

Good Financial Management

Just as it is impossible not to taste honey or poison that one may find at the tip of one's tongue, so is it impossible for one dealing with government funds not to taste, at least a little bit, of the King's wealth.

Kautilya (Prime Minister of a state in northern India)¹

One of the most powerful anti-corruption devices is the establishment of sound financial management practices, with timely and efficient accounting systems combined with punctual, professional reviews by internal and independent auditors. For this to be achieved, top-level management and political commitment to robust controls is vital – be it in the public or in the private sector. Such a commitment is a missing element in many countries today, and in both the public and the private sector.

Too often when fraud and corruption are considered, legal and prosecutorial mechanisms coupled with punitive measures come to mind. However, this is a simplistic approach, and all it accomplishes is a “feel good” glow when harsh laws and draconian penalties are enacted – even though, when one looks around the world, such actions have met with scant success.

One of the major purposes of a sound financial management system in business is to combat and disclose internal white collar crime. Some mistakenly think that the requirement of annual audits is all that is needed to do the trick. However, auditors' hands are tied where inadequate accounting systems obscure the “audit trails” which should permit auditors to find irregularities and determine who is responsible for them.

Poor, disconnected and untimely accounting systems and disintegrated approaches to financial management provide opportunities for fraud. They also serve to cover it up, and, worse still, if fraud is discovered or reported, they make it impossible to identify and punish those responsible. On the other hand, clear and transparent paper trails not only serve to lead quickly to the guilty – and discharge any suspicion of the innocent – but they also provide a powerful deterrent.

The responsibility of a government is not, of course, limited to ensuring the proper financial management of central funds in accordance with standards and procedures. It extends, too, over the whole of the general government sector, including regions, districts and municipalities, as well as central government institutions. This task can be extremely difficult where there is a large degree of decentralisation accompanied by shortages in management and audit capacity, or where local democracy and subsidiarity are deeply embedded in political attitudes and cultures.

¹ Kautilya was writing more than two thousand years ago. Quoted in the Arthashastra (New Delhi: Penguin Books, 1991 at page 281).

The government should also ensure that strong financial management systems are introduced into agencies and organisations that are on the interface of the public and private sectors, and in public corporations that are subject to government regulation. In all of these, sound and reliable standards of governance are often badly needed. This can be complex in practice - in some countries, often thanks to Ministerial patronage, cronyism and nepotism - some agencies have almost developed an independent life of their own. Nevertheless, this only makes the need to bring them under control, and have them performing to acceptable standards, all the more compelling.

What is good financial management?

The objective of good financial management in the private sector is to provide information on which decision-makers can base wise and prudent judgements. In the public sector, however, financial management has been more concerned with compliance with legal mandates than it has been with providing inputs into decision-making. As a consequence, many key financial management decisions in the public sector tend to be based upon present political realities, rather than on a careful analysis of future outcomes.

It is this inevitable mixture of politics, law and public scrutiny that makes governmental financial management so much more difficult and complex than financial management in the business world. As a result, governmental financial management can be much more challenging than its private sector counterpart.

However, it is very important that the objectives for public sector financial management, including the financial management of internationally financed projects, be reformulated along the lines of private sector dynamics.

The scope of financial management responsibilities in government or business includes funding, custodial, analytical and reporting functions, among other elements. The following tasks characterise financial management in both sectors:

- Analysing and assessing the financial impact of management decision both prior and subsequent to implementation;
- Ensuring the necessary cash flow to finance planned activities and operations;
- Safeguarding resources through appropriate financial controls;
- Providing a financial framework for planning future activities and operations;
- Managing transaction processing systems which produce information for the control of planned activities and operations;
- Ensuring legality and regularity in the use of public funds;
- Paying attention to concepts of efficiency and effectiveness; and
- Reporting and interpreting the results of activities and operations measured in financial terms and thereafter ex post audit and evaluation.

As the demands on government have increased, and as new revenue sources have been exhausted, there has been a shift in emphasis among the financial management functions. Almost all nations are cash-poor in relation to the accepted demand made on their governments.

