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Concept Paper 2
Transparency and Accountability in Public Financial Administration

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Introduction

“The term ‘democracy’ minimally presupposes three essential elements: transparency, accountability, and equality. Transparency denotes free access to governmental political and economic activities and decisions. Accountability entails a state being held responsible, by both its people and its elected bodies, for its choices and actions. And the concept of equality includes citizens being treated equally under the law, as well as some degree of equal political participation among them in their own governance. Calls for transparency, accountability, and equality have emerged in the Arab world, with citizens summoning their governments to reveal their incomes and expenditures, as well as strategies and ambitions”.

While the author writes of transparency, accountability and equality as separate attributes, it is evident that the first two are not independent. Transparency enables all stakeholders in a country to see the structure and functions of the government, its policy intentions and fiscal projections, and accounts for past periods. The main purpose of opening these windows is to render those inside accountable and answerable for their decisions and actions. Accountability is the obligation to render an account for the responsibility conferred. When systems for public transparency and accountability are being devised, four questions must be considered: (a) who is accountable? (b) for what is s/he accountable? (c) to whom is s/he accountable? and (d) how is that accountability discharged? As the discharge of accountability requires transparency, in this paper we will henceforth use the term ‘accountability’ as a shorthand for ‘accountability including transparency’.

This paper examines financial aspects of accountability for the use of public funds, that is, fiscal accountability. It explains the growing demand for fiscal accountability, answers the who, for what, to whom and how questions, describes the move toward performance accountability, details the benefits and costs, and concludes with general recommendations. The paper does not cover other elements of governance, in which transparency and accountability are perhaps equally important, such as transparency of national statistics on the national income, balance of payments, banking and non-banking institutions, regulatory bodies, etc. nor the accountability of the private sector and non-government organizations.

The demand for accountability

The genesis of the current emphasis on financial accountability can be attributed to five factors, as follows:

- Two decades of fiscal turbulence have contributed to a substantial erosion of credibility of governmental fiscal machinery, and to a growing distrust of governments;

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1 Shafeeq Ghabra, Professor of Political Science at the University of Kuwait.
2 While accountability subsumes transparency, the opposite is not true. A great deal of ‘transparency’ is public relations ‘spin’.
• The gradual spread of globalization has put economic policymakers in many developing countries and economies in transition in a reactive mood, rather than proactive; external developments that do not always lend themselves to precise identification would appear to have a greater role, or even a dominating role on fiscal policies. Information asymmetries have made the already formidable tasks of policymakers even more complex and intractable. In the absence of crucial information, the risks faced by the policymakers have increased significantly;

• The change in the nature of government and its gradual withdrawal from production activities has made it take an active role in regulation, which adds to the complexity of financial accountability;

• There has been a major change in the composition of expenditures of central and federal governments. Apart from sizeable outlays on the servicing of public debt and on entitlement payments, expenditures at the central government level are increasingly devoted to contract payments, transfers to the private sector, and transfers to regional and local governments. This has contributed to a separation of funding from the actual provision of services and has affected the pattern of financial accountability.

• Over the years, the scope of financial accountability has expanded rapidly and significantly, reflecting changing tasks and expectations and an emphasis on ‘prudent macroeconomic management.’ This enhanced financial accountability requires governments to be accountable for ensuring that there are adequate systems to secure and improve results and to maintain the financial condition of the state (fiscal sustainability, flexibility in the use of resources, and reduced financial vulnerability). Furthermore, governments are expected to demonstrate that the selected programmes are part of the legitimate functions of a government and that the community can afford them.

The current reality in many countries is far from what is expected. “While several newly formed republics (such as those that were formerly in the Soviet Union) have established laws regarding the budget, its contents, and the overall financial system, thus laying a base for fiscal transparency, in several other countries access of the public to the budget, and full accounts, continues to be scant. In some countries, the public gets only bits of information and full documentation on budgets and annual performance continues to be absent from the public domain. It is likely that approximately one third of the world’s population is in this area of darkness”.3

The experience of both industrial and developing countries shows that governments are generally engaged in circumvention of their own laws. The practices include generous window dressing of budget estimates of revenues and expenditures, avoidance of credit

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Transparency and Accountability in Public Financial Administration

Window dressing involves projection of rosy scenarios of economic growth and policy measures yet to be formulated. A gullible public may not always know what the government is doing. While these practices are sought to be minimized in some countries through a review of the estimates by the audit agency, or through an assessment by credit rating agencies, it should be noted that these efforts are, by and large, very limited. Meanwhile, in several cases the budget reflects creative accounting approaches that effectively mask the reality. These practices, to say the least, work against financial accountability.

