The Impact of Public Financial Management Interventions on Corruption

Ben French, Governance Advisor DFID-Pakistan
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Overview

1. In 18 out of 29 DFID Anti-Corruption and Counter Fraud strategies strengthening public financial management (PFM) is a central component of DFID country offices response to corruption and fraud. This focus is supported by research that identifies PFM reforms as some of the only anti-corruption reforms that are both effective and strongly supported by evidence. (Johnson, 2012) However, the linkages between PFM systems and effective Anti-Corruption measures have not been explored in detail. This paper, a product of a three week literature review, aims to explore these linkages by asking the questions: Which components of the PFM cycle are effective anti-corruption measures, and what types of corruption do they address?

2. To undertake this analysis the paper has established a framework as follows: for each PFM reform, the paper examines how this reform may change the opportunity, incentives and sanctions for corrupt acts within a PFM system. The paper then further divides this analysis between petty and grand corruption to take account of the very different nature of these two forms of corruption and how the PFM system, and the politics surrounding it, can impact on both forms of corruption. The main findings are:

    a) Improvements in PFM systems can only take reforms (both PFM and corruption related reforms) so far. In the end, political support is required for PFM reform to have a significant impact on corruption. Without it, PFM reforms will have a larger impact on petty corruption and this may not have a large impact on overall levels corruption within a country.
    b) It is important to consider the inter-linkages between reforms which can be mutually reinforcing (for example improvements in accounting and reporting and reporting and prosecution).
    c) Politics matter. Insufficient political support for reforms creates a permissive environment in which bureaucrats begin to undermine and bypass established (and, in the case of fragile states, nascent) PFM systems. But establishing political support takes time.

Background

3. The Independent Commission on Aid Impact reviewed DFID's approach to addressing corruption in November 2012 and found that DFID needed to take a more standardised view when addressing corruption. Since then, DFID has scaled up its focus on anti-corruption and counter-fraud activities, including the adoption of Anti-Corruption and Counter Fraud strategies in 29 of DFID's country offices. Out of these 29 strategies, 18 intend to strengthen public financial management (PFM) as a central part of their response. In this same period reviews of PFM programming have highlighted that while most PFM programmes implicitly assume an anti-corruption impact to their work, very few of these programmes explicitly identify the linkage between PFM reforms and corruption (The World Bank, 2012). This assertion is driven by on-going research that has identified that PFM reforms, including tax and procurement, as some of the only anti-corruption reforms that are both effective and strongly supported by evidence (Johnson, 2012).

4. The emphasis on PFM reforms in mitigating corruption is not surprising given the assumption that systemic weaknesses in a PFM system "…weak capacity, inadequate internal controls, limited transparency weak management and supervision, and weak external accountability in public spending" (Pradhan, 2007), create a permissive environment for corruption. Drawing on this and similar assumptions, PFM programmes therefore are often viewed as contributing to solving corruption. This paper, the product of a three week literature review, explores this linkage between PFM reforms and corruption, by asking the following two questions:

   a) Which components of the PFM cycle are effective anti-corruption measures?
   b) What types of corruption do they address?

5. In answering these question, this paper, highlights the aspects of the PFM cycle that are most important for tackling fraud and corruption, drawing out in the final section some of the pre-requisites for these reforms success. As much as possible the paper tries to consider examples from FCAS and from a broad range of sectors.

A framework for discussion

6. This section reviews the background theory for PFM and anti-corruption work, and establishes a simple, three-pronged framework through which the paper considers the impact of PFM reforms on corruption.

Definition of Corruption

Corruption is "…is the abuse of entrusted power for private gain." (Transparency International, 2013)

7. DFID follows the Transparency International definition of corruption and for the purpose of this paper the focus will be on the abuse of public power, as private sector corruption would fall outside the direct scope of PFM reforms. This paper further distinguishes between petty and grand corruption or bureaucratic and political corruption.

8. **Bureaucratic corruption** is process-based, occurring during the course of every day government activity. It is the form of corruption that has the most immediate impact on the day to day lives of people (e.g. getting electricity connected, accessing services, or obtaining an official document).

9. **Political corruption** is larger scale, more opaque and less reliant on day to day processes and more on the ability of the political elite to capture and use resources to benefit themselves or their networks (e.g. through the allocation of jobs, favourable contracts, or embezzlement of funds).

Addressing Corruption

10. Building on Klitgaard's 1984, DFID views corruption as a three element equation:

Corruption = Opportunity plus Incentive minus (absence of) Sanctions (Mason, 2012)

11. In order to address corruption action must be taken at all three points of the equation. The goal of anti-corruption interventions is to reduce opportunities for corruption. At the same time it is important to increase the likelihood of detection for corrupt activities, or to better reward good performance, thus reducing the incentive to act in a corrupt manner. Finally, there needs to be a consequence such as criminal, administrative or social sanctions for those who undertake corrupt activities into order to discourage corruption (Mason, 2012; Walters, 2013).

Public Financial Management

Public financial management (PFM) is "the system by which financial resources are planned, directed and controlled to enable and influence the

efficient and effective delivery of public service goals."
(Chartered Institute of Public Finance and Accountancy (CIPFA))

12. Table 1 sets out the key components of the PFM cycle that the paper will examine. To establish a common point of reference, the paper assumes that the expected outputs of a PFM reform programme will be the same as the DFID PFM theory of change.[1] Specifically, "fiscal discipline, strategic allocation of resources and operational efficiency in public spending are widely recognised as high level objectives of PFM" (DFID, 2012)[2].

13. It is important to note that the PFM theory of change recognises that external political, financial and policy factors alter the effectiveness of a PFM reform programme. The centrality of politics in PFM reform programmes is widely accepted by PFM experts. Past experience demonstrates that PFM reform programmes are not purely technocratic processes, but are extremely political and, without political commitment to reform, progress can be slow and unsustainable. (The World Bank, 2012)

Table 1: PFM Cycle aligned with PEFA Indicators

Stage in Budget Cycle	PEFA Indicator	Reform Measure
The mobilisation of revenue to fund expenditure	PI-13	Transparency of taxpayer obligations and liabilities
	PI-14	Effectiveness of measures for taxpayer registration and tax assessment
	PI-15	Effectiveness in collection of tax payments
	PI-16	Predictability in the availability of funds for commitment of expenditures
	PI-17	Recording and management of cash balances, debt and guarantees
	Other	Improved legal and fiscal framework for extractive industries revenue
The preparation of the budget to allocate resources to government priorities;	PI-5	Classification of the budget
	PI-6	Comprehensiveness of information included in budget documentation
	PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting
	PI-11	Orderliness and participation in the annual budget process
The execution of the budget (the raising and expenditure of money, including procurement);	PI-1	Aggregate expenditure out-turn compared to original approved budget
	PI-2	Composition of expenditure out-turn compared to original approved budget
	PI-3	Aggregate revenue out-turn compared to original approved budget
	PI-4	Stock and monitoring of expenditure payment arrears
	PI-18	Effectiveness of payroll controls