Hence, the spotlight of financial management is now on getting cash and managing it - for without cash, budgets cannot be executed. The existence of uncontrollable external economic influences, the questionable reliability of traditional revenue sources, and the insatiable demand for more and more public services, have all acted to bring cash management, including debt management, to the forefront of public sector interest. Yet, few countries have achieved ade-

quate or acceptable cash management systems. Even developed and industrialised countries have only recently begun to introduce new and improved approaches to cash management. The fragmentation of the central financial management functions is another characteristic peculiar to the public sector. Although businesses commonly designate qualified individuals as “chief financial officers”, few governments can identify their own key financial executives. The basic financial management functions are often divided among agencies which compete for influence, instead of collaborating for the common good.

All too often financial information is not available, is not timely, is not reliable and is not used in making the key decisions of government. A sense of financial management consciousness is sorely needed in the public sector. Each government needs an appropriate financial management philosophy, and a clear definition of the scope of the financial management function. Then it must assure competent professional financial management leadership for that function and provide adequate staffing and support.

As countries develop, their need for co-ordinated professional financial management increases. Thus, among the many needs of developing countries is the need to integrate basic financial management functions and responsibilities into a co-ordinated single system under competent professional leadership. This can be done without the extensive use of sophisticated computerised systems.

However, increasingly new microcomputer technology and decreasing costs are bringing integrated financial management systems within the reach of almost every national government. Individual government agencies, municipalities and other government units are likewise able to finance and maintain integrated agency-wide financial management systems which provide information useful and timely in making key managerial decisions, and also provide better accountability to higher levels of government and to all citizens.

How good financial management counteracts corruption

In general, a sound system of financial management and accounting inhibits, discloses and helps confirm and identify corrupt practices and their perpetrators in the following ways:

- It provides sound information for the various anti-corruption “watchdogs” – the Auditor-General (or Supreme Audit Institution), the Public Accounts Committee of the Parliament or Legislature, and the investigative and prosecutorial agencies;
- It forces a disciplined on-time approach to public activity and financial reporting. Sound financial management includes requirements that all transactions adhere to the same rules, eliminating the loopholes and alternative mechanisms which foster and cover up corrupt activities;
- It promotes the development of strong internal managerial controls. These include appropriate “audit trails” (requisites of sound financial management), which strengthen the probability that corrupt practices are discovered and identified as such, so permitting more prompt investigation;
- Managerial control is further strengthened with regards to oversight of discretionary power over resources and expenditures which are subject to a high degree of vulnerability. Typical areas of abuse are travel expenses, consulting contracts often subdivided to come below thresholds of review, particularly valuable or attractive and portable assets such as vehicles and portable computers, etc., not to mention the inevitable temptation for kickbacks posed by very large capital expenditure projects or acquisitions in large amounts;
- It facilitates audit. Professional and timely internal and independent audit which

focuses on highest risk areas is made possible where financial management, especially accounting systems are adequate; and

- It provides psychological control. It has been well established that fear of discovery and punishment is a prime factor in discouraging corrupt practices. The knowledge that internal managerial controls are in place, constantly being emphasised and improved, and subject to selective audit review, is a powerful disincentive to the potentially corrupt.

An Integrated Financial Management System (IFMS)

An Integrated Financial management System (IFMS) is a most important tool for good financial management. Some countries may lack the resources or the capacity to implement a full-blown IFMS, as described here. However, they should not be deterred from putting basic building blocks in place - such as modern accounting, cash management and internal audit systems - and so building up an IFMS on a step-by-step basis.

An IFMS consists of an interrelated set of sub-systems which plan, process, and report on resources, quantifying them in financial terms. The basic sub-systems normally are accounting, budgeting, cash management, debt management, and their related internal controls.

Other sub-systems sometimes included are collection and receivable management, acquisitions and supply management, information management, tax and customs administration, retirement or social security system administration, etc., together with their own related internal controls.

One of the most important elements of modern internal control in any government agency consists of an independent and professional internal audit function, which constitutes, together with the other internal controls, an integral part of an IFMS.

The principal factor which “integrates” the system is a common, single, reliable data base (or several interconnected data bases) to and from which all data expressed in financial terms flows. All of the sub-systems, and all users of financial data, must be required to participate in common data sharing. The validation, classification and recording of data is a function of the accounting sub-system which produces timely reports of classified data for use by all systems, and others who use financial information.