There are vital gaps in most public budgets and accounts. In several cases, they do not provide information on tax expenditures, outstanding guarantees, non-financial assets, and liabilities including contingent ones. Instead, a good deal of detailed information on small operations may be provided, while accounts are generally opaque in important areas such as defence, and extremely brief on the benefits of expenditure programs or the risks involved. Most budgets tend to be very silent on risk management, that is, the changes in strategy in the event of changes in the underlying assumptions. Also, budgets and accounts in government speak a technical language that tends to be extremely difficult for the public to comprehend. The classification of government activities may conceal more than it reveals.

Several measures taken during recent years by many governments reveal the pursuit of contradictory approaches. The enactment of fiscal responsibility legislation and pursuit of hard budget constraints have in some ways contributed to the picture of a strong determination to pursue fiscal rectitude. On the other hand, the passage of zero deficit approaches into law and use of payment systems under which government payments are limited by available revenues have posed serious problems to the pursuit of proper fiscal policy. A fiscal policy implies a balance between fiscal aspects and service delivery. In cash limited approaches, budgeting becomes a back-door exercise in that the budget that is implemented may not be the one that is approved by the legislature but the one that is determined by cash inflows. In such a context, service delivery becomes incidental, and the very approach that is intended to shore up investor confidence ends by eroding public trust in government, and weakens legislative accountability. In some cases, spending cuts are sought to be mitigated through the specification of protected categories of expenditure such as wages, pensions, public debt and defence. This reinforces the popular perception that, in a crisis, the first activity that is protected is not service delivery, but payment of wages to government employees.

Who is accountable?

The short answer is that every person who is in a position of power on trust is accountable for the use of that power. This has most significance in a political system in which power can change hands. In the context of, say, a parliamentary democracy with a separation of powers between the executive and the legislature, the executive is accountable to the legislature, which grants periodic authority over resources. Within the
executive, there is a hierarchical structure by which each level is transparent and accountable to the next higher level, from desk clerk to the cabinet.

Most countries have clear rules on financial responsibilities, based on laws and executive directions, but many countries do not apply them rigorously. For instance, in many Commonwealth countries, the Financial Secretary has legal power to surcharge any public officer (i.e., recover from his/her salary) any loss to the government arising from that officer’s irregularity. Audit reports are full of irregularities, but surcharges are rare. There are several reasons for this inaction: a permissive culture (everyone does it, salaries are very low, the officer has a family to support, etc.); social and ethnic differences which prevent the fair treatment of officers; the amount of time and effort required to push cases through cumbersome procedures; and centralized work processes in which all decisions go to the top, or at least involve several approvals, thus spreading responsibility. For instance, where a department overspends its appropriation, who is responsible? Is it the Vote Book Clerk who failed to maintain up-to-date records, the Finance Officer who failed to supervise the Vote Book Clerk, the Head of Department who as Accounting Officer is answerable to Parliament, but failed to get sufficient trained staff, or the Public Service Commission who blocked applications for training? It is revealing that most surcharge cases are against drivers of government vehicles, who negligently cause damage to them. In such cases there is no sharing of responsibility for control of the vehicle, so it is relatively easy to pin down who is accountable.

The modern tendency to hive off government operations to contractors, executive agencies, local governments and non-government organizations has raised questions about the maintenance of accountability. During the last two decades, a new public management philosophy in governments has become a major feature of public debate. Although there are several versions of this philosophy, so far as financial management is concerned, it comprises the following – creation of small task-oriented agencies, indication of firm advance ceilings for the budget and the results expected during the fiscal year, extensive delegation of financial and administrative powers to the managers of agencies, and a framework of direct accountability to the public and contract accountability to the supervising ministries, who remain accountable to the legislature. Where managers have autonomy, their operational accountability is undivided. This approach, it is suggested, shifts the traditional emphasis in public authorities from the control of minutiae to the control of results. There is much to be said in favour of the new philosophy and it has worked well in some OECD countries. However, experience shows that the discipline inherent in the legislative process and channels of accountability to the legislature must be maintained.4

