Supplementary guidance for subnational PEFA assessments

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Preface

Guidance for subnational public expenditure and financial accountability (PEFA) assessments was issued on January 1, 2013, following an exposure draft in 2008. The 2013 guidance was based on the 2011 version of the general PEFA Framework and provided advice on possible adaptation of the general PEFA indicators and report format to be more practical and useful for subnational governments. The guidance was intended to be applicable to the variety of subnational government levels and structures, which are discussed in more detail in a research paper available on the PEFA website (www.pefa.org).

The PEFA Framework was upgraded in February 2016 following almost four years of review, refinement, and testing. It was therefore necessary to align all supplementary guidance to the upgraded PEFA Framework, including the 2013 guidance for subnational PEFA assessments. This document replaces the 2013 supplementary guidance for subnational PEFA assessments and should be used in conjunction with the PEFA 2016 Framework document.

In the approach used to align the supplementary guidance, the intent and substance of the original guidance is maintained while ensuring that references to the PEFA Framework relate to PEFA 2016 rather than previous versions. This document follows this approach but includes a revision to the supplementary subnational PEFA assessment indicator HLG-1. The scope of HLG-1 has been expanded to incorporate international development grants, along the lines of refinements to PI-1, PI-2, and PI-3 (regarding expenditure and revenue outturns) in the set of PEFA indicators. This is because the impact of external funding is now reflected throughout the PEFA Framework rather than in separate indicators, a shift that more clearly reveals the significance of its influence on processes and outcomes throughout the financial management system.

The application of PEFA at the subnational level is under review. Guidance may be revised later in 2017 in response to the review's findings and recommendations. For updates, please see the PEFA website.

Contents

List of abbreviations and acronyms

BCG	Budgetary central government
CG	Central government
COFOG	Classification of the Functions of Government
GG	General Government sector
HLG	higher-level government
ISO	International Standards Organization
MOF	Ministry of Finance
PEFA	public expenditure and financial accountability
PFM	public financial management
PI	PEFA indicator
SAI	supreme audit institution
SNG	Subnational government

1. Introduction

This guidance supplements the Public Expenditure and Financial Accountability (PEFA) Framework document published on February 1, 2016, the PEFA Assessment Handbook Volume II[1] (published in September 2016) and Volume III (to be published). It provides additional guidance for applying the PEFA methodology at the subnational level. To this end, it offers recommendations on how each of the PEFA dimensions and indicators can be applied or modified to better suit the characteristics of subnational governments. It also contains an additional indicator to be applied in the case of transfers or earmarked grants from higher-level to subnational governments.

Public financial management (PFM) arrangements at the subnational level are likely to depend on arrangements determined by central government, in national legislation or a national constitution. PFM arrangements can vary considerably by country. Variations reflect differences in, among other things, population and geographic size, governance, functions and responsibilities, administrative traditions, and the degree of operational discretion. Section 2 of this document provides advice on planning a subnational assessment (and in doing so, clarifies such an assessment's purpose as well as issues to consider when setting its scope and coverage).

Section 3 focuses on indicators, including how the standard PEFA 2016 indicators may be applied or modified, if necessary, to accommodate differences at the subnational level (see subsection 3.2 for all 31 indicators). Intergovernmental transfers often constitute the largest source of financial resources available to subnational governments. The indicator "HLG-1" is used to assess the accuracy of budget estimates and the timeliness of transfers from higher-level governments (see subsection 3.1 for the methodology involved).

As detailed in section 4, the PEFA report format described in the PEFA Framework document requires some adjustment when applied at the subnational level.

The PEFA 2016 Framework explains page 3 that "*PEFA methodology refers to the GFS*[2] *terminology where possible to provide a standard basis of reference, but this does not imply that PEFA is only relevant where GFS methodology is used. PEFA is adaptable to situations where other classifications and standards are used.*"

To that extent, the terminology from GFS would read as follow in the case of subnational governments: "central government" would cover the budgetary and extrabudgetary units of a subnational government and "budgetary central government", the budgetary units of a subnational government.

Specific indicators and dimensions also refer to GFS: PI-2 (dimensions 1 and 2); PI-3 (dimension 2); PI-4; PI-5 (elements 7 and 8); PI-6; PI-10 (dimension 1); PI-12; PI-16 (dimension 1). The present guidance will specify under each indicator whether an adapted definition different from the GFS is needed.

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[1] "PEFA Assessment Fieldguide (Volume II)" available at:
https://pefa.org/sites/default/files/16_08_30%20Fieldguide_9.pdf

[2] Government Finance Statistics

2. Planning a subnational PEFA assessment

This section provides guidance on issues to be considered when planning a PEFA assessment at the subnational level. General guidance on the entire PEFA assessment cycle is provided in the PEFA Assessment Handbook, Volume I (PEFA Assessment process)[3].

The International Monetary Fund identifies "state" and "local" government units.[4] Both state and local governments are covered by the term "subnational government" in PEFA. Specifically, state and local governments have authority over smaller geographical areas than do central governments; have the authority to own assets, incur liabilities, and/or engage in transactions in their own rights. The right to borrow is not a requirement for treatment as a subnational government in the PEFA Framework.

Deconcentrated units of central government, however, are not subnational governments. Such units perform functions under direction from a central authority but do not have powers to raise or spend funds on their own initiative. Deconcentrated units should be included in assessments of the tier of government that has authority over and responsibility for their activities. This will typically be the central government, but may be the state government in states that cover large areas and have diverse responsibilities.

This additional guidance applies to all level of subnational governments. *However, this guidance may not be applicable in cases where considerable powers and responsibilities are assigned to SNGs that are comparable to those of central governments. In such cases, the PEFA 2016 framework may be applied as is and combined with the subnational PEFA indicator HLG-1 (see page 9). The methodology to be applied should in any case be explained in the terms of reference or the concept note prepared for the PEFA assessment, as well as in the PEFA report.*

2.1. Purpose of the assessment

A PEFA assessment is designed to provide stakeholders with a high-level evaluation of the status of PFM in a country. It is intended to highlight weaknesses in the system and thus allow governments to develop reform plans and provide a platform for dialogue between development partners and governments.

Two types of PEFA are possible at the subnational level: that of an individual government, and an assessment of a group of subnational governments. The quality assurance process and basic methodology are the same for both types.

Ideally, a sample of subnational entities will not involve unintended bias. As such, it may not be the lowest-cost sample possible. A variety of characteristics are to be considered, such as:

- Population size or density
- Climatic or geographic characteristics
- Levels of expenditure per capita
- Focus of the economy (for example, industrial or agricultural) or main source of revenue (such as mining)
- Type of locality (such as municipality, town, district)

[3] "PEFA Assessment process (Volume I)" available at: https://pefa.org/sites/default/files/16_10_18PEFA%20Handbook%20Volume%20I%20-%20Assessment%20Process_edited%20%28final%29.pdf.

[4] International Monetary Fund, *Government Finance Statistics Manual 2014*, p. 25–27, provides a detailed explanation of the characteristics of state and local governments, including when more than three tiers of government are present.

- Rural or urban
- Political representation
- Accessibility to key infrastructure
- Manual or computerized systems
- Extent of development partner support
- Social or ethnic groups present, such as indigenous peoples, language groups or cultural traditions

The number of criteria used to choose the subnational governments in a sample should be limited to maintain clarity on the characteristics the sample represents. The basis for selection and the final sample should be agreed on by all stakeholders.

2.2. Sources of information

The information to be collected for a subnational PEFA assessment is most often that made available by subnational institutions and systems on their areas of responsibility. Some information on PFM systems, procedures, and processes—such as the legal and regulatory framework—may be located at the national level. For the PFM functions that are performed by the central government or shared between the subnational and the central governments, the deconcentrated units of the national governments may also provide information.

Information about development partners' support of subnational governments may be more difficult to find. Such support may be of various types and may involve basket funds or specific projects covering one or more entities.

3. Performance indicators

Subnational PEFA assessments use the same indicators as the national government PEFA assessments, with some adaptation, plus an additional indicator, "HLG-1," for assessing transfers and earmarked grants to subnational governments from higher-level governments.

3.1 Subnational PEFA indicator HLG-1: Transfers from a higher level of government

Description

This indicator assesses the extent to which transfers to the subnational government from a higher-level government are consistent with original approved high-level budgets, and are provided according to acceptable time frames. The indicator contains three dimensions, and uses the M1 (WL - weakest link) method for aggregating dimension scores.

Dimensions and scoring

Score	Minimum requirements for score
HLG-1.1. Outturn of transfers from higher-level government	
A	Transfers have been at least 95 percent of the original budget estimate in two of the last three years.
B	Transfers have been at least 90 percent of the original budget estimate in two of the last three years.
C	Transfers have been at least 85 percent of the original budget estimate in two of the last three years.
D	Performance is less than required for a C score.
HLG-1.2. Earmarked grants outturn	
A	The difference between the original budget estimate and actual earmarked grants was 5 percent or less in each of the last three years.
B	The difference between the original budget estimate and actual earmarked grants was 5 percent or less in two of the last three years.
C	The difference between the original budget estimate and actual earmarked grants was 10 percent or less in two of the last three years.
D	Performance is less than required for a C score.
HLG-1.3. Timeliness of transfers from higher-level government	
A	• A disbursement timetable is part of the agreement between the higher-level government and subnational government. The disbursement timetable is agreed on by all stakeholders at the beginning of the fiscal year. At least 75 percent of actual disbursement (weighted) has been on time in two of the last three years. OR • Actual transfers have been distributed evenly across the year, or with some front-loading, in each of the last three years.
B	• A disbursement timetable is part of the agreement between the higher-level government and subnational government. The disbursement timetable is agreed on by all stakeholders at the beginning of the fiscal year. At least 75 percent of actual disbursement (weighted) has been on time in one of the last three years. OR

Score	Minimum requirements for score
	• Actual transfers have been distributed evenly across the year, or with some front-loading in two of the last three years.
C	• A disbursement timetable is part of the agreement between a higher-level government and subnational government. The disbursement timetable is agreed on by all stakeholders at the beginning of the fiscal year. Fifty percent of actual disbursements have been on time in two of the last three years. OR • Actual transfers have been distributed evenly across the year, or with some front-loading in one of the last three years.
D	Performance is less than required for a C score.

Coverage
GG (general government)

Time period
Last three completed fiscal years

Measurement guidance

Transfers from higher-level governments include all revenues transferred either in the form of blocks or earmarked grants, as well as shared revenues that are not collected and retained by the subnational government. Such transfers include international development funding that is pooled at the central government level and channeled to subnational entities directly or through a line ministry. This indicator applies to top-down transfers only and not to fiscal transfers from subnational to higher-level governments. Funds provided directly to subnational governments are also included. If the funds are not recorded in the budget, this should be identified in indicator PI-6.

The narrative should explain possible reasons for any observed deviation between (i) amounts provided by a higher-level government for inclusion in subnational budget estimates and (ii) actual disbursements. For example, an action agreed on with the central government or development partners as a condition for disbursement may have been delayed or not implemented. Or a transfer may have taken place after the approval of the subnational budget. Assessments of an individual government might comment on whether that entity was responsible for the action required. If a delay or discrepancy is due to macroeconomic, political, or other factors out of the control of the subnational government, this should be explained.