An IFMS can be developed regardless of a specific organisational structure, but it is likely to function better where the four basic sub-systems - accounting, budgeting, cash management, and debt management - are closely related within the organisational structure, under a common, professionally qualified financial management executive.

The failure to integrate financial management information traditionally results in:

- fragmented and unreliable data;
- duplications of data difficult to reconcile;
- failure to utilise actual results in the planning and budgeting processes;
- failure to fully and publicly report results of operations and financial conditions;
- hidden fiscal transactions, including contingent liabilities, quasi-fiscal transactions, government guarantees and the like, which can surface unexpectedly and cause major fiscal disruption;² and,

² The World Bank has carried out pioneering work in codifying these kinds of transactions and encouraging countries to meas-

ure them and to publish information about them as part of regular budget documentation and government financial reports.

- undue emphasis on one of the component sub-systems (usually budgeting) which tends to dominate, duplicate and crowd out the others.

Components of an IFMS

The principal four components of an IFMS are accounting, budgeting, cash management and credit management. These component sub-systems of the IFMS must be permeated by sound internal managerial controls, imbedded and virtually invisible. Each of them must be supported by an environment of ethics and integrity, which must stem from the highest levels of government.

Accounting

The accounting sub-system is at the heart of the IFMS, because the other sub-systems depend on it for useful, timely and reliable data. If the accounting sub-system fails to produce timely data (which is all too frequently the case), the remaining sub-systems cannot function properly. In this case, substitute data is often sought, new ad hoc records are set up to produce indispensable data, and management decisions are made without the information necessary to apply good judgement. Thus, sound development and maintenance of the accounting sub-system are absolutely necessary to the success of the IFMS, and constitute a very important factor in its “integration”.

Among other things, the accounting system allows for:

- providing information to programme managers for use in making informed decisions;
- the substantiation of financial transactions based upon duly organised supporting documentation;
- making it possible to report results in financial terms, and where performance data is maintained, to report costs;
- control over current year budgetary execution as disbursements are made, and preparing future year budgets based upon actual expenditures made; and,
- providing periodic financial reporting and audit-ability, so lending credibility to governmental operations, and strengthening accountability.

It is very important that all accounting and budgeting classification or coding schemes be fully integrated into a single common classification which remains constant over a period of years. Changes in classifications from year to year impair the ability to compare data and to analyse trends.

For accounting purposes the chart of accounts should contemplate and integrate all accounts containing assets, liabilities, government equity, revenues and expenditures in such a manner so as to facilitate the preparation of financial statements in accordance with the accounting principles applicable in the public sector.³

The International Federation of Accountants’ Public Sector Committee (IFAC/PSC) has issued a series of official pronouncements which discuss and interpret the applicability in the public sector of the International Accounting Standards and International Auditing Standards. These Standards were developed in a continuing effort to harmonise the professional standards of the accountancy profession across the world.

³ E.g. the IMF’s Government Finance Statistics (GFS) system.

More recently the IFAC/PSC has issued accounting standards, based as closely as possible on the International Accounting Standards (IAS) applicable in the private sector, and which are specifically designed for all governments to follow. Although these pronouncements obviously cannot be binding on national governments, they do provide professional guidance which governments can use in determining which standards to recognise and apply.

For central government, a relatively uniform accounting system based upon a single general ledger is preferable. However, publicly owned corporations normally require sophisticated accounting systems designed according to the nature of their activities.

IFAC/PSC has generally stated that regardless of the nature of the enterprise (i.e. public or private), the international standards should apply. However it recognises that some government institutions have non-financial or social objectives, and may require different types of information, thus demanding certain modifications in the application of standards designed initially for the private sector.

There should be clear responsibility for the setting of accounting standards in the public sector, and for directing the accounting function throughout the government so as to assure the proper functioning of the accounting system and its adherence to professional standards.

Each public transaction, operation or event quantifiable in monetary terms, should be recorded in the accounting system and reported on. These should include funds outside or “off budget” as well as funds of third parties held in trust or agency, or which are in any other manner under the custody of public officials.

Budgeting

There is more literature available on public sector budgeting than all the other sub-systems of public sector financial management put together. Notwithstanding, it is extremely important to highlight the fact that budgeting must be integrated with the other financial management areas, even if it exists in an independent high level agency outside the finance ministry or treasury department.

