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Sudan

Institutions and Processes in Public Finance Management in Sudan: Assessment and View for Remedy¹

Ahmed A. A. Badawi
Department of Economics, University of Khartoum

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Revised

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1. Introduction:

The importance of sound public finance management (PFM) of financial resources has been recognized as a pre-requisite for the efficient utilization of these resources for post conflict recovery and the fight against poverty. This recognition has been the case at all of the international, regional levels but more so in the context of Sudan. Two years after the signing of the Comprehensive Peace Agreement (CPA), the challenges for both the Government of National Unity (GONU) and that of Southern Sudan (GOSS), remain as ever tremendous. Recovery from conflict in the form of reconstruction and development pose challenges that are further aggravated in light of the lower than expected post-peace donor flows. In addition, the high levels of poverty and disparities in human development that characterize Sudan must be addressed if the dividends of peace are to be realized and progress towards achieving the Millennium Development Goals (MDGs) is to be made. Moreover, the co-existence of higher poverty levels (both urban and rural) and the increasing dependence on oil revenues render the issue of sound management of public financial resources an urgent priority that is increasingly becoming a major concern for the general public (the general population and the taxpayers).

Public expenditure management considerations would not be limited to how spending of resources is planned but would necessarily include how such planning is translated into action, i.e. how the budget is implemented and reporting/monitoring aspects of such implementation. However, it must be noted that different issues arise for the National government (GONU) and for the government of Southern Sudan (GOSS). The existing financial systems in GONU are relatively developed albeit in need of deep seated institutional and procedural reforms which have been the focus of work by the IMF and World Bank and others in the context a fully- fledged Public Expenditure Review (PER) program. Those in GOSS are in need of basic development strategy and capacity building to enable them to manage their oil revenues efficiently. Efforts to do so in GOSS have been undertaken by various international players and implementation is still at an early stage. These differences necessitate a different approach to consideration of public expenditure management issues in the two levels of government.

This paper addresses issues related to institutions and processes of public finance management (PFM) in the context of a transitional economy that is still in the infant stage of building required human and institutional capacities for ever lasting peace. The Public financial management institutions and processes to be tackled are the set of procedures, laws, regulations and structures that are in place to enable government to effectively discharge different budget responsibilities. Assessment of these processes and institutions requires a comprehensive framework that includes assessment of budget credibility; evaluation of budget comprehensiveness, transparency and consistency; policy-based budgeting; predictability and control in budget execution; accounting and reporting; and monitoring, scrutiny and audit.² However, in view of limited time allocated to preparation of current work, the paper follows a partial approach by focusing on some aspects in PFM systems and institutions without denying importance of other aspects and necessity

² World Bank, 2005.

of comprehensive framework in assessing and evaluating PFM processes and institutions. Also the paper will focus on PFM in GONU and issues related to GOSS may arise in passing. The paper draws on previous studies and reports on the issue of PFM in Sudan and relies on information and observations from several visits and interviews with officials and staff at the national, state, and locality levels.

The paper is organised as follows. Section two describes some aspects of institutional arrangements and procedures governing budget processes (preparation, execution, reporting and monitoring) at both the federal and state levels. This includes identification of legal and constitutional references for different revenue entitlements and spending assignments. Section three assesses existing PFM institutional capacity to identify strengths and weaknesses against some broad criteria. Section four highlights challenges facing PFM system and suggests some recommendations.

2. Existing public expenditure management systems and institutions:

Development vision and overall framework for PFM:

The GONU and the SPLM collaboration in Joint Assessment Mission (JAM) resulted in a concerted Poverty Eradication Strategy Concept Note for the country as a whole. The findings of the JAM formed the basis for a medium-term development vision translated into a Framework for Sustained Peace, Development and Poverty Eradication (FSPDPE) completed in March 2005. The FSPDPE underlined two phases to promote human and economic development. The *peace consolidation* phase spans the years 2005-2007 and focuses on, among others, peace building and security, reconciliation, equitable distribution of resources between different regions, provision of basic services, governance, and implementation of institutions and processes under the CPA and 2005 Interim National Constitution (INC). The second phase, *accelerating progress*, spans the period 2008-2011 and builds on progress made in the transitional phase. In phase two policy actions are largely guided by an all-inclusive Poverty Eradication Strategy and Five-Years Development Plan to realize MDGs. The Framework encompasses costed projections until 2011 (updated annually), setting the basis for a Medium Term Economic Programme (MTEP)³. The MTEP provides a comprehensive framework for fiscal management and is updated annually as part of annual fiscal budget process. The MTEP, encapsulated with JAM and CPA and recently DPA and EPA provisions, spells out GONU commitment towards ultimate objective of poverty reduction and presents targets of pro-poor spending of 2.7 and 5.9 percent of GDP in 2005 and 2006 respectively.

Legal and regulatory origins of current PFM institutions and processes:

³ The FSPDPE is consisted of costed projections for eight cluster groups each of which is divided into 20 sub-clusters. The eight cluster groups are institutional development and capacity building; governance and the rule of law; economic policy and management; productive sectors; basic social services; infrastructure; livelihoods and social protection; and information.