[1] http://dfidinsight/stellent/websites/insight_quest.asp?txtDocID=3920501
[2] http://epe-insight/pfm/Pages/Dashboard.aspx

Stage in Budget Cycle	PEFA Indicator	Reform Measure
	PI-19	Competition, value for money and controls in procurement
	PI-20	Effectiveness of internal controls for non-salary expenditure
	PI-21	Effectiveness of internal audit
The accounting and reporting of money spent;	PI-22	Timeliness and regularity of accounts reconciliation
	PI-23	Availability of information on resources received by service delivery units
	PI-24	Quality and timeliness of in-year budget reports
	PI-25	Quality and timeliness of annual financial statements
The audit of these accounts and evaluation of what the expenditure has achieved (including report to the legislature and public)	PI-7	Extent of unreported government operations
	PI-8	Transparency of inter-governmental fiscal relations
	PI-9	Oversight of aggregate fiscal risk from other public sector entities.
	PI-10	Public access to key fiscal information
	PI-26	Scope, nature and follow-up of external audit
	PI-27	Legislative scrutiny of the annual budget law
	PI-28	Legislative scrutiny of external audit report

Setting the framework for analysis

14. The analytical framework applied in this paper, brings together the definitions of anti-corruption, the process for how corruption is addressed, and the PEFA indicators set out in Table 1 above, to provide a structure through which to review the impact of PFM reforms on corruption. Each PFM reform is examined, as follows (adapted from Fjeldstad 2005):

    a) For each PFM reform, the paper will examine how this reform may change the opportunity, incentives and sanctions for corrupt acts within a country's PFM system.
    b) The paper will further divide this analysis between petty and grand corruption to take account of the very different nature of these two forms of corruption and how the PFM system, and the politics surrounding it, can impact on both levels.[3]

Linking anti-corruption and public financial management

[3] As noted in the introduction, this paper has been limited in its ability to undertake detailed research due to time constraints, and has thus been limited to a more theoretical analysis. Thus, while there is a wealth of research on the impact of PFM reforms, and on the impact of anti-corruption measures, there is only limited research that brings these two concepts together and looks at how they interact. This requires the paper to triangulate between the framework set out in the following section and the literature on PFM reforms and corruption to draw conclusions on how PFM reforms impact on corruption. A set of more robust findings could be achieved through a combination of an expanded evaluation of evidence and through a number of country case studies to test hypotheses and explore evidence gaps in a number of different contexts.

15. Building on Isaksen (2005), this section is structured on the PFM cycle as set out in Table 1. Each of the tables within the following section is colour coded.

Box 1: Understanding the colour coding

The colour scale represents a conservative assessment of the available evidence on what the impact of reforms against the associated PEFA indicators on corruption may be.

- Blue suggests weak, limited improvement.
- Orange suggests a moderate improvement that is dependent on political support.
- Green indicates a reform that can impact corruption with little to no political or external support.

The colour coding is not related to improvements in PEFA scores, although Annex 1 provides a short overview of the possible impact of a change in PEFA score on corruption.

Mobilisation of revenue to fund expenditure

16. Revenue mobilisation is an area of PFM that has received a great deal of attention, both from the perspective of revenue generation as well as corruption mitigation. Moreover, donors often view the accountability linkages between revenue raising and good governance as a central tenet of anti-corruption reforms. (Kolstad, 2008). Corruption in revenue generation spans the spectrum of corrupt practices, from bribery and extortion, to embezzlement and misappropriation. In general the favourable allocation of tax exemptions is part of a system of political patronage (grand corruption) while bribes for reductions in tax exposure tend to be a more common form of petty corruption. From a practical PFM reform point of view, there is significant evidence to suggest the importance of eliminating “complex tax and trade regimes – including multiple discretionary exemptions, confusing and non-transparent procedures for tax compliance and excessive discretionary power of tax inspectors – [which] increase opportunities for corruption in revenue collection…” (Pradhan, 2007).[4]

17. This focus means that when the various opportunities for reform in revenue mobilisation are examined for their impact on corruption there are a significant number of reforms that are able to both reduce the

[4] See also The World Bank, 2012 and Fjeldstad, 2013

opportunities for corruption – either through computerisation or simplification – while also increasing the likelihood of detection for corrupt activities. Table 3 provides a conservative assessment of the impact of reforms on corruption.

Table 3: Reform impacts on corruption for revenue mobilisation

Reform Measure		Impact of PFM reform	
		Petty Corruption	**Grand Corruption**
PI-13	Transparency of taxpayer obligations and liabilities	***Opportunity:*** reduced by simplifying the tax code and improving transparency and ease of understanding for the average citizen. ***Incentive:*** reduced through more taxpayer knowledge ***Sanction:*** no impact	***Opportunity:*** uncertain ***Incentive:*** reduced, better public information makes patronage more difficult. ***Sanction:*** no impact
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	***Opportunity:*** reduced through strengthened processes – using IT systems, removing individuals from handling cash, etc. ***Incentive:*** no impact ***Sanction:*** no impact	***Opportunity:*** uncertain ***Incentive:*** no impact ***Sanction:*** no impact
PI-15	Effectiveness in collection of tax payments	***Opportunity:*** reduced through strengthened processes – using IT systems, removing individuals from handling cash, etc. ***Incentive:*** better systems reduced the incentive for corruption by increasing the likelihood that a request for bribes will be detected. Stronger systems also reduce the incentive for tax fraud. ***Sanction:*** no impact	***Opportunity:*** reduced through better information management ***Incentive:*** no impact ***Sanction:*** no impact
PI-16	Predictability in the availability of funds for commitment of expenditures	n/a	n/a
PI-17	Recording and management of cash balances, debt and guarantees	***Opportunity:*** no impact ***Incentive:*** no impact ***Sanction:*** no impact	***Opportunity:*** reduced through improve legal process for entering into loans. ***Incentive:*** reduced, improved possibility of detection. ***Sanction:*** no impact
	Improved legal and fiscal framework for extractive industries revenue	***Opportunity:*** no impact ***Incentive:*** no impact ***Sanction:*** no impact	***Opportunity:*** reduced through improve legal process for use of revenues for resources. ***Incentive:*** reduced, improved possibility of detection. ***Sanction:*** no impact

18. The available evidence indicates that improvements in tax and revenue collection systems and processes (including reporting on revenues collected) can have an impact on corruption, especially petty corruption. Under the indicators for petty corruption, a clear trend, strongly supported in the literature (Fjeldstad, 2005; Le, 2007; Pradhan, 2007) is that improvements in systems, whether information management systems or organisation of tax codes, can facilitate a reduction in corruption. Such improvements tend to take effect through a reduction in opportunities for

corruption – as the public become increasingly aware of their obligation through a transparent and simplified tax code or as tax officials have less discretionary power in making decisions on tax exemptions (Zuleta, 2007).