Furthermore, budget execution data must be derived from the accounting system, and not separately recorded and processed. Many developing countries have lost control over their financial affairs due to the segregation of budgetary execution data from other financial data, and/or due to the maintenance of ad hoc budgetary execution records outside the accounting system. This aspect is probably the most problematic and most important area of integration in an IFMS.

No agency of the public sector should administer public funds outside the budget. Budgetary principles of universality and unity demand that all forecast revenues and all programmed expenditures of all types be accounted for within the government’s budget, including all transfers to other levels of government and autonomous entities or public corporations. This means that any use of “special” (or “earmarked”) revenues that are not paid into the general pool of revenues, should be minimised. So, too, should the use of supplementary budgets, which can distort the fiscal targets and ceilings set in the main budget.

The budgets of public corporations and substantially self-financed entities, need not be centralised within the budget of the state, but should be formally presented to the national budget authority.

The budgetary sub-system should be designed in such a simple and practical manner as to facilitate smooth operation in co-ordination with the other IFMS sub-systems. At the end of the day it is essential to ensure that the budget out turn for a year does not over-run by a substantial margin the figures set in the budget itself.

Cash Management

Cash management seeks to ensure that the achievement of budgeted goals and objectives are not frustrated by a lack of cash liquidity. This is the over-riding problem in governmental financial management today across the world. Meeting cash management objectives requires forecasting the combined flow of funds, and planning to meet financing needs, including short-term borrowing, as budgeted.

The scarcity of financial resources, in the face of growing demands for expenditure on public and social services, has compounded the problems posed by traditional practices of maintaining a multiplicity of idle funds languishing in numerous accounts, with various banks, and for multitudinous purposes. Thus, in the modern and efficient financial management system it is obligatory to unite all cash flows in what is sometimes called the “single bank account”.⁴ Every financial inflow from any source which results in public funds, should be deposited directly into the single cash depository account of the National Treasury. In the same way, all disbursements should be drawn against the same account, and based on authorisations which conform to the cash flow plan of the government.

To assure operational flexibility, public corporations and other substantially self-financed entities should not participate in the unified treasury system. However, like the central government, they should carefully plan and forecast their cash flows to avoid idle cash maintained in accounts, and to ensure that liabilities are met when they fall due.

Credit Management

As governments have incurred more and more indebtedness in recent decades, those institutions who market and underwrite public debt have assumed greater importance. There has been much emphasis on sound debt management since the developing world’s external debt crisis of the 1980’s, and the Asian crisis of the 1990’s.

There is certainly unanimity on the need to improve debt management. However, it is important not to lose sight of the fact that public debt is not, and cannot be, isolated from the rest of the financial management system. It has been the collapse of other financial management sub-systems, especially budgetary control, which have provided the motor for the phenomenal increase in public sector debt over the past two or three decades in almost every country.

Planning indebtedness is just as essential as planning cash flow, and many feel that these two sub-systems should be considered as one owing to their close relationship. Unfortunately, the present situation in nearly every country means that planning of indebtedness is indispensable to “balancing” the budget. Public sector borrowing has become the “finaglefactor” to budgetary stability.⁵ Public indebtedness is often the result of a political decision not to raise taxes or to reduce expenditures to affordable levels, or else as a periodic response to seasonal fluctuations in revenue and disbursement.

4 In practice this will often be a series of linked accounts in respect of which information is continually available, and which can be pooled at the end of each day.

5 Finagle = to get or achieve by trickery, craftiness or persuasion; to use trickery or craftiness (on a person). Collins English Dictionary Millennium Edition.

At the national level, any financing operation based on committing the credit of the state should be channelled through the agency responsible for public credit. This will assure the oversight and proper recording of the transaction as a liability to new debt, and the planning of the corresponding inflow of cash.

Internal Control

Internal control, which may be considered synonymous with managerial control, is of great importance within each of the IFMS sub-systems. Appropriate internal control measures should be integrated within each sub-system in such a manner that their application becomes an integral part of the normal processing of transactions. Internal control comprises all the co-ordinated measures and methods adopted within an entity to:

- safeguard its resources;
- promote the reliability and accuracy of financial and operational information;
- promote efficiency in operations;
- stimulate adherence to legal provisions, policies and standards; and to
- achieve programmed goals and objectives.

