the correction; and
- the fact that comparative information has been restated or that it is impracticable to do so.

Errors in the preparation of the financial statements of one or more prior periods may be discovered in the current period. Errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts, fraud or oversight. When an error is identified in respect of a previous period, the opening balance of cash is adjusted to correct the error and the financial statements, including the comparative information for prior periods, are presented as if the error had been corrected in the period in which it was made. An explanation of the error and its adjustment is included in the notes.

The restatement of comparative information does not necessarily give rise to the amendment of financial statements that have been approved by the governing body or registered or filed with regulatory authorities.

### 33.5 STRUCTURE AND CONTENTS OF THE BLUE BOOK

The financial statements in the Blue Book are prepared in the Activity Based Budgeting format to conform to the budget and the Chart of Accounts according to the Government Finance Statistics (GFS). As explained earlier, the financial statements are prepared using cash basis accounting, implying that revenues are recognised when received, expenditures when payment is being made and assets are expensed fully in the year of purchase. The Blue Book consists of five financial statements – statements A - E, technical notes to the statements and appendixes. The five financial statements are presented in the following:

**Statement A:** Cash receipts and payments. The statement shows actual receipts and payments at the end of the year as well as the previous year by economic classification, net balance and cash at the beginning and end of the period.

**Statement B:** Budget execution. The statement shows total authorised provision by revenue and payment category (economic classification); actual receipts and payments and variance.

**Statement C:** Comparative statement of authorised provision and actual expenditure by Head (e.g. the National Assembly) and Department (e.g. Human Resource and Administration) as signed by Controlling Officers. The statement shows approved estimates, supplementary estimates or savings declared, total



authorised provision, actual expenditure and variance.

**Statement D:** Comparison of budget and actual amount by functional classification. The statement shows original, supplementary and actual receipts divided into taxation, non-tax revenue, external assistance, external and domestic borrowing. On the expenditure side, the statement shows original payments, supplementary appropriations and actual receipts and payments against the ten (10) broad classifications of Government functions.<sup>136</sup>

**Statement E:** Public debt for the year ended. The statement shows opening balance, amount raised, amount paid, net movement and closing debt stock for external and domestic debt.

In addition to the five financial statements, the Blue Book contains a number of appendixes providing additional financial information of great value for Members assessment of the state of affairs in regard to the country's financial position. Examples of information provided in appendixes include inter alia:

- budget releases and expenditure by function;
- personal emoluments by category;
- use of goods and services;
- statement of unretired imprest by MPSA and amount;
- actual debt service for the period ended;
- grant aided institutions and Government controlled entities;
- statement of outstanding commitments;
- statement of audit opinions by Head in the last three (3) years;
- extract from Appropriation Act;
- extract from supplementary estimates; and
- entities that comprise the approved budget.

### 33.6 CONCLUSION

The Blue Book is structured in a way that makes the reader of the annual financial information easily understand the contents and be able to compare the information from one period to another. Since the Blue Book is prepared using the accounting standard, the information can also be compared with those of other countries. The accounting standards (cash basis and/or accrual) set out overall considerations for the presentation of financial statements, guidance for their structure, and minimum requirements for the content of financial statements prepared under the accrual basis of accounting. While usually attracting less political attention than the annual budget proposal for the next financial year, the End-of-Year Financial Statement gives a clear picture of the Government's financial performance in terms of realism in budget assumptions, accuracy in budget estimates and the level of fiscal discipline during the year of budget implementation. Therefore, the Blue Book is an essential source of information for Members assessment of the Executives past financial performance and a valuable tool for assessing the credibility of the fiscal forecasts in the Medium-Term Expenditure Framework.

<sup>136</sup> Including General Public Service; Defence; Public Order and Safety; Economic Affairs; Environmental Protection; Housing and Community Amenities; Health; Recreation, Cultural and Religion; Education and Social protection.

## REFERENCES AND FURTHER READING

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# CHAPTER 34

## Purpose, scope and impact of the reports of the Auditor-General and oversight operations of the Public Accounts Committee (PAC)

One of the significant oversight functions of Parliament is the examination of the Auditor-General's Annual Report, which provides a picture of the state of affairs of government institutions' financial performance and level of compliance with the country's financial legislative and regulatory framework. While the Public Accounts Committee plays a key role in this stage of the budget cycle, it is important that Members of Parliament in general and National Assembly Staff are able to link the funds appropriated by Parliament (Appropriation Act) to the funds utilised and accounted for, as well as the impact on the provision of public goods and service delivery. Members and Staff should eventually be able to synchronise the findings of the Auditor-General with the responses of the Executive in order to direct the PAC's oversight function of ensuring adherence to various regulations and policies including the Constitution of Zambia and the Public Finance Act.

### 34.1 INTRODUCTION

The Auditor-General produces reports on the accounts of the Republic, parastatal bodies and other statutory institutions and performance audits, among others, in accordance with the provisions of Article 250 (1) of the Constitution of the Republic of Zambia and the *Public Audit Act No. 29 of 2016*<sup>137</sup>. The reports

<sup>137</sup> Constitution of Zambia (Amendment), Op.cit, p. 99; The Public Audit Act, No. 29 of 2016

contain audit findings on the accounts of the Republic with respect to the preceding financial year. The purpose of the reports is therefore to inform Parliament on how public resources as appropriated by Parliament or raised by the Government and disbursed have been accounted for and utilised by various State organs, State institutions, provincial administrations, local authorities, and institutions financed from public funds.