Public finance institutions in Sudan are a produce of a combination of political, legal, and administrative mechanisms. Political processes which yield elected or appointed legislature and parliamentary councils play a key role to set monitoring and accountability framework. The legal and constitutional origins of public financial management in form of institutional and procedural functions are enshrined in CPA and INC. The Financial Accounting and Procedures Law 1977 (amended in 2006 to accommodate CPA fiscal and financial provisions) set the legal framework for fiscal and financial policies. In view of long history of fiscal practice in Sudan, some fiscal traditions and rules emerged to be a significant component of public finance administration. Some functions assigned to different government units and administrations in performing budget preparations and implementations have no legal and constitutional sources but are merely a produce of long public finance management practices that have developed over years since the country's independence.

Budget preparation:

The different articles and chapters in legal and constitutional references in addition to inherited fiscal traditions and rules provide legal and regulatory framework for budget planning, execution and monitoring. Budget preparation at the national level is carried out by the Ministry of Finance and National Economy (MOFNE) of the GONU and follows specific steps from formulation of macroeconomic committees and macroeconomic framework in July of each year to approval of budget in Mid December. Table (1) below shows main steps and timetable for budget preparation and Figure (1) shows organizational structure of the MOFNE. It could be noted from the table that the time allocated for external consultations with line ministries and states is relatively short and perhaps does not permit effective feedback and revision to original budget prepared by the MOFNE.

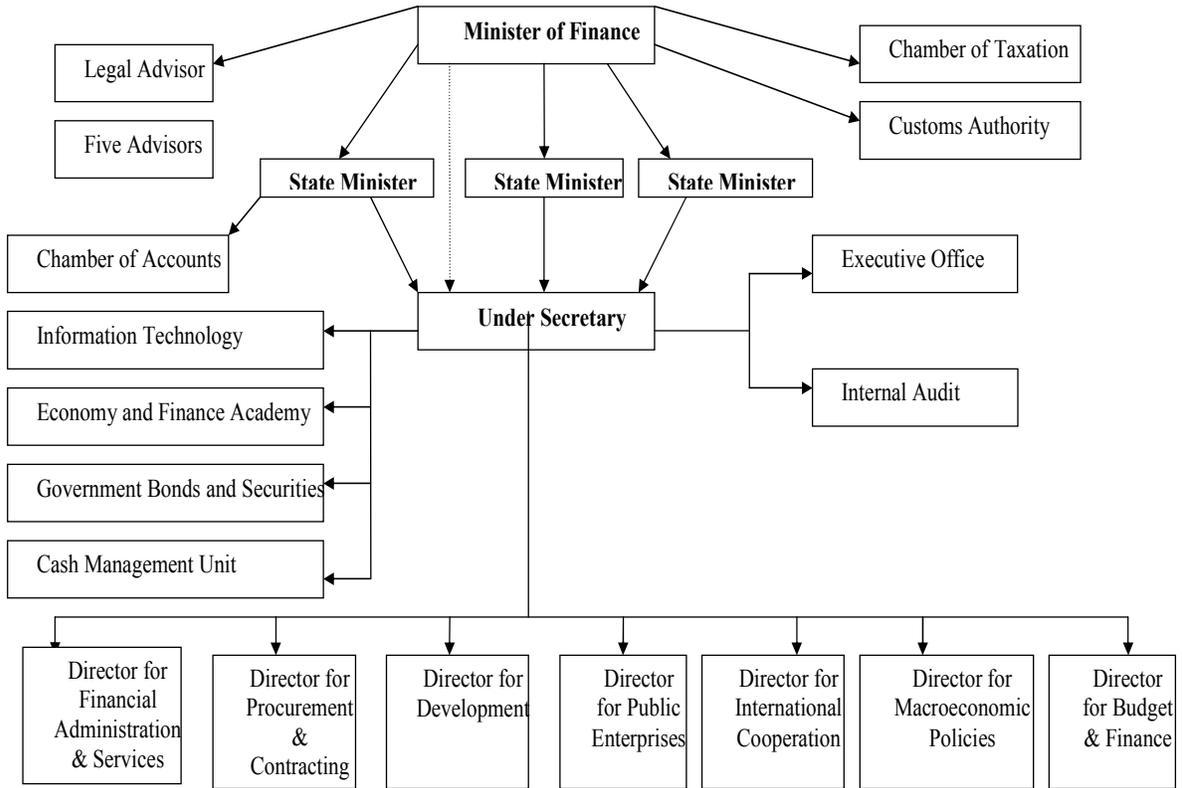
Table (1): National Budget Preparations Steps and Timetables

Functions	Timetable
<p>Phase 1: Formulation of macroeconomic committees. Preparation of macroeconomic framework. Initiation and distribution of budget circular.</p>	<p>2nd week of July to 4th week of August</p>
<p>Phase 2:</p>	<p>4th week of August</p>

MOFNE discussions on budget circular with line ministries, public corporations, and subnational representatives from Northern states and GOSS.	to 1 st week of September
Phase 3: Receipt of budget proposals from line ministries and government units. Review of proposals by budget committees. Completion of first draft of budget.	1 st week of September to 4 th week of September
Phase 4: Discussion of first draft with social actors (trade unions and civil society). Completion of second draft on basis of discussion with social actor.	4 th of September to 3 rd week of October
Phase 5: Approval of draft budget by Budget Higher Committee and signing of draft by the MOFNE Minister.	4 th week of October
Phase 6: Informing subnational representative and discussion with civil society.	4 th week of October to 1 st week of November
Phase 7: Submission of the budget to Council of Ministers	3 rd week of November
Phase 8: Submission of the budget to National Assembly	End November to Early December
Phase 9: Approval of the budget by National Assembly	Mid December

Source: adapted from World Bank, 2007, table (3.7).

