

SUMMARY FINANCIAL MANAGEMENT ASSESSMENT

A. Introduction

1. This financial management assessment was prepared in accordance with Asian Development Bank (ADB) guidelines on *Financial Management and Analysis of Projects*¹ and *Financial Due Diligence: A Methodology Note*.² ADB requires that, during loan preparation and processing, sufficient analysis is undertaken to enable an informed assessment that borrowers' financial management systems are, or will be, sufficiently robust to ensure that funds are used for the purpose intended and that controls will be in place to support project monitoring and supervision. This assessment considers the robustness of the government's public financial management (PFM) systems through which project funds will be channeled and the measures which are being taken to mitigate identified weaknesses. Consideration was given also to the application of ADB's policy on disaster and emergency assistance, with relevance to financial management matters.³

B. Proposed Financial Management Arrangements

2. The proposed emergency assistance loan (EAL) will provide immediate short-term financial support to the government to meet its additional financing gap arising linked to new spending initiatives under the government's Yolanda recovery and rehabilitation plan (YRRP) and other disaster-related public expenditures. The YRRP is expected to be endorsed by government in December 2013. The National Economic and Development Authority (NEDA) will prepare semi-annual YRRP monitoring reports, which will include data on program implementation and target achievement. The following monitoring mechanisms will be employed:

- (i) country PFM systems will be used for monitoring YRRP-related expenditures, which is consistent with ADB's commitment through, for instance, the Paris Declaration, to rely on country PFM systems;⁴
- (ii) a NEDA-led inter-agency coordination committee will be charged with monitoring and reporting responsibilities including public disclosure of information; and
- (iii) civil society organizations (CSO) will support efforts to monitor selected YRRP projects. ADB will coordinate with key CSOs on YRRP monitoring, including the Procurement Transparency Group (PTG) that was established in 2008 under the 2003 Procurement Reform Law. The PTG comprises six CSOs and is mandated to track government procurement, and publish results on its website. Technical assistance is planned to fund CSO monitoring of the YRRP in selected areas.

¹ ADB. 2005. *Financial Management and Analysis of Projects*. Manila.

² ADB. 2009. *Financial Due Diligence: A Methodology Note*. Manila.

³ OM D7 (Disaster and Emergency Assistance)/Bank Policies). "Standard ADB operational policies, including those on procurement, consulting services, financial management, and disbursement, should 'be liberally interpreted to ensure speedy and effective rehabilitation' in the case of emergency assistance." Para. 16.

⁴ ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank 2008-2020*. Manila. p. 23.

C. Previous Assessments

3. PFM arrangements have many strengths including the use of double-entry bookkeeping, a mixed cash-accrual accounting base, a cadre of well-trained accountants, and potential access to a large external pool of trained accountants. Nevertheless, earlier diagnostic studies identified issues including elevated risks of waste, diversion and misuse of funds; a weak internal control environment; weak cash management control; limited budget analysis; and conflict between the Commission on Audit's (COA) auditing and accounting roles.

4. The most recent comprehensive PFM assessment is the 2010 *Public Expenditure and Financial Accountability* (PEFA) assessment⁵ which, although based on 2007 information, remains generally valid, although some areas may be outdated due to implementation of PFM reforms. The findings for the six PFM dimensions were:

- (i) **Credibility of the budget.** Payment arrears were not high and comparisons of revenue forecasts and outturns were possible, but budget credibility was undermined by the difficulty of comparing appropriations to outturns.
- (ii) **Comprehensiveness and transparency.** The budget classification applied by the Department of Budget and Management (DBM) is reasonable, however both DBM and COA apply budget execution classifications that differ from the budget classifications. Other aspects of comprehensiveness and transparency were assessed as good, except for public access to key fiscal information which was deemed limited.
- (iii) **Policy-based budgeting.** The annual budget process was relatively orderly, but approval of appropriations was often delayed. And, while DBM incorporated a multi-year perspective into budgeting through a medium-term expenditure framework (MTEF), its usefulness in resource allocations was limited.
- (iv) **Predictability and control in budget execution.** With the exception of the treasury and procurement functions, other areas of budget execution were deemed weak; particularly payroll integrity, internal controls over non-salary expenditures, and internal audit.
- (v) **Accounting, recording, and reporting.** This was the weakest dimension. Accounts reconciliations were often not undertaken, comprehensive data on the provision of resources to service delivery units was not collected, departmental in-year budget reports were incompatible, and COA's annual consolidated financial statement was considered inadequate as departmental financial statements were based on pre-closing trial balances, among other things.
- (vi) **External scrutiny and audit.** The scope and quality of audit performed was deemed satisfactory and there was evidence of follow-up on audit recommendations. However, legislative scrutiny of external audit reports was lacking and there was no standing committee charged with audit.