The changes in the portfolio of expenditures of government have had serious implications for transparency and accountability. Increasingly, in several cases, a greater share of government expenditures is devoted to transfers to local governments, and, in the case of social services, to non-governmental organizations. This has inevitably contributed to a greater gap between funding of services and the actual provision of services. While

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government agencies concerned with funding engage in a good deal of conditionality aimed at ring fencing, in practice the means of enforcement are limited. Local governments and non-governmental organizations have their own administrative systems and may or may not be subject to end-use audit by the central audit agency. In several cases, non-governmental organizations may not have any self-enforcing standards governing their financial management systems. As a consequence, a whole layer of administration that is beyond the scope of traditional accountability has emerged. In the view of some, this represents a serious leakage in the traditional system of financial control, without any redeeming advantages in service delivery.

**Accountability for what?**

Governments are voted out of office when the electorate loses faith in their ability to deliver the services they need and when opposition promises gain sufficient credibility. In other words, governments are accountable for performance. A distinction is sometimes made between financial performance and overall performance or between financial accountability and performance accountability. Financial accountability is served simply by collecting and spending public funds in accordance with laws (including budget laws) and regulations. While this still needs strengthening in many countries, it is a long way short of performance accountability.

According to the Campos/Pradhan model there are three goals or levels of expenditure management:

- overall control within sustainable limits, involving medium-term expenditure frameworks, financial discipline and compliance with laws and budgets
- strategic prioritization of resource allocation
- efficient and cost-effective management of programmes.5

The first level is equivalent to financial accountability, whereas performance accountability includes level two (allocative efficiency) and level three (x-efficiency). Performance can be assessed at each level, viz. at the first level, performance is assessed in terms of *predictability* of resource flows for planned programmes and *compliance* with the legal framework. At the second level, performance is assessed by three criteria:

- the correspondence of policies to underlying social and economic realities as revealed by programme evaluation;
- the correspondence of budget allocations to policies; and
- the correspondence of actual expenditures to budget allocations.

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Achievements at the third level are measured by conventional indicators of efficiency and cost-effectiveness (value for money).

**To whom is accountability owed?**

Almost all accountability lines in a parliamentary democracy are up a hierarchical chain through project directors, program managers, department heads, secretaries and ministers to the elected representatives of the people in parliament. In elected local government institutions, there is a similar vertical accountability to elected local councils. This is often supplemented by a second vertical line to the central government through the ministry responsible for local government. This is justified by the need to follow central government grants.

There is growing recognition of the potential scope for accountability directly to beneficiaries of government services. This applies particularly to community services such as primary health and education, infrastructure and income-generating activities that affect large numbers of people. This is often called ‘horizontal’ accountability to distinguish it from traditional ‘vertical’ accountability, though the terms are not standardized. Horizontal accountability can apply at all phases in the development process – planning, programming, budgeting (as in Brazilian municipal budgets), release of funds (as in Ugandan education), award of contracts, monitoring of progress and outputs, and evaluation (as in Indian performance score cards). In some projects in developing countries, community-based organizations participate with government agencies in both formulating local projects and monitoring their outputs and outcomes. This has made government agencies far more responsive to local preferences. The participation of community-based organizations and NGOs generally in the budget management cycle can have a greater effect on government behaviour than the prospect, far-distant and uncertain as it is, of strictures by auditors and parliamentary committees. Where absolute poverty, often rural and agro-based, is the biggest development challenge, horizontal accountability should be developed, not only to supplement vertical accountability and go at least part way to compensating for its weaknesses, but also for its value in building popular participation and self-help. However, the building of horizontal accountability should not displace traditional accountability.6

The traditional cycle of accountability is not entirely closed by legislative reviews. A further step in an open democracy is publication of the findings of reviews. Audit and parliamentary committee reports tend to be dry and technical: they are not read by the average citizen. Effective accountability depends on public access to these findings in a form that can be read and acted on. In open democracies, this access is provided by the

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6 There are also costs and risks, such as the additional time and cost of management by a wider circle, risk of capture by an elite or by rogues, and possibility of instability. See, for instance, Swarnim Waglé and Parmesh Shah (2001) An Issue Paper on Participation in Public Expenditure Systems, Social Development Department, World Bank. One might add that much of the machinery of horizontal accountability is project-tied, of short life and unaudited. Accountability to beneficiaries should reinforce traditional accountability as it depends on the same databases and reporting cycles.
media. Newspapers, magazines, radio and television stations have investigative, attention-directing and forum-providing roles that reinforce the accountability of the government to the people. In developing countries, the main constraints on the effectiveness of the media are censorship (especially where media are owned by the government or receive substantial advertising revenue from the government), and lack of capacity. Many countries have recognized the roles that can be played by responsible media. Journalists are trained in investigative techniques and in objective, non-sensational reporting.