Internal control measures and procedures should be installed in each entity and integrated within its administrative operating procedures. Pre-control and approval of administrative operations and transactions are performed by the same employees who are responsible for the ordinary flow of operations. No organisational unit should be specifically set up to perform pre-control functions (sometimes erroneously called “pre-audit”). Internal audit, an important part of internal control, should be exclusively dedicated to “post audit”, which includes a review and evaluation of the internal controls in place.

Internal audit is a part of the internal control structure dedicated to measuring and evaluating the other internal controls. Thus, internal auditors must be professionally independent and should not participate in, or approve, administrative acts or financial transactions. Internal auditors should observe the Standards for the Professional Practice of Internal Auditing promulgated by the Institute of Internal Auditors.

The particular anti-corruption advantages of IFMS

Integrated Financial Management Systems is a term first coined in the 1970’s to describe the systems developed after the near financial collapse and impending bankruptcy of both the City and State of New York. The financial management inadequacies and fragmentation highlighted by this collapse led to the development of high-technology tools for use in the fight against financial corruption, no less than against mismanagement.

IFMS counters corruption in a variety of ways:

- *Multi-level budgetary control* – Budgetary review and control may be exercised at the operational, supervisory, and central levels, based on varying thresholds of activity or other factors. Automatic flash points may be built in to call attention to deviations in areas of high vulnerability as well as to repetitive inappropriate budgetary manipulations.
- *Avoidance of cash flow “surprises”* – Actual cash flows can be monitored at appropriate levels through effective and timely cash management practices. Cash flow forecasts can be prepared, and the typical cash unavailability “surprises” which can provoke draconian austerity crises, can be avoided.
- *Spotlighting weaknesses* – “Exception reports” can be designed to provide prompt

feedback to managers in areas where weaknesses are becoming a trend.

- *Internal validation of integrity* – Validation of the integrity of transaction data is provided for at each key step during the processing of transactions, and is duly documented electronically both to avoid delay in internal controls execution and to limit external controls to those of a “post-audit” function.
- *Accounting control over resources* – The accounting system maintains general ledger controls overall valuable resources which are independent of operations. Governments in developing countries have generally been unable (both for internal purposes and project accountability) to control or account for important assets such as receivables, land, buildings, other fixed assets, vehicles, computer equipment, software, and all types of electronic equipment. An absence of such controls facilitates the “looting” of state resources by officials and their friends.
- *Transparency in public reporting* – Complete and timely financial reports are available for disclosure to legislative oversight committees, and to the public at large, as provided for in most national constitutions but without such a system are rarely produced. Once transparency is achieved it is hard for officials to cover up “bad news” when it is contained in financial reports. The tendency to ensure that “bad news” was never published has been a major reason why disciplined and transparent financial reporting has long been avoided.
- *Consistent enforcement of criteria* – The consistent policies and practices required by an IFMS, such as the use of a single unique Treasury bank account for all public funds and the prohibition of “off budget” expenditures, inhibit corrupt and collusive practices. Where they persist, they are entered into the accounting system of non-acceptable transactions, unless responsible officials are dismissed - which, in itself, results in disclosures of corrupt practices.
- *Decentralisation of authority and accountability* – Each unit or activity chief is in charge of financial planning and transaction authorisation within his or her specific area of responsibility. Original transaction entry is at the operational level, while managerial reports are about execution of their own financial transactions, but, all are subject to either on-line or very timely supervision and oversight from higher levels.
- *Reduced need for accountants* – Typical and repetitive transactions are pre-coded according to type and amount entered, and therefore appropriate accounting entries are made automatically, reducing the need for accounting expertise while at the same time reducing the possibility that transaction data can be manipulated.
- *Immediate audit capability* – Timely entry of transaction data at the point of origin permits internal auditors to pay immediate attention to areas and activities identified as being vulnerable to corrupt practices.
- *Disclosure through comparability* – High speed computer comparison of data available in comparable form (such as double salaried staff, retirees also drawing remuneration, duplicate payments to suppliers, etc.), can quickly and efficiently disclose patterns of corrupt practices and their overall impact.
- *Computer assisted audit* – Computer audit software can be utilised in selecting transactions for audit sampling, greatly reducing audit costs and enabling increased attention to be given to areas which demand more frequent audit coverage. This is an anti-corruption measure which hitherto has traditionally been unavailable in developing countries.