Reasons for the shortfall in shared revenues could be noted, as well as whether the shortfall affected the subnational government more than the higher-level government. Refer to PI-3 of the relevant high-level government assessment for more on the implications of revenue shortfalls.

Dimension HLG-1.1 captures if and how actual total transfers from higher-level to subnational governments deviated from the original total to be allocated.

Dimension HLG-1.2 measures the difference between the actual and estimated transfers of earmarked grants. Depending on the timing of the approval of the subnational budget relative to the higher-level budget, there may be some deviation from the amount included in the higher-level budget. This dimension should be assessed on the same basis as PI-2. All transfers that are not earmarked should be counted in aggregate as one component of earmarking. Discrepancies in all other transfers should be considered sector by sector, corresponding to the 10-part Classification of the Functions of Government (COFOG) of the United Nations, or any similar classification to the extent it is applicable.

Dimension HLG-1.3 assesses the in-year timeliness of transfers from higher-level governments, with reference to timetables for in-year distribution of disbursements. The alternatives for each score are intended to cover situations when formal disbursement schedules are agreed within one month of the start of the subnational government's fiscal year, or when no formal disbursement schedule has been established. The alternatives provided in this dimension relate to circumstances where there is a disbursement schedule, or where there is no formal schedule.

A default standard of a quarterly distribution may be used in the absence of an agreed disbursement timetable. A weighted disbursement delay should be used, calculated as the percentage of funds delayed, and multiplied by the extent of delay within the year. "On time" disbursements refer to those delivered on or before the agreed date, or by the first day of each quarter when there is no agreed disbursement schedule.

3.2 Application of the PEFA 2016 indicators to subnational assessments

This subsection outlines the implications and possible interpretations of standard PEFA indicators for subnational PEFA assessments.

Given the range of subnational government structures, there is no "one size fits all" interpretation of PEFA 2016 at the subnational level. The indicators may need to be adapted to different responsibilities at the subnational level. The guidance highlights the indicators and dimensions that may be applicable with modification or different scoring requirements.

As needed, assessors should provide a detailed explanation of the reasons why indicators are considered not applicable (NA) or are not used (NU). Assessment managers may wish to discuss the relevance or scope of particular indicators and dimensions with the PEFA Secretariat prior to finalizing a concept note or terms of reference.

The following table summarizes the conditions of applicability of the indicators and dimensions to the subnational governments.

Indicator/Dimension	**Applicability**
PI-3.1. Aggregate revenue outturn	Subnational revenues covered by the dimension are: - revenue collected by subnational governments directly and retained by them; - shared revenues retained by subnational governments; - subnational revenues that are collected on behalf of the subnational government by a higher-level revenue authority (these are neither transfers nor shared revenues)
PI-7. Transfers to subnational government	Not applicable when no lower-tier of subnational governments
PI-8. Performance information for service delivery	The scope of the indicator includes programs and services funded by subnational resources including transfers but excluding conditional grants and services managed and financed by other tiers of government if the subnational government significantly finances such services through reimbursements or earmarked grants, or uses other tiers of government as implementing agents
PI-10.1. Monitoring of public corporations	Applicable when the SNG controls or owns shares of public corporations
PI-10.2. Monitoring of subnational governments	Applicable only when the law or any other rule oblige the lower-tiers of subnational governments to report to the assessed subnational government Not applicable when there is no lower-tier of subnational governments

Indicator/Dimension	**Applicability**
PI-12.1. Financial asset monitoring	Not applicable when records are maintained by a higher-level of government with no control from the subnational government
PI-12.2. Nonfinancial asset monitoring	Not applicable when records are maintained by a higher-level of government with no control from the subnational government
PI-13. Debt management	Not applicable when the subnational government is not allowed to borrow
PI-14.2. Fiscal forecasts	Applicability limited to the subnational revenues and related expenditures when data from the higher-level government are not used, or not provided in a timely manner
PI-19. Revenue administration	Applicable when: - the subnational governments raise revenues according to their own administrative arrangements, - the subnational revenues are collected on behalf of the subnational government by a higher level revenue authority if the subnational government has full control of the revenues and of how the overall revenue management is carried out, Not applicable when: - the subnational government raises revenue through only user fees and charges that are related to a specific service provided by the subnational government (without exceeding the costs of this service) - the central (or other higher-level) government collects revenues through its revenue authority and has sharing arrangements with the subnational revenue authority
PI-20. Accounting for revenue	Subnational revenues covered by the dimension are: - Revenue collected by subnational governments directly and retained by them; - Shared revenues retained by subnational governments; - Subnational revenues that are collected on behalf of the subnational government by a higher-level revenue authority (these are neither transfers nor shared revenues).
PI-23. Payroll controls	Applicable when the subnational government manages its payroll and personnel records. If the subnational government is responsible for only part of the subnational payroll, with the remaining part under the purview of a higher level of government, the assessment of this indicator will cover only that

Indicator/Dimension	**Applicability**
	part of the payroll for which the subnational government is responsible. The notion of responsibility refers to full or partial responsibility in the payroll execution from the subnational government budget.
PI-23.1. Integration of payroll and personnel records	Not applicable when all staff members' payroll is covered by the budget of another level of government.
PI-24. Procurement	Applicable only for procurement managed by the subnational government
PI-24.1. Procurement monitoring	Not applicable when records are maintained by a higher-level of government with no control from the subnational government
PI-25.2. Effectiveness of expenditure commitment controls	Applicable even if controls are performed by an agent of another level of government.
PI-26. Internal audit	Not applicable if the internal audit function is performed by a higher-level of government. Otherwise, applicable. If applicable and the function is not performed by the subnational the dimension 26.1 is scored D and other dimensions are NA.
PI-30. External audit	Applicable when external audit is performed by - The national Supreme Audit Institution - A local office of the national SAI - A local audit institution
PI-30.2 Submission of audit reports to the legislature	Applicable when there is an audit of financial reports
PI-30.3 External audit follow-up	Applicable when there is an audit of financial reports
PI-31. Legislative scrutiny of audit reports	Applicable when there is an audit of financial reports

PILLAR ONE: Budget reliability

PI-1. Aggregate expenditure outturn

PI-1.1. Aggregate expenditure outturn

Coverage: Budgetary units of subnational government.

Aggregate expenditure "originally approved" is the total amount of expenditure approved by the subnational legislature, presented in the subnational government budget documentation and fiscal reports. Aggregate expenditure includes planned expenditures and those incurred as a result of exceptional events-which may be met from contingency votes. Expenditures funded by transfers to the subnational government, approved by the national legislature should be included. Expenditures financed by windfall revenues, including privatization, should be included and noted in the supporting fiscal tables and narrative. Expenditures financed externally by loans or grants should be included, if reported in the budget, along with contingency vote(s) and interest on debt (if the subnational government has authority to borrow). Expenditure assigned to suspense accounts, which are under the control of the subnational government, is not included in the aggregate. However, if amounts are held in suspense accounts at the end of any year that could affect the scores if included in the calculations, they can be included. In such cases the reason(s) for inclusion must be clearly stated in the PEFA report.

Actual expenditure outturns can deviate from the originally approved budget for reasons unrelated to the accuracy of forecasts. For example, failure by a higher-level government to transfer resources to a subnational government in accordance with the amounts and time frames stipulated in legislation, statutory or regulatory formulae, bilateral agreements, or other agreed mechanisms between the higher-level government and subnational government, may impact negatively on the subnational government's ability to execute the budget as approved by the legislature. Similarly, delays in the distribution of resources from other financing sources, including budget support and external loans, will also have an impact on subnational budget execution, especially if these funds have to transit through a higher-level treasury system.

While delays in the distribution of transfers from higher-level government may affect both recurrent and capital investment expenditures, typically the impact is greater on capital expenditures. When cash flow is affected, the subnational governments will tend to meet expenditure obligations of a nondiscretionary nature, such as pensions and salaries. This also tends to cause a higher percentage of deviation, considering that major capital projects are often delayed until resources become available. In the PEFA assessment report, assessors should explain any general deviations, as well as those due to lower execution rates in investment and the extent to which they influenced the overall deviation.

In a narrative, assessors should explain any general deviations, as well as those due to lower execution rates in investment (and how they influence overall deviation). The methodology for calculating this dimension is provided in a spreadsheet on the PEFA website www.pefa.org. Calculations for the dimension should be included in the assessment report as an Annex.

PI-2. Expenditure composition outturn

Coverage: All dimensions of this indicator apply to budgetary units of subnational government.

PI-2.1. Expenditure composition outturn by function

It measures the difference between the original budget approved by the subnational legislature and end-of-year outturn in expenditure composition, by functional classification, during the last three years, **excluding** contingency items, and interest on debt. Other expenditures should be included- for example, expenditures funded by transfers to the subnational government, approved by the national legislature, expenditure incurred as a result of exceptional events, expenditures financed by windfall revenues including privatization, SNGs subsidies, and donor funds reported in the budget.

At the administrative level, the subnational budget can be organized according to the agency or department that will implement the work for which the funds are provided, such as the health or water department, the education authority, the waste management department, and so forth. Thus, differences should be calculated for the main budgetary heads/ administrative entities that are responsible for management of the particular public service or function, that are included in the originally approved budget by the subnational legislature. If a functional classification based on GFS/COFOG is used, differences should be based on the main functions which are applicable at subnational level (e.g. defense, public order and safety, and environmental protection may be outside the subnational government responsibility, and managed by the higher-level government). Where a functional classification not based on GFS/COFOG is used, the measurement of difference should be based on the main heads approved by the subnational legislature. If a program basis is used, the program-based categories should be rated at the same level at which they were voted by the subnational legislature.

Potential causes of variations in composition may be different from those observed at the higher government level. Composition of expenditures may be affected by the extent and timing of the release of both general- and specific-purpose grants. Delays in or failure to release general budget support grants typically affect composition by economic type; expenditure of a relatively nondiscretionary nature, such as for salaries and pensions, are generally a first-order priority. Delays in or failure to release specific purpose (i.e., earmarked) grants or loans can impact on particular programs, functions, or sectors.

Assessors should analyze and provide an explanation of reasons for any significant variance from the approved budget in section 3 of the PEFA assessment report. The methodology for calculating this dimension is provided in a spreadsheet on the PEFA website www.pefa.org. Calculations for the indicator should be included in the assessment report as an Annex.

PI-2.2. Expenditure composition outturn by economic type

It measures the difference between the original budget approved by the subnational legislature_and end-of-year outturn in expenditure composition by economic classification during the last three years including interest on debt (if the subnational government has authority to borrow), but excluding contingency items. Expenditures funded by transfers to the subnational government, approved by the national legislature should be included.

While delays in the distribution of transfers from higher-level government may affect both recurrent and capital investment expenditures, typically the impact is greater on capital expenditures. When cash flow is affected, governments will tend to meet expenditure obligations of a nondiscretionary nature, such as salaries and pensions. This also tends to cause a higher percentage of variance as major capital projects are often delayed until resources are available.