19. In relation to grand corruption, the focus is more on the simplification and transparency of tax policy, and standardisation of the tax exemption process. These reforms shift the responsibility for revenue raising decisions from an individual politician to the Parliament.[5] The importance of strong political support for a simplified and standardised process is extremely important, as the experience of tax reforms in Georgia demonstrates. In Georgia a set of technical reforms led to the simplification of the tax code, and reduction in the opportunities for corruption. However, these reforms were only successful when there was also strong political support for the enforcement of tax reforms and sanctions for those who did not reform. (The World Bank, 2012) Box 1 outlines the role of independent revenue authorities.

Box 1: Independent Revenue Authorities

Across the anti-corruption literature there are a number of examples of revenue reform efforts, and these generally focus on the establishment of autonomous revenue authorities, aimed at addressing: "…rampant negotiations with tax officers; companies driven out of business by competitors who pay bribes in lieu of taxes; a company that sought clarification from on tax official only to be fined by another; a foreign enterprise that was hit with an enormous fine for a violation that did not existing, according to his attorney; and businesses that encounter unexplained re-assessments and penalties". (Fjeldstad, 2013)

In general the expectation of autonomous revenue authorities is that better pay and management gained through their separation from the civil service will improve delivery, allow for the simplification of revenue collection processes, thus improving compliance, reduce political interference for exemptions, and limit the opportunities for corruption. To date, this model has had mixed results with regard to its impact on corruption, with a wide range of countries seeking to establish revenue authorities (from Uganda, Georgia, Zambia, Bolivia, etc.). In the most successful cases (Georgia and Bolivia), reductions in corruption have been linked as much to political will as the simplification of processes. (Fjeldstad, 2013; The World Bank, 2012; Juan

[5] Morgner (2013) has noted that there is a risk that Parlimentarians will also unduly influence the law making process, for political purposes. However, there is a general consensus that the risk of corruption is reduced by broadening the accountability mechanism and the number of stakeholders involved.

Carlos Zuleta, 2007)

20. To summarise, the **findings in this section indicate that reforms to revenue collection can have a significant impact on petty corruption and a more limited impact on grand corruption (in an environment lacking effective enforcement).** A focus on simplification and formalising processes appears to be essential to PFM reforms limiting opportunities for corruption. At the same time, publication of information and increased awareness regarding the use and sources of government revenues (including a stronger legal framework for extractive industries and debt) can have an impact in limiting grand corruption.

Preparation of the budget to allocate resources to government priorities

21. The budget preparation and planning side of PFM is consistently identified as an aspect of the PFM cycle that plays an important role in reducing corruption (Johnson, 2012). A number of “cross-country studies show that countries with strong budget management and with greater participation of external stakeholders [civil society, parliament, etc.] in public spending decision making processes (i.e. through participatory budgeting) have lower CPI[6] scores” (Johnson, 2012), demonstrating correlation but not proving causation. Thus, although there is evidence of the impact of budget preparation, and especially in improving the transparency of budget preparation, its functional impact on either petty or grand corruption is less clear. As Table 4 sets out, reforms in the budget preparation and allocation do not seem to have a significant direct impact on corruption within Government.

22. Improved transparency in the budget process is expected to improve the ability of stakeholders in the budget process to limit the use of political power to allocate resources to pet projects, as a form of political patronage, or to allocate resources to contracts that have the potential for personal gain. (Morgner, 2013; Pradhan, 2007) Improved transparency of the budget consists of two key components, clear budget classification and for all expenditures to be reflected on the budget. It is generally acknowledged that a “robust budget classification enables more transparent information on government activities for reporting, control, audit, and ex post accountability for revenue collection and public spending” is an important aspect in improving the transparency of public

[6] CPI stands for the Corruption Perception Index. This is a composite index published by Transparency International that draws upon a combination of surveys and assessments of corruption, collected by a variety of reputable institutions. More detail can be obtained from: http://cpi.transparency.org/cpi2012/in_detail/

finances (Pradhan, 2007). However the actual evidence base to demonstrate linkages between improved transparency in public finances and a reduction is corruption is extremely limited.

23. Having noted this, there is some evidence to suggest that improved access to information is an effective tool for reducing corruption (Le, 2007); this evidence is not by itself particularly robust when compared to the evidence for tax and procurement reforms. (Johnson, 2012) This highlights the importance of the final PEFA indicator under this heading, the orderliness of the budget preparation process. An orderly and timely budget preparation process should limit the opportunities for both petty and grand corruption in the budget formulation process by introducing a structured set of checks and balances into the preparation process. These checks and balances consist of executive and legislative review of the budget, as well as consultation with regional government and civil society. (Isaksen, 2005; Pradhan, 2007).

24. As Isaksen (2005) notes, “in many - if not most - countries there is little time for scrutiny. The preparation and adoption of the budget is a considerable amount of work. Deadlines are set in legal forms and delays will lead to stops in e.g. civil servant salary payments. When delays occur in the earlier phases, the great urgency to have the budget adopted in a timely manner will often lead to a shortened time for legislative scrutiny…” (Isaksen, 2005).

Table 4: Reform impacts on corruption for budget allocation

Reform Measure		Likelihood of reform reducing the following forms of corruption	
		Petty Corruption	**Grand Corruption**
PI-5	Classification of the budget	***Opportunity:*** no impact ***Incentive:*** reduced, improved possibility of detection through better budget classification – making it difficult to divert funds from one budget to another. ***Sanction:*** no impact	***Opportunity:*** no impact ***Incentive:*** reduced, as better information increases possibility of detecting patronage based allocations. ***Sanction:*** no impact
PI-6	Comprehensiveness of information included in budget documentation	***Opportunity:*** no impact ***Incentive:*** reduced, improved guide to improved accounting later in the budget cycle. ***Sanction:*** no impact	***Opportunity:*** no impact ***Incentive:*** reduced, as better information on budget expenditures (a reduction in off-budget expenditure items) increases possibility of detecting patronage based allocations. ***Sanction:*** no impact
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	***Opportunity:*** no impact ***Incentive:*** no impact ***Sanction:*** no impact	***Opportunity:*** no impact ***Incentive:*** reduced, as better information increases possibility of detecting patronage based allocations. ***Sanction:*** no impact
PI-11	Orderliness and participation in the annual	***Opportunity:*** reduced, a more structured process limits opportunities for embezzlement	***Opportunity:*** reduced, a systematic, structured and orderly budget preparation

Reform Measure		Likelihood of reform reducing the following forms of corruption	
		Petty Corruption	**Grand Corruption**
	budget process	and misappropriation of funds. ***Incentive:*** reduced, a structured and orderly budget preparation process ensures the inclusion of detailed budget information, providing an effective link to better accounting practices in the budget execution stage. ***Sanction:*** no impact	process ensures effective legislative and public oversight of the budget and thus reduces opportunities for patronage based corruption ***Incentive:*** reduced, as better information increases possibility of detecting patronage based allocations. ***Sanction:*** increased, as a timely budget can be thoroughly reviewed in parliament.