The scope of the reports hinges on the Provisions of Article 250 (1) of the Constitution of the Republic of Zambia as amended and the *Public Audit Act No. 29 of 2016*<sup>138</sup>. Arising therefrom, the annual reports cover audit findings on revenues and expenditures of state organs, state institutions, provincial administration, local authorities, and institutions financed from public funds based on the funds appropriated by Parliament or raised and disbursed<sup>139</sup>. The parastatal reports cover audit findings of operations of parastatal bodies and other statutory institutions<sup>140</sup>, whereas the Performance Audit reports cover audit findings on the economy, effectiveness, and efficiency of funds expended. All reports cover various accounting and internal control weaknesses and other irregularities.

### **34.2 NATURE AND EXTENT OF AUDITOR-GENERAL'S AUDIT FINDINGS (REPORTS) AND THEIR IMPACT ON PUBLIC FINANCIAL MANAGEMENT.**

The nature and extent of audit findings and their impact on the accountability process within the public financial management domain varies, and depends on the observed weaknesses in the accounting and internal control systems and other irregularities. The observed weaknesses relate to respective state organs, state institutions, provincial administration, local authorities, and institutions financed from audited public funds. The Auditor-General's audit findings are contained in various reports as indicated above. These reports are produced in accordance with the provisions of Article 212 of the Constitution of Zambia and subsequently submitted to the President for tabling at the National Assembly not later than nine months after the end of the financial year<sup>141</sup>. The audit findings contained therein are a result of management letters (letters of internal controls) whose contents were not responded to or not satisfactorily responded to by various Controlling Officers at the time of reporting.

According to Quality Manager (2016), audit findings consist of errors, exceptions, deviations or deficiencies noted by the auditor as a result of an examination of audit evidence (supporting audit findings). The audit findings are as a result of non-compliance with policies; procedures and legal requirements; inadequacies and ineffectiveness of controls; and inefficiencies in the administration of public funds. The Auditor-General carries out systematic audits applying international practice and standards of auditing<sup>142</sup> to ensure that sufficient (in quantity) and appropriate (relevance

138 Ibid.

139 Ibid.

140 Ibid.

141 Constitution of Zambia (Amendment), Op. cit, p. 88.

142 Standards set by the International Organisation of Supreme Audit Institutions and other internationally recognised bodies approved by Government

and quality) audit evidence is obtained to support the audit opinions given in various statements contained in the Financial Report of the Republic of Zambia.

### 34.3 AUDIT FINDINGS

Some common audit findings in the Auditor-General's reports, framed in broad terms, are outlined below (Office of the Auditor General, 2014a and 2014b).

**Unsupported payments** – This indicates that payments made were not supported with relevant documents such as cash sale receipts, invoices, quotations, completion certificates for work done, etc.

**Wasteful expenditure** – This may arise in a situation where the expenditure on goods and services provided does not meet the expected value to be earned, or items procured cannot be put to good use, e.g. maize purchased by the Food Reserve Agency (FRA) and left to rot constitutes wasteful expenditure or equipment/materials procured but not fit for the purpose.

**Misapplication of funds** – This may involve funds meant, for example, for constituency development, which are used to pay salaries, sitting allowances and other unrelated items, rather than being used for carrying out constituency development related activities. Similarly, excess expenditure on one activity applied to other activities where there is a savings within a programme without Treasury Authority may be considered as misapplication of funds.

**Unretired accountable imprest** – This is a sum of money advanced to a person for payment of activities whose expenses are unknown at the point of payment and are only accounted for once the expenditure is known after retirement.

**Misappropriation of funds** – This entails the use of public funds for personal purposes or crediting public funds to a private bank account<sup>143</sup>.

**Unaccounted-for revenue** – This indicates that not all the revenue that is collected is deposited or found on hand, thus unaccounted for. In essence, these funds are not available for public expenditure, and are as good as stolen or misused.

**Unaccounted-for funds** – This is a situation in which funds are drawn or given to an institution or officers but where expenditure details cannot be found. There is a likelihood of the funds having been misused.

**Unaccounted-for stores** – This indicates various stores items procured which had either no receipt or disposal details or both. It could also mean that the items were not received or were stolen.

**Irregular payments** – This is where payment is made for the benefit of an officer or institution without prior authority to justify the payment. It may also mean payments made beyond the given authority, e.g.

<sup>143</sup> Accountant-General's Report 2013, page 424

additional rentals paid beyond the authorised rental period.

***Failure to follow procurement procedures*** – This is a situation where procurement procedures were flouted, or were not in line with the Procurement Act, e.g. single-sourcing was done instead of open tender.

The Auditor General reports on many more irregularities such as missing payment vouchers, missing accountable documents, delayed banking of revenue, unretired imprest, un-audited accounts, unprepared financial statements, qualified and unqualified financial statements, etc.