Transparency implies not only that annual accounts are rendered but also that records are open and accessible to citizens, since government activities are undertaken on their behalf. Currently, many countries classify records as Top Secret, Secret, Confidential and Restricted, and Official Secrets Acts makes unauthorized disclosure a criminal offence. The whole culture of many governments, both developed and developing, is one of secrecy. Freedom-of-information legislation is being progressively introduced, and is redefining the interface between government and civil society. Instead of defining what can be disclosed, or authorizing release of information on a case-by-case basis, all information becomes publicly available on demand, without question, except for carefully defined exceptions. The technological revolution is facilitating this reform; as a first step, government agencies are putting key documents onto tailor-made websites. ‘E-government’ is gathering pace. The major constraint is the fear of many civil servants and politicians of loss of discretionary power enjoyed behind the screen of secrecy.

**How accountability works**

Laws, regulations and codes of conduct are insufficient on their own. Their observance has to be monitored, deviations identified with those responsible and corrective and deterrent steps taken. This is the more difficult side of the coin. Monitoring is through internal controls exercised by the executive on itself, and by external controls exercised by oversight (watchdog) agencies. The level of accountability depends on:

- How much relevant information the control agencies can obtain about the use of funds;

- How well they can analyze the information and develop action-oriented conclusions;

- What kind of response they are able to elicit from the users of funds. Responses are deterrent (strengthening of system, punishment of delinquent officers) and corrective (recovery of losses, correction of accounts).

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7 Corrective action is too often limited to the recovery of losses from delinquent officers. The strengthening of systems and the punishment of offenders to prevent and deter recurrence are a poor second and third.
As observed in the Manual of Fiscal Transparency, sound control systems can make an important contribution to the reliability of fiscal and financial data, and are the starting point for ensuring the integrity of the recording and reporting process. While government systems vary widely, standards for internal control vary less. Broadly defined, internal control is the management tool used to provide assurance that management’s objectives are being achieved. Under this broad definition, internal control also covers administrative controls (procedures governing decision-making processes) and accounting controls (procedures governing the reliability of financial records). Responsibility for internal control, therefore, rests with the head of each individual government agency. However, a central government agency might be assigned responsibility for developing a government-wide standard approach to internal control.

As defined by the International Organization of Supreme Audit Institutions (INTOSAI), the objectives of internal control systems are to promote orderly, economical, efficient, and effective operations; to safeguard resources against loss due to waste, abuse, mismanagement, errors, fraud; to adhere to laws, regulations, and management directives, to develop and maintain reliable financial and management data; and to disclose these data in timely reports. To be effective, internal controls must be appropriate, function consistently as planned throughout the period, and be cost-effective. Internal control standards have been issued by INTOSAI and the Institute of Internal Auditors (US).

The main instruments of financial accountability are government budgets, periodically published data on public finances, annual accounts and the investigative and other general reports prepared by independent agencies. Since annual budgets are typically the legal authority for spending public funds, the entire budgetary process becomes relevant for fiscal management, and for enforcing financial accountability and control at the various levels of operation.

Transparency in government operations has several aspects and dimensions. First, at the aggregate level, transparency requires the provision of reliable information on the government’s fiscal policy intentions and forecasts; second, detailed data and information are required on government operations, including the publication of comprehensive budget documents that contain properly classified accounts for the general government and estimates of quasi-fiscal activities conducted outside the government; third, the behavioral aspects including the clearly established conflict-of-interest rules for elected and appointed officials, freedom-of-information requirements, a transparent regulatory framework, open public procurement and employment practices, a code of conduct for tax officials, and published performance audits.

The IMF has set out four principles that define what transparency should be expected of a government:

- Clarity on the structure and functions of government, responsibilities within government and relations between government and the rest of the economy
• Public availability of comprehensive information on public sector financial stocks and flows, published at specified times

• Public availability of information on how budgets are prepared and executed, and minimum content of budgets and financial reports

• Financial data meeting accepted quality standards and subjected to independent audit scrutiny.  