25. This section **finds that the relationship between reforms in budget preparation and planning and corruption is focused on reducing grand corruption, but that its impact is unlikely to be significant**. This finding is based on the assumption that improvements in information management and the process of budget preparation "…has the potential to reduce ineffective spending and, potentially also opportunities for corruption, by eliminating spending pressures at the end of the fiscal year and creating more predictability." (Morgner, 2013) This is by no means a certainty, and a focus on the elimination of influence trading and political lobbying in the budget process does not appear to be something that technocratic reforms can significantly impact on, only political will and a willingness to prosecute. After all, there are examples from every western country of political lobbying in the budget, or 'pork-barrel' spending. (Glenn T. Ware, 2007; Morgner, 2013) It is important to note that the evidence that supports these assumptions is not nearly as comprehensive as the evidence base for taxation, procurement or accounting reforms.

Box 2: Service delivery in DRC

For a decade or more, service delivery and corruption in the Democratic Republic of the Congo (DRC) has been a locus of attention from donors, who fear that the lack of service provision has significantly undermined the basic accountability relationship and legitimacy of the state with the population. Donors have sought to work with the Government of DRC to address these challenges by supporting the development of the "long route of accountability and their [donor] focus has been on the state as the provider" (Pearson, 2011).

Overcoming corruption and misappropriation has been a key area of focus as part of this reform process. It is also viewed as a way of addressing serious allocation shortfalls to key service delivery sectors. For example, in 2010, just under seven per cent of the budget was allocated to education, and under six per cent to health. Of these amounts only 59 per cent was disbursed in education, and only 25 per cent was disbursed for health. Corruption played a large part in these shortfalls (REF). Sector-level reforms have been used as an entry point to address these issues, with donors focusing on supporting sector budgets through payroll reform, and strengthening the functioning of service delivery institutions.

Key reforms have focused on reducing the opportunities and incentives for corruption, by strengthening the transparency within the service delivery sectors, and providing a feedback mechanism to local communities on how funds are spent. Beyond improving access to budget information efforts have been made to strengthen the budget execution cycle by "reducing exceptional procedures that harness the limited amount of resources available from the national budget" (Baudienville, 2012). Beyond this, efforts have been made to further strengthen the federal-state transfer mechanisms to limit the loss of funds due to corruption, and reduce the incentives at the state level for officials without legal jurisdiction charging informal taxes for service provision.

Unfortunately, there is general agreement that the reform process in DRC still requires stronger political support to increase the transparency and effectiveness of service delivery and reduce corruption in these key sectors.

(Adapted from Pearson, 2011; Baudienville, 2012)

The execution of the budget

26. Box 2 links together reforms in budget formulation and budget execution to identify opportunities to limit corruption. As the evidence from DRC demonstrate budget execution reforms are extremely important to limiting corruption. Budget execution is the broadest aspect of the budget cycle considered in this paper and along with revenue raising (taxation), the area where there is the greatest risk of corruption. (Fjeldstad 2008) There is a strong evidence base that finds that the absence of controls on spending, the procurement of goods, the storage of equipment and the absence of a segregation of duties in expenditure significantly increases the risks of corruption, and limits the ability to detect corrupt practices (Pradhan, 2007; Zuleta, 2007; Chene, 2009). Bill Dorotinsky and Shilpa Pradhan identify the vulnerabilities that increase the risk of corruption during budget execution as "…weak internal controls and weak management control and oversight of public spending. Internal controls include payroll controls, non-payroll expenditures controls, and internal audits that increase the possibility of detection and reduce incentives for engaging in fraudulent activities…" (Pradhan, 2007) Annex 2 contains a list of different systemic issues in the budget execution processes that can lead to corruption.

27. Table 5 sets out the impact of various PFM reform measures on corruption during the budget execution phase of the budget cycle. Within the broad category of budget execution, it is worth flagging two important areas where the risk of corruption is identified as significantly higher than any other stage in budget execution within the literature. These areas are public procurement and the payroll, (Pradhan, 2007) and in line with this, the reforms that have the greatest potential impact on corruption are related to payroll strengthening and the improvements of the public procurement systems. This is broadly linked to the fact that both of these processes normally involve significant financial flows, and can be systemised to break the link between payment authorisation and payment by the cashier.

28. **The first finding of this section is that shifting salary payments towards automated payments directly into bank accounts, while not completely removing the opportunity for corruption (specifically skimming, embezzlement and extortion), can significantly decrease the opportunity for this to take place.** This functions by reducing the opportunity for corruption in the payment process while increasing the risk of detection through more detailed pay sheets and processes, and a permanent paper trail. (Pradhan, 2007)

Table 5: Reform impacts on corruption for budget execution

Reform Measure		Likelihood of reform reducing the following forms of corruption	
		Petty Corruption	**Grand Corruption**
PI-1	Aggregate expenditure out-turn compared to original approved budget	***Opportunity:*** no impact ***Incentive:*** no impact ***Sanction:*** no impact	***Opportunity:*** reduced, spending that is closely aligned to the original approved budget limits the opportunities for in-year patronage based allocations of resources and the embezzlement of funds. ***Incentive:*** no impact ***Sanction:*** no impact
PI-2	Composition of expenditure out-turn compared to original approved budget	***Opportunity:*** reduced, spending that is generally in line with original expenditure classifications can reduce the opportunities for the misappropriation and embezzlement of funds. ***Incentive:*** no impact ***Sanction:*** no impact	***Opportunity:*** reduced, spending that is generally in line with original expenditure classifications can reduce the opportunities for the misappropriation and embezzlement of funds. ***Incentive:*** no impact ***Sanction:*** no impact
PI-3	Aggregate revenue out-turn compared to original approved budget	***Opportunity:*** reduced, provides an indication that revenue has not been misappropriated. ***Incentive:*** no impact ***Sanction:*** no impact	***Opportunity:*** no impact ***Incentive:*** no impact ***Sanction:*** no impact

