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## CURRENCY EQUIVALENTS

Currency Unit	=	Ghanaian Cedi
US\$1	=	¢ 9,207

## FISCAL YEAR

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## ACRONYMS AND ABBREVIATIONS

AAP	Expenditure Tracking Assessment and Action Plan
ADMU	Aid and Debt Management Unit
AFTFM	Africa Financial Management
AFTH2	Africa Human Development 2
AFTPC	Africa Procurement
AFTPR	Africa Public Sector Reform and Capacity
AFTP4	Africa Poverty Reduction and Economic Management 4
BOG	Bank of Ghana
BPEMS	Budget and Public Expenditure Management System
CAGD	Controller and Accountant General's Department
CF	Consolidate Fund
CFAA	Country Financial Accountability Assessment
D.A.C.F.	District Assemblies Common Fund
ERPFM	External Review of Public Financial Management
FAA	Financial Administration Act
GES	Ghana Education Service
G.E.T.F.	Ghana Education Trust Fund
GFS	Government Finance Statistics
GoG	Government of Ghana
GPRS	Ghana Poverty Reduction Strategy
HIPC	Heavily Indebted Poor Country
IAA	Internal Audit Agency
IDA	International Development Association
IGF	Internally Generated Funds
IMF	International Monetary Fund
IPPD	Integrated Personnel and Payroll Database
MDA	Ministries, Departments, and Agencies
MDBS	Multi-Donor Budgetary Support
MDG	Millennium Development Goals
MMDA	Metropolitan, Municipal and District Assemblies
MOFEP	Ministry of Finance and Economic Planning
MTEF	Medium-Term Expenditure Framework
MTPP	Medium-Term Priority Programs
N.E.T.S.	National Expenditure Tracking System
NCTE	National Council for Tertiary Education
N.T.R.U.	Non Tax Revenue Unit
P.E.	Personal Emoluments

PEFA	Public Expenditure and Financial Accountability
PEM	Public Expenditure Management
PER	Public Expenditure Reviews
PETS	Public Expenditure Tracking Surveys
PPB	Public Procurement Board
PRSC	World Bank-financed Poverty Reduction Support Credit
R.F.	Road Fund
SF	Statutory Funds
VAT	Value-Added Tax

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The 2005 ERPFM team is grateful to the Ministry of Finance and Economic Planning for the excellent cooperation and assistance without which this report would not have been prepared. The team also greatly benefited from meetings with the Auditor General, the Chairman of the Public Procurement Board, the Chairman of the Internal Audit Agency Board, the Controller and Accountant-General Department, and teams of the Ministries of Education and Sports, Health, and Roads Transport.

The preparation of this report was led by Marcelo Andrade (AFTP4) and involved Carlos Cavalcanti (AFTP4), Hayat Abdo (AFTP4), and Roberto Tibana (PFM Advisor, MDBS). Mike Stevens, Peter Fairman, and Allan Gustafsson, all World Bank-financed consultants, were also actively involved in the preparation of this report. Marta Berhane, Pierre Lénard, Judite Fernandes (AFTP4), and Emmabel Hammond (AFC10) provided secretarial support to the team. The report was written under the supervision of Robert Blake, Sector Manager of AFTP4, and Mats Karlsson, Country Director for Ghana. The detailed comments provided by the peer reviewers Bill Dorotinsky (PREM Public Sector) and Nicola Smithers (Public Expenditure and Financial Accountability Secretariat) are gratefully acknowledged.





## EXECUTIVE SUMMARY

### MAIN MESSAGES

1. Macroeconomic developments in 2004 were favourable. Despite rising oil prices, prudent macroeconomic management enabled Ghana to break with its past record of slippages in elections years. Sustained commitment to sound fiscal and monetary policies, coupled with progress on the country's policy reform agenda, should enable strong economic growth to continue, accompanied by poverty reduction and employment creation.
2. The main messages of the External Review are:
  - **Aggregate fiscal discipline has improved since 2002.** Discretionary spending financed from the Consolidated Fund (CF) was much closer in total to the voted budget in 2004.
  - **The Ghana Poverty Reduction Strategy (GPRS) is increasingly influencing budget allocations.** Domestically-financed poverty-related spending is growing as a share of GDP and the balance between wages and other items is improving. The Government will need to continue aligning the budget with GPRS priorities, as the latter is updated.
  - **Predictability of the budget in terms of actual spending against appropriations remains a challenge both at the level of ministries, departments and agencies (MDAs), and at the item level (economic classification).** This is a concern because uncertainty of funding discourages spending units from making and implementing work plans, and exacts a toll in service delivery efficiency. Increasing budget predictability to MDAs will be a major challenge in the years ahead.
  - **The Medium-Term Expenditure Framework (MTEF) could be made a more useful tool** for strategic resource allocation and improving predictability of external assistance. Action is also required to reduce shortfalls and delays in cash releases, improve timeliness and accuracy of fiscal reporting, and expand the budget preparation timetable.
  - **To improve control over the wage bill, staffing and salary decisions need to be more fully integrated with the budget process.** Currently, much of the growth in the annual wage bill stems from both staffing and pay increases, and is handled in contingency provisions.
  - **A new regulatory framework for public financial management is taking shape with increased Government ownership of the reforms.** Implementing the new framework, will continue to require, however, close coordination between the new regulatory bodies and Ministry of Finance and Economic Planning (MoFEP), which must retain its overall stewardship function. It will also require a greater willingness than before to hold spending ministries accountable.
3. The findings of the External Review are intended to support the policy dialogue between the Government of Ghana and the MDBS development partners, as they agree the details of the 2005-2006 program of budget support. It is timed to take place after the budget for the current financial year has been approved, and after preliminary accounts of spending in the previous year have become available, yet before the Government has initiated the process of preparing the next year's budget. The review looks at macroeconomic developments and overall fiscal

management, the link between the budget and the GPRS, and the Government's efforts to strengthen public financial management. In this sense there is a continuity of topics covered in External Reviews. At the same time the External Review also provides an opportunity for MDBS development partners to flag issues for dialogue, analysis and support in the coming year. The remainder of this executive summary elaborates on the key findings and assessment of the review and summarizes main recommendations.

## **FINDINGS AND ASSESSMENT**

### **A. MACROECONOMIC DEVELOPMENTS**

4. Overall, macroeconomic developments in Ghana in 2004 have been favorable, notwithstanding a significant rise in the cost of oil imports. This positive outcome reflects sound fundamentals, and good macroeconomic management.

#### **Economic Performance**

5. In a challenging year when the Government had to contend with both a sharp external oil price shock and the running of national elections, macroeconomic performance has been good. Real GDP growth accelerated to 5.8 percent in 2004, inflation fell to 11.8 percent and the imports coverage of gross international reserves rose to nearly 4 months. This commitment to prudent fiscal and monetary policies and economic and social reforms helped Ghana reach the Heavily Indebted Poor Country (HIPC) Completion Point in July, 2004, ensuring irrevocable debt relief that frees up considerable budget resources to finance the country's priority poverty reduction efforts identified in the GPRS.

6. With continued sound macroeconomic management, the prognosis is favourable. Real GDP growth is projected to average about 6 percent a year over the medium term, inflation is forecasted to fall to 6 percent, gross international reserves are planned to increase to over four months of imports coverage and external debt is expected to remain within sustainable bounds.

#### **Aggregate Fiscal Discipline**

7. Aggregate fiscal discipline has improved since 2002, despite the looser than planned fiscal stance in 2004. Revenue increased by almost six percentage points, between 2002 and 2004, to more than 23 percent of GDP. This revenue mobilization effort, supported by HIPC debt relief, allowed Government to both reduce its reliance on domestic financing of the deficit and to increase domestically financed primary expenditure to 23 percent of GDP in 2004, up from 17 percent in 2002. As a result, by 2004 discretionary spending financed from the Consolidated Fund (CF) was much closer to the voted budget. However, three factors in 2004 lead domestic financing to exceed its initial target: (i) an increase in the wage bill; (ii) the decision by Government to increase subsidies to the state-owned oil refinery, rather than adjust domestic prices to rising global prices; and (iii) an overrun of capital and poverty-related expenditures, linked to higher than programmed foreign financing (including from HIPC debt relief). These factors notwithstanding, the Government's medium-term fiscal strategy is sound. It calls for a reduction of the fiscal deficit to about half of the 2004 level (3.6 percent of GDP) and is expected to plan for a reallocation of expenditures to priority spending as the GPRS is updated in 2005.

## **Managing Fiscal Risks**

8. The fiscal outlook is positive if present policies are maintained and the Government tackles the challenges outlined by the Review. The Government projects negative domestic financing over the medium term, leading the domestic public debt to GDP ratio to fall below 10 percent by 2006. The likelihood of this outcome is enhanced by the record of prudent fiscal management, as well as three ongoing and expected reforms. First, the new petroleum sector deregulation, which began to be implemented in February, 2005, and will diminish the risk to public finances of further large subsidies to State owned enterprises. The petroleum deregulation adds to actions already taken to reduce risks arising from contingent liabilities, such as the cross settlement of debts among utilities at end-2003, and other ongoing reforms to improve the efficiency of these enterprises. Second, the new Subvented Agencies Bill will help rationalize the operations of these agencies and strengthen government oversight. Third, Ghana's actions to engage the development partners, and ensure predictability of funding from them, will strengthen the country's revenue prospects, since these partners account today to close to one-third of the country's budget resources.

### **B. BUDGET MANAGEMENT AND THE GPRS**

9. There have also been improvements in public financial management in the past year, with further reforms to ease other structural constraints expected to lead to improved outcomes.

#### **Revenue Performance**

10. The government's revenue performance in recent years has been robust, although the strength of revenue out-turns is due largely to the performance of indirect and international trade taxes. These taxes contributed largely to the increase in the tax to GDP ratio of about 4 percentage points, rising to 22 percent of GDP from 2002 to 2004. Over the longer term, however, trade taxes are vulnerable to fluctuations in international commodity prices, suggesting that efforts must also be directed to further strengthen mobilization of direct tax and non-tax revenues. Also significant in achieving this outcome was the compliance by several public entities, in 2004, with the Financial Administration Act requirement to remit profits to the budget and to disclose their internally generated funds (IGFs). As stated in the GPRS, most of the opportunities for further revenue strengthening are linked to improved tax administration. In this context, the Government is implementing a tax reform program with the assistance of the IMF.

#### **Budget Execution**

11. Predictability of the budget has improved, although to a lesser extent at the MDA and economic classification levels. At the MDA and the economic classification levels, the budget outturn deviates considerably from the approved budget. MDAs in the social sectors tend to overspend and their wage bills show considerable variance relative to the budget plan. These outcomes are due largely to overruns in the wage bills for education and health sectors. As a result, spending by other MDAs, and on other recurrent spending and capital assets, falls short of budget plans. Quasi-fiscal operations of parastatals have also been a source of significant degree of budget variance, largely due to higher than anticipated subsidies to the Tema Oil Refinery (TOR). Finally, in 2004, actual total investment was much higher than programmed *ex ante*. Overall, while the budget has become a relatively effective instrument for ensuring

macroeconomic stability, there is still scope to improved budget predictability at the MDA level and by economic classification. Actions on this front would help to ensure alignment of spending with voted priorities and the provision of services on a cost effective basis. This suggests that the operational efficiency of budget expenditures could be an area of focus for future Reviews.

12. Another issue of concern is that large contingency provisions held by MoFEP, which comprise almost a “budget-within-a-budget”, detracting from budget transparency. These provisions increased from only 1 percent of the domestically financed discretionary budget for MDAs in 2002 to 8.5 percent, in 2004 and are budgeted at 15.7 percent in 2005. MoFEP is aware of the problem, and has indicated it will reduce contingency provisions to no more than 8 percent by 2007. Furthermore, to deal with national emergencies, the Government has indicated it will bring into being a Contingency Fund, as provided for in the Constitution, during 2005. The Government’s approach of separating national emergencies from financial contingencies is correct, and this External Review recognizes that, even when the Contingencies Fund has been created, MoFEP will still need to budget for contingent liabilities of a financial nature, and that provisioning for contingencies is normal in a finance ministry’s vote. Both the current amount and the proposed ceiling for 2007 are however still very high and MoFEP should bring the provision for contingency to an amount below the 5 percent threshold.

13. The Government has done well to better reflect GPRS priorities in the budget. Domestically-financed poverty-related spending is increasing in terms of ratio to GDP and the proportion of wages in this spending is falling. While the predictability of poverty expenditures improved over the 2002-2004 period, further progress is still needed in the coming years. For instance, the executed 2004 budget and the 2005 appropriated budget bear a reasonable correspondence to the aggregate GPRS sector shares, though the shares of economic services and infrastructure fall short of the targets, while social services exceed the initial target. Similarly, the Medium Term Priority Programs (MTPP) expenditure targets are closer to being met at the aggregate level, but are falling short in the infrastructure sector. Over the medium-term, poverty related expenditures are expected to continue to increase in relation to GDP.

### **Wage Bill Management**

14. Budgeting for the wage bill requires improvement, since it is a source of significant budget variance and a major reason for a large contingency reserve planned for 2005. The current procedure is to budget for the wage bill on the basis of existing numbers and pay rates and to provide a contingency for the increases in the wage bill projected for the coming year. Increases in the wage bill during the year typically derive from two sources. The first source is growth in public service employment, which should be consistent with existing policy, affordable within existing MTEF sector envelopes, and consistent with annual establishment decisions. In Ghana’s case, wage bill is driven by new hiring, particularly of teachers. The magnitude of these increases should be known beforehand, and either approved and budgeted for or denied in the budget preparation process.

15. The second source of increase in the wage bill results from salaries and wages being increased at the time of negotiations with unions or at the time of the introduction of new wage scales following a salaries commission review. Pay increases present a problem to the finance

ministry if the size of the increase is not known by the time the budget is submitted to the legislature. If pay negotiations are still underway when budget preparation is concluded there may be no realistic alternative to a provision in the MoFEP's vote to cover the anticipated cost of new pay scales labeled specifically as a salary provision. Alternatively, the Government could submit a Supplementary Appropriation Bill after the financial year has begun for the new salary scales, once agreement has been reached. Although this might be viewed as theoretically better, political considerations may make the first course of action more practical. In the medium term, the Government needs to move ahead with public service reforms (as it is currently considering), addressing the staffing level and policy cost drivers of the wage bill, and developing a new pay policy that gives greater regard to the local labor market for professionals and skilled technicians. Also, if possible, the staging of pay negotiations should be synchronized with budget preparation, so that negotiations are completed ahead of submission of the Appropriation Bill. In this manner, a decision is made on the size of the annual adjustment, and included in the Estimates under the personal emoluments item of each head. This in turn would reduce the need for a large financial contingencies line in the finance ministry's vote.

### **Improving Budget Comprehensiveness and Transparency**

16. The Government recognizes the need to strengthen the comprehensiveness of the budget and increase transparency. For the first time, the 2005 Appropriations Act shows allocations of Internally Generated Funds (IGF). Budgeting for HIPC debt relief funding will be integrated with the regular budget preparation process for 2006. The Government is aware of the need to make the spending plans of statutory funds as transparent as possible. These could be shown in the budget documents, as a memorandum item, or summarized in the Budget Statement, in line with the international best practice.

17. The ring-fenced nature of public finances in Ghana, noted in the 2004 External Review, is unlikely to change in the near term. This is because some of it arises from policy decisions of previous governments, now fixed in law, to treat certain categories of expenditure in specific ways, and also because of the way in which some external aid resources are made available. Nonetheless, fragmentation imposes rigidities, creates transactions costs and causes operational inefficiencies which make it more difficult for the Government to align the strategic allocation of all public funds with its objectives and priorities, and use resources efficiently and effectively. Being structural, these constraints are not easily addressed. Fragmentation arises partly from multiple statutory funds created by act of Parliament outside the CF. Although governments typically have their reasons for creating statutory funds outside the CF, such as directly linking revenues with spending, there may well be powerful political reasons for creating these funds, but this comes at the cost of the unity of the budget.

18. Both the Government and the External Review have a common view on how such funds work. The creation of a statutory fund, in effect, takes an area of spending outside the annual budget process, and puts it on auto pilot. Although the budget will normally show the amount of money that should be transferred from the CF into the fund, this is typically a single line item. In the case of Ghana, for the DACF and GETF, the legislature approves how the transfer will be used and will get at year's end, an account of how the resources have been spent. It meets the democratic standard since before a SF can be created, the legislature must pass the legislation setting up the fund and listing the purposes for which public funds must be used. However,

unlike spending from the CF, spending authorization from a SF does not lapse at the end of the year. While such funds may have a political logic, they detract from the unity of the budget and can make the management of the budget more difficult.

### **Improving Predictability of External Assistance**

19. Donor funding modalities are a major source of budget fragmentation. Despite the general movement from projects to budget support, project aid in Ghana might very well increase as a proportion of total aid, notwithstanding Ghana's progress in improving public finance management in recent years. Development partners need to help the Government reverse this trend since it complicates the strategic allocation role of the budget and the operational efficiency of spending. In the meantime, donors and MDAs jointly could cooperate to improve the accuracy of estimates of aid commitments and disbursements. During the External Review, deficiencies were still identified in this area, despite the attempts by the MoFEP and MDBS to improve donor aid recording procedures. The Government, on its side, is anxious to improve the reporting of donor aid flows, not just for budget transparency reasons, but also because better information is needed for budget management purposes. Its approach is to work first to improve information of major flows, recognizing that there are multiple smaller categories of assistance, for which goods and services are procured offshore by the aid agency directly, which are very difficult to capture.