The scope of expenditure is the same as for dimension 2.1, with the addition of interest on debt (if the subnational government has authority to borrow), as this is one of the categories of economic classification. The calculation should use the second level of the GFS classification (2 digits) or similar. If a different classification is used, the level of aggregation should be comparable to the 2-digit GFS.

The methodology for calculating this dimension is provided in a spreadsheet on the PEFA website www.pefa.org. Calculations for the indicator should be included in the assessment report as an Annex.

PI-2.3. Expenditure from contingency reserves

This measures the average amount of subnational expenditure(s) actually charged to the contingency reserve as a percentage of the total budget approved by the subnational legislature (including expenditures funded by transfers to the subnational government and approved by the national legislature).

The reliability and timing of transfers may affect the subnational government's need to charge expenditure to a contingency vote.

The spreadsheet provided on the PEFA website for dimension 2.1 can also be used to assist with calculations for this dimension.

PI-3. Revenue outturn

Coverage: All dimensions of this indicator apply to budgetary units of subnational government.

PI-3.1. Aggregate revenue outturn

This dimension assesses the change in revenue between the original approved budget and end-of-year outturn. It refers to revenues that legally and exclusively belong to the subnational government.

For the application of this indicator, subnational revenues would include:

- Revenue collected by subnational governments directly[5] and retained by them;
- Shared revenues retained by subnational governments[6];
- Subnational revenues that are collected on behalf of the subnational government by a higher-level revenue authority (these are neither transfers nor shared revenues)[7] .

When revenue is collected by a higher-level revenue authority on behalf of the subnational government, information should be provided on the authority and autonomy of the subnational entity, which are constrained in this case. The level of constraint depends on the relative importance of this revenue with regard to total revenue. Transfers are not covered by this indicator and should not be taken into consideration when evaluating PI-3 at the subnational level.

Calculation of the deviations between approved budgets and outturns for each dimension should be performed using the spreadsheet provided on the PEFA website www.pefa.org. Calculations for the indicator should be included in the assessment report as an Annex.

PI-3.2. Revenue composition outturn

It measures the variance in revenue composition during the last three years. It includes actual revenue by category compared to the original budget approved by the subnational legislature using level three [3 digits] of GFS 2014 classification or a classification that can produce consistent documentation according to comparable hierarchical levels and coverage. This dimension attempts to capture the accuracy of forecasts of the revenue structure and the ability of the subnational government to collect the amounts of each category of revenues as intended.

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[5] Revenues are collected directly when the subnational government has full control (i.e., full authority and autonomy) of its revenue and of how the overall management of revenue collection is carried out.

[6] Shared revenue refers to (i) individual taxes or a pool of taxes (general revenue sharing) and (ii) tax-base sharing (e.g., each level of government has a specific tax such as income tax).

[7] This is the case when subnational governments might delegate tax administration to a higher-level government for efficiency reasons. Sometimes the higher-level government keeps a percentage to compensate for the costs incurred.

PILLAR TWO: Transparency of public finances

PI-4. Budget classification

Coverage: Budgetary units of subnational government.

PI-4.1. Budget classification

This indicator assesses the classification system used for formulation, execution, and reporting of subnational budget. A robust classification system allows transactions to be tracked throughout the subnational budget's formulation, execution, and reporting cycle according to administrative unit, economic category, function/subfunction, or program. For assessing the indicator, the existing legal and regulatory framework for budget classification(s) for the public sector in general and for Central Government and SN entities in particular should be analyzed. Attention should be given to any potential significant difference between the legal frameworks used at the central level and at SN level. At the SN level as far as the legal framework for budget classification is concerned there are three possibilities:

- The legal and regulatory framework for budget classification is the same as for the General Government, including Central Government and SN entities. When the legal and regulatory framework for budget classification is set by the General Government, the SNGs authority is constrained. In this case, the SN entity has no direct control on this framework and it is obliged to adhere to it and it cannot modify it;

- The legal and regulatory framework for budget classification of the SN entities is typical of the entity. In this case, the SN entity has the authority/autonomy to decide on its budget classification;

- Specific standards are defined by the sub-national level as a whole (e.g. association of municipalities) and are mandatory for the sub-national level.

The assessment of the indicator should focus on the application of International Monetary Fund's Government Finance Statistics (GFS)/COFOG standards and **not** to adherence with the existing legal and regulatory framework.

Scoring is the same as for the central government. However, at the subnational level the 10 main functions COFOG and the 69 sub-functions may not be all applicable e.g. defense, public order and safety, and environmental protection may be outside subnational government responsibility and are managed by the higher level government.

The SN entity will not be penalized for the minimum requirements. A score **A** will be assigned when all 10 main functions (minus the functions that do not apply) and the 69 sub-functions (minus those related to the functions that do not apply) are used for the formulation, execution and reporting of the budget. All the other elements to assign an **A** are the same as for Central Government. Otherwise, a lower score will be assigned

PI-5. Budget documentation

Coverage: Budgetary units of subnational government.

PI-5.1. Budget documentation

Annual budget documentation refers to the subnational budget proposals for the next fiscal year with supporting documents, as submitted to the SN legislature for scrutiny and approval. The set of documents provided by the executive should allow a complete picture of subnational government fiscal forecasts, budget proposals, and outturn of the current and previous fiscal years.

All four **basic** elements are applicable at the subnational level. However, some of the additional elements— 5, 6, and 7—may not be applicable:

- Element 6 relating to macroeconomic assumptions may not be applicable at the subnational level if such data are already included in the higher-level budget documentation and/or where collection and analysis of such data are not feasible or appropriate given the size, scope, or structure of the subnational government.
- Element 5 will not be applicable where a subnational government is not permitted to have a budget deficit.
- Element 7 will not be applicable where a subnational government does not have authority to borrow.

Assessors should determine the applicability of the elements to be included on a case-by-case basis and provide reasons for their inclusion or exclusion from the assessment under this indicator. If one or more of the additional elements (of the eight) are not relevant, scoring of this indicator should be done on a pro rata basis.

Scoring will need to be adjusted to reflect the number of the additional elements applicable to the subnational government.

- ***If seven of the additional elements are applicable***:

  A = nine elements including 1–4; B = six elements including three elements of 1–4; C = at least three basic elements (i.e., no change)

- ***If six of the additional elements are applicable***:

  A = eight elements including 1–4; B = five elements including three elements of 1–4; C = at least three basic elements (i.e., no change)

- ***If five of the additional elements are applicable***:

  A = seven elements including elements 1–4; B = four elements including three elements of 1–4; C = at least three basic elements (i.e., no change).

PI-6. Subnational operations outside financial reports

Coverage: All dimensions of this indicator apply to budgetary and extrabugetary units of a subnational government.

PI-6.1. Expenditure outside financial reports

This dimension assesses the amount of expenditure incurred by budgetary and extrabudgetary units (including social security funds) at the subnational level but not reported in subnational financial reports. Such expenditures may include those from fees and charges collected by subnational budgetary and extrabudgetary units outside the approved budget (such as voluntary school fees or medical copayments), as well as expenditures on externally funded projects undertaken by or on behalf of the subnational government, where these are not reported in subnational financial reports.

PI-6.2. Revenue outside financial reports

This dimension measures the magnitude of revenues received by budgetary and extrabudgetary units (including social security funds) at the subnational level but not reported in subnational financial reports. Such revenues may include those received by subnational extrabudgetary units from budgetary transfers (including from higher-level governments) or other revenues, revenues from donor-funded projects, and fees and charges outside the type or amounts approved by the budget (such as voluntary school fees or medical copayments), where any of these are not reported in subnational financial reports.
Calculation of the percentage of expenditure by extrabudgetary units outside SNG financial reports should include expenditure for which the final use of grants/subsidies has not been specified, using the same classification as for budgetary operations.

Table 6.1. EXAMPLE of revenues and expenditures outside the SNG's financial reports (*Actual entities and other details will vary between countries*)

Entity	Type of revenue outside SNG financial reports	Estimated amount of revenue reported outside SNG financial reports	Type of expenditure reported outside SNG financial reports	Estimated amount of expenditure reported outside SNG financial reports	Evidence and reporting
Extrabudgetary Units					
Health centers	Medical registration fees	$	Minor equipment; Vehicles; Meal allowances	$	Revenues from registering medical professionals are retained by authority and not recorded in FMIS. Authority maintains bookkeeping accounts for retained revenues
Municipal slaughterhouse	Fees for cattle slaughter	$	Equipment	$	Bookkeeping records
Municipal markets authority	Fees for booths at the market	$	Booths' equipment	$	Counterfoils
Etc.					

Operations of Budgetary Units outside SNG financial reports					
Directorate for facilities	Direct grant for extension of the sewer system funded by development partner	$			MoU between SNG and development partner. Separate budgetary unit bank a/c. Quarterly report to development partner
Directorate for schools	Voluntary school fees collected from parents encouraged by institutions.	$			School bookkeeping only. No financial reports. Quantity unknown

PI-6.3. Financial reports of extrabudgetary units

This dimension refers to ex-post financial reports of subnational extrabudgetary units that are provided to the subnational government. Annual financial reports should include details of actual revenue and expenditure, assets and liabilities, and guarantees and long term obligations, and provided in a timely manner consistent with budgetary subnational reporting requirements (see PI-28).

PI-7. Transfers to subnational governments

Coverage: All dimensions of this indicator apply to budgetary and extrabugetary units of a subnational government and the lower-tier subnational governments with direct financial relationships to the subnational government (being assessed)

PI-7.1. System for allocating transfers

When applied to a subnational assessment, the indicator should refer to lower levels of a subnational government (if any). This means that relevant fiscal transfers will be those between a higher level and lower level of subnational government (top down). For example, a subnational PEFA assessment at the state level may examine transfers to local districts or councils, whereas one at the district level may look at transfers from district to towns and villages, etc.

The lower levels of governments that receive such transfers from an SNG must meet the definition of SNG provided in the PEFA Framework page 26.

If a lower level does not meet that definition, it will not be included in the scope of the present dimension. For the purpose of the PEFA assessment:

- when the transfer fully covers the budget of that lower level, the latter could be considered as a deconcentrated unit of the SNG;
- when the transfer partially covers the budget of that lower level, the latter may be considered as an extrabudgetary unit as defined under PI-6, provided all other requirements are met in addition to partial funding.