Reform Measure		Likelihood of reform reducing the following forms of corruption	
		Petty Corruption	**Grand Corruption**
PI-4	Stock and monitoring of expenditure payment arrears	***Opportunity:*** reduced, a large in-year stock of arrears has the potential to increase the opportunity for corruption through bribes and extortion for favourable treatment of claims ***Incentive:*** reduced, as above. ***Sanction:*** no impact	***Opportunity:*** reduced, a large in-year stock of arrears can be used as an opportunity for political corruption in favouring the payment of claims based upon patronage networks ***Incentive:*** reduced, as above. ***Sanction:*** no impact
PI-18	Effectiveness of payroll controls	***Opportunity:*** reduced, a transparent, effective, electronic, audited and well managed payroll system has the potential to greatly reduce the opportunities for corruption - increasing the likelihood of detection. Examples - electronic transfer to banks, etc. ***Incentive***: reduced ***Sanction:*** increased	***Opportunity:*** reduced, an improved payroll system with clear controls for appointment, etc., can limit opportunities for patronage based political corruption. ***Incentive:*** reduced ***Sanction:*** no impact
PI-19	Competition, value for money and controls in procurement	***Opportunity:*** reduced, a transparent, structured and competitive procurement system reduces the opportunities for bribery and embezzlement throughout the procurement process ***Incentive:*** reduced, officials are separated from the process thus have less to gain. ***Sanction:*** increased, detection of fraud (misappropriation, collusion, etc.) are more likely	***Opportunity:*** reduced, a transparent, structured and competitive procurement system is less open to political influence ***Incentive:*** reduced, a competitive procurement process should increase the likelihood of detection of politically motivated contracts.. ***Sanction:*** increased, detection of fraud (misappropriation, collusion, etc.) is more likely in a formal and structured procurement system.
PI-20	Effectiveness of internal controls for non-salary expenditure	***Opportunity:*** reduced, an effective accounting system should reduce the opportunities for corruption through a reduction in cash transfers, and increased checks and balances. ***Incentive:*** reduced, a strong accounting system should make the detection of corruption more likely thus reducing the incentive to undertake corrupt practices - likely to be embezzlement. ***Sanction:*** increased, detection of fraud (misappropriation, collusion, etc.) is more likely.	***Opportunity:*** reduced, through fewer opportunities to handle and influence cash allocations ***Incentive:*** reduced, increased possibility of detection of politically motivated uses of funds. ***Sanction:*** no impact
PI-21	Effectiveness of internal audit	***Opportunity:*** no impact ***Incentive:*** reduced, an effective internal audit process increases the possibility of detection of fraud. ***Sanction:*** increase, it will also increase the likelihood of being sanctioned for embezzlement and misappropriation on a small scale.	***Opportunity:*** no impact ***Incentive:*** no impact ***Sanction:*** no impact

29. Ware (2007)'s paper provides a comprehensive overview of the challenges related to public procurement, the key finds of which are set out in Box 3. It indicates that the key difficulty with public procurement is that it tends to involve a limited number of high-value contracts that are politically important and require the discretion of individuals (e.g. people who can be influenced) in the decision making process. (Ware, 2007). In

this way reforms to the procurement process tend to focus on reducing or limiting the opportunities for corruption, but they cannot remove them entirely. At the same time reforms can reduce the incentives for corruption by strengthening the audit trail and processes by which goods, works and services must be procured.

30. Thus, the **second finding of this section is that changes to the procurement process can, on a small scale, limit petty corruption in procurement, mitigating against issues such as kickbacks and bid rigging** (Kolstad, 2008). However, when considering grand corruption and large scale petty corruption, only political will, and the strengthening of sanctions, appear to significantly impact on corrupt procurement practices. (Ware, 2007; The World Bank, 2012)

Box 3: Corruption in Procurement

Ware, et. al. (2007) set out the following classification of corruption within the procurement system. Within these forms of corruption it is possible to see where improvements in processes would limit petty corruption, but would not remove the incentive to participate in grand corruption.

- **Scheme 1 Kickback Brokers:** A person who manages the payment of fees in large public procurements (who may appear to be the local representative of a company). Their role is to ensure that payments are made to facilitate the winning bid.
- **Scheme 2 Bid Rigging:** the manipulation of public procurement to secure a favourable outcome for one supplier or a group of suppliers.
    - Bid-suppression: collusion or coercion amongst bidders to ensure there is only one competitive bid;
    - Complementary bidding: collusions amongst bidders and possibly officials to submit token bids that are intentionally higher than the winning bid (payments will then be made to the token bidders);
    - Bid rotation: agreement amongst bidders to cycle bids amongst regular contracts to win;
    - Market allocation: dividing up areas of work amongst suppliers to limit completion;
    - Low-balling: collusion with public official to establish a low contract price that is then revised upwards after winning.
- **Scheme 3 Front or Shell Companies:** the use front or shell companies allows officials to participate in the process of bidding – usually done in conjunction with other types of bid rigging to ensure the winning company is connected to the official concerned.
- **Others forms of procurement fraud:**

- Misrepresentation of facts where public officials collude with bidders to misrepresent the facts of the actual tendering process and thus favour one supplier.
- Splitting of bids to keep the contracts small thus excluding larger suppliers from bidding, or enabling smaller suppliers to bid for multiple contracts.

Adapted Ware, 2007

31. Reforms to budget execution processes, whether on for example procurement, payroll, non-salary payments., tend to focus on a number of areas which aim to reduce the opportunities for corruption by shifting towards electronic processes where possible, and improving flexibility by reducing the number of steps within the process (Pradhan, 2006; Zuleta, 2007; Ware, 2007). Paying salaries directly into bank accounts is one example of this. Another would be the electronic payment of suppliers, thus removing the opportunities for petty corruption amongst officials handling the payments. At the same time, a focus on improving record keeping and strengthening checks and balances can help remove the opportunity and incentive (through increasing the likelihood of detection) for politically motivated allocation of expenditures. Transparency and the publication of information also plays an important role in procurement (Ware, 2007), payroll and budget reporting (Chene, April 8, 2009), in increasing the risk of detection and thus removing the incentive to undertake corrupt practices, especially political corruption related to embezzlement and misappropriation.