Figure (1): Organizational Structure of the MOFNE



Until recently budget categorization followed economic classification by sectors and economic categories. The adopted budget classification presented 11 sectors⁴, which organized in four spending chapters. Chapter one reports wages, salaries and allowances, chapter two includes spending on goods and services, chapter three provides transfers to states and chapter four encompasses development spending. The MFNE has committed to shift to a cash based Government Finance Statistics Manual 2001 (GFSM 2001) to comply to CPA respective provisions. The GFSM 2001 entails functional classification of public expenditure and is supposed to encounter deficiencies in economic classification based system. Budget classification has been improved slightly in 2007 budget and restructured to reflect subnational transfers. The circular for 2007 budget requested different government institutions and units to abide to three expenditure chapters; chapter one for salaries and operations, chapter two for transfers to the GOSS, and chapter three for transfers to Northern States and development expenditure. The MOFNE has committed to full implementation of GFSM in 2008 budget.

Budget implementation:

Budget execution is vested on the MFNE with Directorate of Budget and Finance (DBF) and Directorate of Development in MFNE managing between them processes of revenue collection, expenditure commitments, cash releases and appropriations, and development expenditure. Oil revenues allocations between GONU and GOSS are made in accordance with oil revenue sharing regulations set in CPA and INC.⁵ Non-oil revenues collected by federal MFNE, the GOSS and states governments (revenue entitlements from non-oil sources) are also stipulated in the CPA and INC.⁶ The federal MFNE transfers revenues vested to northern states to the Fiscal and Financial Allocation and Monitoring Commission, which is discharged by the CPA and INC to allocate and monitor transfers and equalization grants to subnational governments.⁷

Expenditures of different government levels and units are committed in accordance with distribution of responsibilities stated in the INC⁸. Hence appropriations are made to reflect committed spending, which is in turn related to spending responsibility of respective unit toward public service delivery. Budget expenditure is executed by a configuration of different departments and units in the MFNE. Expenditure Unit and Chapter One Unit in Directorate of Budget and Finance are directly discharged with appropriation of recurrent expenditure to line ministries and different government administrations. Development expenditure is a responsibility of the Directorate of Development which manages development contracts and payments. Cash monthly disbursements are administered by the Cash Management Unit, which reports directly to the Under Secretary.

⁴ These sectors are agriculture, industry, transport, energy, sovereignty sector, defense and security, economic and financial services, information and communication, health, education, and administrative and social services.

⁵ INC, chapter 3, 192.

⁶ CPA, chapter 3, wealth sharing, article 6. INC, chapter 4.

⁷ INC, chapter 4, 198.

⁸ See INC, schedules A-D, distribution of responsibilities between levels of government.

Accounting and reporting in existing PFM framework:

Accounting in the GNU is a centralized process wholly administered by the Chamber of Accounts (COA) in the MFNE whose jurisdiction extends to accounting practice and personnel in states and localities. Its principles and regulatory framework are generally guided by accounting procedures, standards and fiscal accountability provisions in INC (article 204) and specifically described in the 1977 Financial and Accounting Procedures Law (and its amendments) and 1995 Financial and Accounting Procedures Regulations. The Chamber of Accounts follows cash-basis accounting methods where revenues are reported in the fiscal period they are received and expenses are reported in the fiscal period they are paid.⁹ The COA sets specific ledgers and formats according to fiscal and accounting regulations to record all transactions pertaining to revenue, payments, commitments, loans, contracts and grants by all line ministries and government units. Each unit reconciles and consolidates its accounts on monthly basis and reports its monthly financial statements to the COA. All financial accounts are reconciled and consolidated by the COA to the end of the financial year to submit to the Auditor General. The same process is mirrored in the states where the State Chamber of Accounts (reports directly to the central COA) compiles financial statements and closed ledgers from state ministries and subnational government units. The COA utilizes the bulk of financial information collected to prepare in-year execution reports to map revenues transferred to MFNE from revenue collecting agencies (including Customs Department and Chamber of Taxation) and payments made by the MFNE to line ministries and states.

Budget monitoring and accountability:

Different budget processes are controlled and supervised by three types of institutions; the National Audit Chamber (NAC); Internal Auditing; and legislative monitoring (provided in different stages of budget preparation and implementation by National Legislature, States Assemblies and Localities Legislative Councils). The NAC is an independent institution headed by National Auditor General who is appointed by the President of the republic with the approval of two-third of National Assembly. The National Audit Chamber sets audit standards for public finance management in the whole country, supervises financial performance and operations of the national and subnational governments, and ensures that revenue collection and expenditure are made in accordance with the budgets approved by the national and state legislature¹⁰. With assistance of its branches in states the NAC is vested with external auditing and performs ex post control over public spending and revenue collection.

⁹ Cash basis accounting is in contrast to accrual basis accounting where revenues are reported in the fiscal period it is earned regardless of when they are collected, and expenditures are deducted in the fiscal period they are committed, regardless of whether they are paid or not.

¹⁰ INC, article 2005.