Given the wide diversity of political arrangements covering subnational entities, there is no standard relationship governing transfers between one subnational level and another. The fiscal relationship between various tiers of subnational government may be set out in the country's constitution and/or specific laws or regulations at various levels of governments determining the layers of subnational governments, their expenditure responsibilities, and revenue-sharing arrangements. The horizontal allocation arrangement may then be the result of a combination of different levels of rules. **Assessors should explain in the narrative the rules governing the transfer arrangement and describe how the latter is applied by highlighting the contribution to performance of each level of government involved.**

Transfers to support lower-level subnational expenditure can be made in the form of unconditional grants, where their final use is determined by the subnational government through its budgets, or through conditional (earmarked) grants to the lower-level subnational government to implement selected service-delivery and expenditure responsibilities—for example, by function or program, typically in accordance with an agreed-upon regulatory or policy standard. The overall level of grants (that is, the vertical allocation) will usually be determined by policy decisions at the discretion of a higher government level (including at the level of central government) or as part of constitutional negotiation processes, and is not assessed by this indicator. However, clear criteria for the distribution of grants among subnational governments—for example, formulae for the horizontal allocation of funds—are needed to ensure allocative transparency and medium-term predictability of funds available for planning and budgeting of expenditure programs by subnational governments.

If there is no lower-tier of subnational government or if there are no budgetary transfers from the assessed SNG to the lower-tiers of SNG, this dimension and the following one will be not applicable.

PI-7.2. Timeliness of information on transfers

Information on transfers to lower-level subnational budgets should be regulated by the higher-level government's annual budget calendar, which should provide reliable information on allocations early in the budget cycle. However, the assessed SNG may send information on transfers to the lower-tier SNGs in compliance with a nationally established budget calendar which does not allow enough time to complete their budget planning on time. In such cases, the dimension may still be scored but the narrative part has to highlight the responsibility of the national rules.

PI-8. Performance information for service delivery

Coverage: All dimensions of this indicator apply to budgetary and extrabudgetary units of a subnational government.

As for the national level:

- Ministries (or their equivalent at the subnational level) have been selected as the government unit for publication of performance information in this indicator.
- For ministries (or their equivalent at the subnational level) such as education and health, assessors may consider 100% of the budget allocated to service delivery programs. In addition, for many countries, a large proportion of service delivery will be accounted for by the ministries of health and education.

For all four dimensions, services managed and financed by other tiers of government should be included if the subnational government significantly finances such services through reimbursements or earmarked grants, or uses other tiers of government as implementing agents.

PI-8.1. Performance plans for service delivery

Performance plans and results relate to programs and services delivered directly by the subnational government and its entities, both budgetary and extrabudgetary units. This will include programs and services funded by transfers, excluding conditional grants. Subnational governments should specify the planned outputs and outcomes of programs and services that they fund or manage from all funding sources.

For programs and services managed by one level of government but funded by another level of government, the assessment should identify the responsibilities for reporting results, such as, for measuring the efficiency and effectiveness of service delivery at the government level responsible for delivering the service, and for measuring the value for money achieved from the resources by the government funding the service.

PI-8.2. Performance achieved for service delivery

This dimension measures the results (i.e., outputs and outcomes) achieved by the programs and services delivered directly by the subnational government and its entities, both budgetary and extrabudgetary units. This will include programs and services funded from all funding sources, excluding conditional grants.

PI-8.3. Resources received by service-delivery units

This dimension measures the resources received by service-delivery units managed at the subnational level, from all funding sources, excluding conditional grants.

The information captured on resources by the selected subnational ministry, or equivalent budget institution, should support the comparison of service performance with the actual resources received.

The reasons for selecting the ministry (or equivalent budget institution) for this dimension should be explained in the report narrative.

PI-8.4. Evaluation of service delivery performance

This dimension relates to evaluations of the performance of programs and services delivered and funded by the subnational government. It includes programs and services funded from all funding sources, excluding conditional grants.

The dimension considers the extent to which the design of subnational public services, and the appropriateness, efficiency, and effectiveness of those services, is assessed in a systematic way through program or performance evaluations.

In the case of a subnational government, the evaluation may be undertaken by a local directorate or organization with a mandate across entities, or by a national organization with a similar mandate, or by the government external auditor, or a combination of those arrangements.

PI-9. Public access to fiscal information

Coverage: Budgetary units of subnational government.

PI-9.1. Public access to fiscal information

Access to fiscal information at the subnational level refers to access of the general public in the area where the SNG has authority. Fiscal transparency depends on whether information on subnational government fiscal plans, positions, and performance is easily accessible to the general public. Public access is defined as availability without restriction, within a reasonable time, without a requirement to register, and free of charge, unless otherwise justified in relation to specific circumstances at the subnational level. Justification provided by subnational government for limits on access, where applicable, should be noted in the report.

If external audits are the responsibility of a supreme audit institution (SAI) at a higher government level, the ability to make element 5 (Audited annual financial report) and element 7 (Other external audit reports) available to the public may not be under the control of the subnational government being assessed. If the subnational government is subject to audit by an SAI outside its jurisdiction, this should be explained in the narrative. If the audit reports have been made available to the subnational government, then these should be available to the public. As with PI-5, element 9 (Macroeconomic forecasts) may also not be applicable.

If some of the additional elements identified for central government assessments are not applicable, they can be replaced by up to two supplementary elements for a maximum of nine elements for the indicator. The two supplementary elements are:

1. Information on fees, charges, and taxes that belong to the subnational government
2. Information on services provided to the community by the subnational government from all funding sources

Scoring will need to be adjusted to reflect the number of “basic” and “additional” elements that are applicable to the subnational government under assessment. It should also take into account any adjustments involving the substitution of supplementary elements for non-applicable additional elements. If one or more of the elements are not applicable, and are not replaced by supplementary elements, scoring of this indicator should be done on a pro-rata basis.

- ***If element 9 is not applicable***:

  A = all five basic elements and one of the three applicable additional elements
  B = four of the five basic elements and one of the three applicable additional elements
  C = four of the five applicable basic elements

- ***If elements 5 and 7 are not applicable***:

  A = all four of the applicable basic elements and one of the applicable additional elements
  B = at least three of the four applicable basic elements and one of the applicable additional elements
  C = three of the four applicable basic elements

- ***If elements 5, 7, and 9 are not applicable***:

  A = all four of the applicable basic elements and the one of the applicable additional elements

B = three of the four applicable basic elements and one of the applicable additional elements
C = three of the four applicable basic elements

PILLAR THREE: Management of assets and liabilities

PI-10. Fiscal risk reporting

PI-10.1. Monitoring of public corporations

Coverage: SNG owned or shared public corporations.

The dimension applies when the subnational government controls or owns shares of public corporations.

Some public corporations may be owned by different levels of government. If the financial statements are sent to another level than the SNG subject to the assessment, the corresponding requirement for a score C is not fulfilled. The score would be D and not NA. However, if the other level forwards the financial statements to the SNG within the prescribed timeframe, then the score could be higher than C, depending on the percentage of the total public corporation expenditure, the publication status and the existence of a consolidated report.

The total expenditure of public corporations is the basis to assess the materiality. To calculate the materiality, expenditure has to be weighted by the percentage of share owned by the subnational government.

A consolidated report prepared by the central government and published by either the central government or the subnational government will fulfill the requirement for an A score if it addresses the fiscal risk arising from all the public corporations owned by the subnational government.

If the assessed subnational government does not control or own any share in a public corporation, the dimension will be NA.

PI-10.2. Monitoring of subnational governments

Coverage: Lower-tier of subnational governments that have direct financial relations with the SNG.

This dimension measures the extent to which higher-level subnational governments monitor those at a lower level.

To be considered as lower-tiers of subnational government, the entities must fulfill the requirements mentioned under PI-7.1.

The dimension applies only if there are subnational entities lower than the one being assessed, and if, by law or any other rule, the lower-level of subnational governments has to report to the assessed subnational government.

A consolidated report on the financial position of *all* lower-tiers of subnational government prepared by the central government and published by either the central or the subnational government would fulfill the requirement to score A if it addresses specifically the fiscal risk arising from the lower-level of subnational governments to the assessed subnational government.

PI-10.3. Contingent liabilities and other fiscal risks

Coverage: Budgetary and extrabudgetary units of subnational government.

This dimension assesses the monitoring and reporting of any explicit contingent liabilities for which the subnational government is responsible, including those of its extrabudgetary units.

Contingent liabilities of a subnational government may also become the contingent liabilities of a higher-level government, and vice-versa. While this dimension is intended to assess the subnational level, the narrative should identify what entity is ultimately responsible for such liabilities should the subnational government not be able to fulfill its legal obligations.

The PEFA report narrative should identify any major implicit fiscal risks faced by the subnational government.

In some cases, the subnational government may participate with the central government or other subnational governments in programs that generate a contingent liability (e.g. crop insurance programs, PPPs). The liability should be quantified according to the involvement of the subnational government in the program.

PI-11. Public investment management

Coverage: All dimensions of this indicator apply to budgetary and extrabudgetary units of subnational government.

This indicator covers major investment projects managed by the subnational government, including those funded from transfers and other external revenue sources. For the purpose of this indicator, "major investment projects" are defined as projects meeting the following criteria:

- The total investment cost of the project amounts to 1 percent or more of total annual subnational government budget expenditure; and
- The project is among the largest 10 projects (by total investment cost) for each of the 5 largest subnational government units, measured by the units' investment project expenditure.

If the subnational government has a different definition of major investment projects that would at least meet these criteria and that would simplify collection of information, the assessor may use the subnational government's definition to identify major investment projects, but scoring should still be done using the definition in this guide.

PI-11.1. Economic analysis of investment proposals

This dimension assesses the extent to which robust appraisal methods, based on economic analysis, are used to conduct feasibility or prefeasibility studies for major investment projects. Economic analyses of subnational government should be conducted in accordance with subnational guidelines. If subnational guidelines are not available, the analyses should be in accordance with relevant national or regional guidelines. Inconsistencies between subnational and higher-level of government's guidelines, where both exists, should be noted in the PEFA report narrative.

PI-11.2. Investment project selection

This dimension requires that subnational governments carry out a central review of major investment project appraisals before including projects in the budget submitted to the subnational legislature. It also requires that subnational government publish and adhere to standard criteria for project selection. "Prioritization by a central entity" refers to a subnational entity.

PI-11.3. Investment project costing

Costing information should be included in subnational budget documents. Assessors should evaluate whether the documentation surrounding the subnational budget includes medium-term projections of investment projects on a full-cost basis, and whether the budget process for capital and recurrent spending is fully integrated.

PI-11.4. Investment project monitoring

Monitoring and reporting arrangements should be managed by the subnational government. Monitoring should cover all major investment projects managed by subnational government from the point of approval and throughout implementation.

PI-12. Public asset management

PI-12.1. Financial asset monitoring

Coverage: This dimension refers to the monitoring of financial assets held by the budgetary and extrabudgetary units of a subnational government.

Records should be maintained by the subnational government. It means that the subnational government should be able to access, capture and modify the records related to their financial assets. When there is a centralized recording system, this would be the case if an agent from a higher level of government can access, capture and modify the records on behalf of and at the request of the subnational government, based on information sent by the subnational government. If the records are maintained by a higher level of government with no control from the subnational government, this dimension is not applicable.