32. This section has drawn on a reasonably extensive evidence base, highlighted the linkages between payroll and procurement reforms and reducing corruption. **It finds that reforms aim to reduce the opportunities for corruption by improving the use of electronic systems and removing 'humans' from the decision making and payment processes.** With regard to procurement, this will always be an area for political corruption, and even more so in fragile and conflict affected states where the need to allocate patronage requires large and often bulky payments. However, corruption in procurement and within other areas of budget execution can be dis-incentivised through improved transparency of information. Though it is unlikely that a significant shift will occur without an improvement in enforcement mechanisms, as has been noted, "generally the less capacity a country has to prevent, detect, and punish corruption – through checks and balances, controls, and monitoring and enforcement of laws and regulations more broadly – the greater the likelihood of corruption." (Ware, 2007)

Accounting and reporting of money spent

33. Accounting and reporting on expenditure is often viewed as a very technical process. However, strengthening public accounting and reporting systems is extremely important if the legislature and the public wish to hold the government to account for expenditures. As noted by Pradhan (2007) "corruption during the budget execution stage is often [only] detectable through strong account and reporting systems, especially if computerised with integrated financial management information systems [IFMIS] or a management information system (MIS)." In part, these reforms impact corruption because they lead to the identification of corrupt practices and the misapproriation of funds (Chene, 2009; Morgner, 2013; Pradhan, 2006; Pradhan, 2007). Timely and accurate reporting of information that is acted upon and enforced by a strong parliament and judicary can signficantly diminish the incentives for corruption, and signficantly increase the likelihood and sanctions for being caught. Due to the reliance on third parties and the application of sanctions, Table 6 finds that the impact of accounting reforms on corruption is relatively limited. The role of sanctions is emphasised in this section, more so than for procurement, budget execution or tax, due to the inability of accounting process changes (e.g. electronic payments, or computerised tax systems) to remove the opportunities for corruption. Accounting reforms do increase the potential for corrupt practices to be identified, but the threat of sanctions is required to reduce corruption.

34. In summary, this section finds that **improvements to account and reporting systems impact on corruption by increasing the transparency of the PFM system and thus increasing the likelihood of detection.** However, these findings are based on a limited evidence base, noting that improvements in the accounting and reporting systems, especially focused on ensuring timely reports to parliament, remain a central part of the PFM system and are integral to any anti-corruption effort. Without reforms in the accounting systems, corruption during the budget execution phase, as noted above, is unlikely to be detected. It is also worth noting that reforms to the accounting processes make government information clearer and more accessible, thus improving the ability of a larger audience to monitor and check on government preformance (Ivar Kolstad, 2008).

Table 6: Reform impacts on corruption for accounting and reporting

Reform Measure	Likelihood of reform reducing the following forms of corruption	
	Petty Corruption	Grand Corruption

Reform Measure		Likelihood of reform reducing the following forms of corruption	
		Petty Corruption	Grand Corruption
PI-22	Timeliness and regularity of accounts reconciliation	***Opportunity***: no impact ***Incentive:*** reduced, effective accounting processes should increase the likelihood of detection, thus reducing the incentives for embezzlement in day to day government functions ***Sanction:*** no impact	***Opportunity:*** no impact ***Incentive:*** reduced, account reconciliation should improve the identification and detection of corruption and specifically embezzlement for patronage ***Sanction:*** no impact
PI-23	Availability of information on resources received by service delivery units	***Opportunity:*** no impact ***Incentive:*** reduced, transparent and regular publication of resources should, in theory, improve the ability of service delivery units, and recipients to hold delivery units to account for the delivery of services - thus reducing petty corruption. ***Sanction:*** no impact	***Opportunity:*** no impact ***Incentive:*** reduced, transparent and regular publication of resources should, in theory, reduce the political desire to engage in patronage based allocations of funds ***Sanction:*** no impact
PI-24	Quality and timeliness of in-year budget reports	***Opportunity:*** no impact ***Incentive:*** no impact ***Sanction:*** no impact	***Opportunity:*** no impact ***Incentive:*** reduced, at the executive level regular reporting can help identifying misappropriation of funding toward patronage driven priorities. ***Sanction:*** no impact
PI-25	Quality and timeliness of annual financial statements	***Opportunity:*** no impact ***Incentive:*** reduced, good reporting increases the possibility of detection. ***Sanction:*** increased, high-quality and timely financial statement permit national legislatures and the public to increase oversight over the use of funds by the government. This may increase the possibility of punishment for petty corruption.	***Opportunity:*** no impact ***Incentive:*** reduced, timely annual financial statements and report can help to identify misappropriated funding and thus increase the risk that patronage based corruption will be sanctioned. ***Sanction:*** increased, as better reporting increases the possibility of punishment for grand corruption.

Audit of accounts and evaluation of what the expenditure has achieved

35. The final stage of the PFM cycle involves the external audit, review and reporting on government expenditure to the legislature and public. Although being similar to, and dependent on, the accounting stage of the PFM cycle (in the sense that corruption can only be reduced through threat of sanctions rather through changes in processes to reduce the opportunities for corruption) the paper finds that a strong audit and evaluation function, especially if linked to a publication and dissemination process can significantly discourage corruption. (Pradhan, 2007; Johnson, 2012)

36. Table 7 sets out the mechanisms through which the audit and reporting on government expenditure impact on corruption are varied. However, the key aspect tends to be ensuring full and accurate disclosure of information. The more information that is not presented publicly increases the opportunities for both petty and grand corruption. As is noted by

Jesper (2012), research demonstrates that, “that control and sanctions have an effect on an individual’s inventive to be corrupt. Principles such as transparency, accountability and completion – and specific incentives such as whistleblowing – have been documented to work if the right preconditions were present.”

37. An initiative in East Timor provides a very positive example of making every effort to provide clear, up-to-date, and easy access to public information through a ‘transparency portal’. An internet based system publishes information on government expenditure on procurement and is updated every 24 hours with the latest data. The review and audit of this important information, as well as debates in parliament, may provide an effective check on officials who undertake corrupt practices. (Pradhan, 2006)

38. Unfortunately, the publication of information is seldom sufficient to stop all forms of corruption, especially political corruption which may be benefiting a large group of people through various patronage networks. Some of the barriers to effective review of government expenditure reporting are:
- The lack of technical and administrative capacity within parliament;
- Excessive fragmentation of funds and accounting procedures (complicating the reporting process);
- Delays in the production of audit reports (for example in Pakistan where until 2012 the public accounts committee was over 15 years behind in reviewing audit reports), and;
- Non-compliance with audit reports once published. (Morgner, 2013; Pradhan, 2006)