#### **34.4 IMPACT OF AUDIT FINDINGS (REPORTS) ON PUBLIC FINANCIAL MANAGEMENT**

In terms of impact, the various weaknesses and irregularities reported by the Auditor-General signify that public funds have not been effectively expended in order to ensure sufficient and appropriate delivery of public goods and services, thus impacting negatively on public financial management. Effectively, the non-compliance with laid-down regulations and procedures is a recipe for the loss of public assets, poor delivery of goods and services, and a further impediment to the achievement of social and economic development of the country. Various social amenities are not likely to receive a fair share of allocated resources, thereby inhibiting human development, productivity and ultimate growth of the economy and the country at large. The audit findings are likely to influence the manner in which financial decisions are made by the executives, thereby ensuring that public funds are utilised in an economical, effective and efficient manner. With good decisions made by the executives, coupled with committed leadership and supervisory skills, public funds can be properly utilised in a bid to enhance public financial management, and ultimate delivery of goods and services to the public. Nonetheless, the fact that the reports are produced, tabled in Parliament and debated by members of Parliament, is in itself a deterrent to further abuse of public funds by would-be culprits.

It should also be mentioned that the Auditor-General has the powers under the *Public Audit Act No. 29 of 2016* to, among others, surcharge a person or disallow expenditure by a person if the expenditure was incurred in contravention of this Act, the *Public Finance Act No 15 of 2004* or any other written law.

#### **34.5 OVERSIGHT ROLE OF THE PUBLIC ACCOUNTS COMMITTEE ON THE PUBLIC FINANCIAL MANAGEMENT.**

The Public Accounts Committee's (PAC's) oversight role in the accountability process of public funds is generally based on Article 63 of the Constitution of Zambia (Functions of Parliament and National Assembly). The appointment of members of the PAC is as provided for under Article 80 (Committees of the National Assembly) section (4) of the Constitution of Zambia. The PAC consists of nine members appointed by the National Assembly at the commencement of every session. The quorum of the Committee is four (National Assembly, 2016).

As part of its oversight role, the Committee examines the accounts showing the appropriation of sums granted by the National Assembly to meet the public expenditure (Ministry of Finance, 2014) and the reports of the Auditor-General on these accounts and such other accounts (Office of the Auditor-General, 2014a and 2014b). In so doing, the provisions of Article 203 (Appropriation Act, Supplementary Appropriation Act & Excess Expenditure Appropriation Act) of the Constitution of Zambia are adhered to. The Committee also exercises the powers conferred on it under Article 117 (5) of the Constitution of the Republic of Zambia (repealed). Upon the tabling of the reports by the Minister of Finance, the reports are referred to the PAC (by standing order) to allow the PAC to conduct sessions and receive submissions from the Executives (Controlling Officers and Secretary to the Treasury). During these sessions, the Auditor-General and the Accountant General act as permanent witnesses. The executives provide their submissions as contained in the Controlling Officers' memoranda. Once the responses have been submitted by the executives, the PAC cross examines the executives' submissions by asking various questions and then give guidance to the Controlling Officers and Secretary to the Treasury (National Assembly, 2014). In this way, the PAC ensures that various Controlling Officers and Secretary to the Treasury take steps to address the gaps in the public financial management. The report of the PAC that contains audit queries, submissions of the Executives and subsequent recommendations by the PAC is then debated in the National Assembly.

After the PAC report has been debated in the House and subsequently adopted, the Executive shall table an Action-Taken Report or a Treasury Minute thereon within sixty days of the adoption of the Committee's report (Standing Orders 2016, section 147). Once the Treasury Minutes have been tabled to the House, the Auditor-General shall audit or verify the details therein so as to provide assurance to the PAC on the facts provided by the Executives (Controlling Officers) during the hearing sessions.

The unresolved issues in the Treasury Minutes constitute the outstanding issues, which may be subject to legal action within a time limit of six years. If no action has been instituted within six years, the time limit imposed by the *Law Reform (Limitation of Actions, etc.) Act of 1963* has been exceeded and Government has forfeited its rights to take legal action against offenders.

It is important that staff and members of PAC understand the nature, extent and context of the responses coming from the Executives in relation to the nature, extent and context of the audit findings. This would ensure that the guidance provided by the PAC addresses the audit findings by the Auditor-General and concerns of the public at large. In this way, the PAC position on various responses based on issues contained in the Treasury Minutes and in its report can be appreciated as articulated sufficiently (The National Assembly, 2014).

PAC meetings are public and broadcasted on Parliamentary radio to further add to transparency and accountability in PAC operations.

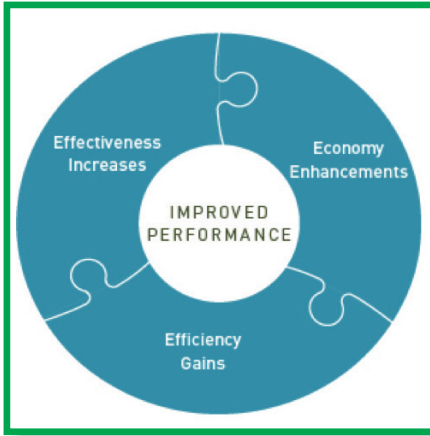
### 34.6 CONCLUSION

A well-functioning PFM system is to a large extent dependent on an independent supreme audit institution; a clear audit purpose; adequacy of the audit scope; and an Executive responsive to the reports of the Auditor General alongside the robust exercise of the oversight role conferred on the Public Accounts Committee on the audit findings. Any gaps in these symbiotic relations are likely to weaken the accountability process and the credibility of the public financial management system as a whole.