PI-12.2. Nonfinancial asset monitoring

Coverage: This dimension refers to the monitoring of financial assets held by the budgetary units of a subnational government.
As for dimension 1, records should be maintained by the subnational government. It means that the subnational government should be able to access, capture and modify the records related to their fixed assets – and all other nonfinancial assets they may monitor. When there is a centralized recording system, this would be the case if an agent from a higher level of government can access, capture and modify the records on behalf of and at the request of the subnational government, based on information sent by the subnational government. If the records are maintained by a higher level of government with no control from the subnational government, this dimension is not applicable.

PI-12.3. Transparency of asset disposal

Coverage: This dimension refers to the monitoring of financial assets held by the budgetary and extrabudgetary units of a subnational government.

Procedures and rules for the transfer or disposal of financial and nonfinancial assets are established either by the subnational government, or a higher level of government, or both.

For an A score, "*legislature*" designates the legislature function at the subnational level of government subject to the assessment. Submission of information to a legislature performing at a higher level of government would not qualify for an A rating.

PI-13. Debt management

Coverage: All dimensions of this indicator apply to budgetary and extrabugetary units of subnational government.

PI-13.1. Recording and reporting of debt and guarantees

This dimension and the other dimensions for this indicator refers to debt and guarantees contracted **directly** by subnational governments and serviced by the subnational government. Whether or not the debt is authorized or guaranteed by the higher-level government or central government is not relevant to assessing this dimension.

This dimension is not applicable if the subnational government is **not** authorized to borrow or to issue guarantees at all.

PI-13.2. Approval of debt and guarantees

Primary legislation authorizing the subnational government to incur debt may be enacted at the subnational or higher level (including that of the central government), within the confines of the national constitution and restrictions imposed by the central government.

Similarly, policies and procedures may be issued by either the subnational government or higher-level government (including the central government).

If the subnational government is permitted to borrow (with or without restrictions) and to issue guarantees, it may have its own legislation or regulation, providing some level of autonomy. The subnational government may also carry out borrowing activities (and issue guarantees) in conformity with an existing legislative framework applicable to all levels of government (central and subnational) and controlled by central government, leaving limited autonomy for the subnational entity.

It is therefore important for assessors to address how existing legislative and regulatory frameworks assign responsibility to both the central and subnational governments.

This dimension is not applicable if the subnational government is **not** authorized to borrow or to issue guarantees at all.

PI-13.3. Debt management strategy

Where the subnational government has the authority to borrow, it should prepare a debt management strategy (for subnational debt only). Progress should be reported annually to the subnational legislature.

The subnational government’s annual borrowing plan should be consistent with its approved debt management strategy. If subnational borrowing is subject to the approval of, or limits set by, a higher-level government (including central government), strategies to manage debt should be aligned across government levels.

Assessors should note the existence of any central government debt management strategy that incorporates subnational debt or guarantees. However only the debt strategy prepared by the SNG is assessed. If the SNG has the right to borrow, possesses debt and does not have a debt strategy, then the score will be D.

This dimension may not be applicable if the central government (or other higher level of government) is the only entity responsible for contracting debt. This dimension is not applicable if the subnational government is not authorized to borrow or to issue guarantees at all.

PILLAR FOUR: Policy based fiscal strategy and budgeting

PI-14. Macroeconomic and fiscal forecasting

PI-14.1. Macroeconomic forecasts

Coverage: Whole economy.

If applicable, this dimension relates to macroeconomic forecasts prepared by the subnational entity only. It will be assessed in the same way as for the central government. In this regard, the assessment should also analyze the extent to which macroeconomic forecasts and assumptions have been reviewed by an entity other than the preparing entity, for example, a fiscal council.

For an A score, the official macroeconomic forecasts must be prepared by a BCG agency. In the case of a subnational government, this would mean a budgetary unit of the subnational government. For B and C scores the official macroeconomic forecasts may be prepared by the Central Bank. In the case of a subnational government, the latter may use macroeconomic forecasts prepared by another public entity, such as the central government MoF or the Central Bank.

PI-14.2. Fiscal forecasts

Coverage: Budgetary and extrabudgetary units of subnational government.

This dimension relates to forecasts of the main subnational fiscal indicators including revenue by type, aggregate expenditure, and budget balance.

For countries that prepare fiscal forecasts for BCG only, this dimension should be assessed on that basis. In the case of a subnational government, only budgetary units would be covered.

Forecasts of subnational revenues should specify their type, where they will be available, and estimates of transfers from the higher-level government. Estimates of expenditure should include, where available, those funded by conditional and unconditional grants and loans.

Any assessment of this dimension depends on the availability of forecasts of transfers (of all kinds) from the higher-level government. The assessment should address any constraints faced by the subnational government regarding the availability of data from the higher-level government.

Where data from the higher-level government are not provided, or not provided in a timely manner, the assessment of the forecasts should be based on subnational revenues (and related expenditures) only.

PI-14.3. Macrofiscal sensitivity analysis

Coverage: Budgetary and extrabudgetary units of subnational government.

Sensitivity analysis will assess the impact of changes in important economic and fiscal circumstances on the subnational government's fiscal position. Scenarios will include unexpected changes to macroeconomic assumptions (whether they are calculated at the subnational or higher level) as well as other external factors that will impact on subnational revenues (including those from higher-level sources), expenditure (including expenditure related to conditional grants and loans), and debt.

PI-15. Fiscal strategy

Coverage: All dimensions of this indicator apply to budgetary and extrabudgetary units of subnational government.

PI-15.1. Fiscal impact of policy proposals

Policy proposals relate to those developed by the subnational government and that impact on subnational revenues and expenditures. This dimension assesses a subnational government's ability to estimate the fiscal impact of revenue and expenditure policy proposals developed during budget preparation.

The fiscal impact of policy proposals should be documented and prepared by the Ministry of Finance (MOF) or equivalent agency at the subnational level.

PI-15.2. Fiscal strategy adoption

This dimension assesses the extent to which the subnational government prepares a fiscal strategy that sets out objectives for at least one budget year and the two following fiscal years. The strategy may be affected by the extent to which the subnational government depends on transfers from a higher-level government. Assessors should note such dependency and the extent to which it is reflected in the strategy document.

PI-15.3. Reporting on fiscal outcomes

This relates to subnational fiscal outcomes as measured against the subnational fiscal strategy. A report should be made available to the subnational legislature as part of an annual budget submission.

PI-16. Medium-term perspective in expenditure budgeting

Coverage: All dimensions of this indicator apply to budgetary units of a subnational government.

PI-16.1. Medium-term expenditure estimates

This dimension assesses the medium-term expenditure estimates prepared by the subnational government as part of the annual budget cycle.

The estimates should include planned expenditures based on legislated or planned transfers, if applicable, from the higher-level government, including conditional and unconditional grants.

PI-16.2. Medium-term expenditure ceilings

This dimension refers to expenditure ceilings set by the subnational executive for subnational ministries (directorate/ department/ service). The dimension assesses whether expenditure ceilings are applied to the estimates produced by subnational ministries to ensure that expenditure beyond the budget year is consistent with subnational fiscal policy and budgetary objectives.

Ceilings may need to be approved by the higher-level government (either at the cabinet level or by the MOF).

PI-16.3. Alignment of strategic plans and medium-term budgets

Only expenditure policy proposals that are the responsibility of the subnational government should be considered. Strategic plans may include those prepared by subnational ministries and/or, if relevant, higher-level ministries where the higher-level government has overarching policy responsibility in a particular sector.

Assessors should take into account the level of devolution of functional responsibility for the delivery of services in key sectors. This will determine the extent of alignment appropriate for strategic plans at different levels of government.

PI-16.4. Consistency of budgets with forecasted estimates

This dimension demonstrates the effectiveness of subnational budget forecasts.

Assessors should highlight the reasons for any variation between forecasted estimates and final approved budgets, including any changes resulting from adjustments and or the timing of transfers from the higher-level government.

PI-17. Budget preparation process

Coverage: All dimensions of this indicator apply to budgetary units of a subnational government.

PI-17.1. Budget calendar

This dimension assesses whether a budget calendar exists for the subnational government, and the extent to which it is adhered to.

For the purpose of this indicator, budgetary units are those that are directly charged with responsibility for implementing the budget, in line with expenditure policies, and that directly receive funds or authorization to spend from the legislature. Subnational government units that report to and received budgetary funds through a parent budgetary unit should not be included in the assessment.

Budgetary units of a subnational governments may be called ministries, secretariats, directorates, departments, services, etc. The assessors should specify what is considered as a budgetary unit according to the above definition.

The subnational government may be required to follow the budget calendar of the higher-level government (MOF, Ministry of Local Government). In such a case, the dimension should be scored but the implications of subnational adherence to the budget calendar of the higher-level government should be clearly analyzed and highlighted in the narrative.

PI-17.2. Guidance on budget preparation

The subnational government should issue a budget circular(s) to the relevant subnational budgetary units. The circular should set out the budget procedures for the preparation of the subnational budget including any procedures and interactions involving the higher-level government.

In some cases, ceilings may need to be approved by the higher-level government (either the cabinet or MOF). This may result in delays in the approval process which may determine the score. Similarly, the information on transfers from the higher-level of government, which is useful to determine the budget ceilings, may be delayed. Such situations should be highlighted in the report.

The processes and guidance on the preparations of budget submissions and issues in and approval of ceilings presented in the budget circular should be analyzed in detail, taking into account interrelationships between subnational and higher-level governments.

PI-17.3. Budget submission to the legislature

This dimension assesses the timeliness of the submission of the subnational budget to the subnational legislature. Timing may be affected by any delays in the higher-level approval of budget transfers to the subnational government. Such delays, outside the control of the subnational government, should be discussed and highlighted in the narrative section of the report.

PI-18. Legislative scrutiny of budgets

Coverage: All dimensions of this indicator apply to budgetary units of a subnational government.

PI-18.1. Scope of budget scrutiny

Legislative scrutiny at the subnational level refers to the relevant subnational legislature, parliament, assembly, council, or any equivalent body (and not to the national or federal parliament).

The ability of the subnational legislature to carry out its responsibilities may be impaired by central government delays in providing necessary inputs to the process. The length of delays should be explained and highlighted in the narrative.

Fiscal policies relate to those of the subnational government. The extent of autonomy with regard to fiscal policies will be determined by the level, timing, and degree of autonomy over revenues, including transfers received from the higher-level government, and the capacity of the subnational government to incur fiscal deficits and undertake borrowing.

PI-18.2. Legislative procedures for budget scrutiny

This dimension assesses the extent to which the procedures of the subnational legislature are established and adhered to. The existence and timing of relevant procedures should be verifiable by reference to records of subnational legislative sessions and decisions.

PI-18.3. Timing of budget approval

This dimension assesses whether, over the last three years, the subnational budget had been approved by the subnational legislature before the commencement of the fiscal year.

The ability of the legislature to approve the budget prior to the commencement of the fiscal year may be impacted by delays in higher-level approval of the amount of budget transfers to the subnational government. Budget approval by the subnational legislature may be subject to formal approval by the higher-level government. The process of budget approval and entities involved should be clearly analyzed, and these specificities (if any) pointed out. Such delays, outside the control of the subnational government, should be discussed in the narrative section of the report.