Advantages of IFMS to the honest

Finally, there is the constant need to protect honest employees from the shadow of suspicion. This invariably falls over the honest no less than the dishonest whenever corruption is sus-

pected or discovered, and whether it involves international projects or public sector activities in general.

IFMS can provide a safety net for dedicated and honest public servants in several ways:

- *It limits the number of people placed under suspicion* – Sound financial management and internal control systems, especially IFMS, establish clear lines of responsibility and authority. They provide for appropriate segregation of incompatible duties, and for clear audit trails which limit the number of individuals placed under suspicion during investigations when irregularities are discovered.
- *It ensures appropriate documentation* – Appropriate paper-based and electronic documentation of evidence supporting financial flows ensure the eventual exoneration of the honest, even when they may have been placed temporarily under suspicion.
- *It discourages pressure and executive override* – Direct pressure from higher officials or peers may be applied on financial staff or others to breach established standards and policies which inhibit corrupt practices. Pressures may also be indirect, such as when financial staff are urged to do nothing but where duty demands action or the reporting of irregularities. In this situation, honest staff soon leave public service if they try to resist such pressure. IFMS provides a disciplined environment and a series of specific control practices which diminish the force of corrupt official and/or peer pressure on financial staff. This in turn makes their professional career service more personally rewarding, instead of being an unbearable burden on their consciences.

Much more could be written about the role of the internal system of managerial controls accompanied by sound financial management systems. The Treadway Commission and the Committee of Sponsoring Organizations (COSO) in the United States, the Cadbury Commission in the United Kingdom, and the Criteria of Control Board in Canada have all focused considerable private sector attention on the importance of internal control for the safeguard of resources and assets.

The concept of internal control, which originated in the accountancy profession during the 1940's, has been expanded to encompass the entire scope of managerial responsibility. It forms today's generally accepted framework for safeguarding and maximising the use of limited resources in the private sector, and it should do the same in the public sector. Fraud and corruption can never be wholly eliminated, but they can be substantially counteracted, and diminished by the use of sound financial management policies and practices.

The IMF Code of Good Practices on Fiscal Transparency

“Fiscal transparency” can be defined as “openness” to the public as to the structure and functions of government, fiscal policy intentions, public sector accounts, and fiscal projections. Greater transparency in these areas can lead to better informed public debate, better functioning markets, and stronger accountability of governments for the design and implementation of fiscal policy. Certainly, awareness of government policies and intentions can only be for the benefit of all – be they major economic decision-makers or ordinary citizens. Just as certainly, accountability is sharply restricted where such openness does not exist.

To promote “fiscal transparency”, in 1998 the International Monetary Fund (IMF) adopted a Code of Good Practices on Fiscal Transparency.⁶ The Code is a highly significant development

⁶ The IMF is supporting the Code through preparation of a manual on fiscal transparency, a fiscal transparency questionnaire and self-assessment report. It has a dedicated web site on its home page for further information (<http://www.imf.org>). The

Fund has also established an email address (fisctran@imf.org) to which anyone seeking further information or technical support can address inquiries.

because it represents the first coherent attempt to set a framework of international standards for the conduct of fiscal policy. Government activities relating to taxation and spending are at the core of the exercise of power. They have a major impact on economic growth and equity, and are a major source of opportunities for corruption.

The Code itself is based on four interlocking high level principles, which provide its framework.⁷ These four general principles reflect the essential elements of fiscal transparency. Collectively, they have the potential to create a self-sustaining fiscal integrity system.

The general principles are:

- *Clarity of Roles and Responsibilities* – roles and responsibilities within government, and between different levels of government, should be clearly defined, with a clear boundary being drawn between the government and the private sector;
- *Public Availability of Information* – governments should commit themselves to providing the public with comprehensive and timely information on a full range of fiscal and quasi-fiscal activities;
- *Open Budget Preparation, Execution and Reporting* – the complete budget process, from preparation through to reporting and auditing, should be conducted in an open and public manner; and
- *Independent Assurances of Integrity* – there should be mechanisms independent of the Executive to scrutinise and ensure the integrity of fiscal information.