⁵ World Bank. 2010. *Philippines, Public Expenditure and Financial Accountability*. Report No. 54584-PH. May.

5. In summary, the PEFA assessment identified the main PFM weaknesses as relating to budget credibility; public access to key fiscal information; predictability in the availability of funds; internal controls (payroll as well as non-salary expenditures); functioning of internal audit; accounting, recording and reporting; and, limited legislative scrutiny of external audit reports.

6. More recent assessments are generally consistent with the PEFA report's findings.⁶ These include a DBM-requested review of financial controls and accountability⁷, which concluded that (i) there is excessive fragmentation and inappropriate delegation of roles, responsibilities and separation of duties, and a lack of central oversight; (ii) many rules, procedures and organizational arrangements intended for control are overly complex to the extent of being ineffective and undermining achievements of their control objectives; and (iii) an explicit focus on risk is absent, and internal audit units do not (yet) have a risk-based approach.

7. These assessments are also fully in line with the 2011 ADB risk assessment and risk management plan, which was prepared as part of ADB's Philippines country partnership strategy (2011–2016)⁸ and which identified PFM risks involving (i) organizational capacity; (ii) budget formulation; (iii) budget execution; (iv) budget accounting and reporting; and (v) external audit and oversight.

D. Reform Initiatives

8. Reflecting concurrence on the above assessments, the government with development partner support, has developed, and is implementing, a comprehensive and coherent suite of PFM reforms to address identified issues and strengthen PFM arrangements.

1. Standalone Actions

9. First, several standalone actions and plans are targeted at specific PFM aspects: (i) internal audit—COA, DBM and the President's Office with support from ADB and AusAID are supporting, through a train-the-trainers program, the implementation of the 2011 Philippine government internal audit manual (PGIAM)⁹; (ii) performance monitoring—in December 2011, the government established an inter-agency task force to develop a unified and integrated Results-Based Performance Management System (RBPMS)¹⁰, which will be used as a basis for determining entitlement to performance-based allowances and incentives for personnel; (iii) expenditure oversight—Congress established in 2012 a Joint Congressional Oversight Committee on Public Expenditures; (iv) online submission of budget proposal system (OSBPS)—DBM in January 2013 introduced the OSBPS through which departments/agencies can enter budget data directly into DBM's system and make real-time submissions of their consolidated 2014 budget proposals, which is improving budget preparation processes, including data aggregation¹¹; (v) performance-informed budgeting (PIB)—DBM has introduced beginning in the 2014 budget process, requirements to incorporate results linkages in budget presentations¹²; and (vi) disbursement improvements—DBM in August 2013 announced fund-

⁶ AusAID. 2012. *Assessment of National Systems, Philippines*. p. 24.

⁷ World Bank. 2011. *Financial Control and Accountability in the Philippines*. Draft Final Report, 27 June (The report was based on a review of the existing policies and practices in DBM as well as selected line departments (DepEd, DPWH and the Armed Forces of the Philippines (AFP)).

⁸ ADB. 2011. *Country Partnership Strategy: Philippines, 2011–2016*. Manila.

⁹ DBM, Circular No. 2011-5, 19 May 2011.

¹⁰ Republic of the Philippines, Executive Order No. 80, 20 July 2012.

¹¹ DBM, National Budget Memorandum No. 115, 10-11 January 2013.

¹² DBM, National Budget Memorandum No. 117, 1 March 2013.

release reforms, which are expected to improve disbursement timeliness and enhance operational efficiency.

2. Good Governance and Anti-Corruption Cluster Plan: 2012–2016

10. Second, the government in January 2012 launched the *Good Governance and Anti-Corruption Cluster Plan 2012-2016*¹³ aimed at improving transparency, accountability, and citizen engagement. The plan includes several PFM-related items, including zero-based budgeting, enhanced civil society participation in budgeting, publication of a people's budget, provision to the public of more comprehensive information on funds disbursement by legislators, and publication of a statement of fiscal risks. The cluster plan has high-level support through the President's leadership.