### **Strengthening the MTEF**

20. Late in 2004, the Government committed itself to conduct an internal review of the Medium Term Expenditure Framework (MTEF) system's workings. This worthwhile exercise is needed, given the still unrealized potential to help the Government allocate resources strategically, manage fiscal shocks, improve policy coherence and enhance operational efficiency. The latter is especially important, given that improvements in tax effort have resulted in more domestic resources than before passing through public financial management systems.

21. As part of the MTEF, the Government has taken some steps towards an increased focus on the outputs and outcomes of public activities. An initial step towards outcome/output oriented budgeting was taken with the introduction of the objective, output, and activity dimensions in the chart-of-accounts. Amongst other things, the MTEF review could look at whether the present objective/output/activity classification system needs simplification and how it could provide for a stronger operational link between the GPRS and the annual budget.

### **Improving Cash Management and Fiscal Reporting**

22. The Government has acted to reduce delays and cutbacks in cash but more remains to be done (e.g. streamlining process of preparing invoices for payment, MDAs need to send their Commitment Control System reports on time). Enabling Parliament to pass the Appropriation Bill before the start of the financial year will also help budget execution. Improving the timeliness and accuracy of fiscal reporting will be critical to the success of accounting decentralization, and would also help increase donor confidence in government financial systems, thereby inducing more budget support in place of project support, with consequent gains in operational efficiency.

## **Budget Preparation Timetable**

23. The External Review concurs with the Government decision to lengthen the timetable for budget preparation. In the past, there has been limited time in the budget preparation calendar to engage the Cabinet on fiscal strategy and spending priorities before issuing the call circular. There is also limited time afterwards for MDAs to study program costs, examine trade-offs and make their budget submission less incremental and more strategic. While for the Budget 2006 the budget calendar gave MDAs up to 4 months to prepare their estimates, for the Budgets 2004 and 2005 that period was only around 3 weeks. Challenges remain to submit the Budget Estimates and Appropriation Bill to Parliament in time for approval before the start of the new financial year. In this regard, early in November 2005, the Government has delivered on the commitment made in the 2005 Budget Statement that it would submit the 2006 Budget to Parliament in sufficient time for enactment before the new financial year begins. There may also be a case for improving the presentation of the budget estimates in the near future.

## **C. IMPLEMENTATION OF PUBLIC FINANCIAL MANAGEMENT REFORMS**

24. The Government continues to carry out an ambitious program of public financial management reforms, comprising the installation of new systems, shifting more responsibility to spending departments, and updating the legal framework for public financial management.

### **Financial Administration Act and Regulations**

25. The Financial Administration Act (FAA) and the Financial Administration Regulations (FAR) are both forward looking and provide, with the Constitution and the new procurement and internal audit agency laws, a strong legal framework for public financial management. In particular, the FAA and FAR should strengthen the MoFEP as the apex body in the government, ensuring that public funds are properly controlled and spent, and fiscal risks are identified and managed. Close coordination between MoFEP, the Public Procurement Board (PPB) and the Internal Audit Agency (IAA) will be essential, as will dissemination of the new rules and training. As the new framework is implemented, Government may find it necessary to adjust and adapt in the light of emerging demands (eg: clarifying the role of the Chief Director of MoFEP in assisting the Minister implement the FAA/FAR, and the relationship between IAA and MoFEP).

### **Public Procurement**

26. The implementation of the Public Procurement Act passed in December 2003 seems to be on track judging both from the clarity of purpose of the PPB three-year Strategic Plan and what has been achieved since the passing of the Act. The Secretariat of the PPB is operational since October 2005 and this is expected to contribute for the implementation of the Act to come up to full speed. Close coordination with MoFEP is essential because of the latter's financial stewardship role.

## **Internal Audit**

27. A new Internal Audit Agency (IAA) Act was also passed in December 2003. The IAA has been established and its Board and Director General were inaugurated in August 2004 and October 2005, respectively. The IAA will serve as an apex oversight body to co-ordinate, facilitate and provide standards and quality assurance for internal audit activities in MDAs / MMDAs. All MDAs / MMDAs will establish internal audit units (IAUs), to be staffed by competent auditors under the guidelines of the IAA.

28. The initial start-up phase should be completed as quickly as possible, in order to ensure that the IAA Act is vigorously implemented in the months ahead. To guide the future actions of the IAA, the three-year strategic plan ought to be further developed by defining specific medium term output milestones against which the IAA and other stakeholders can benchmark progress in the process of strengthening internal auditing across the GoG. Given the overlapping mandate with MoFEP, which under the Financial Administration Act (FAA) is responsible for the management of the Consolidated Fund (CF), cooperation between the two bodies will be essential.

## **Decentralization of Accounting and Treasury functions to MDAs**

29. The *Action Plan for the Implementation of the FAA and FAR* stipulates that the accounting/treasury staff will be transferred to the MDAs along with checks and treasury functions while a single treasury account will be maintained. This transfer is scheduled to be launched early in 2006. Although this transfer is desirable from the perspective of empowering the MDAs, the accounting in the MDAs must first be strengthened and it is of utmost importance that an accurate flow of accounting information from the MDAs to CAGD is ensured before the treasuries that currently operate on behalf of the MDAs are eliminated. To recruit adequately trained accountants for the MDAs, the Government might need to design employment packages that compete with the private sector, and eventually make their pay arrangements consistent with a new pay policy for Government. Giving MDAs greater responsibility for accounting needs to be accompanied by measures to strengthen the accountability of vote holders for adherence to financial management and accounting regulations. Here, the External Review believes the roles of MoFEP, the PPB and the IAA are critical, and must be coordinated.

## **The Budgeting and Public Expenditure Management System (BPEMS)**

30. It is clear that the Government is fully committed to the implementation of BPEMS. The MoFEP has fully taken over the management of the project and the deployment of the system is now funded entirely and directly by GoG. The system is now almost ready for roll-out. What is holding up deployment is the Wide Area Network. Though the connectivity is in place, the speed of the network is currently very slow. MoFEP has therefore decided to extend the IPPD fiber optic network to the BPEMS sites.

31. It is also clear that the BPEMS roll out – initially to 14 sites in 8 MDAs – will require a concerted effort, an effort that should be guided by a systematic critical path implementation plan. An important milestone in such a plan should be the date when BPEMS would replace National Expenditure Tracking System (NETS) for the production of the accounts for the Consolidated Fund. Such a date can and should come well before Oracle Financials – in which



BPEMS is developed – is deployed to all MDAs and all cost centres. At non-connected MDAs and cost centres, the accounts can be done manually and the information subsequently entered at central or regional locations connected to BPEMS.

32. The External Review notes the recent change in BPEMS management responsibility. The CAGD, as principal user of BPEMS, has been given formal system management responsibility. Unifying the overall responsibilities for all the elements – conceptual, technical, institutional, procedural, and human – that are required for the move to BPEMS should increase the likelihood of success.

### **Management of the Payroll**

33. The Government's two track approach to payroll system modernization is pragmatic. To ensure the continued management of the payroll, the original SIGAPIP system is now being rehabilitated to keep it operational. It is important that the "stabilization" of IPPD 1 be completed successfully. For the future it makes sense, however, that SIGAPIP be replaced. The choice made by the Government to replace it with a system compatible with BPEMS makes good sense. The decision by the Government to go ahead and finance the development of IPPD2 on its own, just as it has with BPEMS, is highly commendable and signals clear ownership. In future the development and deployment of IPPD2 should be closely coordinated with the deployment of BPEMS, including in the planned area of the communications network.

34. The Government has decided to implement in 2005 a computerised system to strengthen personnel and payroll management of subvented agencies (SAs). It has also decided that when IPPD2 is up and running, it should also be used for the preparation of the payroll of subvented agencies. This is positive but it is important to underline that this will not automatically solve the problem of payroll overruns. Improved control through a central system must be combined with reforms that reduce the incentive for SAs agencies to overrun on the payroll, and generally strengthen the governance of these agencies, as the SAs Agencies Bill has the potential to do.

### **Accounting Framework**

35. The FAA and FAR reflect the decision by the Government to move to accrual accounting. While accruals bring important benefits, the External Review considers the transition from cash to accrual accounting is a complex process that will take many years to plan and implement. Meanwhile, the authorities should focus on achieving the most effective operation of the current cash accounting system, which BPEMS will facilitate, in accordance with appropriate international accounting standards. As accrual accounting is gradually introduced, senior staff of MDAs will need to be trained in how to use more accrual information in management. The transition to accrual will be more successful if MDAs themselves feel a need for accrual information in the management of their portfolios

36. The Government could also consider simplifying the chart-of-accounts. The present 47 digit code-string divided into ten dimensions can be shortened and simplified substantially without reducing its information content.

## **The Coverage of Accounting, Budgeting and Fiscal Reporting**

37. To meet Government Finance Statistics (GFS) standards for comprehensive fiscal reports the Government is preparing to collate financial statements from the different statutory funds combining this information with the financial statements for the Consolidated Fund including IGF. The Government at this point in time has not yet been able to include external direct funding in the CAGD fiscal reports. The External Review recognizes the difficulty in collecting such data, and that if a start is made, it should be with the larger sources that the Government requires more information on, anyway, for its own fiscal management purposes. Nonetheless, the Review believes that all sources of external financing fall within the Constitutional definition of “public funds”, and to the extent practical, data should be collected and reported. This will support the broader effort to align all assistance with national priorities, and improve the transparency and comprehensiveness of Ghana’s public financial management system. While the practical difficulties of producing an accurate account of direct external assistance should not be underestimated, the Government should continue to strive for more comprehensive reporting, and development partners should provide much more assistance in, periodically, making available information on aid usage.

### **External Audit**

38. The legal framework for external audit was revised several years ago and still provides a good foundation for this function. The focus of the Government has been on timely completion of annual accounts and financial statements. Good progress has been made by both the CAG in completing annual accounts and financial statements and by the Auditor-General with the reduction of external audit backlogs, in compliance with the statutory timetable. Additional resources may be required to sustain the progress made, especially in view of the retirement of key staff in the near future. It will be important for MoFEP, acting with the Financial Administration Tribunal as appropriate, to follow up on audit findings and ensure corrective action is taken by the responsible vote holders.

## **1. INTRODUCTION**

1.1 The 2005 External Review of Public Financial Management (ERPFM) consists of two volumes. The first volume is the main text, while the second volume comprises statistical annexes. In the first chapter of volume I, after this introduction, macroeconomic developments are assessed, including aggregate fiscal discipline and the risks to the fiscal outlook and macroeconomic stability. The next chapter focuses on budget management and the GPRS. After a brief review of recent revenue trends, public expenditure management (PEM) is assessed in more detail through examining budget predictability and reliability and the implications for the strategic resource allocation role of the budget and the operational efficiency of public spending. The extent of alignment of the budget with GPRS is also reviewed. Finally, challenges to improving public expenditure management are discussed. The last chapter examines accountability issues through an assessment of the progress in implementing the new regulatory framework for public financial management, including the Financial Administration Act, the Public Procurement Act and the Internal Audit Agency Act, as well as the Budget and Public Expenditure Management System (BPEMS) and Integrated Personnel and Payroll Database (IPPD) systems. Volume II presents three annexes with information complementing the analysis of the main report and a Statistical Annex.

1.2 This report follows from the external review conducted by the World Bank in 2004, jointly with a number of donors involved in the MDBS, as finalized in the report “Supporting Reforms for Accountable and Transparent Public Expenditure Management” (September, 2004). The main message from the 2004 External Review was the need for Government to focus on: (i) maintaining aggregate fiscal discipline; (ii) curtailing budget fragmentation to better align the budget with the country’s strategic priorities; and (iii) improving the efficiency and effectiveness of public spending in support of better service delivery.

## **2. MACROECONOMIC DEVELOPMENTS**

### **A. ECONOMIC PERFORMANCE**

2.1 Despite the shock of rising oil prices during the year, the Ghana economy performed well in 2004, and the Government’s macroeconomic management was sound. Real GDP accelerated to about 5.8 percent during 2004, up from 5.2 percent in 2003 well above the GPRS target of 5.0 percent. Buoyant cocoa (record harvest) and gold exports (higher prices) and record remittances from Ghanaians living abroad broadly offset the adverse impact of the rise in petroleum prices on the international markets during the year (average 37 percent). Gross international reserves improved to almost 4 months of imports coverage and the nominal exchange rate for the cedi remained broadly unchanged during the year. Inflation fell sharply to 11.8 percent at the end of 2004 from 23.6 percent the year before. Overall, prudent macroeconomic management enabled Ghana to break with its past record of fiscal slippage in election years.

2.2 As a consequence of improved macroeconomic performance and progress in economic reform, Ghana reached the HIPC completion point in July 2004. This provides Ghana with irrevocable debt relief of about \$2.2 billion in net present value terms. Debt relief has helped to bring the country’s debt burden indicators to manageable levels and should keep debt servicing on a sustainable path in the medium and long term, provided the country follows sound

economic policies and is not affected by permanent adverse shocks, or a combination of shocks. In the near future, debt relief provides annual savings to the budget which average about 2 percent of GDP.

**Table 2.1: Macroeconomic Developments and Prospects, 2002-2007**

	2002 Act.	2003 Act.	2004 Est.	2005 Prog.	2006 Prog.	2007 Prog.
Real GDP Growth (%)	4.5	5.2	5.8	5.8	5.8	5.8
Inflation (% change, end-year CPI)	15.2	23.6	11.8	14.1	7.3	6.0
Fiscal balance/GDP (% , excluding grants)	-9.9	-9.1	-9.9	-8.5	-7.1	-6.5
Fiscal balance/GDP (% , including grants)	-6.8	-4.4	-3.6	-2.6	-1.6	-1.3
NPV of total government debt (% of GDP)	88.0	89.8	50.5	43.5	38.6	34.5
Of which, external debt	64.1	71.5	35.3	32.1	31.1	30.1
Gross international reserves (months of imports of goods and services)	1.9	3.2	3.7	3.9	4.0	4.1
NPV of external debt (% of exports of goods & services)	157.4	175.7	89.6	92.3	96.7	96.4
External debt service due (% of exports of goods and services)	18.4	14.5	14.8	13.5	12.1	11.1

Source: Ghanaian authorities and IMF staff

2.3 The solid macroeconomic performance is expected to be maintained during 2005. Real GDP is anticipated to grow by 5.8 percent, driven by buoyant cocoa, construction and mining activity. The substantial increase in petroleum prices in February, following the introduction of a new pricing mechanism, however, has put pressure on prices; year-end inflation is projected at 14 percent. Projected large capital inflows will help sustain international reserves at about four months of imports coverage.

2.4 Macroeconomic prospects over the medium term are favorable (Table 2.1). Annual GDP growth of 6 percent is feasible, supported by prudent macroeconomic and fiscal policies, strong investment, including in infrastructure, and increasing productivity in agriculture. Headline inflation is projected to decline to about 6 percent by 2007. Gross international reserves are projected to increase slightly to over 4 months of imports. Public debt is projected to remain within sustainability bounds. In terms of economic growth performance, the country is well positioned to make further progress in implementing its poverty reduction strategy and meeting the Millennium Development Goal (MDG) of halving poverty by 2015.

## **B. AGGREGATE FISCAL DISCIPLINE**

2.5 Aggregate fiscal discipline has improved since 2002, contributing towards the favorable macroeconomic situation. In 2004, however, it was looser than originally anticipated. The fiscal deficit fell to 3.6 percent of GDP in 2004 from 4.4 percent of GDP in 2003, continuing the downward trend of the last few years. However, net domestic financing of the deficit amounted

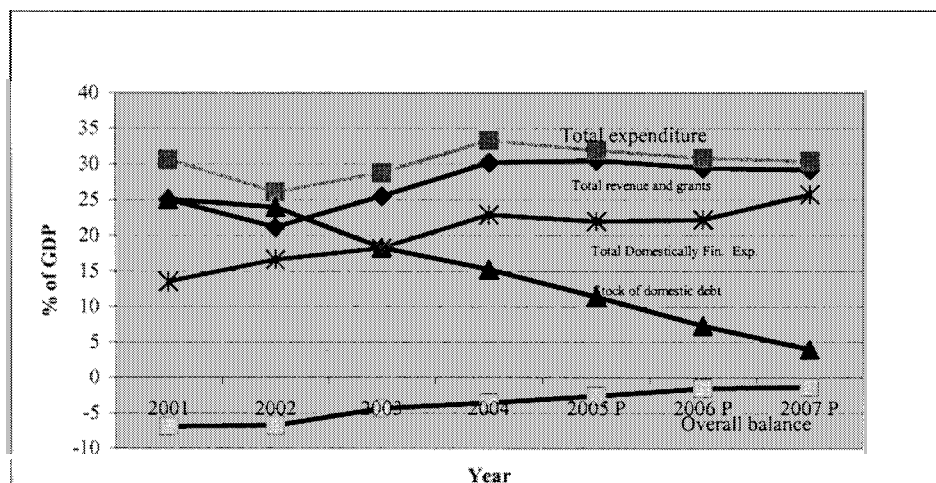
to 0.5 percent of GDP in 2004 significantly lower than during 2000-2002, but higher than in 2003 and higher than the programmed financing of negative 1.4 percent of GDP that would have allowed the Government to make net financial resource transfers into the domestic banking system. The reasons were higher expenditure than programmed and inflation-linked bond savings being lower than projected (Table 1 and 2, Statistical Annex).