There are three levels involved - legislative bodies, political directorates and operating entities. In most developing countries and economies in transition government budgeting is an executive function. Interaction with the legislature is essentially formalistic and its inputs are limited and insignificant. Thus, the exercise of financial control and the enforcement of accountability becomes an executive function. Some countries have recognized this reality and have institutionalized control and accountability functions within the executive branch. For example, a ministry of finance can exercise strict control through a financial directorate.

The role of the legislature has undergone major changes during recent years. In the name of quick decision making, that is so essential to macroeconomic management, much of the power relating to the control of the purse, has shifted to the executive branch of government. In addition, the role of parliaments has been reduced by permanent legislation governing budgetary outlays. In many developing countries, most of the available resources are already committed before the annual budget process, so flexibility is very limited. Even in such countries as the United States, where the legislature has been viewed as traditionally dominant, nearly 70 per cent of the outlays in the annual budget are determined by pre-existing legislation. These trends have made governments more vulnerable, reduced their capacity to avoid financial crises and lowered their esteem in the eyes of the public. The financial management cycle, it is perceived, has become a ritual that is carried on for its own sake, or for the international financial institutions, rather than for the public.

In countries with strong legislatures, the legislative system plays a key role in the budget process. A meaningful committee system that includes committees for appropriations and public accounts has enabled many legislatures to increase their role in the budgetary process. The emergence of strong supreme audit institutions has facilitated the effective parliamentary control of the purse.

At a Conference on Oversight Functions held in Dhaka in September 2000, it was emphasized that control of public expenditure starts with controls by Parliament on itself. Adequate remuneration, institution of a rigid code of conduct and public statements of assets and liabilities by all Members of Parliament on election to office were

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recommended, together with orientation in the framework of public accountability, particularly on the opening of a new Parliament.

Financial accountability and control within the executive commence with the budget preparation that lays the foundation for all subsequent measures. The budget determines programme concepts and structures, modalities for implementation and costs. Budgets of various departments and agencies are reviewed in their totality and consolidated in a single document, thereby enabling the government to examine the budget in terms of legal requirements, national economic policy and objectives and resource availabilities.

Legislative appropriation is the basis of financial control. The system of appropriations is based on three principles: (1) a sum appropriated for a particular purpose cannot be spent on any another purpose; (2) the sum appropriated is the maximum and cannot be exceeded; and (3) monies are available only for the year for which they are appropriated unless specifically provided for otherwise. However, all three principles are commonly circumvented by devices such as re-appropriations (within the executive), supplementary grants, year-end peaks of expenditure, and the transfer of funds to special accounts. The approval of the legislature is usually obtained after the fact.

After the budget is approved, its execution becomes the responsibility of the budget agency, which may require additional information from operating departments before releasing the funds appropriated by the legislature. Releases may be made for the whole appropriation for the year, or in periodic instalments (such as monthly warrants), or even for individual transactions. There are two separate but related fiscal control measures that occur during the execution stage:

- The first fiscal control measure involves the examination and approval of each proposed expenditure to ensure that it is prudent, legal and covered by budget appropriation and availability of funds. This pre-audit function, which used to be exercised mainly by the Treasury, is nowadays entrusted to operating departments, both to eliminate delays and to emphasize their responsibility;

- A second measure involves the recording of actual treasury business, including the receipt, disbursement, allocation and accounting of funds. Both the recording of transactions and accounting of funds are usually done by a network of government treasuries functioning under the authority of the Ministry of Finance. The development of banking networks in most developing countries and economies in transition is bringing about reforms in this area.

After the end of the fiscal year, the accounts are closed for the period and submitted for audit. This involves the post mortem examination and verification of completed transactions and their related accounts by the supreme audit authority of the country. The form of audit varies from one country to another. In some francophone countries, the audit body is endowed with judicial powers and can impose penalties. Most state audit bodies are engaged in a posteriori compliance audit. The arrangements for the audit of state enterprises and public bodies vary considerably. In a few countries, audit may be
called upon to provide an ‘opinion’ on the accounts. Similarly, the timetables for audit and actions thereon vary. Although practices vary, the real issue relates to the extent to which transparency and related accountability are effective in fulfilling the tasks for which they were designed.