3. PFM Reform Roadmap: 2011–2016

11. Third, the government in 2011 launched the *PFM Reform Roadmap for 2011-2016*,¹⁴ which aims to strengthen PFM arrangements, through six projects, including:¹⁵

- (i) **Budget reporting and performance management.** This project aims to harmonize budget and accounting classifications, simplify and consolidate formats for data collection, and apply a consistent set of accounting rules and regulations for generating financial reports. Planned activities include revising the chart of accounts,¹⁶ designing a common results-based reporting framework, and codifying laws, rules, regulations and processes in a new PFM manual. The aim is to make departments more accountable for using appropriations, and make oversight agencies more effective in ensuring that performance is in accordance with plans and policies. DBM and COA have developed a harmonized budget classification and unified account code structure (UACS),¹⁷ which has been rolled out for the 2014 budget formulation process. Budget execution (accounting and reporting) based on the UACS is to commence in January 2014, and preparations to enable this are on-going. Successful implementation of the UACS is essential to address the lack of integration between budgeting and accounting, and enabling proper financial reporting and monitoring. When implemented, the UACS will allow for accurate and timely reporting on appropriations, allotments, obligations and disbursements, which will help in streamlining and simplifying financial reporting, removing redundancies of reporting requirements between oversight agencies, and hence strengthening overall government accountability. The UACS is also a critical prerequisite for the GIFMIS implementation.

¹³ Government of the Philippines. 2012. *Good Governance and Anti-Corruption Cluster Plan: 2012-2016*. Manila.

¹⁴ The implementation of the Roadmap is overseen by a PFM Committee (Executive Order No. 55, 2011), which includes a comprehensive four-level governance set-up with participation of all four oversight agencies.

¹⁵ GIFMIS Committee. *Philippine Public Financial Management Reform Roadmap: Towards Improved Accountability and Transparency 2011 to 2015* (The other two projects are: Capacity Building (to build capabilities within the government as well as Congress, CSOs and other stakeholders for PFM reform implementation), and Management of Contingent Liabilities (developing a list of contingent liabilities to facilitate central monitoring and management of guaranteed loans)).

¹⁶ A chart of accounts usually covers all classification dimensions, but in the Philippines, COA has traditionally used the term as referring only to the object codes (assets, liabilities, equity, revenue/income and expenses), and hence not covering codes for funding source, organization, location and major final output (MFO)/program, activity, project (PAP).

¹⁷ Government of the Philippines. 2013. *Unified Accounts Code Structure Manual*. DBM-DoF-CoA Joint Circular No. 2013-1. 6 August.

- (ii) **Government integrated financial management information system (GIFMIS).** This project is intended to facilitate the phasing out of disintegrated financial management processes and systems through implementation of a common GIFMIS. It is to be implemented through a two-track approach: (a) Track I focuses on developing the comprehensive human resource information system (CHRIS), which is presently in the procurement stage. Also, new systems to enable online submissions by departments/ agencies of quarterly financial reports as well as performance indicator reports are being developed and are expected to be ready for March 2014 quarter reporting; (b) Track II is the design and development of GIFMIS, an integrated system for fiscal planning, budget preparation, budget execution, and financial reporting. As of October 2013, a comprehensive conceptual design for the GIFMIS had been outlined,¹⁸ functional and technical requirements specified, bidding documents prepared, and the procurement of a turn-key solution is on-going. The full GIFMIS is intended to be operational by 2016 with full roll-out completed by end-2017.
- (iii) **Treasury cash management operations.** This project seeks to improve treasury management through a treasury single account (TSA) to increase operational efficiency of departments while minimizing the cost of treasury operations by ensuring accurate data on bank account balances, revenue and cash positions, and fund utilization. The TSA is expected to become operational during 2014. The TSA implementation will involve the gradual closing of government bank accounts, consolidation of remaining bank accounts in the Bureau of Treasury.
- (iv) **Accounting and auditing reforms.** This project seeks to enhance the accounting system and new government accounting system (NGAS) as well as strengthen external audit capability and practices. Activities conducted so far include reviewing 25 Philippine public sector accounting standards (PPSAS), which have been harmonized with international public sector accounting standards (IPSAS), but have yet to be approved. Also, COA has developed and adopted Philippine public sector standards on auditing (PPSSA).

12. ADB has been supporting various aspects of the government's PFM reform program.¹⁹ Positive progress is being made. An interim stocktaking in mid-2013 shows tentatively that, while the government's PFM reforms have not yet had significant measured impacts on actual financial management performance, up to 7 of the 28 PEFA indicators may be expected to improve if/when the PEFA assessment is done in 2014.²⁰

13. Furthermore, recent improvements in PFM are, for example, highlighted in the Global Competitiveness Index, which for 2013 showed an improvement in scores related to the functioning of public institutions, including regarding ethics and corruption.²¹

¹⁸ AusAID-PFMP. 2013. *Report on Conceptual Design for Government Integrated Financial Management Information System (GIFMIS)*. PricewaterhouseCoopers Pvt. Ltd.