Internal Auditing is essentially an ex ante control and is centralized in the MFNE under direct supervision of the Ministry's Under Secretary. The Internal Audit administration has personnel present in all spending units. The organizational arrangements of internal auditing resemble that of accounting. National and subnational legislatures exert a fundamental impact in budget preparation stage in their capacity to authorize annual allocation of resources and revenues and to approve annual budget. They also provide a check on budget implementation and execution in their capacity to interrogate respective ministers and government officials on performance and general outcomes of ongoing budgets.

Budget preparation, execution and monitoring in the states:

Budget preparation, execution and monitoring in the states generally follow the same modality and fiscal tradition used at the federal level. Upon receipt of federal budget circular, state Ministry of Finance and Economy forms budget committees and releases its own circular to line ministries and localities. The state circular encompasses central government directives and in addition lays state own fiscal policies. Line ministries, localities and other government units budget proposals are reviewed and consolidated by the budget committees on consultations with officials from line ministries and localities before presented to state Council of Ministers and State Assembly for discussion and approval. Locality planned budgets are approved by local councils before presented to the state Ministry of Finance.

Budget execution and cash flow management are undertaken by the state Ministry of Finance with all revenue and spending units reporting on monthly basis to the Ministry on revenues collected and spending commitment executed. All fiscal operations of budget execution are audited by Internal Audit Administration based in state Ministry of Finance. States Internal Auditing Administration – vertically linked to Central Internal Auditing at the national MFNE is responsible for controlling and monitoring different spending commitments and authorizing their effects.

3. Assessment of existing public expenditure institutions and processes:

Budget classification system, macroeconomic framework and overall objective of poverty reduction:

The economic classification system applied currently should in principle categorise different expenditures in terms of their economic characteristics whether payments for labour, goods and services, capital maintenance, or new capital (development expenditure). However, in practice the system manifests many drawbacks. First, some spending transactions do not share the same economic characteristics of the spending category. This is apparent in centralized items under goods and services or chapter two. The centralized items are lumped payments of no common economic nature (interest payments, cash compensations, vacations travel tickets, petrol transport costs, etc). Second, there is no sound economic basis for classification. For example, public health

subsidies and social subsidies (electricity consumption subsidy) are classified under expenditure on goods and services. Third, the classification only reports cash transactions and non-cash transactions are largely unrecorded in respective spending chapters. Last but not least, liability and asset transactions seemed to be confused with budget transactions. Receipts from financial assets are reported on net basis to revenues and payments for *principal* debts are reported as net recurrent expenditure. Such practice would distort total aggregates of revenues and expenditures and weaken ability of budget use for controlling issuance and reimbursement of debts and securities.

The current system of classification as it stands does not allow tracking spending by functions and makes difficult linking budget to macroeconomic framework and poverty reduction targets. This in particular vitiates the fundamental role of using budget as a policy instrument to promote pro-poor spending and reduce poverty and inequality. Although a shift to a new GFSM is underway, expenditure mapping in terms of functional classification needs to be done for past budgets so that historic comparisons can be undertaken.

A note on oil revenue management and central budget credibility:

Oil revenues have been an important source of finance for the GONU accounting for almost half government revenues over 2000-2007. Oil revenue management and institutions and processes laid for this purpose have therefore assumed tremendous importance for public expenditure. Similar to other oil producing countries¹¹, three types of fiscal institutions arise to characterise oil revenue management in Sudan; (i) oil revenue stabilisation fund or account; (ii) fiscal rules, fiscal guidelines, and fiscal responsibility legislation enshrined in CPA and INC; (iii) budgetary oil price or a benchmark price to set budgetary resource envelope.

It is central for obtaining adequate budgetary outcomes is that oil revenues to be budgeted efficiently and effectively in government budget. This requires in particular setting reasonable benchmark production and prices giving due attention to risks associated with oil revenue projections that precipitated by international oil price volatility and uncertainties generated by potential production and shipment predicaments.¹² The current institutional relationship between the Ministry of Energy and Mining and National Petroleum Commission on one side and MOFNE on the other side does not permit efficient projection of oil production and oil revenues and thus causes overly optimistic projections leading to in-year revenue shortfall and expenditure rationing. [Tables (2) and (3) below show considerable deviations of actual revenue collected and received from planned budget particularly for oil revenues in MOFNE fiscal budget.] The exiting system of institutional relationship places the MFNE on the downstream in reporting chain and information flow process. The MFNE prepares oil revenue forecasts on the basis of benchmark oil production and benchmark prices it receives from the National Petroleum Commission. Also data and information in form of statistics and reports on

¹¹ IMF 2007.

¹² IMF 2008.

project contracts (existing and potential) and business developments in oil sector are relatively less transparent¹³. The latter type of information assists in building medium term forecast for oil revenues. The lack of efficient and timely reporting and information feedback from respective institutions could be held responsible for low quality forecast of oil revenues, which led to expenditure rationing and depleting Oil Revenue Stabilization Account (for example for 2006 budget).¹⁴

Table (2) : Comparison of Original Budgeted and Actual Domestic Revenue Receipts 2004-2006*

	2004	2005	2006
Budgeted revenues (bs SDD)	821	1275	1709.4
Actual revenues (bs SDD)	1023.94	1218.44	1499.78
Difference between actual and budgeted (bs SDD)	202.94	-56.56	-209.62
Difference as a % of budgeted	24.72	-4.44	-12.26

Computed from MOFNE annual budget data.

* Revenue receipts include oil and non-oil revenues and exclude external grants and support.