PI-18.4. Rules for budget adjustments by the executive

This dimension covers subnational legislative rules on budget adjustments that apply to the subnational executive.

Rules on budget adjustments may be set by the subnational legislature. Rules may also be applied by the higher-level government. These are not assessed as part of the scoring of this dimension but should be noted in the narrative.

PILLAR FIVE: Predictability and control in budget execution

PI-19. Revenue administration

Coverage: All dimensions of this indicator apply to budgetary and extrabudgetary units of subnational government.

This indicator relates to subnational revenue administration entities, which have a payer base and revenue collection large enough to be meaningful and sustainable. Thus, this indicator is applicable to only those subnational governments that raise revenues according to their own administrative arrangements. This indicator is also applicable when the subnational revenues are collected on behalf of the subnational government by a higher level revenue authority (these are neither transfers nor shared revenues), but the subnational government has full control of the revenues and of how the overall revenue management is carried out (i.e. informing payers about their rights and obligations for revenue measures, revenue risk management, audit and investigations, and revenue arrears monitoring).

This indicator, doesn't not apply in the following situations:

- When the subnational government raises revenue through only user fees and charges that are related to a specific service provided by the subnational government (without exceeding the costs of this service).
- When the central (or other higher-level) government collects revenues through its revenue authority and has sharing arrangements with the subnational revenue authority.

PI-19.1. Rights and obligations for revenue measures

This dimension assesses the extent to which individual and enterprises have access to information about their rights and obligations, and also to administrative procedures and processes that allow redress, such as a fair and independent body outside of the general legal system (ideally a "tax court") that is able to consider appeal.

PI-19.2. Revenue risk management

This dimension assesses the extent to which a comprehensive, structured, and systematic approach is used within subnational revenue administration entities for assessing and prioritizing compliance risks.

PI-19.3. Revenue audit and investigation

This dimension assesses whether subnational revenue administration entities have put in place sufficient controls to deter evasion and ensure that instances of noncompliance are revealed. Sound audit and fraud investigation systems managed and reported in accordance with a documented compliance improvement plan must be in place to ensure that, once risks have been identified, there is follow up to minimize revenue leakage.

PI-19.4. Revenue arrears monitoring

This dimension assesses the extent of proper management of arrears within the subnational revenue administration entities by focusing on the level and age of revenue arrears.

PI-20. Accounting for revenue

Coverage: All dimensions of this indicator apply to budgetary and extrabudgetary units of subnational government.

This indicator assesses procedures for recording and reporting revenue collections, consolidating revenues collected, and reconciling revenue accounts. For the application of this indicator, revenues would include:

- Revenue collected by subnational governments directly and retained by them;
- Shared revenues retained by subnational governments;
- Subnational revenues that are collected on behalf of the subnational government by a higher-level revenue authority (these are neither transfers nor shared revenues).

PI-20.1. Information on revenue collections

This dimension assesses the extent to which a ministry of the subnational government (such as the MOF or a body with similar responsibilities) coordinates revenue administration activities and collects, accounts for, and reports timely information on collected revenue.

PI-20.2. Transfer of revenue collections

This dimension assesses the promptness of collected revenues being transferred to the subnational treasury or another designated agency.

PI-20.3. Revenue accounts reconciliation

This dimension assesses the extent to which aggregate amounts related to assessments, charges, collections, arrears, and transfers to (and receipts by) the subnational treasury or another designated agency take place regularly and are reconciled in a timely manner.

PI-21. Predictability of in-year resource allocation

Coverage: All dimensions of this indicator apply to budgetary units of a subnational government.

PI-21.1. Consolidation of cash balances

This dimension refers to the cash balances of only subnational governments.

Assessors should first establish the extent to which the consolidation process is an autonomous one for the subnational government (and to what extent it is linked to the central government).

The subnational government may have its own treasury system or may share use of a central treasury with the entire public sector. A national treasury may also extend coverage of a treasury single account to subnational levels through regional treasuries[8] or equivalent payment agencies.

PI-21.2. Cash forecasting and monitoring

This dimension refers to cash-flow forecasts prepared at the subnational level and monitored by an MOF, directorate of finance, treasury, or equivalent body.

It will be necessary to establish the extent of the subnational government's autonomy in the process of cash-flow forecasting and monitoring. The subnational government may depend on transfers from the higher-level government, and this may impact the extent to which cash flows are forecasted and monitored. Where relevant, forecasts of cash inflows should include revenue from subnational sources and, if applicable, planned transfers from the higher-level government. These forecasts should also reflect subnational expenditures.

The subnational government may also not have its own treasury and therefore may not fully control the process of forecasting and monitoring cash flow, and may be unable to plan and commit to expenditures. The report should highlight how the lack of autonomy reflects on the performance measured by that dimension.

PI-21.3. Information on commitment ceilings

Commitment ceilings are those established by the subnational government. The level of dependence on transfers from the higher-level government will affect the subnational government's ability to establish reliable ceilings for committed expenditures, which should be highlighted in the report.

PI-21.4. Significance of in-year budget adjustments

This dimension measures the extent to which the subnational government makes in-year budget adjustments. The frequency of adjustments may also depend on the reliability and frequency of transfers from the higher-level government, which should be highlighted in the report.

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[8] This is the case in the Russian Federation, for example.

PI-22. Expenditure arrears

Coverage: This indicator and all dimensions refer to expenditure payment arrears under the purview of the subnational government.

Definitions and regulations applicable to expenditure arrears can be established either by the subnational government, or a higher level of government, or both.

PI-22.1. Stock of expenditure arrears

This dimension assesses the stock of expenditure arrears under the purview of the subnational government.

Expenditure payment arrears are expenditure obligations that have been incurred by government, for which payment to an employee, supplier, contractor, or loan creditor is overdue, and which constitute a form of nontransparent financing. Subnational regulations or practices may specify when an unpaid claim is in arrears. If a local practice is applied to measuring the stock of arrears, then its content and basis should be described in the narrative. Definitions and regulations can be established either by the subnational government, or a higher level of government, or both.

The definition should cover all types of arrears such as those to employees or contractors (wages, salaries, fees), to suppliers (for the purchase of goods and services) and to creditors (short-, medium- and long-term loans).

PI-22.2. Expenditure arrears monitoring

This dimension assesses the monitoring of expenditure arrears under the purview of the subnational government. It focuses on which aspects of subnational expenditure arrears are monitored and how frequently and quickly the information is generated.

PI-23. Payroll controls

Coverage: All dimensions apply to budgetary and extrabudgetary units of a subnational government.

This indicator applies if the subnational government manages its payroll and personnel records. If the subnational government is responsible for only part of the subnational payroll, with the remaining part under the purview of a higher level of government, the assessment of this indicator will cover only that part of the payroll for which the subnational government is responsible. The notion of responsibility refers to full or partial responsibility in the payroll execution from the subnational government budget.

PI-23.1. Integration of payroll and personnel records

Dimension 23.1 assesses the degree of integration among subnational personnel, payroll, and budget data. A clear and detailed description of the entire integration process and the relevant roles and responsibilities should be included (including for funding and payment), as defined and described above in the general description for indicator 23.

This dimension is not applicable if all staff members' payroll is covered by the budget of another level of government.

PI-23.2. Management of payroll changes

This dimension covers the changes to personnel and payroll data made by staff from the subnational government, or by an agent from another level of government operating on behalf of and at the request of the subnational government, based on information sent by the latter.

PI-23.3. Internal control of payroll

This dimension covers the controls that are applied to subnational personnel as defined above in the general description for indicator 23. As for dimension 2, the controls applied to the making of the changes can be performed by staff from the subnational government, or by an agent from another level of government operating on behalf of and at the request of the subnational government.

PI-23.4. Payroll audit

This dimension assesses payroll audits covering subnational personnel as defined above under the general description of indicator PI-23.

The payroll audit may fall under the responsibility of a higher level of government. This dimension would still be applicable. Such an arrangement may affect the scope and frequency of subnational payroll audits and should be described in the narrative, as well as any adverse impact it may have on the score.

If there is no payroll audit in place, the score is D.

PI-24. Procurement

Coverage: All dimensions of this indicator apply to budgetary and extrabugetary units of a subnational government.

PI-24.1. Procurement monitoring

This dimension analyzes the monitoring of procurement by the subnational governments.

Databases or records of contracts should be maintained by the subnational government. It means that the subnational government should be able to access, capture and modify the records related to its procurement. When there is a centralized recording system, this would be the case if an agent from a higher level of government can access, capture and modify the records on behalf of and at the request of the subnational government, based on information sent by the subnational government. If the records are maintained by a higher level of government with no control from the subnational government, this dimension is not applicable.

PI-24.2. Procurement methods

This dimension assesses the procurement methods used by the subnational government and analyzes the percentage of the total value of subnational contracts awarded with and without competition. It covers only procurement managed by the subnational government.

As explained in the Fieldguide under para 24.2:2, assessors are encouraged to mention in the narrative the percentage of the total value of contracts carried out under the set threshold for which open competition is the default method.

PI-24.3. Public access to procurement information

This dimension reviews the level of public access to complete, reliable, and timely procurement information at the subnational level. It covers only procurement managed by the subnational government.

Information published in a national or a higher-level of government's media may comply with the dimension requirement if local citizens, civil society organizations and businesses can access it easily. For instance, a link on the subnational government website may redirect to the national government website or the nationwide newspaper containing the bidding opportunities that can easily be found within the territory of the subnational government.

PI-24.4. Procurement complaints management

This dimension assesses the existence and effectiveness of an independent, administrative complaint-resolution mechanism for subnational procurement. It covers only procurement managed by the subnational government.

To be effective, the submission and resolution of complaints against subnational procurement must be processed in a fair, transparent, independent, and timely manner. The process may involve a separate body at the subnational or a higher government level that reviews complaints on behalf of the subnational government.

PI-25. Internal controls on nonsalary expenditure

Coverage: All dimensions of this indicator apply to budgetary and extrabugetary units of a subnational government.

PI-25.1. Segregation of duties

This dimension assesses the existence of the segregation of duties for the control of nonsalary expenditure at the subnational level.

Rules applicable to segregation of duties can be established either by the subnational government or a higher level of government, or both. In all cases, the dimension is applicable. Duties can be performed either by staff from the subnational government, or by an agent from another level of government.
The report should provide a clear explanation of when the subnational government has limited (or no) autonomy in guiding the process of expenditure control and other internal rules and procedures that apply to its case.

PI-25.2. Effectiveness of expenditure commitment controls

This dimension assesses the effectiveness of controls on subnational expenditure commitments. As for dimension 1, rules applicable to expenditure commitment controls can be established either by the subnational government or a higher level of government, or both. In all cases, the dimension is applicable. Controls can be performed either by staff from the subnational government, or by an agent from another level of government.

The report should specify if the subnational government has limited (or no) autonomy in guiding the process of expenditure controls and other internal rules and procedures that apply to the subnational government.

PI-25.3. Compliance with payment rules and procedures

This dimension assesses the extent of compliance with the payment control rules and procedures at the subnational level. As for dimensions 1 and 2, rules applicable to payments and exceptions can be established either by the subnational government or a higher level of government, or both. In all cases, the dimension is applicable.