2.6 Revenue and grants continued to increase during 2004. Revenue grew to 23.8 percent of GDP during 2004, from 20.8 percent in 2003. The setting up of a one-stop system for dealing with large taxpayers, the introduction of Ghana Customs Management System, the Debt Recovery Levy on petroleum products, the compliance by several public entities with the Financial Administration Act requirement to remit profits to the budget, and the implementation of the National Health Insurance Levy, approved in 2004, contributed to strengthened resource mobilisation. Grants increased to 6.4 percent of GDP in 2004 from 4.7 percent in 2003, with project and program grants both higher than programmed.

2.7 Total expenditure rose to 33.3 percent of GDP in 2004, from 28.8 percent in 2003. Expenditure was considerably larger (by about 4.5 percent of GDP) than programmed due to: (i) higher capital and poverty-related expenditure (by 3 percent of GDP), particularly that financed by development partners and HIPC; (ii) unprogrammed subsidies (almost 1 percent of GDP) to Tema Oil Refinery (TOR), due to the shock of rising crude oil prices during the year and the GoG's decision not to allow retail prices of petroleum products to be adjusted upwards; and (iii) overspending on wages and goods and services. The additional capital expenditure was mainly self-financed from external sources. However, the higher than programmed domestic revenue was more than offset on the expenditure side. In turn, this contributed to the higher than programmed domestic financing and delayed the planned repayment of domestic debt.

2.8 The Government appointed after the December 2004 general election has reaffirmed its commitment to maintain aggregate fiscal discipline over the medium term in support of macroeconomic stability. The overall fiscal deficit is projected to fall to about 2.6 percent of GDP in 2005 and decline further over the medium term (Figure 2.1). The fiscal strategy anticipates domestic resource mobilization to be kept at about 24 percent of GDP and aims at containing expenditure pressures from the wage bill and from quasi-fiscal operations of the state. By 2007, the first is planned to fall to about 30 percent of total primary spending and the latter to become negligible. As a result, domestic financing of the deficit is projected to continue to fall, allowing domestic debt to fall below 10 percent of GDP by 2006. This should free up resources that will be available to implement the GPRS, currently being updated, and contribute to almost double poverty-related spending (in nominal terms).

**Figure 2.1: Central Government Operations, 2001-2007**



Source: Table 2 of the Statistical Annex

2.9 The implementation of the Government's fiscal strategy should allow a considerable reduction in domestic public debt with benefits accruing to the private sector through lower interest rates and greater access to domestic credit. The benefits of sound fiscal management are already being observed with the share of domestic credit to the private sector increasing from 46 percent in 2002 to 58 percent in 2004. Coupled with ongoing reforms to strengthen the financial sector and improve the environment for private sector development, implementation of the medium-term fiscal objectives is critical to the achievement of the country's development goals.

### C. MANAGING FISCAL RISKS

2.10 The main risks to the fiscal outlook and macroeconomic stability are quasi-fiscal subsidies, overruns on the budget and unpredictability and mix of donor funding. Though not large enough to jeopardise the achieving of macro/fiscal objectives, developments in 2004 illustrate the sources of risk and their impact on reducing the reliability of the budget and thus the quality of spending programs.

#### Quasi-Fiscal Subsidies

2.11 The overspending in 2004 attributable to the subsidy to TOR (about 2 percent of GDP) is unlikely to be repeated due to the Government's bold decision to adopt a new deregulated regime for petroleum products, effective from February, 2005. Other state owned enterprises (SOEs) remain a risk. A joint Bank-Fund study undertaken in September, 2004 estimated that including the largest wholly government-owned enterprises in public financial operations would increase the overall fiscal deficit to about 13 percent of GDP on average over 2000-03, due to quasi-fiscal subsidies. Wholly owned state enterprises number 32 in Ghana of which about 19 can be categorised as non-commercial, including most of the largest enterprises. Many of these are inefficient, barely profitable and a potential drain on the budget. Prices for utilities are set by the Public Utility and Regulatory Commission but the utility companies still operate at a loss.

2.12 Nevertheless, the Government has been acting to improve public enterprise finances. In its letter of intent submitted to the IMF under the current PRGF arrangement, the Government committed to eliminate SOE cross debts and take measures to improve efficiency. In this way the balance sheets of enterprises are being cleaned. Each company is required to produce a monitorable financial performance plan and submit performance reports to the Ministry of Finance and Economic Planning (MoFEP). Also, the Government has committed to implementation of the automatic formulae for adjusting water and electricity tariffs. Efficiency improving measures started to be implemented during 2004 in the three utility companies. Finally, the Government is continuing to divest its holdings in a number of joint venture companies. Divestiture receipts amounted to 0.5 percent of GDP in 2004 and similar performance is projected in 2005 and 2006. By these measures the Government is reducing fiscal risks of the state enterprise sector, which are lower than they were a year ago, and likely to remain so over the medium term.

### **Wage Bill Overruns and Their Effect on Non-Wage Spending**

2.13 Part of the spending overrun has stemmed from the wage bill. The wage bill has averaged about 70 percent of the total discretionary spending financed from the Consolidated Fund (CF) over the last three years and is already at the high end of the range for African countries as a share of GDP. The pressure for additional spending on wages has been offset by cuts in voted non-wage spending. While this releases resources to pay wages and salaries, it lowers budget predictability. At one level, the problem lies with the difficulty the GoG has experience in budgeting fully for the wage bill during budget preparation. More fundamentally, the problem is structural. At current levels of pay and numbers the government wage bill is already very large and strains public finances. Yet government pay scales make it difficult to attract/retain professional and skilled technical staff. Furthermore, existing policy in several areas, such as education, requires the government to continue hiring. Government pay policy and the wage bill remain critical areas of concern for external partners. In turn, as the Government recognizes the challenges, it has relaunched a Public Service reform agenda. The issue of the wage bill is discussed in more detail in Sections B and D of the next chapter.

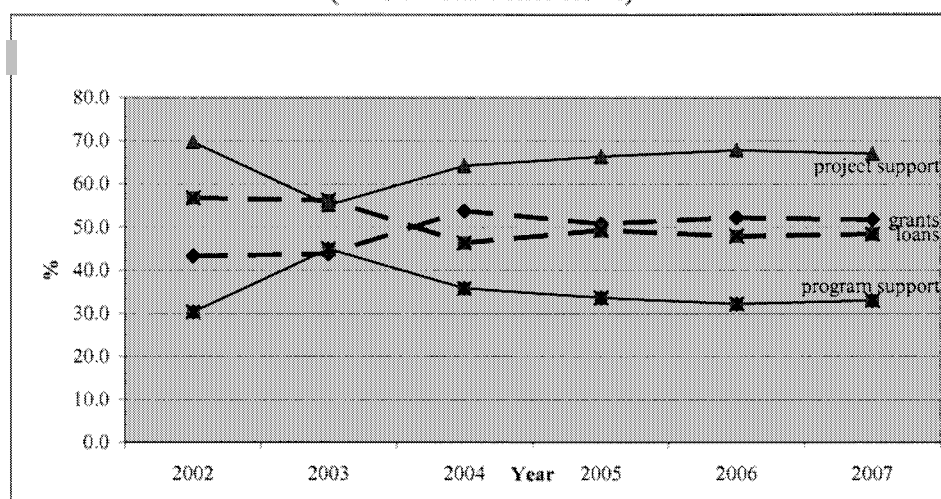
2.14 Non-CF financing sources have largely offset the cuts in CF non-wage spending, but the fragmented and ring fenced nature of these sources detracts from their *ex ante* reliability. The 2004 External Review commented on the fragmentation of public finances and the adverse effects this has on PEM. Encouragingly, the Government is taking steps to increase the transparency of public finances. First, the 2005 Appropriations Act shows allocations of IGFs and to a degree it also covers Statutory Funds. Second, the 2005 Budget Statement provides improved coverage of external assistance flows. Third, HIPC debt relief funded expenditures will be included by MDAs in the 2006 budget estimates. And transfers to statutory funds (as opposed to spending from the SFs) have always had to be voted through the budget.<sup>1</sup> Although

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<sup>1</sup> This is inherent in the nature of a statutory fund outside the CF. By approving the law creating a SF, the legislature, in effect, gives up its right to scrutinize *ex ante* spending in the area covered by the fund, and instead votes a block transfer. It does, however, under the terms of the law, determine the purposes for which expenditures out of the fund may be made, and requires annually the CAG to present the opening and closing balances of the fund, together with information on spending, to be presented by the SF to the parliament. Thus creating a statutory fund takes the details of spending out of the budget estimates approval process. And by creating the SF separate to the CF, balances in the SF, and thus spending authority, do not lapse at the end of the financial year.

the GoG has taken actions to reduce fragmentation, it should be noted that a large share of government operations continues to be financed outside the CF.

**Figure 2.2: Trends in External Assistance**  
(in % of total donor flows)



Source: Table 1, Statistical Annex

### Magnitude and Composition of Aid

2.15 Growing donor aid is supportive of aggregate fiscal discipline if it is predictable.<sup>2</sup> With donors financing close to one third of the budget, predictability of flows is necessary in order to avoid disruptions in spending programs. In the last three years, Ghana has made significant progress in mobilizing external assistance to implement its poverty reduction strategy. As a result, donor flows (including HIPC) have grown steadily from just below 6 percent of GDP in 2002 to a little over 10 percent in 2004. Figure 2.2 indicates the composition of donor flows over the past few years and medium term projections.

2.16 The medium term outlook suggests reasonable stability of external assistance. Continued progress in stabilizing the economy, steadily following through on the country's homegrown reforms and implementation of the updated GPRS, planned to be completed in 2005, positions Ghana well to benefit from the scaling up of financial support efforts being considered by the international community to assist progress towards the MDGs. Nevertheless, the increasing proportion of donor aid in the form of project aid (closer to 70 percent) is a concern from the point of view of the strategic allocation role of the budget and the operating efficiency of spending programs. This issue is discussed in the following chapters.

<sup>2</sup> This is assuming that resources are used efficiently (absorptive capacity is adequate) and that spending of aid does not crowd out the private sector through appreciating real exchange and rising real interest rates. With the fiscal deficit, excluding grants, lower in terms of GDP (projected at 8.5 percent in 2005) than in previous years and projected to fall further, such crowding out appears unlikely to arise. In other countries in receipt of large and increasing aid flows, the fiscal deficit, excluding grants, rose rapidly and appreciating real exchange and interest rates became a major macroeconomic policy issue.



### **3. BUDGET MANAGEMENT AND THE GPRS**

3.1 In recent years, domestic revenue performance has improved considerably. Although expenditure management has also been improving, as confirmed in the 2004 HIPC AAP, it still requires considerable upgrading to bring it to a level comparable to that of other good performing Sub-Saharan African countries. In this connection, the HIPC-AAP framework itself is evolving towards the PFM Performance Management Framework developed by the multi-donor Public Expenditure and Financial Accountability (PEFA) Secretariat based in the World Bank. This framework is a set of high level indicators which draws on the HIPC expenditure tracking benchmarks, the IMF's Fiscal Transparency Code and other international standards. The Framework has been developed as part of the "Strengthened Approach" to supporting PFM reform and was adopted in June 2005 by the PEFA Board. It emphasizes country-led reform, donor harmonization and alignment around the country strategy, and a focus on monitoring and results. A country's performance against the 28 indicators in the framework should be assessed periodically, and the information should constitute a common set of PFM measurements to be used by both government and development partners to track progress towards agreed goals. The framework for the first time contains a section evaluating donor practices in areas like predictability of budget support, willingness to use country systems, and the adequacy of financial information provided to government by donors. MDBS partners and the Government are discussing the feasibility of integrating the PEFA PFM Strengthened Approach into the MDBS process, which already incorporates many of its features. This chapter briefly examines the recent revenue trends, followed by a detailed analysis of expenditure management.

#### **A. REVENUE PERFORMANCE**

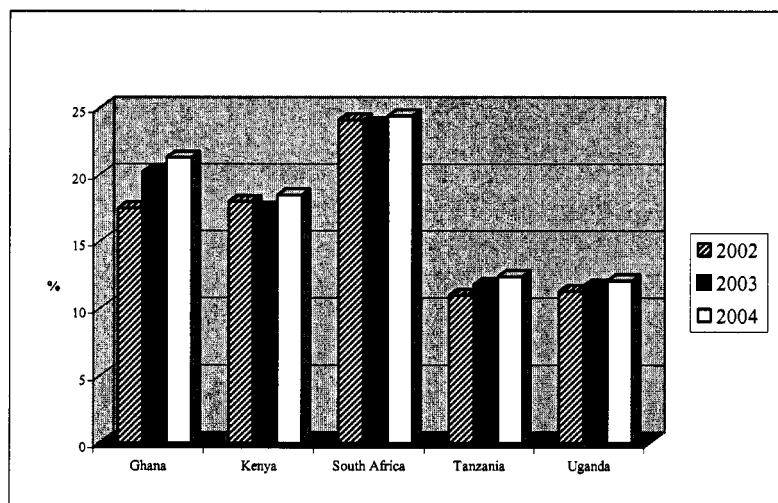
3.2 Government's revenue performance in recent years has been robust. In each of the last three years, the Government has exceeded its domestic revenue-generation budget forecast by between 1.0 percent and 6.0 percent. Tax revenue as a percentage of GDP has increased by about four percentage points over the last three years, reaching almost 22 percent of GDP in 2004. The encouraging revenue out-turns are largely due to strong performance of indirect and international trade taxes. With regard to non-tax revenue, of greater significance is the fact that IGFs by MDAs have been better accounted for in 2004. As a result, IGFs collection is estimated to have doubled compared to 2003 (about 1 percent of GDP) and they are now captured in the budget statement and the Appropriations Act.

3.3 Ghana's tax revenue mobilization gains place the country among the best performers of non-natural resource rich Sub-Saharan African (SSA) countries (Figure 3.1). It needs to be acknowledged that much of the revenue increase in recent years has come from international trade which in the longer term are vulnerable to fluctuations in international commodity prices. Ghana would need to make progress as far as direct tax mobilization is concerned (Figure 1 and 2, Statistical Annex). As correctly stated in the GPRS, most of the opportunities for further revenue strengthening are linked to improved tax administration, but this is likely to be a gradual process. Widening the tax net is critical to better performance in domestic resource mobilization.

3.4 Progress achieved in revenue mobilization is largely associated with the strong mandate given to the Revenue Agencies Governing Board (RAGB) by the Revenue Agency Act of 2000. There is also a tax reform program developed in cooperation with the IMF, which the

Government is implementing. RAGB is the apex entity responsible for ensuring the supervision and co-ordination of the three revenue agencies (Internal Revenue Service - IRS, Customs & Excise Preventive Service – CEPS, and Value Added Tax Service - VATS) and developing and maintaining an effective, fair and efficient revenue collection system. The IRS, CEPS and VATS account for 32 percent, 56 percent and 12 percent of fiscal revenues, respectively. The first is mainly responsible for collecting direct taxes. The second is mostly accountable for collecting taxes levied on international trade. The third collects the domestic-value-added tax and excise duties. A Taxpayer Identification Number has been implemented and in April 2004, the Large Taxpayers Unit (LTU) was formed to provide approximately 360 large taxpayers with “one stop shop” services. In 2002, the Ghana Community Network Services (GCNet) IT system was introduced into CEPS to determine electronically tax obligations of importers. The system is linked to all seaports, airport and major land borders of the country. The introductions of the LTU and GCNet have impacted very favourably in revenue collection. As for non-tax revenue, progress made being made results from the setting up in MoFEP, in 2002, of the Non-Tax Revenue Unit (NTRU) with a mandate to facilitate the collection, accounting and timely reporting of non-tax revenues, work with all agencies to increase their revenue generation potential, ensure compliance with the policy on State Assets Management, and ensure that those institutions capable of generating sufficient IGFs for their operations, are moved from subvention status.

**Figure 3.1: Trends in Tax Revenue**  
(% of GDP)



Source: Table 2, Statistical Annex and IMF data.