Table (3): Budgeted and Actual Oil revenues and Deviations

	2003	2004	2005	2006	2007
Budgeted (bs SDD)	249	373.6	706	908.4	929.1
Actual (bs SDD)	399	498.95	608	758	1004.76
Difference between actual and budgeted	150	125.4	-98	-150.4	75.66
Difference as a % of budgeted	60	33.6	-13.9	-16.6	8.1

Computed from MOFNE annual budget data.

Oil revenues are revenues transferred to MOFNE under CPA provisions.

Public spending and cash flow management under current functional and organisational structures of the MOFNE:

Lack of budget credibility may also be attributed to relatively inefficient functional and organisational structure defining relationship between different expenditure executing units in MOFNE. Processes of expenditure management, execution and monitoring are considerably fragmented over different MOFNE departments and units including in particular states affairs unit, chapter one and expenditure units under Budget and Finance Directorate; cash management department on a higher administration level reporting to the Under Secretary, development spending execution departments under Directorate of Development which is parallel to Budget and Finance Directorate; and accounting and internal audit departments (see Figure(1)).¹⁵ These departments perform different yet related functions on the expenditure chain of commitment, appropriation, execution, and

¹³ No detailed reports and statistics on oil sector developments are produced by the Ministry of Energy and Mining nor much information and public accounts are published and released by the Sudan Petroleum Corporation (state-owned oil company).

¹⁴ Oil Revenue Stabilization Account is revenue deposits from government oil net revenue derived from actual export sales above an agreed benchmark price. The benchmark price is set annually as part of the national budget.

¹⁵ IMF, 2006.

monitoring. The existing setting of organisational relationship deters lucid and timely flow of information between different units and hence hinders effective reporting. Moreover, it reduces efficiency of cash planning and management and effective control of expenditure commitment and releases.

Repercussions of such organisation can be seen in unsatisfactory performance of monthly cash flow from MOFNE to line ministries and states. In spite of slight improvement in deviations of aggregate expenditure from approved budget over the last years (though still inexcusable by international standards), MOFNE monthly cash flow has shown large deviations from committed or budgeted amounts particularly development projects cash releases.^{16,17} While the impact of such cash flow deficiencies on pro-poor spending and poverty reduction commitment is devastating, their impact on state budgets, which are largely dependent on central transfers, is annihilating. Unless all or most of expenditure management and execution functions are consolidated in one (or at least few) department expenditure commitments and budget credibility are likely to be jeopardised.

Table (4) : Comparison of Original Budgeted and Actual Expenditures 2004-2006

	2004	2005	2006
Budgeted primary expenditure (bs SDD)	982	1,361.02	1,926.36
Actual primary expenditure (bs SDD)	1,004.86	1,296.57	1,690
Difference between actual and budgeted (bs SDD)	22.86	-64.44	-236.36
Difference as a % of budgeted	2.3	-4.7	-12.3

Computed from MOFNE annual budget data.

Accounting and reporting:

The legal and regulatory framework for accounting and reporting is relatively well developed in the GONU.¹⁸ However the current accounting system reveals several weaknesses. First, the current system of recording different stages of expenditure execution does not reflect spending commitment information; only authorized appropriations and actual cash payments are recorded.¹⁹ Incomplete accounts prevent systematic track of spending arrears and efficient monitoring of fiscal conduct of different spending units. Second, in-year budget execution reporting is inadequate and incomprehensive for the reason that accounting and financial data used for most spending transactions are not well integrated and hence show significant discrepancies. Third, there is no regular and timely reporting from government units at subnational level. Incomplete and irregular presentation of state fiscal data and accounts deters regular and effective

¹⁶World Bank, 2007, p. 32-33.

¹⁷ Reportedly only about on-third of foreign disbursements of national development projects for 2006 were released in the month of December. Further, nearly 20 percent of 2006 state development transfers were released in December.

¹⁸ IMF, 2006, p. 31.

¹⁹ The cash based treasury ledger system – adopted by Chamber of Accounts – should in principle record all stages of expenditure execution by recording in sequence the approved spending ceiling for each spending traction as indicated by the MPFNE, the commitment of spending, the occurrence of spending (receipt of spending invoices), and finally the payment order and effected spending.

consolidation of state budgets into a unified national fiscal budget. Taken together these setbacks produce a reporting and accounting framework that is woefully inadequate for effective budget control and monitoring and sound management of macro fiscal aggregates.

Federal monitoring and management of subnational debt:

One important fiscal provision in the CPA and INC allows subnational governments to issue debts and loans (internally and externally) as instruments to finance public spending in states.²⁰ This form of finance has been used in limited amounts to finance public expenditure in states, yet it constitutes a potential source of fund in a growing domestic economy with more favourable credit conditions and increasingly opening up domestic economy to international capital markets. Subnational debts – whether direct in form of debts or loans or indirect in form of building arrears - can pose serious implications for overall macroeconomic stability and management specially when left unmonitored and uncontrolled.²¹

Although states debts are now possible tools for expenditure finance, no clear framework exists at the national level to describe the processes and mechanisms by which federal government can administer these provisions. The macroeconomic framework used to anchor budget preparation and execution does not provide any form of borrowing constraints or benchmarks to inform budget preparation and debt management at the state level. Moreover, no monitoring and management framework has been development to ensure that subnational debts are adequately controlled and put within prudent limits. In spite of the fact that state debts issuance is a state liability with no federal obligation²², they may cause pressures of write offs and bail out on central government particularly when they are not readily managed and consolidated in federal budget.