Only after audit does the legislature get a chance to review the execution of the budget. The audited accounts and audit report are submitted to the legislature for review. The legislature (the lower House in a bicameral legislature) commonly establishes a Public Accounts Committee (PAC) from amongst its members to undertake the review and report to the full House. In Westminster-style governments, the chairmanship of the PAC traditionally goes to an opposition member, so that the PAC is seen to be independent of the party in power. For the same reason, members who hold executive office, such as ministers, are excluded since they cannot be expected to bring an independent view to bear.9

In principle, the PAC examines the public accounts and report(s) of the state audit institution with a view to ensure: firstly, that the expenditures shown in the account as disbursed were legally available for the purpose on which they were spent; secondly, that the expenditures conformed to the authority governing them; thirdly, that every re-appropriation was made in accordance with the rules; and fourthly, that all revenues were brought to account. For this function it can call on the heads of departments or other officers who are legally responsible for financial administration. The PAC holds hearings taking up the audit objections and reports back to the legislature. Reports may also go to the respective heads of departments and to the Ministry of Finance for follow up. In practice, the PACs in many developing countries, where they exist at all, are weak: they may fail to meet, or be unable to work together, or fail to issue reports, or their reports are ignored.

**The move to performance accountability and accrual-base accounting**

The basis of recording government transactions - cash, accrual and variants of these - has important implications for accountability. Reliance solely on cash-based accounting, although helpful for assessing the impact of government operations on aggregate demand, inflation and the external balance, can result in a misstatement of the magnitude and timing of fiscal operations. Cash measures have serious limitations from this perspective, including the inability to capture the effects of non-cash items. Expenditure arrears, transactions-in-kind, contingent liabilities and other non-cash operations have an economic impact before they are reported in cash- or modified cash-based reporting systems.

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9 This is not true in respect of accounts for years when their party was not in power. Given a typical parliament life of four to five years and two parties taking power alternately, a corresponding delay of four to five years in the completion of audited accounts would mean that the opposition members of a PAC would always be examining their own periods in office. In some developing countries, some years’ accounts escape legislative scrutiny altogether as PAC chairmen are unwilling to expose maladministration in which their colleagues may be implicated.
These effects are recognized in accrual-based systems and can be taken into account in macroeconomic policy-making. Accrual-based accounting is indispensable for gauging the macroeconomic repercussions of fiscal policy, especially over the short term.10 Accrual basis accounts, though technically more demanding and more subject to estimation, will help governments assess their effectiveness and efficiency in utilizing the resources at their disposal. There is a global trend towards the development of financial management systems which will support resource management by relating expenditure to results, so that efficiency can be measured. Value-for-money audit, the descendants of programme and performance budgeting systems and other techniques to raise the productivity and efficiency of public expenditures, all depend on accrual-based accounts.

The work of IFAC and the revision of IMF’s GFS Manual together with the Code for Fiscal Transparency are steps towards development of standards that will help improve international comparison of data and contribute to improved fiscal accountability. The Public Sector Committee (PSC) of IFAC has issued a series of International Public Sector Accounting Standards (IPSAS), based on private sector accounting standards, for governments that keep their accounts on an accrual basis. Recognizing that most governments still keep their accounts on a cash basis, IFAC has also issued a study ‘Governmental Financial Reporting’ aimed primarily at helping such governments prepare more transparent financial statements, and an exposure draft on a standard for financial reporting on a cash basis. The latter is expected to be issued as an IPSAS.11

IMF has recently changed the GFS from its former cash basis to an accrual basis of reporting. This change recognizes the growing importance of accrual concepts for government accounting and aims at harmonising GFS with other international financial statistics systems, such as the SNA that also uses the accrual concept. The revision will not require that countries immediately adopt an accrual accounting system: a staged transition is envisaged, and countries could adjust data from their cash accounts or, in many cases, use cash data where differences between cash and accrual are not substantial.

IMF’s Code for Fiscal Transparency aims to support the application of GFS and international accounting standards emphasizing that, firstly, all countries report on financial assets and liabilities by introducing some elements of a modified accrual standard; secondly, all countries should aim to have an accounting system that can produce reliable reports on arrears. Such reports could be produced at a memorandum level by a cash system. The need to extend this system to a modified accruals system where accounts payable are automatically recorded as expenditure should be determined by each country on a cost-benefit basis. These changes will also facilitate the development of more reliable fiscal reports for macroeconomic analysis.3

Many governments have embarked on ambitious projects of improving accounting and financial reporting standards. Although most governments operate cash- or modified cash-based accounting systems, at least certain aspects of accrual standards could be adopted by most governments.