Each high level principle stands at the pinnacle of a hierarchy of specific principles, which in turn are underpinned by good fiscal transparency practices.

Although the Code is aimed primarily at improving governance and fiscal performance across the board, and is not directed specifically at reducing corrupt practices, critically important elements of the Code do bear directly on the incidence and severity of corruption.

Of particular relevance in this regard are the following provisions:

1.1.2 Government involvement in the rest of the economy (e.g. through regulation and equity ownership) should be conducted in an open and public manner on the basis of clear rules and procedures, which are applied in a non-discriminatory manner.

1.2.1 Fiscal management should be governed by comprehensive laws and administrative rules applying to budgetary and extra-budgetary activities. Any commitment or expenditure of government funds should have a legal authority.

1.2.2 Taxes, duties, fees and charges should have an explicit legal basis. Tax laws and regulations should be easily accessible and understandable, and clear criteria should guide any administrative discretion in their application.

1.2.3 Ethical standards of behaviour for public servants should be clear and well-publicised.

⁷ The full text of the Code is reproduced in the Best Practice documentation on the web site version of this Source Book

(<http://www.transparency.org>), and it also appears on the IMF web site.

2.1.3 Statements should be published with the annual budget giving a description of the nature and fiscal significance of contingent liabilities, tax expenditures, and quasi-fiscal activities.

2.1.4 The central government should regularly publish information on the level and composition of its debt and financial assets. Government transactions should be on a gross basis, distinguishing revenue, expenditure and financing, and classifying expenditures on an economic and functional basis. In addition expenditure should be classified by administrative category. Data on extra-budgetary operations should be similarly classified. Budget data should be presented in a way that allows international comparisons.

3.2.4 The annual budget and final accounts should include a statement of the accounting basis (i.e. cash or accrual) and standards used in the preparation and presentation of budget data.

3.3.1 A comprehensive, integrated accounting system should be established. It should provide a reliable basis for assessing payment arrears.

3.3.2 Procedures for procurement and employment should be standardised and accessible to all interested parties.

3.3.3 Budget execution should be internally audited, and audit procedures should be open to review.

3.4.2 Timely, comprehensive, audited final accounts of budget operations, together with full information on extra-budgetary accounts, should be presented to the legislature.

4.1.1 A national audit body, or equivalent organisation, should be appointed by the legislature, with the responsibility to provide timely reports to the legislature and public on the financial integrity of government accounts.

Each of the general principles, specific principles, and good practices, is explained in a manual on fiscal transparency which is being made available on the IMF web site. The manual aims to provide practical guidance for the implementation of the Code, by illustrating in more detail the specific minimum practices which are required of countries if they are to adhere to the Code. The manual also provides information and examples of best practice from a number of countries.

The good practices on which the Code is based are conceived, not so much as “best practices”, but as practices which all 182 IMF member countries should adopt.

At present it is likely that no country fully meets every standard in the Code, although a small number of industrial countries are close to doing so. For developing countries and countries in transition, however, a significant number of the practices are not yet established.

All countries are encouraged to adopt the good practices proposed in the Code, but the emphasis is on voluntary implementation. For those countries starting from a low base, in terms of the principles and practices required in the Code, the manual will identify a sub-set of good practices which could form the core focus for initial efforts to increase fiscal transparency.

A “fiscal transparency questionnaire”, and a “self evaluation report” have also been prepared, as tools to assist assessments of the level of compliance of individual countries with the Code. The questionnaire is cross-referenced to the manual, and both follow the structure of the Code. The expectation is that country authorities will be interested in completing the questionnaire and self evaluation report as a basis for developing country-specific plans to increase fiscal transparency, and to identify their need for technical assistance in this area.⁸

It is open to anyone, however, to use the fiscal transparency framework developed by the IMF to conduct their own assessments of compliance of individual countries with the Code. Indeed, while the IMF will promote transparency in connection with its surveillance and technical assistance activities, the impact of the Code will be greatest if a wide range of official and non-governmental organisations and interests use the Code to assess country performance and to bring pressure to bear for improvements.