States budget credibility:

In the states pronounced budget credibility problems emerges from relatively ineffective public expenditure management system. Large deviations of public spending from budgeted expenditures are not uncommon for almost all types of spending (Figure (2)). Several causes combine together to explain such bad budget outcomes.²³ First, lack of technical and analytical capacity prevents states and localities from undertaking efficient revenue forecasts and sound expenditure budgeting particularly development spending. Second, unavailability of information technology facilities (computer, analytical and data processing software, etc.) incapacitates staff to undertake efficient and sound costed budgeting, cash flow planning, risk management assessments and other budget related analysis. Third, recurring use of budget as a political signaling rather than a fiscal instrument often jeopardises budget credibility and causes a dearth of revenue and

²⁰ CPA, chapter 3, article 6.3.15 and INC, chapter 4, article 195.

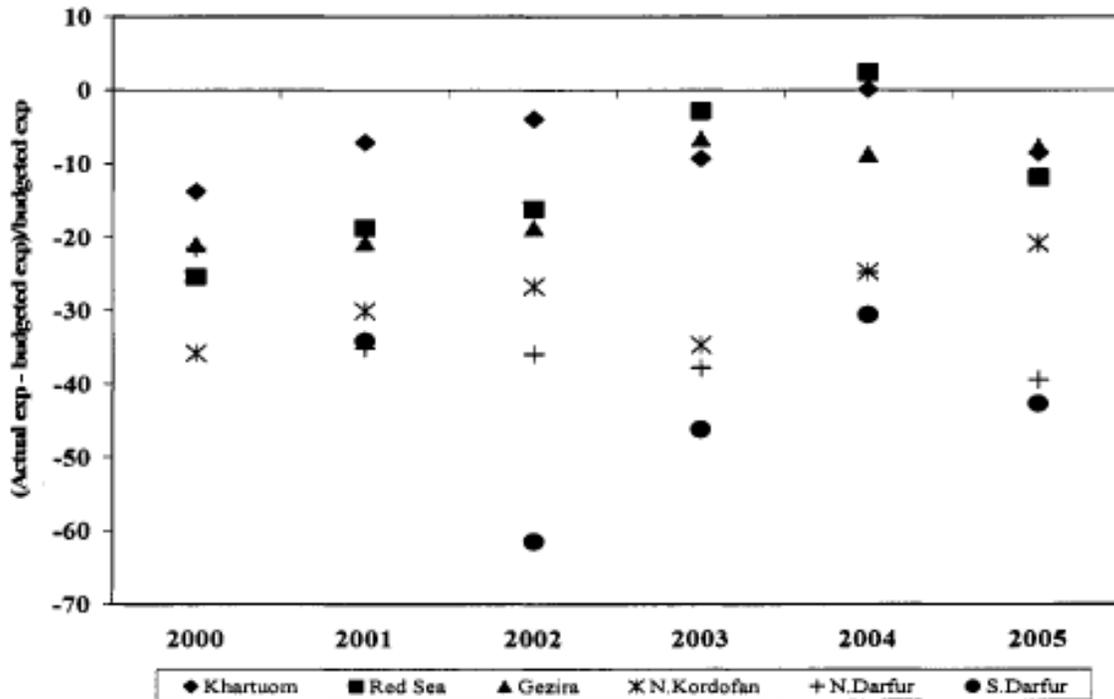
²¹ Ahmed et al, 2005.

²² CPA, chapter 3, article 10.1.

²³ World Bank, 2007, p. 61.

unrealised expenditure commitments. It is common to see expenditures (particularly development) inflated and matched by rather ambitious revenues beyond state fiscal capacity.²⁴ Last but not least, high dependence of states on central transfers combined with lack of accurate and untimely estimates of these transfers from the center precipitated huge gap between actual and budgeted revenues. States forecast of revenues beyond their control (including revenues collected by localities) has always been problematic.

Figure (2): State Budget Credibility, Planned Vs. Actual Expenditures



Source: World Bank, 2007, Figure 6.3, p. 61.

State budget comprehensiveness and consistency:

In several instances state budgets seem to overlook basic financial disciplines and hence to appear incomprehensive and internally inconsistent. Due to poor reporting processes and ineffective auditing, localities budgets are not appropriately consolidated in state budget and revenues and expenditure reporting are left entirely to locality initiative. Further, considerable extra-budgetary or off-budget expenditures in line ministries are not accommodated in state budget. This weakened ability of state government (state ministry of finance and economy) to effect expenditure ceilings and constraints by creating somewhat of an uncoordinated, parallel budgets.

²⁴ In North Kordofan state initial 2006 local budget planned own-revenues were nearly doubled from 2.8 to 5 billion dinar by the state assembly. The approved 5 billion revenues became a budget law that to be observed by localities in revenue collection process.

Internal inconsistency is manifested in incompatibility between different budget components particularly current expenditure needed for capital maintenance and replacement (chapter three) and capital or investment budget (chapter four). In principle capital maintenance should reflect size of capital budget. Dualism in budget system in the states (and in the center as well) with two separate current and development budgets operating and normally prepared by different administrations with insufficient reporting and feedbacks, made it difficult to relate provisions for capital service to development budget. This problem of inconsistency is exacerbated by inexistence - or at best - ineffectiveness of public assets assessment procedures and rules.