¹⁹ ADB support for PFM reforms which was approved in 2013 includes: (i) 47212: Strengthening Results-Based Human Resource Processes at the Department of Finance; (ii) 47113: Strengthening Treasury's Liquidity Management; and (iii) 44253: Local Government Finance and Fiscal Decentralization Reform Program.

²⁰ World Bank. 2013. *Philippines Public Expenditure and Financial Accountability (PEFA) Performance – Interim Stocktaking for PFM Reform Learning Conference and Planning Workshop (Tagaytay 6)*. pp. 3-7.

²¹ World Economic Forum. 2013. *The Global Competitiveness Report 2013-2014*. p. 315.

14. Nevertheless, the weak PFM systems described above—particularly less-than-effective budget execution (including internal controls over non-salary expenditures)—have done little to hamper high-profile cases of public funds’ diversions (for instance, revelations regarding the diversion of funds from the Priority Development Assistance Fund).

Table 1: Summary of Risk Assessment

15. Table 1, which is based on the PEFA dimensions, summarizes the assessment of pre-mitigation risks and relevant mitigating measures.

Risk type	Risk Assessment²²	Description	Mitigation Measures
Credibility of the budget	M	Budget credibility undermined by difficulty of comparing appropriations to outturns	Unified account code structure (UACS) to be introduced through budget reporting and performance management project under PFM Reform Roadmap for 2011-2016 Phased introduction of Government integrated financial management information system (GIFMIS) under PFM Reform Roadmap.
Comprehensiveness and transparency	S	Mismatched ex ante and ex post classification systems undermine analysis and transparency, but other aspects of comprehensiveness and transparency assessed as good	UACS introduction under PFM Reform Roadmap for 2011-2016
Policy-based budgeting	S	Annual budget process orderly, but delayed approval of appropriations and limited medium-term perspective	Introduction in 2014 of enhanced performance monitoring through unified and integrated Results-Based Performance Management System (RBPMS), implementation of online submission of budget proposal system (OSBPS), and performance-informed budgeting (PIB)
Predictability and control in budget execution	H	Budget execution is weak; particularly payroll integrity, internal controls over non-salary expenditures, and internal audit	Improvements to internal audit through train-the-trainers program, and the implementation of the 2011 Philippine government internal audit manual (PGIAM) Disbursement improvements through fund-release reforms (from 2013), which are expected to improve disbursement timeliness and enhance operational efficiency

²² H = High, S = Substantial, M = Moderate, N = Negligible or Low.

Risk type	Risk Assessment²²	Description	Mitigation Measures
Accounting, recording, and reporting.	S	Accounts reconciliations are often not undertaken, comprehensive data on resource provision to service delivery units not collected, in-year reports incompatible	Improved performance monitoring through RBPMS UACS and GIFMIS to support improved monitoring and reporting Project to enhance accounting through the new government accounting system (NGAS) as part of PFM Reform Roadmap Planned introduction under PFM Reform Roadmap of Philippine public sector accounting standards (PPSAS), which have been harmonized with international public sector accounting standards (IPSAS)
External scrutiny and audit	S	Scope and quality of audit satisfactory and evidence of follow-up on audit recommendations. But legislative scrutiny lacking	Establishment in 2012 of Joint Congressional Oversight Committee on Public Expenditures Strengthening external audit capability and practices as part of PFM Reform Roadmap, including COA's adoption of new Philippine public sector standards on auditing
Overall Risk	S		

16. Based on the assessments described, this assessment rates pre-mitigation PFM risk as substantial.²³

E. Conclusion

17. Although PFM risk is rated as substantial, this is considered acceptable given (i) the wide-ranging PFM reform program which the government has in place, indications of initial positive impacts, and additional measures which are proposed including monitoring arrangements; and (ii) flexibility regarding financial management arrangements under ADB's disaster and emergency assistance policy. In addition to the agreed measures, it is also proposed that, within 6 months of the effective date of the loan, the government will develop good governance mechanisms for implementing and monitoring the YRRP, in consultation with ADB. These mechanisms will include, among other things, public disclosure of information, audit, civil society monitoring, and a grievance redress mechanism.

²³ On a four-point scale of negligible, moderate, substantial, and high.