Table 7: Reform impacts on corruption for audit and evaluation

Reform Measure		Likelihood of reform reducing the following forms of corruption	
		Petty Corruption	**Grand Corruption**
PI-7	Extent of unreported government operations	***Opportunity:*** reduced, a high degree of unreported government operations increases the opportunity for corruption - specifically misappropriation and embezzlement ***Incentive:*** no impact ***Sanction:*** no impact	***Opportunity:*** reduced, a high degree of unreported government operations increases the opportunity for corruption - specifically patronage based allocations, misappropriation and embezzlement ***Incentive:*** no impact ***Sanction:*** no impact
PI-8	Transparency of inter-governmental fiscal relations	***Opportunity:*** no impact ***Incentive:*** no impact ***Sanction:*** no impact	***Opportunity:*** reduced, Increases in the transparency and regularity of inter-governmental transfers can limit patronage based corruption, and serious misappropriation ***Incentive:*** no impact ***Sanction:*** no impact

PI-9	Oversight of aggregate fiscal risk from other public sector entities.	n/a	n/a
PI-10	Public access to key fiscal information	***Opportunity:*** no impact ***Incentive:*** reduced ***Sanction:*** increased, increased public access to information can increase the likelihood of sanction for the miss-use of public funds	***Opportunity:*** no impact ***Incentive:*** reduced ***Sanction:*** increased, increased public access to information can increase the likelihood of sanction for the miss-use of public funds
PI-26	Scope, nature and follow-up of external audit	***Opportunity:*** no impact ***Incentive:*** reduced, a detailed and extensive external audit will help in identifying potential corrupt practices (specifically misappropriation and embezzlement) which may lead to sanctions ***Sanction:*** increased	***Opportunity:*** no impact ***Incentive:*** reduced, a detailed and extensive external audit will help in identifying potential corrupt practices (specifically embezzlement and patronage) which may lead to sanctions ***Sanction:*** increased
PI-27	Legislative scrutiny of the annual budget law	***Opportunity:*** no impact ***Incentive:*** no impact ***Sanction:*** no impact	***Opportunity:*** no impact ***Incentive:*** no impact ***Sanction:*** no impact
PI-28	Legislative scrutiny of external audit report	***Opportunity:*** no impact ***Incentive:*** no impact ***Sanction:*** increased, a detailed review of the external audit report may increase the likelihood of sanctions for embezzlement and misappropriation	***Opportunity:*** no impact ***Incentive:*** no impact ***Sanction:*** increased, a detailed review of the external audit report may increase the likelihood of sanction for embezzlement and patronage based reallocation of funds

39. To summarise, this section finds **that audit and reporting on government expenditure can function as an effective check on corruption**. This occurs when information is transparently presented and reviewed, creating a negative incentive for officials to act in a corrupt manner by increasing the likelihood of the detection of corruption. For this function to be effective, however, it is important that the government is clearly reporting financial information, in a comprehensive and understandable manner. Moreover, in supporting activities of the audit chamber and the parliament, through the public accounts committee, awareness of the political dynamics at play is critical in ensuring that support for improved transparency does not become a destabilising factor in conflict affected environments.

Conditions for successful reform

40. The previous sections have examined the relationship between PFM reforms and corruption. This section places these reforms in the wider country political context, drawing on lessons from both PFM and anti-corruption literature to identify key criteria necessary for a PFM reform process to take hold and have a durable impact on corruption. It finds that, **the willingness and support of the political elite is vital to a strong PFM based anti-corruption push**. (The World Bank, 2012)

41. Within the anti-corruption literature it is recognised that corruption plays both a stabilising and destabilising role, especially in situation of conflict and immediate post-conflict, depending on how corruption is organised. (Stabilisation Unit, 2012; Zaum, 2012). The organisation of corruption[7] is inherently political, and any changes to its organisation will likely impact on a country's politics and state-society relations, and thus political stablitiy within a country.

42. Equally PFM reforms are also inherently political and highly dependent on political will for their implantation. The 2012 World Bank "Synthesis Report on Public Financial Management Reform in Conflict Affected and Fragile States" highlights three key requirements for successful PFM reforms:

    a) Strong political will, commitment and support by the national government;
    b) Adaptation of 'best practices' to the specific context in the country, and;
    c) Domestic ownership of the reform process, including the parliament and the public (civil society, business, media). (The World Bank, 2012)

43. This brief review of the literature underscores the both the role of politics in PFM and anti-corruption reforms as well as the impact of both PFM and anti-corruption reforms on politics. (DFID, 2010) These reforms are inherently political, and thus politics must be considered when considering the role of a PFM reform on corruption. This means, that the impact of PFM reforms on corruption cannot be viewed as a purely technocratic process. Instead these reforms influence and are influenced by a countries political climate. Reforms to a PFM system are more likely to have an impact on corruption when they are undertaken in a political environment that is supportive of both the reforms and of sanction for corrupt acts. (Pradhan, 2007; Fjeldstad, 2005) Moreover, political support also helps to break the linkages between petty corruption and grand corruption, by encouraging behavioural change in the civil service and a stronger anti-corruption ethos (Zuleta, 2007; Pradhan, 2007; DFID, 2010; DFID, 2012; Fjeldstad, 2005).

Emerging Messages

[7] Zaum (2012) has noted that in general, centralised corruption, "where a small ruling elite effectively 'captures' the state, controls key resources, and dispenses patronage" can create political and social stability for a limited – albeit in some cases quite lengthy – period of time. On the other hand decentralised corruption "where a divided political elite competes for access to power and control over resources" can be extremely destabilising.

Box 4: Key Messages

- Analysing the anti-corruption impact of PFM reform based upon a framework of petty and grand corruption, and opportunities, incentives and sanctions creates an effective analytical link between these two key reform areas.
- Improvements in PFM systems can only take reforms (both PFM and corruption related reforms) so far. In the end, political support for sanctions is required for PFM reform to have a significant impact on corruption.
- Without political support PFM reforms will have a larger impact on petty corruption and will not impact on grand corruption, which is influenced more by sanctions against corrupt behaviour than changes to the opportunities and incentives for corruption.
- It is important to consider the inter-linkages between reforms which can be mutually reinforcing (for example improvements in accounting and reporting and reporting and prosecution).
- Politics matter. Insufficient political support for reforms creates a permissive environment in which bureaucrats begin to undermine and bypass established (and, in the case of fragile states, nascent) PFM systems. But establishing political support takes time.

44. The preceding sections have reviewed the relationship between PFM reforms and their impact on corruption. Each section has sought to establish how reforms to PFM systems change the opportunities, incentives and sanctions for corruption. It is important to stress that no PFM system is perfect, being only as strong as its weakest link (Pradhan W. D., 2007). At the same time, improvements to PFM systems do not necessarily lead to stronger states and to a reduction of corruption. The remainder of this section sets out the papers core findings.