Public expenditure in the states under existing state-locality revenue sharing arrangements:

A pattern has emerged over years to characterise fiscal relationship between states and localities in revenue sharing and distribution of expenditure responsibilities. This pattern plays a crucial role in determining localities fiscal capacities and thereby largely affected basic service delivery to end users. Foundations of revenue sharing between states and localities are laid in the 12th Constitutional Charter of 1995 and 2003 Local Government Act (and its amendment), which identify shares and sources of revenues available to localities.²⁵ Moreover, the INC (article 185.11) stipulates the principle that ‘no level of government should withhold any allocation or financial transfers due to any other level of government’. Localities have their own revenues composed of fees and charges collected by localities and retained for localities own expenditures, and receives 40% from business profit tax, property tax, sales tax, and animal and agricultural production tax. Taxes constituting pool for shared revenues are collected by Chamber of Taxation office based in state.

Although legal and constitutional provisions for revenue sharing between states and localities set very clear sharing arrangements, in practice fiscal resource allocation is overly determined by negotiations and agreement between state government and localities. Negotiations are often dictated and influenced by higher level of government and fiscal autonomy of localities is overmuch compromised. Every so often localities receive stated shares of 40% from pooled revenues, and more often than not they receive less state support for locality expenditure. Such sharing practice puts fiscal pressures on localities particularly those undertaking development spending (as the case in North Kordofan). Further, resources may move the wrong way from localities to states if what localities give up of their revenue entitlement exceeds what they get as state support for expenditure chapters (negative transfer). Eventually, current sharing arrangements would take their toll on delivery of basic services including health, education and sanitation which are locality responsibility.

²⁵ 1995 Constitutional Charter, article 14.a and Local Government Act, chapter 7, article 27.

Audit and monitoring issues:

Monitoring and audit framework in states is adequately established with functions and audit responsibilities of Internal Audit Administration are clearly defined. Internal Audit staff are backed by immunity and independence provided by several acts and laws to ensure proper monitoring. However in practice these rules and regulations are not effectuated. Enforcement of fiscal laws and regulation always seem to be a problem. It is customary for the Internal Audit personnel to lack ability to exert control over unbudgeted and excess spending and their supervisory role is often minimised and ignored by senior executives. This clash of responsibilities prevents effective correction and amendment to improper fiscal conduct and creates incentive for different spending unit particularly in localities to neglect stipulated spending ceilings.

4. Conclusions and recommendations:

Summary of the main findings of the assessment of PFM institutions and processes:

- 1. Difficulty of tracking pro-poor spending due to improper economic classification hinders proper anchoring of fiscal budget outcomes to macroeconomic framework and hence limits use of budget as an effective policy instrument for poverty mitigation.***
- 2. The current institutional relationship between the Ministry of Energy and Mining and National Petroleum Commission on one side and MOFNE on the other side does not permit efficient projection of oil production and oil revenues and thus causes overly optimistic projections leading to in-year revenue shortfall and expenditure rationing.***
- 3. Lack of budget credibility may be attributed to relatively inefficient functional and organisational structure that defines relationship between different expenditure executing units in MOFNE. Repercussions of such organisation can be seen in accumulating arrears and unsatisfactory performance of monthly cash flow from MOFNE to line ministries and states.***
- 4. The legal and regulatory framework for accounting and reporting is relatively well developed in the GONU. However, the current accounting system reveals several drawbacks including incomplete and inadequate recording of some important aspects in expenditure execution process (e.g spending commitments); lack of consistent integration of accounting and fiscal information; and irregular, untimely, and incomplete subnational reporting to central government. Taken together these setbacks produce a reporting and accounting framework that is woefully inadequate for effective budget control and monitoring and for sound macroeconomic management.***

5. Subnational debts can pose serious implications for overall macroeconomic stability and management specially when left unmonitored and uncontrolled. Nevertheless no clear framework exists at the national level to provide for processes and mechanisms required to administer such provisions. The macroeconomic framework is incomplete as it lacks any form of borrowing constraints or benchmarks, and the existing monitoring and management mechanisms are not developed enough to ensure adequately controlled and prudent subnational debts.

6. State budget shows considerable credibility problems with actual spending deviating significantly from planned budget. Bad budget performance may be attributed to insufficient human and technical capacity, recurring political interference with budget process and ensuing use of budget as a device for political signaling, and improper and untimely reporting on central transfers which accounts for a large proportion of states revenues.

7. State budget appears incomprehensive as localities budget are not well consolidated in state budget and sizable extra-budgetary or off-budget expenditures are missed out. It also seems internally inconsistent due to the fact that some budget components like current and development spending are incompatible; development budget is not reflected in provision for capital maintenance. Budget incomprehensiveness and inconsistency created incomplete and uncoordinated, parallel systems, thus vitiated state ability to pursue sound fiscal policies.

8. Revenue sharing between state and localities does not draw very much on regulatory and legal framework, it rather follows negotiated sharing arrangements which some times appear disadvantageous to lower level of government (localities). Given localities expenditure responsibilities, these arrangements force a critical spending constraint on localities and result in spending arrears and rationing in addition to basic service delivery compromise.

9. Monitoring and audit framework in states lacks practical enforcement. Inability to effect monitoring and auditing rules and regulations jeopardised effective correction and amendment to improper fiscal conduct and created incentive for spending unit to neglect stipulated spending ceilings.