National regulations may not have been adapted to local circumstances, thus reducing their relevance, or there may be contradictions between local and national regulations and confusion regarding their jurisdiction.

PI-26. Internal audit

Coverage: All dimensions of this indicator apply to budgetary and extrabugetary units of a subnational government.

PI-26.1. Coverage of internal audit

This dimension assesses the extent to which subnational entities are subject to internal audit.

This is measured as the proportion of total planned expenditure or revenue collection of the subnational entities covered by annual audit activities, whether or not substantive audit work is carried out. If a higher-level entity is responsible for the internal audit function of a subnational government (partially or totally), because the subnational government has partial (or no) autonomy in undertaking this function, detailed explanations should be provided in the report.

In the absence of an internal audit function, assessors will need to determine whether this is due to the function being performed by the higher-level government, in which case the indicator is not applicable. However, assessors should mention the extent and characteristics of the audit performed by the higher-level of government.

If it is applicable, but the function does not exist, the score for dimension PI-26.1 is "**D**."

PI-26.2. Nature of audits and standards applied

This dimension assesses the nature of subnational audits performed and the extent of their adherence to professional standards. Internal audits may be undertaken by the subnational government, a higher-level government, or not at all. When internal audits of the subnational government are carried out by a higher-level government or by a combination of central and subnational auditors, the assessment should discuss implications for the audits' coverage and ability to assess systemic issues.

When the score of PI-26.1 is D because the audit function does not exist, PI-26.2 is not applicable (NA).

PI-26.3. Implementation of internal audits and reporting

This dimension assesses specific evidence of an effective subnational internal audit (or system monitoring) function as shown by the preparation of annual audit programs.

The entities to receive the report at the subnational level are the audited entity, the MOF (or its equivalent, such as the entity in charge of the budget), and the SAI.

Some local legislation may require the audit report to be sent to the subnational legislative council (or to the mayor, in the case of a municipality).

When the score of PI-26.1 is D because the audit function does not exist, PI-26.3 is not applicable (NA).

PI-26.4. Response to internal audits

This dimension assesses the extent to which subnational institutions act on internal audit findings.

When the score of PI-26.1 is D because the audit function does not exist, PI-26.4 is not applicable (NA).

PILLAR SIX: Accounting and reporting

PI-27. Financial data integrity

PI-27.1. Bank account reconciliation

Coverage: This dimension applies to budgetary and extrabugetary units of a subnational government.

This dimension evaluates the timeliness and regularity of the reconciliation of bank accounts under subnational control (where these can be managed by the subnational treasury or its equivalent).

27.2. Suspense accounts

Coverage: This dimension applies to budgetary units of a subnational government.

This dimension evaluates the timeliness and regularity of the reconciliation and clearance of suspense accounts under subnational control (where these can be managed by the subnational treasury or its equivalent).

27.3. Advance accounts

Coverage: This dimension applies to budgetary units of a subnational government.

The advances considered are those exclusive to a subnational entity.

27.4. Financial data integrity processes

Coverage: This dimension applies to budgetary units of a subnational government.

This dimension assesses the extent to which processes support the delivery of subnational financial information, as well as the accuracy and completeness of the data delivered. It focuses on two key aspects: access to subnational information (and any changes to records); and the existence of a body, unit, or team in charge of verifying data integrity.

PI-28. In-year budget reports

Coverage: All dimensions of this indicator apply to budgetary units of a subnational government.

28.1. Coverage and comparability of reports

This dimension assesses the extent to which subnational financial information is reported within a given year, and in a form that is easily compared to the original budget.

How responsibility for the reports' preparation is divided between a subnational directorate of finance and line directorates (or equivalent bodies) will depend on the type of accounting and payment system in operation (centralized, deconcentrated, or devolved).

The deconcentrated units referred to in the requirements to score A and B are only the deconcentrated units of the subnational government.

PI-28.2. Timing of in-year budget reports

This dimension assesses whether subnational financial information is submitted in a timely manner and accompanied by an analysis and commentary on budget execution.

The report should highlight the nature of the relationship between the subnational and higher-level governments, and the impact this may have on the timeliness of in-year budget reports.

28.3. Accuracy of in-year budget reports

This dimension assesses the accuracy of the information submitted, including whether expenditure for both the commitment and the payment stage is provided. The report should highlight the nature of the relationship between the subnational and higher-level governments, and the impact this may have on the accuracy of in-year budget reports.

PI-29. Annual financial reports

Coverage: All dimensions of this indicator apply to budgetary units of a subnational government.

PI-29.1. Completeness of annual financial reports

This dimension assesses whether financial reports for subnational governments are prepared annually and are comparable with the approved budget.

The financial reports should include all cost centers (ministries or equivalent, departments or equivalents, agencies or equivalent, service-delivery units) under subnational jurisdiction.

'Compte de gestion', 'compte administratif'. Names and forms of financial reports depend on what the countries use. To be considered as financial reports for this dimension, these reports must fulfill the requirements of comparability and coverage of the set of data required for each score.

PI-29.2. Submission of reports for external audit

This dimension assesses the timeliness of submission of reconciled year-end subnational financial reports for external audit.

Application of the framework at the central government level calls for submission of the financial statements to the audit entity to precede the submission to the legislature. However, in some cases the statements need to be first approved by the subnational legislature (or equivalent review body) prior to being submitted for external audit. In this case, the process of submission to the legislature and (then) for external audit should be described in detail, with a particular emphasis on timeliness.

Any mandatory transmission to central government or another institution before submission to the SAI may delay the submission. This should be explained in the narrative but the dimension should still be scored by calculating the time between the end of the fiscal year and the submission for external audit.

PI-29.3. Accounting standards

This dimension measures the extent to which the basis of recording subnational operations relies on accounting standards and is transparent and consistent over time. This dimension differs from the one applicable to central governments. To score the dimension, assessors should use the following calibration:

A: Accounting standards applied to financial reports are consistent with ***all*** the country's legal framework's requirements. The standards used in preparing annual financial reports are disclosed.
B: Accounting standards applied to financial reports are consistent with ***most of*** the country's legal framework's requirements and ensure consistency of reporting over time. The standards used in preparing annual financial reports are disclosed.
C: Financial reports are presented in consistent format over time. The standards used in preparing annual financial reports are disclosed.
D: Performance is less than required for a C score.

This dimension does not assess the incorporation of international standards within the national standards. However, assessors may describe the country's legal framework and the extent of its consistency with international standards.

PILLAR SEVEN: External scrutiny and audit

PI-30. External audit

Coverage: All dimensions of this indicator apply to budgetary and extrabugetary units of a subnational government.

PI-30.1. Audit coverage and standards

This dimension refers to financial reports of subnational budgetary and extrabudgetary institutions.

To evaluate this indicator, the audit entity in charge of carrying out audits at the subnational level should first be clearly identified, and several key points should be documented, including whether the subnational government depends on an audit office which is different from the SAI in charge of auditing central government accounts.

If the SAI responsible for the external audit of higher-level entities also audits subnational entities, through local or regional offices, a specialized unit of chamber of the SAI or even the same units than those in charge of central government, then the relationship of the subnational government to the SAI should be explained, including how audit work is undertaken and how the audit reports are submitted to the subnational legislature or local assembly (refer to PI-30.2).

In addition, there may be an overlap in responsibilities/functions between the SAI and the subnational audit office. This may result in duplication of efforts and potential gaps in review when there is no clear delegation of authority. In this case the report should specify the context of the external audit.

The standards applied by the SAI may be:

- In the case of a national SAI: ISSAIs or national standards (to score A, national standards should be consistent with ISSAIs),
- In the case of a local audit office: ISSAIs or national or local standards. The local audit office may endorse the international standards or the national ones or even follow its own local standards. These standards should be consistent with ISSAIs to score A.

To score this dimension, materiality is calculated on the total of subnational government expenditure covered during the last three completed fiscal years by one or more audit of financial statements.

PI-30.2. Submission of audit reports to the legislature

This dimension refers to audit reports submitted to the subnational government's legislature.

The dimension does not consider submission of audit reports on subnational governments to the central government's legislature, even if the audit is performed by the national SAI. If the audit reports are only submitted to the central government's legislature, the dimension should be scored D.

This dimension assesses the timeliness of the submission of the audit report(s) on budget execution to the subnational government's legislature. Any mandatory transmission to another institution before submission to the local legislature or local assembly may delay the submission. This should be explained in the narrative but the dimension should still be scored by calculating the time between the ability of the audit institution to implement its audit and the submission to the local legislature or assembly. Such mandatory transmissions may be transmission to the local executive, to the national or higher-level of government's executive, to the national or higher-level of government's legislature, from a local audit office to the national SAI, etc.

PI-30.3. External audit follow-up

This dimension assesses the extent to which audit recommendations are followed up by the subnational executive or audited entity. Follow-up should take place whether the audit is undertaken by a subnational or higher-level SAI.

This dimension only covers the recommendations made to the subnational government.

PI-30.4. Supreme audit institution (SAI) independence

This dimension assesses the extent to which the relevant audit institution is independent from the subnational and other level of governments' executive. This dimension relates to the SAI that provides oversight to the subnational government, whether the SAI is national or subnational.

The local audit office has not to be independent from the national SAI. In the cases of a local audit office not independent from the national SAI, assessors should evaluate the extent to which the national SAI is independent from the national executive and legislature.

PI-31. Legislative scrutiny of audit reports

Coverage: All dimensions of this indicator apply to budgetary and extrabugetary units of a subnational government.

PI-31.1. Timing of audit report scrutiny

This dimension assesses the extent to which a subnational legislature scrutinizes external audit reports. This has to be undertaken at subnational level. If the scrutiny of audit reports are only scrutinized by the national legislature or a higher-level of government legislature, then the score is D. Assessors should explain and highlight it in the narrative.

Responsibility for the legislative scrutiny of subnational audits (whether performed by a subnational or higher-level SAI) should be clearly analyzed. For example, if a higher-level legislature plays a role in scrutinizing external audit reports, the autonomy of the subnational government is limited in this regard. The report should explain and analyze the context in which audit reports are scrutinized.

PI-31.2. Hearings on audit findings

This dimension measures the extent to which the subnational legislature or local assembly conducts hearings on the findings of subnational audit reports. It assesses the level of legislative scrutiny of audits performed by an SAI or local audit office.

PI-31.3. Recommendations on audit by the legislature

This dimension covers recommendations made by the subnational legislature or local assembly regarding subnational audits. Only the recommendations made by the subnational legislature or local assembly to the subnational executive are concerned with this dimension. Based on the audits reports, local assemblies or subnational legislature may also make recommendations to the executive of higher-level of government or the central government. Such recommendations are not covered by the dimension but may be mentioned in the narrative part.

PI-31.4. Transparency of legislative scrutiny of audit reports

This dimension relates to the hearings conducted by the subnational legislature on audit reports relating to subnational resources and activities.

