

# Pefa as a Tool for Fiscal Reform: Measuring Progress in Public Expenditure and Financial Accountability

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## Abstract

The European Commission's Enlargement Strategy for 2014-15, in which the EC defines recommendations to candidate countries and potential candidates for membership, specifies the "fundamentals first" principle, which refers to the three main pillars of the enlargement process, which include:

- 1) public administration reform;
- 2) rule of law; and
- 3) economic governance.

The need to further improve public financial management is one of the key areas of current and future strategic documents related to public administration reforms. Public finance management reform is necessary to ensure fiscal sustainability and sound public finance management in accordance with the provisions of European Union (EU) legislation and aims to achieve results that will enable significant improvement in the functioning of the budget system, the management accountability system, budget execution, internal and external audit.

The preparation and adoption of the Public Finance Management Reform Programme is also a key basis for securing further support from the Instrument for Pre-Accession Assistance (IPA) funds and one of the preconditions for using sectoral budget support from IPA. Also, one of the objectives of the Programme is to pool all available funds, both from the budget and from the donor community, and thus enable better coordination and allocation according to national priorities.

**Key words:** management, financial, reform, budget.

## Introduction

For countries wishing to improve their budget transparency levels, there is much authoritative guidance available on the standards that should be followed, and how they should be applied across different phases of the budget cycle, from its preparation and planning stages, through to presentation, debate, authorisation, execution, reporting and accountability.

There are also many resources available in a range of formats – from user- friendly to highly technical and in-depth – aimed at different practitioners and users of budget data. Not surprisingly, it can sometimes seem difficult to know where exactly to start. Several international organisations provide official standards on budget and fiscal transparency, and there are a range of other bodies – inter-governmental groups, civil society organisations, professional bodies and others – that provide additional information and

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guidance. All share a common cause of promoting higher levels of transparency in the financial affairs of government and public bodies; however users of this information can sometimes find it difficult to understand how the different standards and guidance materials fit together and can be used.

In line with the broad global consensus on the importance of PFM, the Public Expenditure and Financial Accountability (PEFA) Programme was launched in 2001 by seven international development partners:

- European Commission,
- International Monetary Fund,
- World Bank and the governments of France,
- Norway,
- Switzerland and the
- United Kingdom.
- In 2019, the Ministry of Finance of the Slovak Republic and the Ministry of Finance of the Grand Duchy of Luxembourg joined the PEFA partnership.

The PEFA programme began as a means of harmonizing PFM assessments across its partner organisations and was designed to establish a standardised methodology and reference tools for PFM diagnostic assessments. PEFA was also expected to serve as a basis for dialogue on strategies and priorities for PFM reform and to generate a body of information that could contribute to PFM research and analysis more broadly. Since 2001, PEFA has become the recognised standard for assessments of PFM systems. As of October 31, 2019, over 600 reports had been produced based on assessment procedures conducted in 151 countries.<sup>1</sup>

PEFA 2016 represents a significant improvement over the previous version of PEFA, which was largely identical to the version adopted at the launch of the programme. PEFA 2016 recognises the changes in PFM reforms and the development of good practices achieved over the past decade. Experience has also identified areas where clarification and improvements were needed, which have been incorporated into the core PEFA guidelines.

These improvements have also been made as a result of significant feedback from PEFA partners, users and observers during the global public consultation conducted in 2014, followed by extensive testing in 2015. PEFA 2016 builds on the 2005 and 2011 versions, introducing four new indicators, expanding and refining existing indicators and aligning baseline standards of good performance in a number of areas. PEFA 2016 places greater emphasis on the elements of internal financial control that can be observed through PEFA assessments and establishes a clearer and more consistent structure for reporting on the findings of these assessments. From the date of adoption, PEFA 2016 replaces PEFA 2011 as the framework to be applied for all new PEFA assessments.

The PEFA program produced the PEFA framework, which assesses the status of a country's PFM. It measures the extent to which PFM systems, processes, and institutions contribute to the achievement of desirable budget outcomes: aggregate fiscal discipline, strategic allocation of resources, and efficient service delivery.

### **What PEFA Measures**

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<sup>1</sup> <https://documents1.worldbank.org/curated/en/688551551759153145/pdf/PEFA-Public-Financial-Management-and-Good-Governance.pdf>

The purpose of a good PFM system is to enable public policies to be implemented as intended and to achieve their objectives. An open and orderly PFM system is one of the components necessary for achieving desired fiscal and budgetary outcomes:

- Fiscal discipline as a whole requires effective control over the overall budget and the management of fiscal risks.
- Strategic resource allocation involves planning and executing the budget in accordance with the priorities of the state aimed at achieving public policy objectives.
- Efficient service delivery requires the use of budgeted resources to achieve the highest level of quality of public services that can be achieved with the use of available resources.

The PEFA framework identifies seven pillars of performance in an open and orderly PFM system that are crucial to achieving these goals. These seven pillars define the key elements of a PFM system. They also reflect what is desirable and feasible to measure. The pillars are as follows:

I. Budget reliability. The state budget is realistic and is executed as intended. This is measured by comparing actual revenues and expenditures (the direct results of the PFM system) with the originally approved budget.

II. Transparency of public finances. Information on PFM is comprehensive, consistent and accessible to users. This is achieved through a comprehensive budget classification, transparency of all state revenues and expenditures, including transfers between different levels of government, publication of information on service delivery performance and easy access to fiscal and budgetary documentation.