For TI National Chapters, the Code and supporting material represent a potentially very useful means of assessing the integrity of their countries’ fiscal management systems. The transparency code brings together the interconnections between the different elements of a high integrity fiscal system, including many that bear directly on corruption. It therefore has value in that it provides a framework for developing coherent proposals for reform in individual countries, focusing on the highest priority areas where there is the potential for creating a self-reinforcing and self-sustaining financial integrity system.

What has been done so far?

In recent years the bilateral and International Financing Institutions (IFI’s) have taken measures to improve financial management both in their own projects (the enclave approach) and in national governments. However, a strengthening of financial management limited only to projects may shield the donor from embarrassment, but does not protect the recipient government and its people from fraud and waste. Funds are fungible, and national funds may easily be taken and replaced by those from international sources, leaving no record of any irregularity in the books of the project or their “audited” financial statements.

A much stronger position than hitherto has been taken by the World Bank since its President, Jim Wolfensohn, speaking at the 1996 World Bank – IMF Annual Meeting, said:

“...Let’s not mince words: we need to deal with the cancer of corruption. In country after country, it is the people who are demanding action on this issue. They know that corruption diverts resources from the poor to the rich, increases the cost of running businesses, distorts public expenditures, and deters foreign investors...it is a major barrier to sound and equitable development...”

“...Working with our partners, the Bank Group will help any of our member countries to implement national programmes that discourage corrupt practices. And we will support international efforts to fight corruption...”

“...Let me emphasise that the Bank Group will not tolerate corruption in the programmes that we support...”

⁸ The United Kingdom is the first country to complete and publish an assessment of its level of compliance with the Code (see

<http://www.hm-treasury.gov.uk/pub/html/docs/fpccs.html>).

During the past decade the World Bank and other IFI's have greatly increased the number of country projects in which they are assisting in the modernisation and professionalisation of financial management and auditing systems at the national level.⁹

However, donor "enclave-based" efforts to strengthen project accountability have, for the most part, entirely ignored the importance of sound internal controls, and the role of internal auditors in reviewing and reporting on them. Most donors have been extremely lax in enforcing their own accountability requirements, and have chosen austerity over accountability where accountability oversight staffing has been involved. Most donor agencies, other than USAID, have failed to exploit the resources available through the accountancy profession, which has long played a leadership role in this area of the private sector.

In summary, although the IFI's have begun to face up to the problem of financial corruption in several ways, there is much more that can be achieved.

Some indicators of the effectiveness of the Financial Management System as an integrity pillar

- Does the financial management system provide complete and timely financial reports for Legislative and Parliamentary oversight committees, and to the public at large?
- Does the system promote the development of strong internal managerial controls? Does it create appropriate "audit trails", so facilitating prompt and effective investigation and prosecution?
- Is the complete budget process, from preparation through to reporting and auditing, conducted in an open and public manner?
- Are steps being taken to develop and improve tools for good financial management?
- Is there clear responsibility for the setting of accounting standards in the public sector, and for directing the accounting function throughout government so as to ensure the proper functioning of the accounting system and its adherence to professional standards?
- Does the financial management system in practice provide timely, reliable and comprehensive information for public decision making?
- Do agencies of government administer public funds outside the budget?

9 In the Latin America and Caribbean (LAC) Region, the IFI's have established or are planning Integrated Financial Management Systems (IFMS) in Bolivia, Argentina, Guatemala, Honduras, Ecuador, Colombia, Venezuela, Nicaragua, El Salvador, Panama and the Dominican Republic. The Spanish government has been collaborating with Uruguay and Costa Rica. USAID was a pioneer in the field, with its Model Integrated Financial Management System for Latin America (SIMAFAL). This has served as the conceptual model for all such systems. Other regions have begun to adopt the IFMS approach, including Ghana and Vietnam. Many of the projects have not fully developed the concept of internal managerial control as a management responsibility,

nor have they included the strengthening of the internal audit function. Most heads of LAC Supreme Audit Institutions are not qualified auditors, but rather are political appointees, a factor which severely limits the effectiveness of their organisations in contributing to anti-corruption efforts. (For example, a Comptroller General of Ecuador (a vocal supporter of anti-corruption efforts) who had already resigned, was impeached and formally discharged from office by the Congress owing to corruption allegations involving his review of confidential expenditures authorised by the Vice President. More recently a highly controversial appointment was made in Peru, following the tarnished election of President Fujimori in 2000.)