**Benefits of accountability**

Poverty is the biggest challenge facing the globe in the new millennium. There is mounting evidence that poverty is associated with poor governance, where government is less accountable and responsive to citizens. Since the poor lack the resources to give bribes, they do not get equal access to government services. Conversely, improvements in governance are associated with higher per capita income, higher adult literacy, lower infant mortality and reduced poverty.

Fiscal transparency is a necessary condition for sound economic governance. Timely publication of a clearly presented budget document enables the market to evaluate government’s intentions and allows itself a constructive discipline on the government. Transparency increases the political risk of unsustainable policies whereas the lack thereof means that fiscal profligacy can go undetected for longer. Moreover, a transparent public financial accounting policy makes it possible to determine what the government has done and to compare budgeted and actual financial operations. Further, open procurement policies not only facilitate the achievement of basic macroeconomic policy objectives, but also increase the productivity of public expenditure.

There is growing recognition of the importance of *expectations* in determining economic behaviour, especially in economies with open financial markets. This has, in its turn, brought greater attention to the importance of transparency and accountability in the conduct of economic policy, so that market expectations are, as far as possible, based on informed assessments of current economic conditions and policies. In particular, transparency and accountability help ensure that participants in economic activities have sufficient information to make sound judgments and make meaningful comparisons of different situations for making correct economic decisions. Moreover, they contribute to the effectiveness of announced policies by reducing uncertainty about policy intentions.

Accountability imposes discipline on national authorities by ensuring that the authorities are answerable to the general public and market participants for their decisions. Accountability thereby lessens the likelihood that national authorities will make imprudent policy decisions. More particularly, transparency and accountability should result in *better-informed public debate* about the design and objectives of fiscal and monetary policies and thereby strengthen the credibility and public understanding of macroeconomic policies and choices, as well as the quality of decisions taken. To facilitate the efficient allocation of resources and the effectiveness of public policies, fiscal and monetary authorities should be transparent about their policy objectives and

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12 UNDP's 1996 Report on Human Development in Bangladesh: A Pro-Poor Agenda, provides examples of this with reference to education, health services and relief and food aid.
their strategies for achieving them. Transparency helps the general public and market participants hold national authorities accountable for their policy decisions.

One of the underlying objectives of improved transparency and accountability is to reduce the extent of corruption in the management of governmental affairs. The nature of corruption, however, is a complex one, and may not be fully addressed by the existing fiscal machinery. Conceptually, corruption arises, in so far as the tax collection machinery is concerned, when the transactions between the assessor and the taxpayer are not transparent. In several countries, tax assessment is in part negotiated between the assessor and taxpayer. Even in regard to indirect taxes, e.g. customs, the scope for negotiated settlement is quite substantial and may be inherent in the system. In one country, for instance, the customs law specifies forty-five varieties of imported steel, each with its own rate of tax. Given the subtle distinctions, the levy becomes a matter of negotiation, with the inevitable prospect of corruption, with the taxpayer. Similarly, the application of the law relating to tax expenditures, which in many countries, is extensive and covers a wide ground, also permits, in some cases by design, a good deal of discretionary action, contributing in turn to corruption. It could be argued that efforts aimed at reducing corruption should therefore address the task of revamping the tax system, and related laws.

As for expenditures, financial management systems including effective internal and external audit control systems can deal only with embezzlements and motivated award of contracts. In both types, the proof of mala fide intentions and practices is pursued, in most cases, as a part of criminal law, rather than as a part of the audit process. The introduction of electronic payment systems, particularly for payroll, pensions and public debt, has reduced the scope for corruption. Even here, however, the inadequate maintenance of manual records and the quick transition to electronic systems has contributed to the emergence of ‘ghost employees’ and ‘ghost pensioners.’ These aspects illustrate the need for a good deal of supplementary action aimed at improving the administrative infrastructure.