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# CHAPTER 35

## Performance auditing, including examination of the impact of spending on service delivery, economic growth and poverty reduction.

With the change of budget methods to focus more on results than inputs, the orientation of the audit has changed simultaneously. Thus, most supreme audit institutions have introduced value-for-money or performance auditing with a focus on achieved results against set objectives and targets and the money spent. Since the performance audit focuses on assessing the economy, effectiveness and efficiency of the operational nature of the organisation, the strategic impact on service delivery, economic growth and poverty reduction of public spending has become easier to assess. This chapter aims to explicate the importance of performance auditing to Members and Staff of Parliament in determining as to whether various state organs, state institutions, provincial administrations, local authorities, and institutions financed from public funds are achieving economy, efficiency and effectiveness in the employment of available resources.

### 35.1 INTRODUCTION

Performance auditing is a tool or process used to assess the employment or utilisation of public resources appropriated by Parliament or raised by the Government and disbursed. Performance auditing is also known as value-for-money audit, which mainly focuses on economy, efficiency and effectiveness ('the 3Es') in the allocation and utilisation of public resources. The conduct of financial and value-for-money audits, including forensic audits and any other

types of audit, in respect of a project that involves the use of public funds is provided for in the Constitution of Zambia (Amendment), 2016, Article 250 (1), which provides that the Auditor-General shall:

- (a) Audit the accounts of
  - (i) state organs, state institutions, provincial administration and local authorities; and
  - (ii) institutions financed from public funds;
- (b) Audit the accounts that relate to the stocks, shares and stores of the Government;
- (c) Conduct financial and value for money audits, including forensic audits and any other type of audit, in respect of a project that involves the use of public funds;
- (d) Ascertain that money appropriated by Parliament or raised by the Government and disbursed—
  - (i) has been applied for the purpose for which it was appropriated or raised;
  - (ii) was expended in conformity with the authority that governs it; and
  - (iii) was expended economically, efficiently and effectively;
- (e) Recommend to the Director of Public Prosecutions or a law enforcement agency any matter within the competence of the Auditor-General that may require prosecution.

## 35.2 PERFORMANCE AUDITING

### Performance auditing concept

Performance auditing can be defined as an audit tool or audit process used to determine as to whether an institution or beneficiary of public funds, is achieving effectiveness, efficiency and economy employment of available resources.

Effectiveness measures the degree to which results/objectives have been achieved. An effective organisation is one that achieves its results and objectives. It should be understood more from the deliverable basis and the achievement of goals.

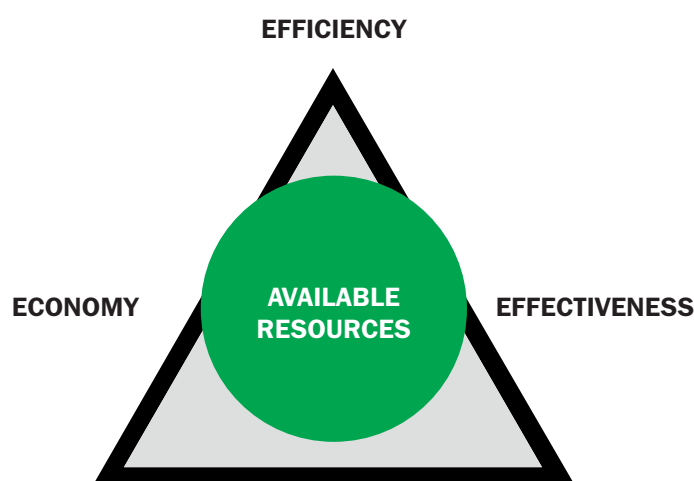
Efficiency measures how productively inputs (money, time, equipment, personnel, etc.) were used in the creation of outputs (products, outcomes, and results). An efficient organisation is one that achieves its objectives with the most resourceful expenditures of resources. It is about the right use of resources.

Economy measures the use of resources to achieve the right goals at the reasonable cost. It is about reducing the cost of inputs without a compromise in quality, i.e. keeping the cost low.

In order to create and deliver value to the various beneficiaries in terms of goods and services, and

eventually meet the set long-term strategies on economic growth and poverty reduction, there is a need to create a balance amongst the 3Es. The value proposition can be derived from the manner the 3Es relate based on the resource availability. The 3Es are depicted by the triangle in Figure 35.1 below.

**Figure 35.1:** Economy, Efficient and Effectiveness Triangle.



Based on Figure 35.1, any compromise on how each of the 3Es is stimulated would affect the manner in which the available resources are employed. For instance, a compromise on effectiveness would reflect on the manner in which available resources are employed from the economy and efficiency points of view and eventually affect the institution or project performance. The same would apply when there was a compromise on economy and efficiency respectively. Nonetheless, and in order to achieve a balanced value proposition, a lot of effort and commitment is required by those vested with the authority and responsibility of ensuring that resources are properly utilised and accounted for. If this is done properly, equilibrium in the public financial management is attained.