## **B. PUBLIC EXPENDITURE MANAGEMENT**

3.5 Good PEM aims at a reliable and predictable budget that allocates resources according to the strategic objectives and priorities of the government’s development strategy, and does so in a way that supports operational efficiency. Significant deviations from the budget plan indicate that spending programs are not being implemented as programmed and that policy objectives are being compromised. Inefficiencies in budget preparation and execution (e.g. weak wage bill forecasting, delays in cash releases, releases not reaching intended targets and inadequate value

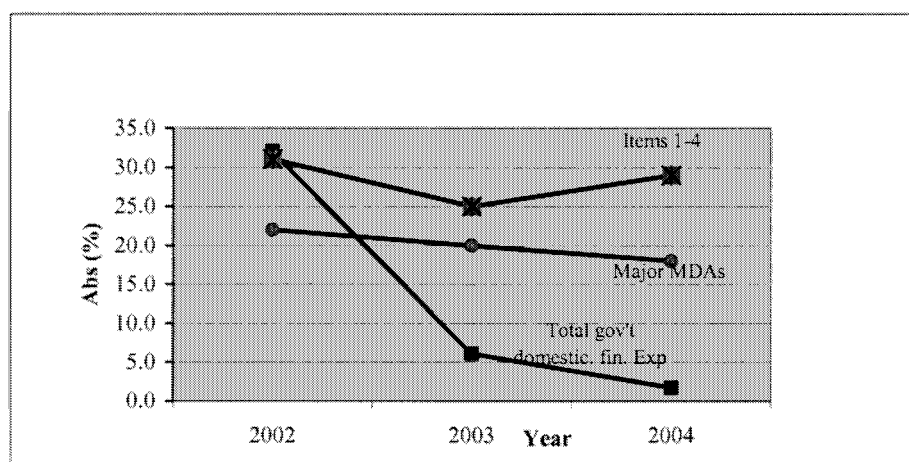
for money in procuring inputs) may also affect the quality of spending programs. Inadequate reporting and accounting systems may cast doubts amongst taxpayers over whether their funds are being utilized as intended. Perceptions that the budget is a poor predictor of budget outcomes and that operational inefficiencies are affecting the quality of spending programs may result in reduced willingness to finance the budget. Furthermore, if this persists, it could erode local tax payer efforts. This section and Section D therefore assesses the quality of PEM in terms of the reliability and operational efficiency of the budget.

3.6 Government expenditure performance is analyzed first in terms of the budget financed out of the Consolidated Fund, as approved by Parliament through the Appropriations Act. The Consolidated Fund finances only about half of public spending, the rest being financed from internally generated funds, HIPC debt relief, statutory funds and donors disbursing directly to projects. Government expenditure performance is therefore also analyzed in terms of the broad measure of public spending.

### Performance of the Discretionary Budget Financed from the Consolidated Fund

3.7 Budget performance over 2002-04 presents a mixed picture. Aggregate performance has been improving and is much closer to the planned budget by 2003 and 2004, but with large deviations continuing at the MDA and economic classification level (Figure 3.2). In 2002, the budget was overspent by about 30 percent. Aggregate fiscal discipline strengthened considerably in 2003 and was good in 2004, despite some slippage.

Figure 3.2: Budget Deviation Index, 2002-2004



Source: Table 7 of the Statistical Annex

3.8 Deviations at the MDA level continue to be relatively high, after a marginal decline to about 18 percent by 2004. The Ministry of Education – the largest ministry - accounted for nearly half of the deviation, overspending its budget by 20 percent. The Ministry of Health was the next largest overspender. Many other ministries underspent by significant amounts (Tables 4 and 6, Statistical Annex). Similarly, deviations at the economic classification level continue to be high, still close to 29 percent in 2004. Overspending has mainly been on wages, partly offset by underspending on other recurrent spending and investment. Wages were overspent by 7 percent, while goods and services and investment shortfalls were at 17 percent and 42 percent,

respectively (Table 5, Statistical Annex). Wage overruns, in turn, reflect under-budgeting of staff increases (teacher trainees), staff benefits (ADHA), or pay increases or inadequately controlled SAs. In 2004, wage overruns in the social sectors were more than twice the wage reserve contingency. MDAs with relatively low labor-intensity have tended to underspend (Table 6 of Statistical Annex).

3.9 The overspending on the wage bill thus appears to be structural in character, and can be brought under lasting control only when the Government is ready to tackle deep seated public service reform issues, and, specifically, the policies which drive wage bill costs in critical sectors like education and health.

### **Budget Predictability and the Contingency Reserve**

3.10 In Ghana, at the aggregate level, the budget outturn does not differ considerably from the original budget. However, deviations of the budget as spent from the approved budget, by MDAs and economic classification, are still considerable. The main issues that need to be addressed in order to improve budget predictability are elaborated on in more detail in Section D.

3.11 The contingency reserve, shown under the MoFEP's vote has increased sharply since 2002, from 1 percent of total domestic discretionary spending to 8.3 percent in 2004 and is budgeted at 15.7 percent in 2005 (Table 6 of Statistical Annex). It is divided between the four main economic classification items (wages, administrative services, other goods and services and capital assets). Out of 870 billion cedis budgeted in 2004 as contingency 560 billion cedis were spent on items 2, 3 and 4. The unaudited accounts for 2004 do not break the contingency allocation down by MDA, so it is not possible to tell the extent to which it affected deviations. As Table 6 in the Statistical Annex indicates, over the years, most of the wage contingency appears to have been allocated to the wage bill for education (the wage bill for education in 2004 was 600 billion cedis higher than budgeted while the wage contingency was 311 billion cedis).

3.12 Contingency provisions of this magnitude are an undesirable budget practice as it weakens the principle of Parliament approving the budget *ex ante* according to pre-stated public policy objectives. Large contingency reserves provide excessive discretion in resource allocation. It could be argued that Parliament knowingly approves the contingency reserves through the Appropriations Act, but, in practice, legislators approve a contingency provision without knowing the details on what the money will be spent. Thus, a contingency provision within the finance ministry (or anywhere else in the budget) if it grows too large, becomes a "budget-within-a-budget". This calls into question the transparency of the budget as a whole.

3.13 One way to address the problem is to separate the different types of contingencies the Government must provide for. Many countries have a special Contingency Fund, set apart from the CF, which may be drawn down in the case of an unforeseen national disaster. Typically, the authority to spend is given to the president, but he must inform the legislature immediately, and seek the replenishment of the fund as soon as possible through a supplementary budget. The Constitution (Articles 175, 177) in fact provides for a Contingency Fund, for urgent and unforeseen needs, as authorized, in Ghana's case, by a special parliamentary committee. The Government intends to activate such a fund in 2005, precisely for national emergencies.

3.14 Contingency funds of this type are intended for emergency use, usually if there is a natural disaster. Contingency funds are normally neither used for unforeseen financial contingencies (such as claims against the government arising from a SOE failure), nor for spending requirements which arise in the course of the year because poor financial planning prevented them from being anticipated and budgeted for. The correct way to budget for the first type of contingency spending is to have each year a financial contingencies item in the finance ministry's vote – often termed “contingent liabilities”. The second type of contingency is best addressed by improved budget preparation – ensuring that MDAs properly anticipate the costs they will have to meet in the course of the year, and to either budget for them or change policy to avoid the costs.

3.15 The contingency reserve shown in the MTEF for 2005-07 of 8 percent of total domestic discretionary spending by 2007 (Appendix Table 5 of 2005 Budget Statement) is large, and should be reviewed to reduce it to below the 5 percent threshold. But the MTEF is a spending plan, not an annual budget, and in this sense a contingency amount in the outer years of the MTEF may serve a different purpose. In other countries<sup>3</sup> it can be a mechanism for identifying the “headroom” available for new policy. How to handle contingency amounts in the outer years of the MTEF is an issue to be considered by MoFEP.

### **Performance of Public Expenditure Financed from all Funding Sources**

3.16 From a broader perspective, budget predictability continues to show considerable variance when the “budget” is examined from a broader perspective than the CF. In 2004, the shortfalls in CF budget execution for economic services and infrastructure and for items 3 and 4 were more than offset once the non-CF funds are included, particularly HIPC and donor funding (See Tables 5 and 10, Statistical Annex).<sup>4</sup>

3.17 The pattern of public spending indicated above is confirmed in the health sector. Data by source of funds and economic classification for 2004 is presented in Table 3.1 below, as extracted from the unaudited accounts for the Ministry of Health (MoH). It confirms that the GoG financed 43 percent of total health expenditure in 2004, but financed 97 percent of wage expenditure and only 1.4 percent of capital expenditure. The preparation of Table 3.1 by the MoH as part of its end of year accounts is a welcome development and hopefully other ministries will follow the example for the 2005 accounts. The Ministries of Education and Roads Transport produced similar tables for the ERPFM review, and these are summarized in Table 11 and 12 in the Statistical Annex. The patterns are similar, with the Consolidated Fund financing the wage bill but only a small proportion of items 3 and 4.

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<sup>3</sup> In South Africa, which has a well developed MTEF, it serves this purpose. But in this case it is a true residual since existing programs are fully costed.

<sup>4</sup> 2004 is the first year for which ex ante estimates of spending on a functional and economic classification basis are available for non-CF funding sources.

**Table 3.1: Ministry of Health Expenditure, 2004**

Source of Funds	Item 1 %	Item 2 %	Item 3 %	Item 4 %	Total %	Total Billion cedis
GoG	96.6	11.4	10.2	1.4	42.6	1098.6
Borrowing 1/				54	11.5	295.1
IGF	3.4	29.6	28.9	2.1	13.2	341.5
Donor Health Fund		59	36.7	20.3	21.1	543.2
MOH programs			21.4		6.1	158.5
HIPC fund			2.8	22.2	5.5	141.2
<b>Total</b>	100	100	100	100	100	2578.1
% of Total Expend.	39.5	10.6	28.7	21.2	100	
Expend. (billion cedis)	1018.7	272.6	740.3	546.5	2578.1	

Source: 2004 Unaudited Accounts of Ministry of Health.

1/ Health Sector Program financed by IDA.

3.18 While the table provided by the Ministry of Health on health spending is very clear on the different sources financing health sector expenditure, it reveals the fragmentation of Ghana's public finances. The financing of non-wage expenditure from other sources of funding is far from ideal, however, and greatly complicates the ability of the government to allocate its resources according to its strategic objectives and priorities. The ring fencing nature of other funding sources puts the brunt of adjustment on the CF in the event of expenditure overruns or revenue shortfalls, with adverse consequences for both the operational efficiency and effectiveness of spending programs. Moreover, the modalities for other funding sources tend to be less efficient than funding through the CF. Transactions costs tend to be high due to the involvement of different agencies, and the higher costs of donor projects relative to government-executed spending. Donor projects also may distort wage incentives and can undermine efforts to increase capacities within government.

3.19 The 2005 Appropriations Act and subsequent MoFEP statements indicate progress towards reducing fragmentation. Internally Generated Funds (IGF) are included for the first time by MDA and economic classification and GoG indicates that the same will happen for HIPC's for the 2006 budget. The transfers to SFs are shown in the Appropriations Act. The expenditures financed by these SFs are legally difficult to include in the Appropriations Act as they are covered by other legislation. But at least the spending plans of these funds should be shown in the budget documents, in line with the international best practice treatment of the expenditure of extra-budgetary funds in other countries. The 2005 Budget Statement also provides, for the first time, comprehensive information on actual donor flows, both grants and loans. This issue is analyzed in more detail in section D of this chapter.

### C. POVERTY ORIENTATION OF THE BUDGET

3.20 Assessing the poverty orientation of the budget requires, first comparing the sectoral composition of the budget with the planned expenditures as laid out in GPRS and, second, within each sector, reviewing the extent to which spending is poverty-related and represents a reasonable balance between wage and non-wage spending. The spending base for the first should be the same as the second, but in Ghana they are not, thus complicating assessment. The sectoral composition targets under GPRS (Table 5.1 in GPRS) are based on discretionary spending financed by CF and donors, while the definition of poverty-related spending in a sector is based on non-interest spending including HIPC and Statutory Funds but excluding donor-financed spending. The sector proportions can differ sharply between the two cases. For example, the 2004 Budget envisaged that economic services plus infrastructure should comprise 20 percent of total discretionary spending in 2004 (Table 3.2 below). Using total domestically-financed discretionary expenditure as a base, economic services and infrastructure comprises 10 percent of planned spending in 2004, the difference representing donor funding (Table 8, Statistical Annex).

#### **Medium Term Priority Programs (MTPPs)**

3.21 Poverty-related spending should therefore be the sum of domestically-financed poverty related spending plus that financed by donors, which are largely identified in the Medium Term Priority Programs (MTPPs). These cover projects and programs under “themes” that are mainly donor-financed and largely cover investment costs.<sup>5</sup> Adding in donor-financed spending and spending financed by IGFs would provide a complete picture of the sectoral composition of public poverty-related spending per sector. IGF finances only about 5 percent of total public spending, but a much larger share of social services spending (about 10 percent). At present, however, it is not possible to differentiate between non poverty and poverty spending financed by donors and IGFs.

#### **GPRS and Budget Spending Compared**

3.22 In the next page, Table 3.2 reviews the sectoral composition of discretionary government spending (defined as spending out of the CF plus donor spending) with that envisaged under the GPRS. In 2004, due to donor aid being more than double the expected amount, and more than offsetting the shortfall in CF funding, the spending share for economic services (including infrastructure) was much higher than initially budgeted for and closer to the GPRS share. The share for social services was also sharply higher than the budget estimate, due both to donor aid being double the projected amount and funding from the CF much higher (reflecting the wage overspend). The share for social services was also well-above the GPRS target. The shares for general administration and public safety were lower than budgeted, but close to the GPRS targets.

3.23 In the 2005 budget, the share for infrastructure is lower than the one planned for under the GPRS while the share for social services is higher. The outturn for social services in 2005

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<sup>5</sup> The annual budget speeches contain footnotes differentiating between domestic poverty-related spending and MTPPs. MTPPs focus mainly on growth” (footnote to para. 914 of 2005 Budget Speech).

will most likely be even higher, reflecting the under-budgeting of wages for education (as discussed below). To cover the latter, funds are likely to be taken out of the contingency reserve.

**Table 3.2: Distribution of Total Discretionary Expenditure, 2002-2005**

Sector (in percent)	2002	GPRS 2003 Target	2003 Budget Outturn	GPRS 2004 Target	2004 Budget	2004 Budget Outturn	GPRS 2005 Target	2005 Budget
Administration	19.8	14.2	14.8	13.3	17.3	13.6	13.3	13.5
Economic	18.0	9.7	9.1	10.3	8.9	9.6	10.3	10.3
Infrastructure	17.2	17.2	15.5	19.1	10.9	18.6	19.1	16.8
Social	34.7	38.1	38.7	34.3	38.8	42.2	34.3	37.4
Public Safety	9.7	11.1	11.5	9.0	11.9	8.8	9.0	6.9
Utilities	-	2.8	2.7	3.2	2.5	0.5	3.2	1.7
Revenue Agencies	-		3.1		3.0	2.7		2.7
Contingency	0.6	6.9	4.6	10.8	6.7	4.0	10.8	10.7
<b>Total</b>	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: 2003-2005, GPRS; 2003-2005 Appropriations Acts, and unaudited CF accounts of 2003-04.

Note: Discretionary expenditure defined as GoG discretionary spending plus donor spending

### **Poverty Spending Financed from the Consolidated Fund**

3.24 The deviations between budget plans and budget execution for the CF are reflected also in the poverty-related areas of the CF budget. The weighted average budget deviation of poverty-related spending was 19 percent, relative to 16 percent for the budget as a whole (Tables 16 and 4, Statistical Annex). In terms of poverty-related spending funded by GoG resources, the main overspenders were the Education (mainly reflecting the wage bill overrun) and Public Safety sectors (Tables 16, 18 and 20, Statistical Annex). Most other sectors underspent, including health.

3.25 Similarly to what happened with government spending financed by non-CF sources, other funding sources (HIPC and Road Fund) helped to make up for shortfalls of poverty-related expenditures under the CF, although underruns occurred in some key sectors (health and rural water) (Table 16, Statistical Annex). The tables prepared by CAGD only report spending from CF and HIPCs, which were 7 and 35 percent higher than initially planned, respectively (Tables 18 and 20, Statistical Annex). Most of the shortfalls in transfers to GETF and DACF were accommodated by cuts in their contribution to financing poverty-related expenditures (Tables 3, 18 and 20, Statistical Annex).

### **Trends in the Share and Composition of Poverty Spending**

3.26 Rapid primary expenditure growth, of which about half financed additional subsidies to the petroleum sector, resulted in domestically-financed poverty-related spending being higher than planned for 2004. As a ratio to GDP, they were more than half a percentage point above the initially anticipated level of 6.9 percent (Table 17, Statistical Annex). However, as a share of



total primary spending, the outturn of domestically-financed poverty related expenditures in 2004 (27 percent) was somewhat lower than that in 2003 (28 percent), being planned to reach 30 percent in 2005. Considerable progress was made in improving the balance mix between wage and non-wage pro-poor spending. Overall, the share of wages in poverty-spending has fallen considerably, although ending slightly above the level initially envisaged (Table 3.3 below, Table 15, Statistical Annex). The picture is mixed for poverty spending in each sector, in particular due to spending shortfalls in critical sectors such as primary health care and rural water. Detailed assessment of the poverty focus of the 2005 budget is not possible by sector as the savings from HIPC debt relief (1.6 trillion cedi) have yet to be allocated (Table 22, Statistical Annex).<sup>6</sup> However, at the aggregate level, the Government is determined to increase poverty-alleviation spending to 8.3 percent of GDP and scale up the share of the non-wage component to almost 50 percent. It is worth noting that the share of wages in poverty-related spending is falling in all sectors except basic education and rural electrification. In the former, it appears to have stabilised at about 77 percent of total sector spending (Table 15, Statistical Annex).