It is difficult to prove that fiscal transparency always leads to better policy settings that are translated into improved fiscal and economic outcomes, since the transparent practices are only one influence on the overall outcome and the difficulty in specifying the counterfactual experience. However, countries characterized by high degree of fiscal transparency have exhibited greater degree of fiscal discipline and have achieved a more robust economic performance than other broadly comparable- in terms of resource endowment and cultural characteristics – countries with less transparent practices within the same region.13 There are countries where secrecy in government operations and a lack of discipline contributed to a disastrous economic performance, despite an ample resource endowment, There is a positive relationship between broadly defined transparent

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13 Botswana, Chile, Denmark, and New Zealand which display considerable fiscal transparency and discipline have experienced macroeconomic stability and strong growth in recent years. Both Hungary and Jordan, despite major handicaps relative to other countries in their respective regions (high indebtedness and a lack of significant resource endowment), have seen an improvement in economic performance while implementing fiscal adjustment in an increasingly transparent manner.
budget practices and fiscal discipline. Non-transparent fiscal practices tend to be destabilizing, to create allocative distortions and to exacerbate inequities. Non-transparent tax concessions, quasi-fiscal subsidies and off-budget spending all contribute to fiscal imbalances. The destabilizing consequences of an accumulation of payment arrears and of unfounded contingent liabilities are usually felt with longer lags. All taxes and subsidies as well as economic regulations, alter relative prices and factor returns and cause distortions in resource allocation. In addition, when they are not transparent, the harmful impact of these practices, including the benefits they may provide to influential interest groups, at the expense of poorer and less vocal groups, is hidden from public view and debate.

**Costs of accountability**

Fiscal transparency can impose costs, namely, up-front costs in creating the technical capacity and institutions to establish a centralized information system, develop reliable forecasting tools, implement appropriate accounting techniques, and simplify regulatory practices or make their cost visible. In addition, there are recurrent but declining costs in maintaining these practices and disseminating the generated information. The costs of transforming a culture of secrecy into one of transparency may be at least equally large. A basic requirement for transparency in the overall structure and functions of government is a clear demarcation of the boundaries between the public and private sectors. As part of the delineation of areas of competence, it is necessary to limit private rent seeking by officials in the public domain through enforcement of conflict-of-interest legislation. At the same time, freedom-of-information legislation helps ensure government transparency and accountability by giving citizens access to public documents and assigning to government the burden of justifying non-disclosure.

**Conclusion**

Enough has been said to show that fiscal transparency and accountability are cross-cutting attributes of all public sector financial structures and processes. They can be enhanced through a public financial management improvement programme. The components of such a programme would vary from country to country. The first step is not to see how a particular model can be introduced into a country, but rather to analyse the existing financial management arrangements and identify the weaknesses in meeting the fiscal objectives of the country. Major donor agencies such as UNDP and the World Bank are in the process of harmonizing and perfecting their approaches to the diagnosis of financial accountability. For instance, the purpose of the World Bank’s Country Financial Accountability Assessment (CFAA) is to assess the risk that public funds may be used illegitimately, inefficiently or ineffectively, by comparing the financial management standards and practices of agencies using (or regulating the use of) funds against an international or ‘best practice’ standard. The UNDP’s CONTACT instrument has a similar purpose. Such diagnoses can provide the basis for prioritizing the weaknesses to be addressed, formulating a reform programme including strategies, work plans and progress indicators, and providing baseline data for monitoring progress and programme evaluation. In many cases, a financial management improvement programme
is best implemented as part of a broader public sector reform programme, which can address issues such as managerial incentives and integrity. Where a country hopes to qualify for sector program support or general budget support, donors have to agree (with the government and amongst themselves) on how initial fiduciary diagnosis is to be done, how risks can be managed and how aid agreements can be monitored.

Most developing countries and economies in transition need to work on many fronts to improve government budgeting and financial accountability. There is a danger that they try to do too much too soon. Allen Schick has warned of the need to ‘get the basics right’:

- Foster an environment that supports and demands performance before introducing performance or output budgeting
- Control inputs before seeking to control outputs
- Account for cash before accounting for accruals
- Establish external controls before introducing internal control
- Establish internal control before introducing managerial accountability
- Operate a reliable accounting system before installing an integrated financial management system
- Budget for work to be done before budgeting for results to be achieved
- Enforce formal contracts in the market sector before introducing performance contracts in the public sector
- Have effective financial auditing before moving to performance auditing
- Adopt and implement predictable budgets before insisting that managers efficiently use the resources entrusted to them.\(^{14}\)