Performance auditing therefore goes beyond the achievement of results (financial audit and effectiveness) by taking into account components of efficiency and economy in the deployment of available resources. It is therefore more encompassing than a financial audit.

### **Nature and extent of performance auditing**

The nature of performance auditing is much dependent on the enabling legal framework, policies and procedures as promulgated from time to time. While auditing a profit-making organisation (financial audit) would mainly be based on determining its profitability, non-profit-making organisations such as Government would mainly want to see, for instance, how service provision has impacted on its citizenry. Performance auditing elucidates the need to ensure that the employment of available

resources has created the expected value to be earned from the service provided. Thus its extent is more to do with the degree or magnitude of various stakeholders' expectations. Basically, there is a need to know the extent to which certain strategies and policies have been met by combining both financial and non-financial aspects of operations. Therefore, unlike the private sector where a single bottom line of profitability prevails, for the Government, there is a triple bottom line that has to be balanced, as pointed out above.

Further, it could be asserted that the nature and extent of performance auditing largely depends on addressing the needs and requirements of the Government based on its national agenda (Vision 2030: Zambia being a prosperous middle income country). Its strategic focus is mainly on the employment of available resources in an economical, efficient and effective manner. Performance Audit Reports, as produced by the Auditor-General, should therefore cover audit findings based on the 3Es and speak to the strategic intent of the respective organisations being audited.

### **35.3 IMPACT OF SPENDING ON SERVICE DELIVERY, ECONOMIC GROWTH AND POVERTY REDUCTION.**

Public funds raised, disbursed and expended on goods and services should achieve the set aims and objectives, in a timely manner and with clear outputs and impacts seen. For instance, when the Government commits to the construction of 650 health posts in all the districts in the country by December 2016, the delivery of the 650 health posts would be considered to be effective if the means employed, the outputs produced and impacts observed are in line with the policy framework or implementation plan.

The impacts that can be noted from the performance audit report on effectiveness could include the following:

- Government programmes were effectively prepared, clearly designed and consistent;
- the objectives and the means provided, whether legal or financial, for a new or ongoing government programmes were proper, consistent, suitable or relevant and that they were achieved;
- the original structure, decision making process and management systems for programme implementation were effective;
- the quality of the public service meets the people's expectations or the stipulated objectives;
- Government investments, programmes and/or their individual components were effective (goals and objectives were met).

In so doing, service delivery would be deemed to have been achieved based on effectiveness.

### Impact on service delivery based on audit of economy

While effectiveness could have been achieved during service delivery, we still need to ask ourselves whether the right cost was allocated to improve value delivery without compromising quality (economy). In the 650 health post construction example, it would be fundamentally right to balance the use of resources to achieve the right goals at a reasonable cost (effectiveness and economy), i.e. keeping the cost low. Where this is not the case, service delivery may be affected despite achieving the results (effectiveness). For instance, the following should be seen in the report:

- the means chosen, such as the procurement process, or the equipment obtained, such as Cancer Test Equipment, represents the most economic use of public resources;
- that the human, financial and material resources used in the construction of the health posts were used economically;
- that the management activities were performed in accordance with sound administrative principles and good management policies.

In so doing, service delivery would be ensured based on economy.

### Impact on service delivery based on audit of efficiency

The impact on service delivery would be ensured if the institutions involved made the most of available resources by putting them to optimal or satisfactory use. In the case where the right level of allocation of resources is not achieved (input not producing the required output or not being efficient), it would mean that available resources were not properly employed and would point to a high cost of service delivery. In the construction of the 650 health posts, efficiency would only be attained if a trend of reducing waste and consuming less to deliver the same amount of value was visible. Effectively, the intended impact can only be achieved if the institution is getting the most output in terms of quantity and quality from the inputs and actions.

For instance, the following should be seen in the report:

- clearly stating that human, financial and other resources were efficiently managed;
- that government programmes, entities and activities are efficiently managed, regulated, organised, executed, monitored and evaluated;
- that the activities in government entities were consistent with stipulated objectives and requirements;
- public services were in good quality, client oriented and delivered on time; and
- that the objectives of government programmes were reached cost effectively.

Overall, any waste or misuse of public funds or non-attainment of set objectives would impact adversely on service delivery.

### Economic growth and poverty reduction

There is a high-level correlation between service delivery, economic growth and poverty reduction. Services delivered in an economical, effective and efficient manner would spur economic growth

and eventually reduce poverty. The productive nature and value proposition arising from the goods and services provided would enable growth in different sectors of the economy. Increased spending on capital increases productivity and income levels that eventually enables improvements in the Gross Domestic Product (GDP) or Per Capital Income (PCI) of individuals. It is expected that once this happens, a certain level of poverty reduction would be recorded. It is therefore important that available resources directed at the productive assets, for eventual generation of income levels and improvement in the GDP and PCI are optimally utilised.

### 35.4 CONCLUSION

Performance auditing has become a useful tool in overseeing and ensuring that public funds are being used in a cost-effective and efficient manner and that governments are achieving set objectives. Staff and Members of the PAC should therefore give adequate attention to these audit processes in the budget cycle. The reports and respective findings contained therein should be adequately debated on an equal basis or even more like irregularity audits. This would enhance the formulation of policies and regulation that speaks to the way public expenditure on goods and services should be seen in a bid to grow the economy and reduce poverty.