III. Asset and liability management. Effective asset and liability management ensures that public investments provide value for money, that assets are recorded and managed, that fiscal risks are identified, and that liabilities and guarantees are carefully planned, approved and monitored.

IV. Fiscal strategy and budgeting based on public policies. The fiscal strategy and budget are developed with due regard to the government's fiscal policies, strategic plans and relevant macroeconomic and fiscal projections.

V. Predictability and control of budget execution. The budget is implemented within a system of effective standards, processes and internal controls, ensuring that funds are obtained and used for their intended purpose.

VI. Accounting and reporting. Accurate and reliable records are kept, and information is prepared and submitted in a timely manner to meet decision-making, management and reporting needs.

VII. External oversight and audit. Public finances are subject to independent oversight and there is external monitoring of the implementation of recommendations for improvement addressed to the executive.<sup>2</sup>

### **Institutions that PEFA does cover**

The core of the PEFA methodology was originally focused on central government, including related institutions that provide oversight and ensure accountability of stakeholders, such as the legislature and the state audit institution. However, PEFA is increasingly being used to assess the performance of territorial autonomies and local governments in the area of PFM. The coverage of the category "central government", according to the PEFA definition, is based on the classification structure developed by the International Monetary Fund (IMF) for Government Finance Statistics (GFS). The PEFA methodology refers to the GFS terminology

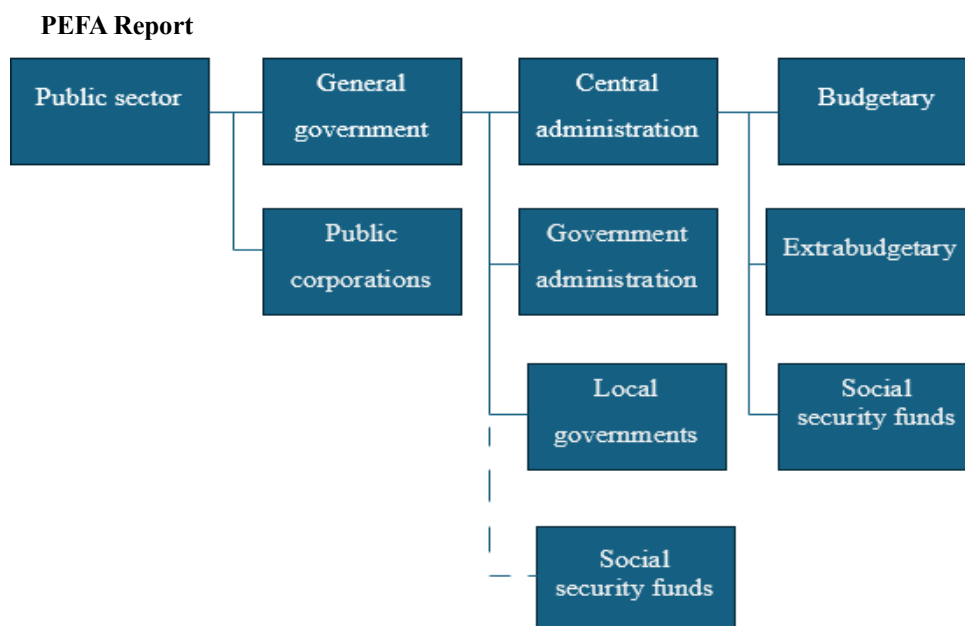
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<sup>2</sup> [https://www.pefa.org/sites/pefa/files/resources/downloads/2021000523SRsr001\\_web-Serbian.pdf](https://www.pefa.org/sites/pefa/files/resources/downloads/2021000523SRsr001_web-Serbian.pdf)

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wherever possible in order to establish a standard reference framework, but this does not mean that PEFA is only relevant in cases where the GFS methodology is used. PEFA is adaptable to situations where other classifications and standards are used.

FIGURE 1: Public sector and its basic components according to the DFS definition used by PEFA<sup>3</sup>



The objective of the PEFA report is to provide an evidence-based assessment of PFM performance, based on the analysis of indicators and other key information, in a concise and standardized manner. The information presented in the PEFA report should contribute to the dialogue on system reform.

The PEFA report includes the following elements:

- Executive summary, which provides a brief overview of the main findings on the performance of the system and their implications for the country's ability to achieve desired fiscal and budgetary outcomes.
- Introduction, which explains the context, purpose and process of the report and outlines the institutional scope.
- Overview of relevant country-specific information, which provides the context that provides the framework for the results for individual indicators and the overall PFM performance. This section provides a brief overview of the country's economic situation and describes the structure of the public sector, budgetary outcomes measured by other analyses, and the legal and institutional framework for PFM.
- Performance assessment against the seven pillars of the PFM system. This section provides an analysis and measurement of results against 31 PFM performance indicators.
- Conclusion and horizontal analysis using the information from the report to provide an integrated assessment of the PFM system of a specific country. This section analyzes the likely impact of the strengths and weaknesses of PFM on three main fiscal and budgetary outcomes: overall fiscal discipline, strategic resource allocation, and efficient service delivery.
- Overview of Government Initiatives to Improve PFM Performance. This section summarizes the overall approach to PFM reforms, including recent and ongoing government actions. It analyzes institutional factors that are likely to influence reform planning and future implementation.

<sup>3</sup> excerpt from IMF (2014), Government Finance Statistics Manual 2014, op. cit.

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