**Table 3.3: Poverty Related Expenditure, 2002-2004**

	2002	2003	2004	2004
	Actual	Actual	Budget	Actual
<i>Domestic poverty related spending</i>				
<i>Percent of GDP</i>	4.8	6.5	6.9	7.7
Social Services	3.4	4.5	4.8	5.1
Economic Services & Infrastructure	0.7	0.8	0.9	1
Other	0.7	1.2	1.2	1.6
<i>Percent of Domestic Primary Spending</i>	28.8	35.0	33.1	33.5
Social Services	50.3	58.5	62.8	58.7
Economic Services & Infrastructure	52.2	44.2	45.3	47.7
Other	7.6	13.0	10.4	13.1
<i>Percent of Wages in poverty spending</i>		69.3	54.8	55.6
Social Services		83.3	68.7	71.6
Economic Services & Infrastructure		17.9	12.11	13.6
Other		49.7	30.9	30.6

Source: Tables 9, 15, 20 and 24 of Statistical Annex

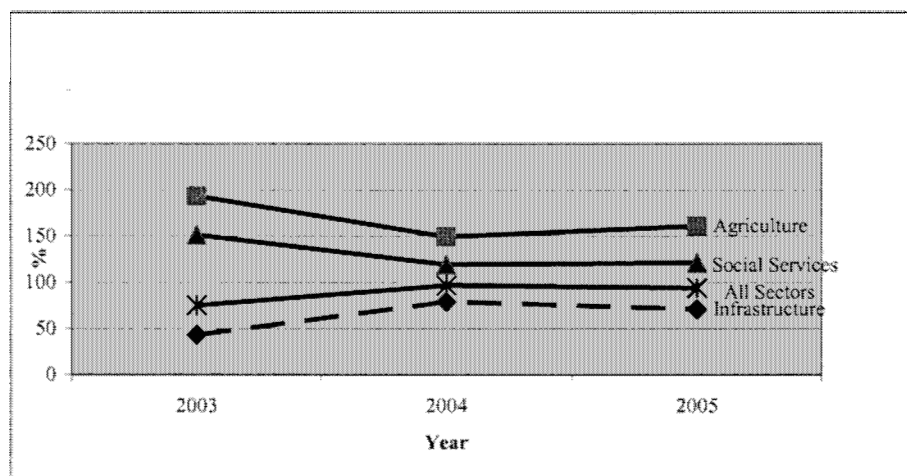
## MTPP Spending

3.27 The performance of MTPP spending programs, which represent, so to speak, a cut-down version of the GPRS with a bias towards investment, is summarized in Figure 3.3 (see also Table

<sup>6</sup> "Other" poverty spending has been adjusted downwards to reflect HIPC's funding for education, primary health care (to include sanitation) and rural water channelled through Ministry of Local Government and Rural Development.

24 in Annex). The proportions of expenditure have been higher than under MTPP except for infrastructure. Total expenditure in 2004 was 97 percent of what had been initially projected for the MTPP relative to the budgeted 79 percent, reflecting larger donor inflows than expected. The 2005 budget shows the proportion of expenditure at 94 percent of the GPRS target, with infrastructure budgeted at 71 percent of the MTPP target.

**Figure 3.3: Implementation of MTPPs**  
(deviation from initial program, in %)



Source: Table 24. Statistical Annex

3.28 In conclusion, the GoG's focus on poverty-related spending continues to evolve in the right direction and is expected to expand further as quasi-fiscal subsidies fall during 2005. The same observations relating to budget fragmentation and efficiency losses apply as for total spending, as discussed above. The shares planned under GPRS are largely being maintained. Total poverty spending is increasing in terms of GDP, the increase **being distributed between** both the social and economic services sectors.

#### **D. CHALLENGES FOR PUBLIC EXPENDITURE MANAGEMENT**

3.29 Overall, the budget in Ghana has become a relatively effective instrument for macroeconomic stability, but predictability still needs to be improved to ensure alignment of spending with voted priorities and the provision of services on a cost effective basis. This shows up when the budget as spent is compared with the budget as approved, both at the level of individual ministry spending, and by economic function.

3.30 The net effect of this unpredictability is likely to be a considerable loss in operational efficiency. Further work will be needed in the course of the coming year such as service delivery surveys or public expenditure tracking surveys and analyzing outcome data. The Review considers that issues of operational efficiency would be worthwhile bringing to the fore in the dialogue between the **Government and the development partners**. The rest of this chapter discusses some critical areas where improvements are in reach which could increase the predictability of future budgets. The first is better control over the wage bill. The second is making the MTEF more useful as a strategic resource allocation mechanism. The third is improving predictability of external assistance. The fourth is reducing shortfalls and delays in

cash releases. The fifth is timeliness and accuracy of fiscal reporting. The sixth is expanding the budget preparation timetable. Collectively, these should improve both strategic allocation and operational efficiency.

### Controlling the Wage Bill

3.31 Improving budget performance over the medium term hinges on how effectively the Government is able to control the wage bill. Presently, the wage bill accounts for more than two thirds of discretionary (i.e. non-statutory) expenditure out of the CF. Overall, the government wage bill approaches 9 percent in relation to GDP. There are several other countries with similar wage bill shares, but only those with higher relative domestic revenues are able to sustain a large public sector wage bill without fiscal strain.

**Table 3.4: Wage Bill in Selected African Countries**

	Ghana	Mauritius	S. Africa	Tanzania	Botswana
Wage and Salaries					
as % of GDP	9	6	10	4	11
as % of Tax Revenue	41	35	33	30	35
as % of Total Expenditures	32	23	37	25	25

Source: IMF, most recent published Article IV Consultation. Data for Ghana is planned for 2005.

3.32 But these comparisons should be made with caution, as the Ghanaian budget is strained by the heavy demands the wage bill makes on CF discretionary resources (68 percent). The large wage bill crowds out other categories of spending in the domestically financed current budget and making their funding over-dependent on the assistance of development partners. Some comparator countries are also struggling to meet their wage bills. Furthermore, the underlying structure of pay it represents is insufficient, certainly for professional, managerial and technical grades, to properly motivate staff.

3.33 Over the longer term, the wage bill is driven by policy decisions on the scope of government and the manner in which services are delivered. These issues are expected to be addressed by the public service reform programs, re-launched earlier in 2005. More immediately, the wage bill is influenced by both budgeting and technical issues. On the budgeting side, MoFEP's control over the wage bill is complicated by the staffing increase demands of MDAs. Discussions on the wage bill requirements for next year's budget happen late in a compressed budget preparation calendar (discussed later in this section). An allocation is determined for the overall increase in the wage bill, and appears in the Appropriations Act as a "contingency reserve", to be distributed later on during the year, as discussed in chapter 2. For 2005, the Ministry of Education has already requested MoFEP for an increase in its wage bill provision by 530 billion cedis (of which about 60 percent is for MOE and GES and the remainder is for tertiary education) (Table 3.5 below). As in the past, the strongest driver of wage bill costs is the education sector, specifically the GES and the NTEC.

**Table 3.5: Education Sector Wage Bill**  
(in billion cedis)

Division	2005 budget	Request	Shortfall	2004 Budget	2004 Actual	Difference
Main Ministry	159.3	215.6	56.3	158.5	200.4	41.9
GES	2949.8	3224.8	274.9	2392.6	2961.3	568.7
Tertiary	510.4	707.7	197.2	464.4	464.4	0
<b>TOTAL</b>	<b>3619.5</b>	<b>4148.1</b>	<b>528.4</b>	<b>3015.5</b>	<b>3626.1</b>	<b>610.6</b>

Source: Ministry of Education

3.34 Although the contingency provision budgeted for 2005 under the CF is sufficient (over 1 trillion cedis) to cover the extra wage bill, the process of budget preparation would have been better served if the wage bill increase had been properly costed as an integral part of the Ministry's budget submission. In that way, the wage demands of the education sector could have been examined in relation to the claims for resources by other sectors and perhaps savings could have been found, or the increase in staffing denied. Providing fully for the wage bill during budget preparation would strengthen the credibility of the MTEF and the hard budget constraints reflected in the call circular, and, moreover, underpin the principle of Parliament giving prior approval to spending of public funds through the Appropriations Act.

3.35 A possible justification for a wage bill contingency might be uncertainty over the magnitude of new hiring, but this is not the case in Ghana. The numbers of new staff coming on board at the start of the school year in October are accurately known in advance and there is no need to assume, as with current practice, that staff strength will remain the same. For example, it was known that 9000 graduate teachers were expected to join the GES in October 2004. Thus the magnitude of these increases should be known beforehand, and costed and budgeted for in the Ministry's submission, which can then be accepted or disallowed.

3.36 A more justifiable source of uncertainty is adjustments to pay, the outcome of periodic negotiations between the GES and teachers unions, and likewise in the health sector. There is a case for looking afresh at how wage increases should be handled in the budget. If pay negotiations are still underway when budget preparation is concluded, the Government choices are limited. One option is to include a special salaries provision in the MoFEP's vote to cover the cost of new pay scales. Alternatively, when the amount of wage bill cost is known, the Government could return to Parliament with a Supplementary Appropriation Bill to cover the cost of the new scales, and to indicate how they will be financed. Although this might be viewed as theoretically the correct way to proceed, it may be impractical from a political perspective. A third option would be to ensure that pay negotiating bodies/salaries commissions complete their work ahead of finalization of the budget estimates, and that the new salaries and wages commence with the start of the FY. In the medium term, the Government intends to move forward with public service reforms. In this way it can address the staffing level and policy cost drivers of the wage bill, and develop a new pay policy which places greater regard to the local labour market for professionals and skilled technicians.

3.37 Technical problems also impede control over the wage bill. The MoFEP has considerable control over the IPPD1 wage bill, through its IT and reporting systems through which names and correct pay rates are verified. Payroll audits since 2000 have succeeded in cleaning up the payroll, with thousands of ghost workers removed from the payroll, particularly in the GES; the number of ghost workers identified in GES fell to less than 100 in 2004. The “ghosts” problem is not yet eliminated, however, and continual payroll cleaning exercises are still required. In addition, the IT system for IDDP1 is antiquated and in danger of becoming non operational (the next chapter discusses this issue further).

3.38 An adequate degree of verification is not available for the SAs. Although the payroll list is reported to the MoFEP, the latter has no independent means of verifying this. The situation is even more problematic for tertiary education, as the wage bill is paid to the umbrella organisation National Council for Tertiary Education (NCTE), which then pays out to the SAs falling under it. The situation has arisen that the SAs use part of the wage bill provided to them to increase their non-wage spending. This partly explains the discrepancy between CAGD estimates of spending for SAs under items 1 and 2 and SAs estimates. The MoFEP is considering imposing control over the SA payroll through having just one payroll for all the SAs.

3.39 Better control of the wage bill over the longer term requires comprehensive public sector reform, through rationalising of the number of government agencies. It also requires revisiting the way in which current policies are delivered, and the dividing line between the state and private/community provision. GoG is aware of this and of the fact that such reform is a long term task. However, improved wage budgeting practices, better technical solutions, regular payroll audits and bringing the SAs wage bill under control can be achieved in the near future.

### **Improving the MTEF as a Strategic Resource Allocation Instrument**

3.40 The MTEF should serve as the main strategic resource allocation tool for ensuring that the mix of spending programs is consistent with GPRS objectives (and orientations drawn from the Annual Progress Reports) and also that the GPRS itself is consistent with a sound aggregate fiscal strategy. The 2005-07 MTEF (Appendix Table 5 of 2005 Budget Speech) suggests some improvements in functionality. In the past, the MTEF showed constant sector shares derived mechanically, thereby rendering it of little use as a resource allocation tool. This year, however, recommends some variation between sectors indicating a degree of strategic prioritisation. The share of general administration falls from 13.5 percent to 10.7 percent and the share of the contingency falls from 15.7 percent to 8 percent, which is more reasonable but still too high. The shares of economic and social services, and public safety also increase (Table 14, Annex).

3.41 The MTEF would be more effective if it were comprehensive in terms of sources of funds. At present it captures GoG and donor expenditures but omits HIPC, IGFs, GETF, DACF and the Road Fund which in total represent about 30 percent of broadly defined public spending (Table 9, Statistical Annex). Now that Ghana has reached the HIPC Completion Point, the annual magnitude of debt relief is known with considerable certainty. Including HIPC resources in the MTEF should therefore not represent a major challenge and is consistent with the Government’s recent decision that HIPC funding will be integrated in the regular 2006 budget process. With IGF appearing for the first time in the 2005 Appropriations Act by MDA and economic classification item, it should also not be difficult to incorporate these into the MTEF.

As for the Statutory Funds, external partners acknowledge existing structural constraints, unlikely to change in the near future, and suggest that the Government considers (a) synchronizing the preparation of the SFs spending plans with the timetable of the budget elaboration, and (b) including them in the budget statement documents in a manner that suits existing rules and regulations. Expected expenditures from the SFs could be shown as a memorandum item, with the transfers into them; as funds to be voted.<sup>7</sup>

3.42 There is also scope for using the MTEF more strategically, as an instrument to improve management of aid flows (particularly project aid), rather than allow spending to be driven by variations in external finance availability.

3.43 Late in 2004, the Government committed itself to conduct an internal review of the MTEF. This worthwhile exercise is needed, given the still unrealized potential to help the Government allocate resources strategically, manage fiscal shocks, improve policy coherence and enhance operational efficiency. Amongst other things, the MTEF review could look at whether the present objective/output/activity classification system needs simplification and how it could provide for a stronger operational link between the GPRS and the annual budget.

### **Improving Predictability of External Assistance**

3.44 During the last three years, the Government of Ghana made substantial progress in mobilizing external financial assistance to implement its poverty reduction agenda. ADMU estimates that about US\$2.2 billion were contracted in the period 2002-2004, of which slightly less than half was in the form of grants and the rest in soft loans (Tables 28 to 33, Statistical Annex). This has rejuvenated the country's foreign assistance portfolio, and resources disbursed in 2004 were largely made from loans and grants signed over the period in reference. Still, about 70 percent of those resources are available for the period 2005 onwards. While debt relief in the context of the HIPC initiative has also freed-up significant resources, the country's financing requirements identified in the GPRS, including those needed to meet the MDGs, will continue to be substantial and preferably contracted in grant and concessional loan terms to preserve debt sustainability.

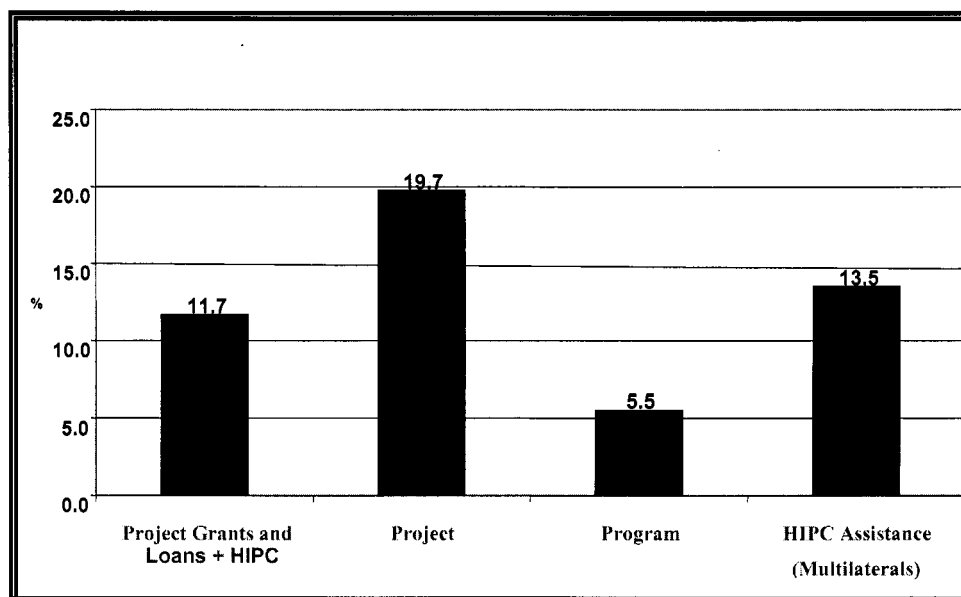
3.45 The weak predictability of external funding and the fact that large amounts flow off-budget pose major challenges to both the Government and the donors as they affect the reliability and comprehensiveness of the budget and adversely impact on the efficiency of the country's programs. In 2002, ADMU instituted a standardised format for reporting on donor inflows for project and budget support. This effort has received broader cooperation and is yielding a more comprehensive reporting. An application system CSDRM 2000+ is operational in MoFEP, CAGD and BoG to handle all aid and debt management of the government. The 2005 budget statement provides a much improved coverage of foreign assistance, both planned for the current year and outturn data for 2004. Notwithstanding this achievement, accounting for external flows remains a significant challenge and the variance between budget estimates and actual disbursement continues to be excessively high (Figure 3.4 below and Table 9, Statistical Annex).

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<sup>7</sup> This would enable a comparison to be made between the planned spending of SFs and their actual outturns. In the case of the GETF, a sizable proportion of the transfers to it, in recent years, seem to have been invested in financial assets rather than spent on current outlays.

The 2005 Budget statement indicates that all MDAs will be required to submit to MoFEP (as established in the FAA) quarterly financial reports detailing receipts of grants and loans. It also states the need to ensure an appropriate ex-post integration of donor disbursements in the financial reports of MDAs. These actions fit well with the intention of ADMU to implement, shortly, a system of periodic reconciliation of grants and loans involving MDAs.