Challenges and recommendations:

The GONU, working toward the prime objective of poverty reduction, has undoubtedly a basic role to manage national resources and discharge various services, observing many fiscal provisions and rules that underline fiscal decentralization and wealth and power sharing arrangements. An effective and efficient framework for managing fiscal resources and delivering basic services requires building ‘good’ institutions and processes for effective and operational public finance management system. The GONU does not only face the challenge of mobilising huge fiscal resources and committing large sums of spending, it also faces the more pressing challenge of building ‘good’ public finance management systems and institutions in order to deliver the right amount and type of public goods and services to the most needy people and most hit regions.

In order to discharge its constitutional responsibilities effectively the GONU should ensure that institutions and processes in place could provide: (i) clear functions for different levels of government; (ii) clear expenditure assignments and revenue entitlements; (iii) clear legislations for spending prioritisation and authorization; (iv) clear mechanisms for expenditure commitment and execution; (v) effective, accurate and timely reporting to ensure transparency and accountability; and (vi) effective legislations to ensure fiscal laws enforcement and in turn adherence to fiscal discipline.

Against above stated general attribute of effective PFM system, a number of specific recommendations could be put forward:

- (i) The government should enhance and consolidate its current efforts to employ GFS 2001 manual to ensure that proper and effective tracking of pro-poor spending is possible. In this respect, the government has to make clear legislative provisions for adoption of GFS since current regulations allow for adoption of both economic and functional classifications.²⁶ Moreover, efforts have to be made to accelerate application of GFS to states budgets for consistent consolidation of these budgets in central fiscal system. Revision of public expenditure in last years by mapping function classification is critical for historic comparisons in order to depict trends and cycles in pro-poor spending.
- (ii) Given significant reliance of public expenditure on oil revenues, procedures and processes of oil revenue management should be developed. In particular, an effective system of reporting and flows of oil information should be put in place to enhance oil revenue forecast and budget credibility. Further, all units charged with functions pertaining to expenditure execution and cash flow management need to be consolidated under a single administration (creation of a Treasure administration) to improve management of cash follow and expenditure authorization and commitment, and in addition to develop a

²⁶ Article 7, amended Financial and Accounting Procedures Law.

sound and effective management framework for government spending arrears and debts. In their current fragmented form loss of efficiency could be minimized by improving expenditure reporting infrastructure across different expenditure executing units. This requires in particular consolidating fiscal and accounting perspectives that set backgrounds for fiscal and accounting information.

- (iii) Lack of national budget that consolidates and integrate subnational fiscal budgets is a major hindrance for effective fiscal planning and macroeconomic management. States budgets should be consolidated in federal budget, and necessary steps should be taken and clearly sequenced to ensure state adoption of GFS. Also the central government should ensure that CPA provision that subnational governments should report financial and fiscal data to central government is practically effective.²⁷ Without state timely and comprehensive reporting of public expenditure execution, monitoring state spending toward objective of effective service delivery would be impractical and difficult. This has a particular relevance to supervisory and monitoring role of the Fiscal and Financial Allocation and Monitoring Commission charged to it by the INC.²⁸
- (iv) In view of significant expenditure responsibilities and insufficient fiscal capacity of most states in Sudan, debt finance would emerge as a justifiable and essential source of finance. An effective management of fiscal aggregates including overall risk, national public debt and aggregate expenditure, requires a comprehensive framework to manage public debt and finance. A definitive and streamlined framework should be drawn to set the processes and mechanisms by which subnational debts are managed, monitored and consolidated in national budget frame.
- (v) An important integral in subnational debt management framework is the macroeconomic aspect, which should identify clearly borrowing limits for respective states. Borrowing constraints and benchmarks in macroeconomic framework should be determined in accordance with a careful and in-depth assessment of fiscal capacity and needs of each state, and could be articulated in budget circular as federal directive.
- (vi) It is particularly essential for the GONU to derive a monitoring and accountability framework for efficient management of states debts with the ultimate objective of achieving prudent fiscal position. In this regard developed processes and institutions to monitor subnational debts should pay a particular concern to states fiscal autonomy, which is an important cause for successful fiscal decentralization. A possible way to strike such balance between monitoring and requirements of macroeconomic stability and state

²⁷ CPA, article 14.14.

²⁸ Article 198.2.

autonomy is perhaps by undertaking negotiated actions in which states representatives play a clear and effective role.

- (vii) Clear guidelines should be prepared for revenue sharing and expenditure assignment between state and localities. Revenue sharing arrangements should draw on legal and constitutional provisions, and should reflect basic service spending responsibilities on level of government. Reporting and auditing should be enhanced to increase budget credibility. Localities should record expenditure and revenues in a consistent template and should ensure monthly reporting to state government. Autonomy and independence of state Audit Administration need to be strengthened by identifying streamlined accountability mechanisms for uncommitted and off-budget expenditure and other forms of fiscal misconduct.
- (viii) Building and enhancing human capacity is a very important prerequisite for successful and effective management of fiscal resources. Trained and skilled staff, with know-how capacity, combines with 'right' institutions and processes and benevolent political will to set the launch ground for effective and equitable delivery of basic services. Therefore, identification of priority needs for staff training and development should be undertaken for all required skills including professional, technical and managerial skills. There is serious capacity shortages in subnational governments, and hence urgent need for capacity building and development should be addressed (for example, only 11% of public service staff in North Kordofan state have above higher-secondary certificate).

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