### REFERENCES AND FURTHER READING

Constitution of Zambia (Amendment), Act No.2 of 2016

# Annex I: Glossary

TERM	MEANING
<b>Accountability</b>	The responsibility of individuals and or committees for performing their duties conscientiously and with integrity.
<b>Accounting Standards</b>	Authoritative standards for financial accounting and reporting developed through an organised standard-setting process and issued by a recognised standard-setting body.
<b>Accrual accounting</b>	Accounting method that records income and expenses when they are incurred, regardless of when cash is exchanged. Accrual accounting also records assets and liabilities. The term “accrual” refers to any individual entry recording revenue or expense in the absence of a cash transaction.
<b>Activity-based budgeting (ABB)</b>	A method of budgeting where costs are allocated to categories of activity using an allocation basis which ideally reflects the real consumption of resources by those activity categories.
<b>Aggregate fiscal discipline</b>	The Government’s actions to ensure that the overall levels of revenue collection and spending are consistent with targets for the fiscal balance, and do not generate unsustainable levels of public debt.
<b>Aggregate fiscal policy</b>	The Government’s overarching objectives for the budget deficit, debt and other relevant fiscal aggregates.
<b>Allocative efficiency</b>	Refers to a situation where public resources are allocated in accordance with agreed strategic priorities.
<b>Appropriation Act</b>	An Act of Parliament that gives the Executive authority to collect revenues and incur expenditures in accordance with approved estimates of revenue and expenditure.
<b>ASYCUDA World</b>	A computerised customs management system which covers most foreign trade procedures. The system handles manifests and customs declarations, accounting procedures, and transit and suspense procedures. ASYCUDA generates trade data that can be used for statistical economic analysis.
<b>Balance sheet</b>	A balance sheet is a statement of the values of the stock positions of assets owned and of the liabilities owed by an institutional unit or group of units, drawn up in respect of a particular point in time. The balance sheet, presents the stock positions of assets and liabilities at the end of the reporting period in comparison to the stock positions at the beginning of the reporting period. The main balancing item on the balance sheet is <i>net worth</i> . The net worth of an institutional unit or a Government as a whole is the total value of its assets minus the total value of its liabilities. The change in net worth (comprising the change in net worth due to transactions in revenue and expense and the change in net worth due to other economic flows) is a fiscal indicator for assessing the sustainability of fiscal activities. As the produce of full balance sheets require accrual accounting, only relatively few governments’ produce full balance sheets.
<b>Budget</b>	Financial plan of action for some future period, usually a fiscal year. It shows how Government intends to spend planned revenue within the fiscal year to deliver public goods and services to the people or community it serves in the most efficient and effective way.
<b>Budget Cycle</b>	Refers to four distinct stages in the budget process, namely 1. The budget preparation stage; 2. Budget approval stage; 3. Budget implementation stage, and 4. Post budget implementation stage.
<b>Budgeting</b>	The process of compiling data and revenue and expenditure estimates, including costing of revenue measures, programmes and activities. The process also entails the prioritisation between competing expenditure needs within the constraint of the estimated resource envelope.
<b>Cash accounting</b>	An accounting method that records income upon receipt and expenses when payment is made.
<b>Cash-flow</b>	The amount of income and expenditure that takes place within a certain time period.
<b>Cash-flow management</b>	The actions initiated to ensure that liquidity is sufficient to meet mandatory expenses at any time.

<b>Chart of Accounts</b>	System of classification of transactions – revenue, expenditure and financing - used for accounting purposes.
<b>Classification of the Functions of Government (COFOG)</b>	Functional classification of expenditure developed by the United Nations. The COFOG applies the Government Finance Statistic standard and contains ten main functions at the highest level and 69 functions at the second (sub-functional) level.
<b>Commitment</b>	Contractual obligation to make a future payment.
<b>Cost-drivers</b>	Refers to cost elements which drive the expenditure of a project or spending entity, e.g. number of school children, patients, kilometers of roads, number of employees, etc.
<b>Cost-effectiveness</b>	The achievement of intended outputs and outcomes at lowest possible cost without compromising quality.
<b>Creditworthiness</b>	A valuation performed by lenders that determines the possibility a borrower may default on his debt obligations. It considers factors, such as repayment history and credit score.
<b>Devolution or devolved governance</b>	The statutory transfer of political, administrative and financial powers from the central government of a sovereign state to the subnational level, such as a regional or local level. Devolution differs from delegation and de-concentration in that administrative, political and financial powers are vested in elected sub-national governments, e.g. District Councils, whereas deconcentrated or delegated powers are subject to Central Government supervision and can be withdrawn anytime.
<b>Economic classification</b>	Identifies budget input categories, such as goods, services, wages, subsidies, interest and capital expenditure.
<b>Economic fundamentals</b>	Basic economic indicators used to measure the health of the state's economy, including such economic measures as economic growth (GDP), employment, interest rates, the Government's budget deficit, the country's balance of payment account (relating to exports and imports), the level of domestic business confidence, the inflation rate, the state of (and confidence in) the banking and wider financial sector and consumer confidence.
<b>Economy</b>	Measures the use of resources to achieve set output targets in the "best and cheapest" way. It is about reducing the cost of inputs without compromising quality.
<b>Effectiveness</b>	Measures the degree to which Government is achieving set objectives.
<b>Efficiency</b>	Measures how productively Government uses input (money, time, equipment, personnel, etc.) in the creation of outputs (products and results). It is about the right use of resources.
<b>Estimate</b>	A statement of the amounts that the Government propose to spend on a specific programme or activity in a financial year.
<b>Executive</b>	The President of the Republic, Members of the Cabinet, the Administration and Government institutions (MPSAs). The Executive is the arm of government responsible for the formulation and execution of policies.
<b>Expenditure assignment</b>	Refers to the financing need of local authorities to be able to deliver assigned public service delivery responsibilities.
<b>Fiscal decentralisation</b>	Fiscal decentralisation can be defined as a two-dimensional policy that involves either decentralisation of a tax instrument to give local governments the power to raise taxes, or decentralisation of expenditures to give governments the responsibility for implementing expenditure functions, i.e. service delivery. The Zambian fiscal decentralisation policy has adopted the doctrine: 'funds follow functions'.
<b>Fiscal consolidation</b>	A policy aimed at reducing government deficits and debt accumulation to sustainable levels.