**Figure 3.4: Variance of Donor Flows by Type of Funding**  
Average 2002-2004



3.46 Despite the worldwide trend from projects to budget support, project aid in Ghana might very well increase as a share of total aid (Figure 2.2) in the absence of a major concerted effort by Government and donors. One reason for this trend might be that donors and MDAs still lack confidence in the ability of MoFEP to manage public finance due to large deviations at MDA level in budget execution, cutbacks in non wage spending and delays in cash releases.

3.47 Administration of donor support outside the Government budget weakens budget management and accountability, particularly with donor flows financing about one third of the budget. Tackling this problem calls for a stronger partnership between the Government and donors and requires that the Government demonstrates resolve to improve budget management, transparency and accountability. The principles recently agreed in the paper “Harmonization and Alignment in Ghana for Aid Effectiveness: a common approach for Ghana and its Development Partners” provide a good platform to move forward. The Government is conscious of the need to collect better information on directly provided aid resources, but at the same time it is aware that its own capacity to obtain this information is limited, and that donors cannot be compelled. Its priority, therefore, is to collect as much information as it can about the directly provided assistance of major program donors.

## **Reducing Shortfalls and Delays in Cash Releases**

3.48 In recent years MoFEP has improved the system for the release of cash to MDAs and strengthened commitment control. Nevertheless, there is still some distance to go. Delays in cash releases and incurring of payments arrears still occur, as evidenced by the considerable deviations between the budget as approved and the budget as spent, both across MDAs and within economic classifications. A key message of this review is that these deviations detract from budget predictability, a vital attribute of a well functioning budget system that delivers cost-efficient public services. Ministries tend to complain about MoFEP delaying cash releases or releasing less cash than indicated by the quarterly cash ceilings. The Auditor General's Office raises this as an issue in its report on the Ministry of Health's financial statements for 2003. The picture is not obvious, however, as clear information was not available on this issue. However, MoFEP also indicates that MDAs do not always submit monthly fiscal reports, on which cash planning depends.

3.49 Main reasons for delays/shortfalls in cash releases and/or for arrears build up are:

3.50 Preparing of invoices for payment is a time consuming process involving several steps; for example, an invoice submitted by a roads project contractor operating in a district relatively far away from Accra can take several weeks to process. Arrears may be incurred if the expiry date for payment has passed. Arrears will then mount if the contractor charges interest penalties, as has happened in Ghana. But once the invoice is approved, then, according to the Budget Department of MoFEP, cash release should soon follow suit.

- MDAs do not send in their Commitment Control System (CCS) reports on time. Under CCS, for which 2004 was the first full year of operation, MDAs are not allowed to commit more than the cash available under the quarterly cash ceilings. This is mainly the case for items 3 and 4, as items 1 and 2 are paid automatically within the quarterly cash ceiling (e.g the payroll bill). Monthly reports on commitments and payments have to be submitted to MoFEP in order to obtain the cash release for the following month. Complaints from MDAs about delays in cash releases may also stem from their failure to submit these reports on time.
- MDAs may deliberately overcommit in violation of CCS, resulting eventually in payments arrears. The Budget Department in MoFEP is satisfied that the CCS is working well and is aware of the need to keep a close watch on the system in order to guard against underreporting of commitments.
- Delays in cash releases due to attempts to meet the net credit to government ceilings under the PRGF.

3.51 Monitoring of the accounts payable of agencies with large contracts would be worthwhile in order to identify potential problem areas. The Notes to the Financial Statements of the Road Fund include information on accounts payable by the different roads agencies. They show a doubling of accounts payable (representing contractors certificates presented to the agencies but not paid at the end of the year) to about 270 billion cedis. These are not necessarily arrears, but nevertheless the sharp increase should be noted. According to MoFEP, outstanding commitments totaled 45 billion cedis at the end of 2004.



### **Timeliness and Accuracy of Reports**

3.52 Since August 2005, monthly budget execution reports are finalized by CAGD 6 weeks after the end of the month in question. With regard to annual reports it is encouraging to note that CAGD has again succeeded in formally transmitting its report on the public accounts to the Auditor General within the statutory deadline of 3 months following the end of the fiscal year.

3.53 CAGD prepares bank reconciliation reports every month. Entries into cash books (reflecting revenues and expenditure commitments) are reconciled against bank statements showing credits and debits. Reconciliation records (unedited) of Ministry of Health for the end of 2004 were reviewed in the context of the ERPFM. The reconciliation errors were a very small proportion of total transactions indicating that recording of revenue and expenditure is reasonably accurate. This does not guarantee that the expenditure being accurately reported is the budgeted expenditure, but internal control systems appear to be capable of ensuring that only spending provided for in the budget is approved for execution.

3.54 In recent years, Ghana has made considerable progress in improving fiscal reporting and the preparation of end of year accounts. As Ghana makes the transition to an integrated financial management system, it will be important to sustain these gains. Improving the timeliness and accuracy of fiscal reporting will be critical to the success of accounting decentralization, as discussed in the next chapter. It will also help increase donor confidence in government financial systems.

### **Expanding the Budget Preparation Timetable**

3.55 In the past, the timetable for preparing the budget has been compressed. This has several drawbacks. First, there is insufficient time for presenting the Government's overall fiscal strategy to the Cabinet and generating consensus behind the MTEF spending priorities. Next, MoFEP needs time to translate the outcome of cabinet's discussion of policy priorities into resource envelopes to be communicated to the MDAs through the call circular. Third, MDAs need more time to review existing and new programs, make trade-offs between alternatives, and ensure that their budget submissions reflect a strategic rather than incremental view on planned spending. Evidence of this is the incomplete way in which the wage bill is estimated in some ministries. Fourth, the Parliament needs enough time to review and debate the budget estimates, and approve the Appropriation Bill before the start of the new financial year.

3.56 One of the reasons provided by MoFEP for the delay in starting budget preparation is that estimates of available resources are not finalized until late in the year. Uncertainty of resource availability should not, however, be a reason for delaying budget preparation as the MTEF implies that spending should not be driven by year-to-year revenue and aid availability, but by a medium term view on the share of national resources channeled through government spending. Firm spending ceilings could be provided earlier in the year, allowing MDAs to start preparing their budgets by looking at the efficiency and effectiveness of present spending in relation to sector policy objectives.

3.57 The Government is determined to expand the budget preparation timetable. In this regard, for the Budget 2006 the budget calendar gave MDAs up to 4 months to prepare their

estimates, much longer than a period of around 3 weeks for the Budgets 2004 and 2005. Also, early in November 2005, the Government has delivered on the commitment made in the 2005 Budget Statement that it would submit the 2006 Budget to Parliament in sufficient time for enactment before the new financial year begins.

3.58 At present, the Budget presented to Parliament is complex. It consists of the Minister's Budget Statement combined with several volumes of detailed MDA Estimates. The latter, includes a detailed listing of objectives, outputs, activities and costing of activities; as a result the amount of documentation is massive. While detailed costing of activities is obviously commendable, the details are used primarily for internal working purposes. There may be a case for improving the presentation of the budget estimates in the near future<sup>8</sup>.

#### **4. IMPLEMENTATION OF PUBLIC FINANCIAL MANAGEMENT REFORMS**

4.1 The GoG is in the process of implementing a number of interdependent reforms, which together constitute a significant modernization of public financial management in Ghana. The most important elements of these reforms are:

- decentralisation of the authority to execute the budget to the MDAs accompanied by the unification of public accounting at the MDA level (eliminating Treasury accounting in its present form);
- computerisation of MDA accounting and change of system to produce consolidated accounts of the Consolidated Fund (CF) through the roll-out of the Budget and Public Expenditure Management System (BPEMS);
- strengthening of payroll management;
- modernisation of the accounting framework;
- making the public accounts and the budget more comprehensive, to include IGFs, direct donor funding and statutory funds;
- increasing the focus on outputs and outcomes;
- improving public procurement; and
- strengthening internal audit.

4.2 In this chapter of the report, developments in each of these eight components of the Government's reform program plus development in the area of external audit are reviewed and commented upon. Here the purpose of the report shifts from budget review and analysis, with its focus on budget provision and outturn data, to an assessment of the important PFM process changes underway. Thus the report both describes the reforms that the Government has embarked upon, discusses how implementation is proceeding, and also offers some suggestions

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<sup>8</sup> While Governments should always err on the side of providing more information than less, there is a case for looking afresh at the information provided in the Estimates presented to Parliament alongside the Appropriations Bill. The Performance Measurement Framework adopted, in June 2005, by the Public Expenditure and Financial Accountability (PEFA) Secretariat provides standards that could usefully be considered.

as to next steps, including how some technical challenges might be addressed. The starting point for the review is the three Acts, on Financial Administration, Procurement and Internal Audit respectively, the draft *“Action Plan for the Implementation of the FAA and FAR”* prepared by CAGD as well as a draft *“Action Plan on the Stabilisation of IPPD 1”* and a draft *“IPPD 2 Implementation Plan”*. Other documents were also reviewed such as the *“Broad Guidelines for a more Comprehensive Collation of Annual Accounts”*, the draft three-year *“Strategic Plan”* prepared by the Public Procurement Board, and the draft *“Strategic and Resource Plan”* prepared by the Board of the Internal Audit Agency, respectively.

## **A. THE LEGAL FRAMEWORK**

4.3 The legal framework for the reforms is provided at the highest level by the finance chapter in the constitution, which contains 16 articles covering such matters as the authority of parliament over taxing and spending, the operation of the Consolidated Fund and the Contingency Fund, the annual estimates and the appropriation act, the raising of loans and the servicing of public debt, the role of the Bank of Ghana, the statistical service and the Auditor-General.

4.4 Next in level of importance is the Financial Administration Act (FAA), 2003, Act 654, which is Ghana’s organic finance law, and prescribes the roles, responsibilities and powers of those responsible for public financial management, such as the Minister of Finance, the Controller and Accountant general (CAG) and the Principal Spending Officers (effectively the Vote holders) in the line ministries. In June 2004, the FAA was complemented by the Financial Administration Regulations (FAR). The FAR consists of 313 regulations divided into 15 parts. The FAR represents a considerable effort for which the Government should be commended. In addition, there are laws which govern public procurement, internal audit, financial management at the sub-national level, and the roles and responsibilities of the external auditor.

4.5 To regulate financial administration in the midst of a multiplicity of reforms is obviously difficult. On the one hand there is a need for a legal mechanism to drive the reforms. At the same time the rules and regulations must establish the procedures that should be followed here and now. These two objectives may lead to tensions and to some extent this is reflected in the FAA and FAR. For example: it is stated (in §186 of the Regulations) that “The Public Accounts and other government accounts shall generally be prepared on an accrual basis”<sup>9</sup>. While this is a commendable goal, at present is not possible for the MDAs to live up to it – and it will not be for some time. Another example: The Act vests the authority to execute payments in the heads of department while in practice that authority is still with the treasuries. And it will probably only be possible to phase out the latter gradually.

4.6 There can also be tension between different components of the legal framework. The parts need to fit together to support a coherent concept of public financial management and clear accountabilities. Generally, this has been done, though there are some areas (such as with internal audit, discussed later in this chapter) where there is overlap on roles and thus a potential for disagreement which the Government may have to manage. There can also be gaps. For

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<sup>9</sup> Albeit with the caveat that “the specific basis and procedures for preparing the accounts shall be determined by the Controller and Accountant-General”

example, the Memorandum to the FAA says that the Act describes the key roles of the Minister of Finance and the Chief Director. In the law, this is done fully for the Minister, but nowhere is the Chief Director mentioned. In other countries there may be a Finance Secretary, equivalent to the Chief Director, who has a statutory responsibility to assist and advise the Minister in the carrying out of his functions. This clarification of roles, which is missing in the FAA, could contribute to strengthen the effectiveness of the Ministry.

4.7 A way to handle the contradiction between the present and the future would be to regularly amend the Regulations – changing specific paragraphs as and when the reforms are implemented – effectively making it a loose-leaf system and thus make it a living document. Another approach, which for example was adopted in South Africa, is to specify in the Regulations from which date specific paragraphs shall apply. The Government may also have to update the various Acts from time to time in the light of implementation experience<sup>10</sup> and to ensure that the various parts of the legal framework for PFM continue to cohere.

4.8 The FAA and the FAR should also be looked upon as living documents in the sense that they should be widely and actively disseminated and made a cornerstone of systematic and recurring training efforts directed at all Accounting Officers in Government and their staff.

## **B. DECENTRALIZATION OF ACCOUNTING AND TREASURY FUNCTIONS TO MDAS**

### **Background**

4.9 In accordance with the new FAA and the FAR the expenditure part of the budget is executed in the following major steps:

- By the issue of warrants signed by the Minister of Finance departments are authorised to commit funds;
- By the issue of cash release instructions the Controller and Accountant General is authorised to disburse funds to the special bank account of the departments;
- Heads of department exercise budgetary control over the activities of the department; and
- Payments out of the special bank account relating to an appropriation are made under the direction and control of the head of the department.

4.10 The FAA and the FAR thus vest the authority to exercise budgetary control and to execute payments in the heads of departments. Noticeable is the lack of reference to the treasuries which hitherto have had a central role in this process. Under the previous system budgetary control was likewise devolved to departments, but payments were executed by treasuries staffed by CAG accountants, often in the same building, on instructions issued by departmental spending units.

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<sup>10</sup> But this is likely to be less frequent, since an organic finance law, such as the FAA, should be concerned primarily about roles and responsibilities and general principles of public financial management, leaving implementation details to the regulations issued under the law.

## Conclusions and Recommendations

4.11 There are two issues arising from the implementation of the Government's plans to decentralize accounting and treasury functions to MDAs. The first has to do with the recruitment of the professional manpower needed for successful decentralization. The second is the implications for treasury management. Below, the review also covers issues related to transitional arrangements as BPEMS is rolled out, conditions for successful decentralization of accounts and managing fiscal risks.

### *Recruitment of qualified accountants*

4.12 With the implementation of the FAA and FAR, the accounting/treasury staff will be transferred to the MDAs along with checks and treasury functions while a single treasury account will be maintained. This transfer is scheduled to be launched early in 2006. At the same time CAGD considers that the full transfer of responsibilities to the MDAs will require that qualified accountants to be placed in the MDAs. The decentralization of accounting to MDAs makes it essential that their accounting units be headed by a fully qualified professional accountant. Thus the view of the CAG that professionally qualified accountants be recruited to head MDA accounting units is endorsed. Four are already in place in the ministries of Education, Health, Roads and Transports, and Agriculture. Unless some very drastic measures are taken, filling the remaining posts poses a challenge given the difficulties in recruiting qualified accounting staff to the public sector. With wage differentials vis-à-vis the private sector of up to 400 percent, either the organisational set-up will have to be rethought or ways found that will make it possible for the MDAs to offer competitive salaries to accountants.<sup>11</sup>

4.13 One option may be to bring in qualified accountants on time-bound – three to five years – contracts at remuneration levels that can compete with the private sector as well as with privileged government institutions such as the IRS. To complement such a measure it could be worth looking at the possibility of establishing a corps of roving qualified accountants that each could assist a number of MDAs until the day when all the positions of chief accountant in the MDAs are filled.<sup>12</sup>

4.14 Success in decentralizing accounting to MDAs will also depend on a government-wide determination to hold budget controllers accountable for the use of their votes. Here the new FAA and FAR provides a strong framework for enabling the MoFEP to exercise its stewardship role, and for MDAs to regularly report the use of funds and be accountable for the control and recording of expenditures.

### *Treasury management*

4.15 It will be important that the shift in departmental accounting responsibilities to MDAs does not end up in weakening the Government's ability to conduct efficient treasury

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<sup>11</sup> Behind this is a structural issue of pay adequacy across the Public Service for professionals and skilled technical staff. The report "Towards a New Public Service for Ghana", published by the GoG in June 2004, recommends the progressive adoption of "paying transparent, competitive cash salaries to civil servants..."

<sup>12</sup> It should be noted that there are actually no qualified accountants in the treasuries. At CAGD there at present seventeen.

management. It is critical the issue of how the responsibilities of the MDAs new professional heads are defined, and what is provided for in the new CAG approved accounting instructions, including daily reporting of balances and the role played by the Central Bank.

#### ***Transitional arrangements as BPEMS is rolled out***

4.16 It is imperative that the CAGD, fully supported by the Ministry, take a proactive role in this process to ensure that the MDAs assume responsibility for putting the necessary human and other resources in place for them to be able to assume the responsibilities that follow from the devolution of authority.

4.17 It is important to point out, however, that the devolution of authority to the MDAs does not hinge on and should not be made dependent on the full deployment of BPEMS. The accounts can be done manually and by using simple Excel-templates in the different cost centres around the country and the information can be entered into BPEMS at central or regional locations.

4.18 Manual accounting will coexist with computerised accounting in many of the MDAs as BPEMS is gradually being rolled out. To handle this situation, paper forms that mimic BPEMS screen templates are being developed. Using these forms it will be possible to record the same information as when using the computerised system, including that related to purchasing. The information is then entered into BPEMS at regional or central MDA centres.

4.19 At present two sets of accounts that relate to the Consolidated Funds are prepared: 1) those based on the recording by the treasuries of transactions carried out by them on behalf of the MDAs, and 2) the accounts of the departments themselves. As a consequence of the transfer of execution and payment authority to the MDAs the treasuries will eventually become extinct and with them the duplicate recording of cash transactions relating to the CF.