4. PEFA report for subnational assessments

The basic structure of the PEFA report is the same for national and subnational assessments, as shown in the table below. The main difference is the addition of an annex for the subnational government profile, as presented in subsection 2.3 of this guide. There may also be specific matters that should be raised in particular parts of the narrative report, as discussed in the subsections below.

STRUCTURE OF THE PEFA REPORT
Executive summary **1. Introduction** **1.1 Rationale and purpose** **1.2 Assessment management and quality assurance** **1.3 Assessment methodology** **2. Country background information** **2.1 Economic situation** **2.1.1. Country economic situation** **2.1.2. Subnational government economic situation** **2.2 Fiscal and budgetary trends** **2.3 Legal and regulatory arrangements** **2.3.1. Legal and regulatory arrangements for decentralization** **2.3.2. Legal and regulatory arrangements for PFM** **2.4 Institutional arrangements for PFM** **2.5 Other important features of PFM and its operating environment** **3. Assessment of PFM performance** **3.1 Budget reliability** **3.2 Transparency of public finances** **3.3 Management of assets and liabilities** **3.4 Policy-based fiscal strategy and budgeting** **3.5 Predictability and control in budget execution** **3.6 Accounting and reporting** **3.7 External scrutiny and audit** **4. Conclusions on the analysis of PFM systems** **4.1 Integrated assessment of PFM performance** **4.2 Effectiveness of the internal control framework** **4.3 PFM strengths and weaknesses** **4.4 Performance changes since a previous assessment** **5. Government PFM reform process** **5.1 Approach to PFM reform** **5.2 Recent and ongoing reform actions** **5.3 Institutional considerations** **Annexes** **Annex 1: Performance indicator summary** **Annex 2: Summary of observations on the internal control framework** **Annex 3: Sources of information**

1. Introduction

1.1. Rationale and purpose

This section describes the objective of the PEFA assessment and important background information as a report for central government does.

In particular, this section should highlight the context in which the assessment of the subnational government takes place:

- Is the assessment part of a set of assessments? or
- Is this a standalone assessment?

When the assessment is part of a set of assessment, this section should list all the subnational governments assessed in parallel of the one that is the subject of the report and specify the tier of subnational governments they belong to. In addition, the section should explain the rationale for doing a set of assessments: e.g. assess the national fiscal decentralization system; or assess the PFM system of a given country's subnational governments belonging to one or several tiers of decentralization.

1.2. Assessment management and quality assurance

In this section, assessors should focus on the assessment that is subject of the report. Some parts of the assessment management and quality assurance arrangements may concern all the assessments of a set of assessments, e.g. the role of donors or of the central government. Some other parts are specific to the assessed subnational government.

Assessors should clearly specify the general arrangements and the arrangements specific to the assessed subnational government, including the involvement of the local authorities.

1.3. Assessment methodology

In addition to what is mentioned in the PEFA framework, assessors should mention in this section:

- Where the assessment is a part of a set of assessment, details of the sampling methodology and the rationale for selecting the subnational government that is the subject of the report;
- The significance of national government policies and practices for subnational government PFM, particularly where the subnational governments are highly dependent on central government;
- The rationale for the non-use of indicators and dimension, if any.

2. Country background information

The standard sections of this part of the PEFA report remain relevant, while the subsections relating to fiscal and budgetary trends, legal and regulatory arrangements, institutional arrangements, and other important features are to be adapted to relate to the subnational level.

2.1 Economic situation

For a subnational government assessment, this section should consist of the two following subsections.

Subsection 2.1.1 Country economic situation

This subsection should present the economic situation of the country to which the subnational government belongs. In the case of a set of assessment, this subsection should be similar in all the individual reports. The content is the same as described in the PEFA 2016 framework.

Subsection 2.1.2 Subnational government economic situation

In addition, assessors should include a second subsection describing the economic situation of the subnational government. They may use the key economic indicators available for the subnational government such as population, GDP, GDP per capita, real GDP growth, sectoral breakdown of GDP, unemployment rate, etc. These indicators should be compared to the national situation and, if possible, to the average situation of the subnational governments belonging to the same tier.

2.2 Fiscal and budgetary trends

This subsection should focus on the subnational fiscal and budgetary trends. Tables 2.2, 2.3 and 2.4 have to be filled in with the subnational figures. In table 2.2, the breakdown of revenues should identify the transfers from higher-level of governments, included central government.

In addition to table 2.2, assessors may mention and describe in the narrative the kind of revenues which compose the own revenues of the subnational government (taxes, resource rent, fees, etc.)

Tables 2.3 and 2.4 may be difficult to complete when functional and administrative classifications are not used. Assessors may try to provide similar information while specifying the source.

2.3 Legal and regulatory arrangements

For a subnational government assessment, this section should consist of the two following subsections. In the cases of assessments of a set of subnational governments of a same tier of decentralization, these subsections might be the same in all the reports.

Subsection 2.3.1: Legal and regulatory arrangements for decentralization

This subsection should:

- Identify and describe the higher-level government legislation and regulations defining and guiding the subnational government structure. It's important to name, date and describe the laws on decentralization.
- Provide information on the number of government level and administrative tiers and the average size of the population they serve by filling in the table below (which presents an example).

Table SNG -1. Overview of subnational governance structure

Government level or administrative tier	Corporate body?	Own political leadership?	Approves own budget?	Number of jurisdictions	Average population	Percentage of public expenditure	Percentage of public revenues	Percentage funded by transfers
Central	Yes	Yes	Yes	1	10 million	30	80	0
State	Yes	Yes	No	10	1 million	15	5	80
Local 1	Yes	Yes	Yes	100	100,000	35	15	30
Local 2	No	No	No	1000	10,000	20	0	100

Note 1: Add more rows as needed to include all government levels or administrative tiers.

Note2: Provide a footnote if the government level does not cover the entire territory (as in the case of municipalities) or if there are major asymmetries in the subnational governance structure.

- Based on the table, indicate which level of subnational government is the most significant in terms of its public service delivery and public expenditure.
- Identify the main responsibilities of the government level under consideration and their extent (e.g. full responsibility for water sanitation, schools' equipment, farm insurance) and explain where these responsibilities assignments are defined (e.g., in law or a constitution). Assessors should also precise whether these assignments are generally accepted, clear, and followed in practice and whether these responsibilities are devolved, delegated, or shared with a higher-level government.
- Mention the extent to which the assessed subnational government complies fully or partially with its assignments, highlighting the responsibilities it does not undertake and those it implements beyond that which is required by regulations.

When the assessed subnational government is part of an assessment of a set of subnational government, this subsection may be the same in all the reports except for the last point.

Subsection 2.3.2: Legal and regulatory arrangements for PFM

The content is the same as described in the framework but assessors should, in addition, describe the key features of the fiscal decentralization system applied to the level of decentralization the assessed subnational government belongs to, in particular:

- The arrangements for preparing and adopting the budget (adoption by the subnational's legislature, right of subsequent modification by a higher-level government).
- The arrangements for the holding of accounts (part of the national treasury, bank accounts in their own name, requirement to hold accounts in the central bank).

• The extent to which the subnational governments can procure their own supplies and capital infrastructure.

• The right to borrow and guaranteeing debts.

•The composition of financial resources collected and received by the subnational government, in particular the transfers from higher-level of government (unconditional grants, earmarked grants) and own revenue (tax and non-tax revenue).

• The ability of the subnational governments to increase its revenues (right to set the rate and basis of local taxes).

• The extent to which the subnational governments are able to appoint their staff, including the higher-level staff (chief administration officer, chief financial officer, internal auditors, etc.)

To complement the above, the report should describe the share of responsibility between the subnational government and the central government or higher-level of subnational governments concerning the following PFM functions:

- Payment
- Revenue administration
- Performance arrangements for service delivery involving the subnational government
- Monitoring of public corporations
- Monitoring of lower tiers of subnational governments
- Public investment
- Management, monitoring and recording of assets
- Debt management
- Macroeconomic forecasting
- Cash monitoring and forecasting
- Payroll
- Procurement
- Internal audit
- Financial reporting

When the assessed subnational government is part of an assessment of a set of subnational government, this subsection may be the same in all the reports

2.4 Institutional arrangements for PFM

This subsection is specific to each subnational government.

Table 2.5 of the framework may be replaced by the following table. Tables 2.6 and 2.7 are only focused on the subnational government's budgetary and extrabudgetary units and, if any, social security funds. Assessors should try to fill them with available information while ensuring that the entities does not belong to the central government.

Table 2.5. Structure of the public sector (number of entities and financial turn-over)

Year:	Public sector				
	Government subsector		Social security funds	Public corporation subsector	
	Budgetary unit	Extrabudgetary unit		Nonfinancial public corporations	Financial public corporations
Subnational government					
Lower tier(s) of subnational					

In addition, assessors may identify and describe deconcentrated units of the central government that are located within the subnational government's territory.

2.5 Other important features of PFM and its operating environment

This subsection should present the same structure and content as a central government's assessment.

3. Assessment of PFM performance

HLG-1 should be presented at the beginning of the discussion of PEFA indicators, except where the report combines national and subnational government assessments in one report. If presented in combination, the indicators from PI-1 to PI-31 and associated narrative should be provided first. Assessments of multiple subnational governments should be presented in separate to make it easier to share them with the stakeholders of each subnational government.

4. Conclusions on the analysis of PFM systems

This section contains the same subsections than the central government report:

- 4.1. Integrated assessment of PFM performance
- 4.2. Effectiveness of the internal control framework
- 4.3. PFM strengths and weaknesses
- 4.4. Performance changes since a previous assessment

The content is the same and guidance on writing the report can be found in Volume III of the PEFA Handbook.

However, the assessors should clearly:

- describe, when necessary, the contribution to performance of each level of government,
- highlight which areas can be improved as a result of decisions made by the subnational government unilaterally, and
- explain which areas are bound by regulations or legislation at the national level (such as national accounting standards and classification systems prescribed by law) and thus could be addressed by a PFM decentralization reform.

5. Conclusions on the analysis of PFM systems

This section contains the same subsections as a central government assessment report:

- 5.1. Approach to PFM reforms
- 5.2. Recent and on-going reform actions
- 5.3. Institutional considerations

If needed, each of the subsection may be divided in two parts: a subsection focused on reforms of the subnational government and a subsection focused on reforms conducted at the central government regarding the PFM decentralization system.

Aggregation of results

If two or more levels of government have been assessed in the same country, it is not appropriate to aggregate the results. Aggregation is not recommended for units at the same or different levels of government because important differences between units will be lost. Care must also be taken in ranking or direct comparisons as these can be highly sensitive and need to be considered in a wider public administration context.

The results for assessments of more than one subnational unit can be presented in a report in an aggregated form, with appropriate caveats. Individual assessments could be kept as separate reports to facilitate detailed dialogue and the development of appropriate remedial measures.

Aggregation of the results may be more appropriate using the statistical mode (or most popular score), or by using the median value. The following table provides an example of both methods.

	State V	State W	State X	State Y	State Z
Score	A	B	C	C+	C+
Median	Aggregate score C				
Mode	Aggregate score C+				