<b>Fiscal risk</b>	<p>Possibility of deviations of fiscal outcomes from what was expected at the time of the budget. Sources of fiscal risks include, among others, unexpected changes in macroeconomic variables, most notably in the case of exchange rate depreciations; contingent liabilities in the banking system or in the public sector (e.g. related to state-owned enterprises and subnational levels of government), or the Government's interactions with the private sector through PPPs.</p> <p>Risk management refers to the actions taken to assess and manage these uncertainties.</p>
<b>Functional classification</b>	Identifies categories of expenditure according to the purposes and objectives for which they are intended.
<b>Government</b>	The party or a coalition of parties that governs by virtue of having gained the most seats in a parliamentary election. The term is sometimes also used more narrowly to mean the Executive and the State administration.
<b>Government Finance Statistics (GFS)</b>	The international standard for classification systems. The GFS provides the framework for economic and functional classification of transactions.
<b>Gross Domestic Product (GDP)</b>	<p>A measure of economic activities in a country. The GDP measures the total monetary value of goods and services produced in a given year.</p> <p>GDP = total consumption, investment, government spending and net export.</p>
<b>Horizontal fiscal imbalance</b>	Fiscal imbalance refers to a mismatch between the revenue powers and expenditure responsibilities of a government. <i>Horizontal</i> fiscal imbalances refer to disparities between sub-national governments at the same level (e.g. Provinces or Districts). Disparities between sub-national governments at the same level are normally sought equalised through transfers from the Central Government to sub-national governments (in Zambia, through the Local Government Equalisation Fund).
<b>Incremental budgeting</b>	The budgeting process which considers last year's budget and makes only incremental (minor) adjustments to a new budget.
<b>Inflation</b>	<p>Inflation is usually defined as the sustained rise in the general level of prices. Inflation has a negative effect on people's savings and purchasing power, which - in particular - affects the poor, most of whom cannot adjust their earnings in the face of inflation. Positive effects include reducing the real burden of public and private debt, keeping nominal interest rates above zero so that central banks can adjust interest rates to stabilise the economy.</p> <p>When the Bank of Zambia wants to control inflation, it resorts to tight monetary policy in order to reduce the amount of money available in the economy. On the other hand, when it wants to stimulate economic growth it may implement expansionary monetary policy through an increase of money in the economy.</p>
<b>Integrated Financial Management Information System (IFMIS)</b>	<p>An integrated financial management system to bring about transformation and automation of Government business processes, including the acquisition, allocation, utilisation and conservation of public financial resources, whilst allowing for financial discipline and control of resources.</p> <p>The Zambian IFMIS contains the following six modules: 1) budget (annual budget and budget releases); 2) materials management (purchasing and commitment accounting); 3) payments; 4) cash management and bank reconciliations; 5) revenues, and 6) financial reporting.</p>
<b>Intergovernmental fiscal transfers</b>	<p>Transfers from Central Government to sub-national governments to compensate for gaps between decentralised expenditure responsibilities and revenue-raising abilities, and/or to even out disparities between sub-national governments at the same level.</p> <p>Subnational governments are almost never self-sufficient financially. Their revenue-raising responsibilities fall short of their expenditure responsibilities, forcing them to rely on financial transfers from the national government.</p>
<b>Legislature</b>	A law-making body of elected representatives. The arm of Government (Parliament) with the power to make and change laws.