4.20 The basis for the consolidated accounts prepared by CAGD will thus in future have to be the accounts kept by the MDAs. This requires that the MDA accounts are accurate and that the simple logistics of getting the accounting information from the different cost centres to their respective MDAs and on to CAGD (or directly to CAGD) is in place and can be complied with in a timely manner.

#### ***Conditions for Successful Decentralization of Accounts***

4.21 To ensure this may take some time. For that reason it may be necessary to phase out the treasuries gradually. Full authority should be turned over to an MDA only when there are assurances that its accounts are of a required quality and the routines for capturing the data are in place. The carrot would be that, once this capacity is proven, the authority to issue checks would be transferred from the respective treasuries to the cost centres.

4.22 Routines have been established to digitise the information in the cash books presently kept by treasuries and then have it transferred to CAGD. Transactions are already coded using the new 47 digit code-string and they can and have been entered directly into BPEMS. To

facilitate data entry, the BPEMS project has developed an Excel template and an Application Desktop Integrator interface for entering this information into Oracle Financials.<sup>13</sup>

4.23 However, as the BPEMS has not been the primary system for producing the consolidated accounts for the CF, this entry of data has lagged seriously behind. Priority has instead been given to the entry of the same information into the National Expenditure Tracking System (NETS) using a transformation table from the 47 digit code string to the old one used in NETS.

4.24 The transfer of accounting data as it is being done today is shown graphically in Annex B of Volume II which also contains charts describing how it will be done during the transition phase, and once BPEMS is fully deployed.

### ***Managing fiscal risks***

4.25 Transferring payment and accounting functions to MDAs means that the CAG no longer has the comfort of knowing that his own staff is discharging these functions across government. CAGD is expected to continue to be responsible for the recruitment and posting of staff to the MDAs and MMDAs. However, it will have to rely upon MDAs staff correctly observing government accounting rules. It will be important, therefore, for the MoFEP to pay close attention to:

- Regularity of monthly fiscal reporting by all departments;
- Drafting and approving Departmental Accounting Instructions and to periodically inspect accounting units in MDAs (in accordance with FAR 33) to ensure adherence to government accounting rules; and
- Determined action by MoFED to hold Principal Spending Officers accountable for the effective discharge of their enlarged financial management responsibilities as vote controllers under the FAA.

4.26 In addition, steps will need to be taken to reflect the new arrangements for decentralized accounting in the existing accounting cadre/service rules, and to ensure that uniform standards in the recruitment and promotion of accounting staff of all grades continue to be applied.

## **C. THE BUDGET AND PUBLIC EXPENDITURE MANAGEMENT SYSTEM (BPEMS)**

### **Background**

4.27 The development of BPEMS – which is a prerequisite for the implementation of important components of the FAA – has taken a long time with a series of stops and goes. Some encouraging progress has been made in the last year. The MoFEP has fully taken over the management of the project and the consultant team that replaced Ernst & Young has been phased out. The development and deployment of the system is now funded entirely and directly by GoG.

4.28 Progress has also been made on the systems front. Responsibilities, security and profile options have been defined and set up on the system. The assignment of responsibilities to the

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<sup>13</sup> This template can be used either by a treasury or an MDA.

staff in the eight pilot MDAs that originally will be using the system has been completed. The configuration of the Purchase Order, Accounts Payable, General Ledger, Accounts Receivable, Public Sector Budgeting and Cash Management modules for the 14 sites has also been completed. Core functionalities (General Ledger, Purchase Order and Accounts Payable modules) have been deployed to MoFEP, CAGD, MoH and GHS. The 8 MDAs already connected to BPEMS will be ready to use the system early in 2006.

4.29 Training manuals have also been prepared and training has been provided to the users in the MDAs that will be part of the first deployment phase. Due to the delay in deployment, most staff that has received training will, however, receive some refresher sessions throughout the implementation period at all the MDAs sites.

### **Current Status**

4.30 A year ago the Government estimated that BPEMS would be rolled out to 14 sites in 8 pilot ministries at the beginning of 2005. This has not happened. The singly most important factor that holds up deployment is the non-operation of the Wide Area Network (WAN). A 19 node wireless local loop system has been installed and was running properly for a year. Starting August 2004 technical problems have led to a dramatic reduction in transmission speed to the point that the network is for all practical purposes unusable. But for contractual reasons those problems have taken time to be resolved and the roll-out has been delayed. Though the connectivity is now in place for the 8 MDAs, the speed of the network is very slow. MoFEP has therefore decided to extend the IPPD fiber-optic network to the BPEMS sites, an action expected to be completed in all 8 MDAs early in 2006. In the meantime, the Government is committed to the signing of the maintenance contract with Siemens.

4.31 Another factor affecting the roll-out is the delay in relocating of all central BPEMS equipment from its present temporary quarters to the MoFEP's Financial Information Centre. A year ago the Ministry reported that the move was due any day. It is now planned to be completed early in 2006.

4.32 A problem that needs to be resolved is that, in order to go live, say from January 2006, opening balances must be correct. The bare-bone General Ledger information from the other MDAs discussed above has only partially been entered into the system. In fact the backlog goes back to 2003. Consequently the closing balances would be incorrect and could not be used as opening balances even if BPEMS ran parallel with NETS this year.

4.33 There are two immediate options: (1) concerted efforts could be made to eliminate the backlog and make all cash book information up-to-date; and (2) the partial information that is in the system could simply be purged and the 2005 closing balances from NETS used. MoFEP has decided that BPEMS will be purged to allow for data to be used with effect from 2006.

4.34 Another set of issues that will need to be addressed is how the accounting information from the MDAs that are not connected, as well as information from the remote cost centers within the linked-up MDAs will be entered into the system. This information will continue to be prepared manually and subsequently uploaded into BPEMS after being entered at the central or



regional locations by using an Application Desktop Integrator that has been installed and configured to capture the approved budget and transaction data into the General Ledger module.

4.35 Regardless of the responsibility for entering data into BPEMS, for safety reasons, MoFEP has decided that for an interim period data will be entered and run in parallel into ACCPAC and NETS for the production of the accounts for the Consolidated Fund.

4.36 A general issue that has now been resolved is the managerial ownership of BPEMS. Until recently, the development of the system has been organised as a distinct and separate unit within MoFEP answering, as from last year, directly to the Chief Director. It is clear that the changes in the management set-up implemented since last year have been positive. Development has shifted from being a consultant driven process to one genuinely owned by the Government. At the same time, it must be recognised that progress has been uneven.

4.37 Once in production, BPEMS will be critical and any failures of the system will have serious repercussions on the function of Government and will discredit Government vis-à-vis Parliament, the public and its international partners. Experience shows that it is prudent to make the institution and people that are immediately responsible for the contents of the system also responsible, in a managerial sense, for the system as such. As a result, MoFEP has recently decided to transfer management responsibility to BPEMS principal user, the CAGD.

4.38 Unifying the overall responsibilities for all the elements – conceptual, technical, institutional, procedural, and human – that are required for the move to BPEMS should increase the likelihood of success. CAGD is now deeply engaged in the final development of the BPEMS system to be rolled out. It must also take the steps necessary – not the least in terms of human resources – to ensure that it is capable of assuming the responsibility.

## **Conclusions and Recommendations**

4.39 The Government is fully committed to BPEMS implementation. In order to manage the process, the Government would be well advised to prepare and follow a critical path action plan. The action plan should take as its starting point a target date for making BPEMS the primary system for the accounts for the Consolidated Fund. For that to be possible the connectivity problem will need to be resolved. Timely implementation of the recent decision to extend the IPPD fiber-optic network to the BPEMS sites will solve the connectivity problem and also make it possible to get the eight first-wave MDAs up and running.

4.40 Making BPEMS the primary system for the accounts for the CF, and giving the eight MDAs access to the full functionality of BPEMS, requires more than just solving the connectivity problem. A list of critical issues – including those already discussed above – that a critical path action plan would need to address includes:

- Resolving all outstanding contractual issues that impede or risk impeding BPEMS deployment and maintenance (Siemens, Oracle, HP, building contractors, etc.);
- Developing and implementing contractual arrangements that will make it possible to contract and retain key accounting and IT-staff;

- Budgeting immediate, short-term and medium-term financing requirements and ensuring that adequate CF funding is made available when needed;
- Creating necessary technical and human capacity at CAGD to feed information into and run the BPEMS and ACCPAC and NETS in parallel – until ACCPAC and NETS can be decommissioned;
- Ensuring the required technical and human capacity in the MDAs to run BPEMS;
- Taking steps to ensure that BPEMS will be purged to allow the system to go live; and
- Ensuring that all staff is trained or refreshed and that MDA in-house training capacity is created.

4.41 The above list just illustrates the different types of issues – technical, contractual, institutional, human resource – that need to be resolved in order for a roll-out to be successful. To ensure these benefits are maintained, it will be in the Government's interest to ensure, from time to time, that the operation of the system is reviewed by external assessors from the perspective of functional quality.

#### **D. MANAGEMENT OF THE PAYROLL**

##### **Background**

4.42 Work on the payroll system has for a long time proceeded along two tracks. The original payroll system IPPD1 was installed in 1993. The system, a French system SIGAPIP developed in COBOL is no longer supported and the Government has since 1998 been determined to replace it with a modern system. The development of the latter system (IPPD2) has, however, encountered countless problems of a nature similar to those that have marred the BPEMS project. Funding problems and contractual conflicts have bedevilled the relationship with consultants.

4.43 To ensure the continued management of the payroll, the original SIGAPIP system is being rehabilitated to keep it operational. Separate funding has been made available for a “stabilisation project” to ensure that the hardware, most importantly the servers, on which IPPD1 depend is adequate. The *Action Plan on the Stabilisation of IPPD1* is being executed and will be completed shortly.

4.44 For the future, however, the Government is determined to replace SIGAPIP. The choice made by the Government to replace it with a human resource system including payroll management from Oracle makes good sense in view of its choice of Oracle Financial for its accounting and budget control system. Common database infrastructure and programme logic makes for an easy interface between the two systems; an interface that ought to be established as soon as possible after the first roll-out of BPEMS is accomplished.

##### **Conclusions and Recommendations**

4.45 Current efforts to stabilize the original SIGAPIP system makes good sense as a stop gap measure. As payroll management is an absolutely critical process, the Government must ensure that there is a system in place to do it. The Government can take no risks in this area and it is important that the ongoing stabilization project is successfully completed.

4.46 In a related development, the Government is determined to strengthen the management of the payroll of SAs. Earlier in 2004, MoFEP determined that SAs had to submit returns on their previous month's expenditure before their current month's allocation would be released. The government estimates that there are currently about 150 subvented agencies and acknowledges that management of SA's staffing needs to be strengthened. While some progress has already been achieved, the government has decided to implement, by end 2005, a computerised system to ensure an efficient and improved process to manage and control SA's personnel and payroll data. The Government's decision is encouraging in view of the fact that an important share of wage-bill overruns in recent years is associated with the SAs. It is the Government's intention to centralise the management of the payroll of the SAs using IPPD2, once it is up and running.

4.47 In future the development and deployment of IPPD2 should be closely coordinated with the deployment of BPEMS. One area where coordination is imperative is in regard to the communications network. The same applies to hardware in the MDAs. Training is another area where coordination would keep costs down.

4.48 It is important to underline, however, that using a central system for preparing the payroll of the SAs is a stop gap measure to solve the problem of payroll overruns in the latter. The Government should carefully analyse what incentives SAs have – or rather do not have – to control their payroll. Effective control in the long term may require changes in that incentive structure. The present soft budget constraint will have to be replaced by a hard one. This issue could usefully be dealt with as the governance framework for SAs is under revision, and a Subvented Agencies Bill is planned to be submitted to Parliament by the end of July, 2005.

4.49 One of the problems with developing adequate support for payroll management is that it has been dependent on project financing. The decision by the Government to go ahead and finance the development of IPPD2 on its own, just as it has with BPEMS, is highly commendable and signals clear ownership and high priority being given to strengthening payroll management. The Government should, however, be aware that substantial costs will be involved and if the move to IPPD2 is to be met, there can be no delays in releasing funds to meet these costs.

4.50 Just as in the case of BPEMS, it is critical to take care of outstanding contractual issues, and ensure that, as planned, IPPD 2 successfully runs in parallel with IPPD 1 during 2006, before the latter can be decommissioned.

## **E. ACCOUNTING FRAMEWORK**

### **Background**

#### ***Accruals***

4.51 The FAA and FAR reflect a decision by the Government to move to accrual accounting. This decision must be considered correct in view of the information, control and management needs incumbent on the Ghanaian public sector. However the transition from cash to accrual accounting is a complex process. It should be guided by a clear reform strategy and carried out in steps. It is a process that requires a series of reforms and capacity improvement on a number of fronts. Developing and codifying the accounting model must go in step with institutional

changes, the improvement of staff capacity and the development and implementation of IT-system support.

4.52 Accrual accounting in the public sector is relatively new, but Ghana has the advantage – in relation to the very early adopters – of being able to draw on standards developed by the International Public Sector Accounting Standards Board of the International Federation of Accountants. The Institute of Chartered Accountants (Ghana) is a member of IFAC. While the focus of IFAC is the definition of best practice, the Institute recognises and emphasises that the move to accruals can not and should not be done in one fell swoop, and certainly not in a country where trained accountants are in short supply.<sup>14</sup>

### ***Chart of accounts***

4.53 The chart-of-accounts which has been implemented in BPEMS is made up of ten dimensions: a) functional group as per COFOG, b) institution (MDA), c) fund type, d) CF Source, e) sector, f) broad economic category (personal emoluments, administration, services, investment), g) objective, h) output, i) activity, and j) location of treasury. Altogether the different dimensions add up to a code string of 47 digits.

4.54 In the *2004 Public Expenditure Management Review* comments were offered on the present appropriation structure and the chart of accounts.<sup>15</sup> It was recommended that the chart-of-accounts be rearranged and simplified. In this vein the Government has taken an initiative to “standardise activities on the medium term framework”.

## **Conclusions and Recommendations**

### ***Accruals***

4.55 To guide the transition to accruals it behooves the Government to formulate a medium and long term strategy and a broad and timed road map for reform as the transition from cash to accrual accounting is a complex process.

4.56 What will facilitate and most likely catalyze the transition in Ghana is the roll-out of BPEMS. Thus rather than being a subordinate, albeit crucial component of a reform process, in Ghana the deployment of a modern accounting system is likely to, to some degree, drive the process. The fact that the system is built on a very complete and standard platform makes further reform of the financial management system a lot easier. Moreover, the system has the advantage of being capable and flexible enough to accommodate the entire transition. There will thus be no need to change the accounting software as the different phases towards full accruals run their course.

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<sup>14</sup> Accounting standards for the public sector as well as reflections on the transition process can be found at: <http://www.ifac.org/PublicSector/>

<sup>15</sup> Refer to the main text as well as Annex 7.

4.57 The deployment of BPEMS is likely to drive the move towards accruals because the potential of improving the accounts will be obvious and more or less easily at hand. For example:

- Through the use of the Accounts Payables and Accounts Receivables<sup>16</sup> modules the individual MDAs as well as Government as a whole will, once fully rolled out, have immediately at hand a complete record of arrears in regard to payment to be made from the CF;
- With some additional effort the recording and management of all traditional financial assets and liabilities – advances and loans to staff, other advances and loans, deposits, trust moneys, investments, etc. – can be done through BPEMS;
- Likewise with some additional efforts, it will be possible to bring accounting information regarding the external and internal debt into BPEMS;
- The most difficult and therefore the likely last step in the reform of the accounting framework will be to bring all physical assets in to BPEMS and on to the balance sheet. That may very well have to wait a few years.

4.58 Besides enhancing the information content and the coverage of the account, moving to BPEMS will also greatly improve the integrity of the accounting system. There will be a complete audit trail and the possibilities of tampering with the accounts will be reduced. Audits will be facilitated as it will be possible to give the AG direct reading access to the system permitting the auditors to base their audits on systematic risk assessments.

4.59 Notwithstanding that the benefits of modernizing the accounting framework and exploiting the full potential of Oracle Financial are obvious and thus likely to spontaneously move the process forward, there would be clear benefits to having the reform process be guided by a carefully considered strategy. Such a strategy would inform the preparation and systematic revision and extension of the accounting manual. It would also provide guidance to all the other steps of an organizational and human resource nature that will need to be taken if the benefits listed above are to be reaped.

4.60 A critical part of this will be the need to train senior MDA managers, and especially Principal Spending Officers, in what the progressive adoption of accrual accounting means for public financial management, and how they will be expected to use accrual information to improve departmental performance.

### ***Chart of accounts***

4.61 The draft set of “standardised activities” referred to above bear all the characteristics of what would normally be considered to be instances of an economic expenditure classification: *external professional services, construction and acquisition of buildings, acquisitions of vehicles* etc. The exercise thus points to the possibility of actually eliminating *Activity* from the chart-of-accounts rather than just reducing the number. When pondering this possibility, the drafting team

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<sup>16</sup> The recording accounts of accounts payables and accounts receivable is per se a first step towards accruals. It implies recording initially a liability and an asset respectively – before recording the ensuing payment.

for the accounting manual might also consider replacing the *Objective* and *Output* dimensions with a single *Programme/Project* dimension as suggested in the 2004 report.