45. **This paper finds that the distinction between petty and grand corruption is important. PFM reforms are far more likely to reduce the opportunities for petty corruption than to impact on grand corruption.** This is due to the more important role played by sanctions in limiting and reducing grand corruption, as aspect of anti-corruption measures that PFM reforms appear to have the most limited impact on. Although there are some aspects of PFM reforms that increase the opportunities for sanctions to be applied, to a very significant extent, the final application of sanctions is a political decision outside the influence of PFM reforms.

46. The case of Afghanistan highlights this point and importance of understanding the role of corruption in centralising power. In Afghanistan "…substantial progress on PFM reforms on the one hand has been

associated with virtually no progress on government effectiveness or control of corruption on the other hand." (The World Bank, 2012) This case highlights how PFM reforms have supported a centralisation of corruption and an increase in grand corruption, even as PFM systems have improved to limit petty corruption.

47. **Addressing only petty corruption is insufficient.** Mason 2012 highlights that to meaningfully address corruption issues of both petty and grand corruption must be effectively resolved to reduce corruption. Moreover, given the linkages between petty and grand corruption, it is difficult to expect technical reforms to lead to a reduction in a country's overall level of corruption where other factors are equally important in driving it (culture and history for example). (Isaksen, 2005; Kolstad, 2008)

48. **Linkages between PFM reforms and other legal reforms greatly impact the ability of a government to limit or reduce corruption.** Examples of these links are: the accounting and reporting functions, the link between a strong budget classification and budget reporting, and more widely the importance of strengthening the government's ability to prosecute corruption while also strengthening its ability to detect corruption. A number of authors have noted that without an effective enforcement system, no amount of improvement in detection or reduction in opportunities will prevent corruption, especially grand corruption. (Glenn, 2007; Mason, 2012)

49. **Reforms take both time and political commitment.** PFM reforms are increasingly identified as long term processes, even technical ones. Moreover, the PFM reforms that appear to have had the greatest impact on corruption have focused not only on improving technical processes but also on behaviour change (i.e. procurement practices), which can take a generation. Transparency International reports that anti-corruption efforts in post-conflict countries suggest that marked, but modest, progress can be achieved over a decade (Stabalisation Unit, 2012). This estimate seems reasonable based upon the review of examples within this paper – for example Bolivia's tax reforms. (Zuleta, 2007)

50. Finally, it is worth noting that the framework applied in this paper, linking PFM reforms, through the PEFA indicators, to corruption, through a matrix of opportunities, incentives and sanctions for petty and grand corruption provides an effective analytical link between these reforms in these two mutually reinforcing areas. Moreover, it provides a useful tool through which DFID country offices can use to consider the impact of PFM reforms on corruption. But, it is important to stress that PFM reforms only address

corruption in the PFM sphere of influence, corruption on a wider scale must be addressed different[8].

Conclusions

51. This paper has attempted to systematically review the linkages between PFM reforms and corruption. Drawing on a variable evidence base, the paper's findings emphasise the role of PFM reforms in reducing the opportunities and incentives for corruption, over the impact of these reforms on increasing the effectiveness of sanctions. The strongest evidence supported a link between those reforms that change how money flows, such as tax and budget execution reforms, and corruption. The evidence was less conclusive regarding the role of PFM reforms on nepotism and patronage based corruption. These reforms focused on improving budget preparation, accounting and audit, and rely on linkages between reporting, transparency and sanctions to reduce corruption.

52. Finally, the paper's findings underscore the importance of taking a conservative approach when assessing the impact of PFM reforms on corruption, and to measuring the impact of reforms not just the assumed impact. The evidence that links PFM reforms and corruption is extremely variable, and needs strengthening in key areas. Specifically a focus on the linkages between PFM reforms and strengthened sanctions, as well as the impact of PFM reforms on corruption in the private sector, is required to draw more definitive conclusions.

[8] http://blog-pfm.imf.org/pfmblog/2013/08/the-long-and-windingfight-against-corruption.html

Annex 1: Some thoughts on PEFA scores and corruption

Although this paper does not attempt to create an explicit link between corruption and changes in PEFA scores (see www.pefa.org), there is an implicit question as to how improvements in PEFA scores (i.e. from D to C) would impact on corruption.

The paper provides some indication of the potential impact of PFM reforms on corruption, through a colour coding system. To take this further and directly link changes in corruption to changes in the PEFA score is difficult, however, it would not be unreasonable to assume that for almost all indicators where there is assumed impact on the opportunity for corruption a full grade (i.e. C to B, or B to A) improvement in the PEFA score would significantly reduce this opportunity. The impact of grade improvements on incentives and sanctions is likely less clear. However, that being said the shift from D to C grades would likely have reasonably significant impact on the incentive to commit a corrupt act, by improving detection, etc. Within the audit and reporting scales, B and A scores likely indicate a much higher probability that sanctions will be applied, thus reducing the probability of corruption.

Further research would be required in order to turn this assessment into an analytical tool, but it should be possible to link changes in PEFA to reductions in corruption.

Annex 2: PFM System Weaknesses and Patterns of Administrative Corruption

Economic Class	Systemic Contributing Factors	Examples of Corruption
Employee compensation	• Absence of clear rules on hiring • Absence of management controls, internal controls • Absence or weakness in internal audit, external audit • Absence of treasury payroll matching • Absence of records, weak record keeping • Absence of management mandates for and review of regular financial reports	• Ghost employees • Nepotism • Absenteeism • Queue jumping in payments and consultants fees • Capture by higher ranking officers of job opportunities and salary and allowance payments
Goods and services	• Absence of non-payroll expenditure controls • Absence of inventory control, asset registry • Weak procurement system • Absence of management oversight and review of payment and procurement practices	• Contract steering • Collusion • Fraudulent invoices • Payment for goods and services not received • Theft of government supplies • False or doctored suppliers lists • Manipulation of forex rates
Capital expenditures	• Absence of non-payroll expenditure controls • Absence of inventory control, assets registry • Weak procurement system • Absence of management oversight and review of payment and procurement practices	• Favouritism in payments or contract awards • Use of substandard material or practices in construction • Collusive pricing • Under-pricing bids and using change orders to raise cost • Theft of stock • Illegal or unethical sub-contracting
Transfers	• Cash or in-kind transfer • Weak or no record keeping • Absence of clear procedures for processing applicants • Failure to follow procedures	• Transfers to unauthorised, fictitious, or deceased individuals • Transferring less than approved levels and pocketing

	• Absence of clear laws, regulations, rules for eligibility	difference • Kickbacks • Favouritism in approving eligibility

Adapted from Pradhan W. D., 2007, page 274.

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