<b>Line-item budgeting</b>	A budgeting method in which agencies are provided with budget appropriations specified in terms of input categories by economic classification.
<b>Macro-economy</b>	A branch of economics dealing with the performance, structure, behaviour, and decision-making of an economy as a whole rather than individual markets. This includes national, regional, and global economies.
<b>Medium-Term Expenditure Framework (MTEF)</b>	Budget planning approach and tool that encompasses forecasts of all revenues and expenditures and links the national plans and medium-term sector plans with the medium-term budgetary framework, which in turn forms the basis for the annual budget.
<b>Member of Parliament</b>	A person elected to the National Assembly. The National Assembly consists of 168 members composed as follows: 156 members directly elected on the basis of simple majority vote under the first-past-the-post-system; 8 nominated members; The Vice-President; The Speaker; and The First and Second Deputy Speakers.
<b>Microeconomics</b>	A branch of economics dealing with the study of units within the economy, e.g. firms, markets, and individual consumers. It looks at issues such as consumer behaviour, individual labour markets, and the theory of firms.
<b>Money Bill</b>	A bill imposing a tax or levy or proposing the spending of money for a particular purpose. The Appropriation Bill is a money bill.
<b>Medium-Term Expenditure Framework (MTEF)</b>	Three years rolling financial planning framework linking plans, policy priorities and programmes with multi-year fiscal and economic forecasts and annual budget estimates.
<b>Operational efficiency</b>	Refers to a situation where maximum value for money in the delivery of services is achieved.
<b>Outcome</b>	An outcome is the change brought about by Government intervention. If the level of malaria falls for reasons which have nothing to do with government actions – for example drought – this fall is not an outcome linked to performance. Neither is it an outcome if the rate of economic growth increases substantially because the world economy is very buoyant. The fall in malaria or the boost in the growth rate are outcomes if they are the result of Government actions.
<b>Output</b>	Outputs are changes in skills or abilities and capacities of individuals or institutions, or the availability of new products and services that result from the completion of activities within a development intervention within the control of the organisation. They are achieved with the resources provided and within the time period specified. A set of outputs lead to an outcome.
<b>Parliamentary oversight</b>	Refers to Parliament's constitutional mandate to oversee the performance of the Executive (Article 62 (2)), including its compliance with the guiding principles of public finance as provided in Article 198 of the Constitution.
<b>PEFA Assessment Framework</b>	PEFA is a methodology for assessing public financial management performance. It provides the foundation for evidence-based measurement of countries' PFM systems. A PEFA assessment measures the extent to which PFM systems, processes and institutions contribute to the achievement of desirable budget outcomes.
<b>Performance audit</b>	Audit tool or audit process used to determine whether an institution or beneficiary of public funds is achieving economy, efficiency and effectiveness in the use of available resources.
<b>Performance-based grant systems</b>	Refers to intergovernmental fiscal transfer systems, where the size of Central Government transfers to sub-national governments, or part of the transfers, depends on the performance of the respective local governments. The performance assessment may include indicators, such as: timely produce and passing of budget; timely and accurate reporting on spending and project implementation progress; number and nature of audit queries; timely and accurate end-of-year financial statement, and level of public participation in the planning and budgeting process.

<b>Performance indicator</b>	Quantitative and qualitative measures which provide information on the efficiency and effectiveness of actions, programmes and organisations.
<b>Port Folio Committee</b>	A committee whose membership is confined to a specific number of members of the National Assembly. Portfolio committees exercise oversight over a particular government department or sector ("portfolio") and deal with bills and other issues within that portfolio.
<b>Procurement</b>	Refers to the process of .....
<b>Programme classification</b>	Identifies sets of interconnected activities aiming at achieving specific outputs. In the Yellow Book - Volume I - 'Capacity Building' constitutes a programme. In Volume II, 'Primary Education' constitutes a programme.
<b>Programme budgeting</b>	The systematic use of performance information to inform decisions about budgetary priorities between competing programmes, based on the programme classification of expenditure.
<b>Public Financial Management (PFM)</b>	Refers to the set of laws, rules, systems and processes used by Government to mobilise revenue, allocate public funds, undertake public spending, account for the money spent and audit results. It also refers to the political decision making process of formulating economic and financial policies and maintaining fiscal discipline, the budget approval and financial oversight function performed by Parliament and civil society's involvement in the budget cycle.
<b>Public Private Partnership (PPP)</b>	<p>Refers to an arrangement between the public and private sectors (consistent with a broad range of possible partnership structures) with clear agreement on shared objectives for the delivery of public infrastructure and/or public services by the private sector that would otherwise have been provided through traditional public sector procurement.</p> <p>The PPP approach has the potential to offer value for money and timely delivery of infrastructure when applied to projects of the right scale, risk and operational profile.</p> <p>One key aspect of the PPP approach is that risk is transferred to the party that can manage it best.</p>
<b>Sub-National Government</b>	Sub-National or Local Government is the collective term for local councils or local authorities. Local councils are made up of councillors (members) who are voted for by the public in local elections and paid council staff (officers) who deliver services.
<b>Subsidiarity principle</b>	Holds that decisions should be taken as closely as possible to the citizen. Hence, decision-making and activities should be carried out by the least centralised competent authority.
<b>Treasury Single Account (TSA)</b>	The TSA is a unified structure of Government bank accounts under the management of the Ministry of Finance through which government transacts all its receipts and payments and gets a consolidated view of its cash position at the end of each day.
<b>Value-for-Money</b>	Refers to the three E's: Economy, Efficiency and Effectiveness.
<b>Zero-Based Budgeting</b>	The annual line item re-determination of budget and costs of activities based on the spending entity's work or business plan.