4.62 Furthermore: *Fund Type* may not be needed because each *Source of Funds* could, in an auxiliary table, be tagged with *Fund Type*. In the same manner *Sector* could be eliminated and in an auxiliary table tagged to either the *Organisation* or to the suggested *Programme/Project* dimension. Once the authority to issue checks is fully transferred to the cost centres, the *Location of Treasury* dimension can be eliminated.

4.63 Collapsing the “performance-oriented” dimension into one and eliminating some others would free up *space* for recording other important transaction characteristics. A *counter-party* dimension may be needed unless Oracle Financial can be set up in some other way to ensure correct elimination of intra-governmental transactions. If direct donor support is to be brought into the accounts, it may be necessary to allow for the recording of a donor specific economic classification so as to make it possible to report back to the donors in a way that meets donor needs.

## **F. COMPREHENSIVE ACCOUNTING AND BUDGETING**

### **Background**

4.64 As already mentioned, at present two set of accounts capturing the transactions of the Consolidated Fund are prepared: a) those based on the records of the treasuries and compiled by CAGD, and b) those prepared by the MDAs. The MDA accounts also – in principle – include the internally generated funds and related expenditure. Donor budget support, both grants and loans, is captured in the CAGD accounts as revenue or financing. It is also captured as expenditure (though not linked to source) in the MDA accounts because they become part of the Consolidated Fund. Direct donor financing, on the other hand, is not captured in the Consolidated Fund accounting system. Block transfers to the statutory funds are captured in the CAGD accounts. Any direct revenue to the statutory funds and the details of total statutory fund spending is captured only in the accounts of the statutory funds.

4.65 To meet GFS standards for comprehensive fiscal reports that cover everything that pertains to “public funds” the Government is preparing to collate financial statements from the different statutory funds combining this information with the financial statements for the Consolidated Fund. In keeping with the FAA, the Government is also keen to include information on IGFs. The Government is also determined to include direct sector and project support in CAGD fiscal reports.

4.66 In regard to the budget, on the other hand, the Government has as from this year extended its coverage by including fully IGFs and their application – and as much information on direct donor support as MOFEP has been able to garner. The information is incomplete due to the difficulty of obtaining data from some donors but the ADMU of the MOFEP is making concerted efforts to improve the coverage.

## Conclusions and Recommendations

4.67 The main theme of the 2004 *External Review* was the fragmentation of public financial management in Ghana and its adverse effect on aggregate fiscal discipline as well as on the possibilities of reorienting public spending so as to reflect political priorities.

4.68 The CAGD has created a Departmental Accounting Unit which compiles a “Memorandum Statement” of revenue and expenditure of GoG accounts drawn on the treasury system in particular as well as from other inflows and outflows of MDAs. Collating information from the different “financial jurisdictions” in order to produce more comprehensive fiscal reports is a step in the right direction and actually the only thing that can be done today given the present accounting framework and the systems support for it.

4.69 Direct sector and project aid still stand in the way of the Government attaining the goal of comprehensiveness both in the budget and fiscal reporting. The practical difficulties of collecting data on aid flows not under the control of the Government should not be underrated, and for them to be resolved, development partners will have to provide more assistance in terms of regular information on aid usage. Despite the difficulty to produce an accurate account of direct external assistance, the Government should not give up its efforts at more comprehensive reporting. In the first place, Article 176 of the Constitution, in our view, supports a broad definition of revenues and other moneys that typically cover grant flows. Second, comprehensiveness is a basic principle of public financial management, contributing to transparency and thus underpinning democratic accountability (and consistent with GFS guidelines). Third, to refrain from doing could send the wrong signal to donors, perhaps suggesting that direct assistance need not be oriented with national priorities.<sup>17</sup> Here, the Government is taking a pragmatic approach. It acknowledges the desirability of comprehensive reporting of all donor aid in budgets and accounts, but recognizes that this is an ideal that can be attained only gradually. Its focus, therefore, is on improving the reporting of major flows, the priority for its own fiscal management purposes.

4.70 The deployment of BPEMS will make it possible to go beyond the piecing together of information from different sources and actually base the fiscal reporting on comprehensive accounts. To begin with BPEMS will make it possible to merge the accounting of the IGFs with that of central funds. The chart of accounts is designed so as to be able to handle different *Sources of Funds*. Thus the accounts for IGFs can be done using BPEMS and the information merged with that pertaining to the CF. Provided that the article of the FAR on bank accounts for departments is respected, i.e. that all department bank accounts should be part of the CF, BPEMS can also be used for the bank reconciliation of IGF.

4.71 For the same reason it will be possible for BPEMS to be used for the accounting of direct donor funding. Because of the possibility to classify transactions by source of funds, the system can produce separate reports for each project. If, in addition, the direct donor funds provided

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<sup>17</sup> Article 176 of the Constitution uses language very similar to that found in other countries with similar financial management traditions. It provides that: “There shall be paid into the Consolidated Fund...all revenues or other moneys raised or received for the purposes of, or on behalf of, the government....” In other countries wording like this has generally been interpreted to include directly provided aid funds.

were held in a sub-account of the Consolidated Fund account in BoG, it would have the additional benefit of improving government liquidity and thus cash management.<sup>18</sup>

4.72 What applies to direct donor funding also largely applies to the statutory funds. Without prejudicing the statutory authorities' control of the funds accruing to them they could use / be instructed to use BPEMS for their accounting.

## **G. OUTPUT AND OUTCOME FOCUS**

### **Background**

4.73 The Government has taken some initial steps towards an increased focus on the outputs and outcomes of public activities with the inclusion of performance information in the budget documents produced under the MTEF. An initial step towards outcome/output oriented budgeting was created with the introduction of the objective, output, and activity dimensions in the chart-of-accounts.

4.74 Another hint at an output/outcome perspective is Article 41 in the FAA: "Notes that form part of the accounts which shall include particulars of the extent to which the performance criteria specified in the estimate in relation to the provision of the department's output were satisfied."

### **Conclusions and Recommendations**

4.75 Overall, the MTEF remains a highly desirable tool, but one that has yet to yield its full potential. The investment of time and effort in preparing the current MTEF information is yielding few dividends. Last year's external review report indicated that in the future, the present objective/output/ activity hierarchy could usefully be replaced with a simpler programmatic structure. However, to do so requires a good deal of efforts, including far-reaching consultations with the immediate stakeholders. In this light, the Government planned to conduct an MTEF review which could determine whether simplifying the objective/output and activity classification and eventually replacing it by a simpler programmatic classification might be the way forward. This would be a useful exercise, and should result in an action plan to improve the relevance, coverage and effectiveness of the MTEF.

## **H. PUBLIC PROCUREMENT**

### **Background**

4.76 The Public Procurement Act (PPA) was passed in 2003. It establishes the principle of open, competitive tendering for goods, works and services for all public entities, and provides for a new regulatory body, the Public Procurement Board (PPB), to issue procedural rules and standard documentation and to oversee procurement implementation. The Public Procurement Board has now been created and the Chairperson and most of its staff has been appointed. The Secretariat of PPB is operational since October 2005. In the meantime, as of end-September,

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<sup>18</sup> This is one of the core benefits of single treasury accounts or, what is a better term, group accounts – the pooling of liquidity.



encouraging progress has been made in setting up the procurement institutions at central and ministerial levels. In this regard, about 97 percent of Tender Review Boards (TRBs) and Entity Tender Committees (ETCs) have been set up. At local (MMDAs) level, progress has also been achieved with 62 percent and 54 percent of TRBs and ETCs having been established.

4.77 A comprehensive 3-year Strategic Plan including a listing of outputs and activities for the period 2005 – 2007 has been adopted. Standard Bidding Documents have been prepared and are being used in the MDAs. At the end of the trial period, legislative instruments and Guidelines/Manuals will be issued. Preparation of operational manuals and regulations has also been contracted out.

4.78 It is still difficult to ascertain how broadly the act is being applied. However, the number of tenders advertised in the press has increased and several MDAs have submitted procurement plans. The PPB Board has adopted a monitoring and evaluation tool and, later in October 2005, launched an evaluation of 100 entities. This exercise is expected to establish evidence of the extent to which the act is being implemented.

4.79 An initial capacity building program to meet immediate needs has been carried out nationwide through awareness workshops. With a view to improve compliance with the act, later in the year, the Board will launch a training program for ETCs and TRBs.

## **Conclusions and Recommendations**

4.80 The implementation of the Public Procurement Act seems to be on track judging both from the clarity of purpose of the Strategic Plan and progress since the passing of the Act.

4.81 What to some extent has slowed down the operations of the Secretariat to the Board was the delay in the appointment of the Chief Executive of the Secretariat and some of the other key staff. This has had a negative impact on the training in the use of the tender documents, the dialogue with the Public Service Commission/Office of the Head of Civil Service on the career paths of procurement personnel, and on the preparation of short, medium and long term monitorable Action Plans by MDAs.

4.82 Traditionally public procurement policy setting has always been a Ministry of Finance and Economic Planning function, given that ministry's overall stewardship role for the proper use of public moneys, and for managing fiscal risks. The Act acknowledges this role, given that the PPB reports to the Minister of Finance, advises the Minister on the issue of regulations, and vests in the Minister (Clause 14) the power to override the PPB's prescribed procedures in the national interest. Thus it will be important for the PPB to work closely with MoFEP, particularly the Chief Director and the CAGD, to ensure that the goals of both the PPB and the FAA are achieved.

## **I. INTERNAL AUDIT**

### **Background**

4.83 The GoG has a long-standing system of internal control for government as a whole. But deficient application of relevant laws, financial regulations and the principles of effective,

efficient and economical management results in significant losses and a reputation of inadequate governance. This has been confirmed in a number of audit reports, previous CFAA's, HIPC assessments and also the PETS studies. The control system is largely static and not responsive to risk. The main focus is on compliance with laws and regulations, but in general this is not actively backed by a system of incentives and sanctions to influence staff behaviour. Also missing is a sense that management should use its system of internal controls to achieve its objectives whilst managing its risks.

4.84 Internal auditors, until recently under the operational supervision and direction of the CAGD, carry out four main types of audit:

- Pre-examination of payment orders;
- Physical verification of goods received (equipment and stock);
- Reviews of control systems; and
- Ad hoc investigations.

4.85 The first two account for most of the time spent by internal auditors. The CAGD issued guidance to internal auditors in the form of circulars but no formal audit standards or internal audit guidelines existed.

4.86 To improve the effectiveness of the internal control system several initiatives have been launched and implementation has been initiated.

4.87 A new Internal Audit Agency Act (IAA) was passed (Act 658) in December 2003. Under this act the IAA would be established as an apex oversight body to co-ordinate, facilitate and provide standards and quality assurance for internal audit activities in MDA's / MMDA's, with a view to enhance efficiency, accountability and transparency in the management of resources in the public sector. The IAA is governed by a Board that is accountable to the President. All MDA's / MMDA's must establish internal audit units (IAU's), to be staffed by competent auditors under the guidelines of the IAA. Internal auditors would report to their relevant management with copies to the IAA and the Auditor General.

4.88 The IAA has now been established and its Board was inaugurated in August 2004. A 3-year strategic plan has been developed, including a proposed organizational structure, work plan and budget. The Director-General of the IAA has been appointed in October 2005 and progress has been made in the process to appoint deputy directors-general and administrative staff.

4.89 The number of entities in the audit universe has been defined and full staffing of IAU's of all MDA's / MMDA's is planned over a 3-year period. The Agency is currently developing Audit Standards and Programmes for all MDAs and MMDAs.

## **Conclusions and Recommendations**

4.90 The legal basis and role of the IAA, anchored in the accountability of the IAA Board to the President, is intended to increase the managerial and parliamentary oversight focus on the effectiveness of the internal control and audit systems in the GoG.

4.91 Substantial value would potentially be gained from the implementation of the FAA/FAR and the deployment of BPEMS. However, to full reap the benefits of these reforms, the IAA would need to ensure the effectiveness of IAU's in MDA's / MMDA's. Without effective IAU's in MDA's / MMDA's, the role and potential benefit of establishing the IAA will be lessened.

4.92 Ensuring effective IAU's is highly dependent on their independent operation, with appropriate audit standards, audit approaches, systems and audit resources. The IAA therefore needs to actively campaign, monitor and support the independence of IAU's, and indicate that it would do so through the establishment of Audit Implementation Committees in MDA's/MMDA's and by ensuring that it receives audit reports of appropriate quality. More precise definition and measurement of its constitution, membership and impact over the medium term will also benefit the process of introducing effective internal audit in the GoG.

4.93 Quality assurance needs to be underpinned by adopting and monitoring compliance with international internal audit standards and best practice audit approaches. In this regard active support from a professional body for the development and accreditation of internal auditors will benefit the IAA in delivering on its mandate.

4.94 Staffing capacity and audit resources should be determined from and monitored against the overall definition of the risk universe, the most effective audit approach to it, potential synergies between external and internal auditing, and previous audit results.

4.95 The 3-year strategic plan of the IAA is largely inward looking, focusing on setting and staffing the IAA secretariat. To guide the future actions of the IAA, the strategic plan ought to be further developed by defining specific medium term output milestones, against which the IAA and other stakeholders can benchmark progress in the process of strengthening internal auditing across the GoG.

4.96 Specifically the implementation of the following aspects of the action plan could benefit from a more precise definition of actions and benchmarking over in the medium term as they constitute potential stumbling blocks to achieving the stated objectives of the reform:

- The attraction and retention of qualified professional staff for key positions. The IAA has defined post hierarchies, designations and professional qualifications for MDA's / MMDA's, but it is unclear what plans are in operation to ensure adequate supply and retention of appropriately qualified professional staff for key positions. In addition, the role of and interaction with a professional internal audit body, such as the Institute of Internal Auditors, in supplying qualification and accreditation systems that the GoG can use, is not clearly defined.
- The introduction of risk-based auditing in the GoG. Like in any enterprise, it is a fact that not all transactions and activities in the GoG can, or should be, subjected to internal audit. The cost to do this will be prohibitive and the value questionable. Given the traditional internal audit approaches, it is imperative for the IAA to ensure that audit in GoG is risk based.

4.97 Ultimately, the effectiveness of the internal audit function is critically dependent on the demand of internal audit services by heads of departments, and above them, Accounting Officers

who are statutorily responsible for: (i) the Votes approved by Parliament through the Appropriation Act; (ii) the revenues to be collected; and (iii) the public assets to be managed. While the establishment of the IAA should strengthen the supply of internal audit capacity, the demand for effective control systems will increase only if Principal Spending Officers and their staff are held accountable for the use of public moneys. This in turn depends crucially on the way in which the finance ministry sets the climate for public financial management and imposes sanctions, through the actions of the Finance Administration Tribunal, on those whose conduct cause public losses.

4.98 It should be noted that the IAA Act defines the roles and responsibilities of the Agency very broadly, duplicating (Clause 3 of IAA Act) the Minister of Finance's stewardship role specified in the FAA (Clauses 1 and 2). Furthermore, while the Minister is *ex officio* a member of the IAA Board, the latter's Director General has considerable independence. Under some circumstances, this could weaken the Minister's ability to ensure control systems are in place across government to safeguard public funds and assets and promote economy, efficiency and effectiveness in their use. As the Agency goes forward, it will be important that it works closely and harmoniously with the MoFEP, and each complements the other in the discharge of their joint stewardship mandates.

## **J. EXTERNAL AUDIT**

### **Background**

4.99 The legal framework for external audit was revised several years ago and still provides a good foundation for this function (Audit Service Act, 2000). As a result, the focus of the Government is on ensuring compliance with existing rules and regulations.

4.100 Good progress has been made by the Auditor-General with the reduction of external audit backlogs. The lag between the end of the fiscal year and submission to Parliament of the audited Public Accounts for MDAs was reduced from 16 months (April 2004) for FY 2002 to 9-10 months for FY 2003 (September 2004) and FY 2004 (October 2005). As for the audited Public Accounts for the Consolidated Fund, the same lag was reduced from 20 months (August 2004) for FY 2002 to 17 months (May 2005) for FY2003 and 12 months (December 2005) for FY 2004.

4.101 The recently completed audit reports for MDAs and Consolidated Fund produced by the Auditor General (or by private accounting companies under contract to the Auditor General) are a very useful source of information on the accuracy of the financial statements and the strength of internal controls. In Ghana's case they permit interested outsiders to understand better the financial linkages and the accounting for the several different sources of funds.

4.102 The goal of the Office of the Auditor General is to submit the financial audit work for the Consolidated Fund for FY 2005 within the legally established period of 6 months after the end of the fiscal year.

4.103 The Auditor-General indicated to the mission that effort and additional resources will be required to sustain the good progress made, especially in lieu of retirement of key staff in the near future.

## **Recommendations**

4.104 The review recommends that succession planning for key staff in the Ghana Audit Service be assessed by the Public Accounts Committee and appropriate action taken to prevent future slippage in the completion of audits due.

4.105 The key to effectiveness of the external audit system is the extent to which (i) the finance ministry takes action on audit findings, both during the financial year, and after PAC review of the Auditor-General's report, and (ii) mechanisms for sanctioning financial malfeasance are operated. In this connection, it is necessary to complete the appointment of the members of the Financial Administration Tribunal, as provided for in the FAA, so that it can become operational and initiate sanctions against those whose conduct cause public losses.

