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 general 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 general 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 general 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 2016 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. It provides additional guidance for applying the PEFA methodology at the subnational level. To this end, it offers commentary 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, and preparing a subnational profile). A template provided in subsection 2.3 may be used to record the main features of public governance and financial management at the subnational level.

Section 3 focuses on indicators, including how the standard PEFA 2016 indicators may be interpreted 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.

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 on the PEFA website.[1]

The International Monetary Fund identifies "state" and "local" government units.[2] 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; may appoint their own officers, independent of external administrative control; and are able to raise, allocate, and spend some funds on their own initiative and within their own area of responsibility.

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.

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 a comparative 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)
- 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

[1] "10 steps for planning, implementing, and using PEFA," available at: http://www.pefa.org/sites/pefa.org/files/PEFA%20in%2010%20steps_Feb%208_2016.pdf.

[2] 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.

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.

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.

2.3. Compiling a subnational profile

It is good practice to prepare a profile of the entity or group of entities covered by each subnational PEFA assessment. This will allow the unique characteristics of these entities’ structures, functions, and resource allocation patterns to be identified and more easily linked to assessment results. The template below offers a clear basis for understanding and explaining assessment results:

Subnational government, <country>

This profile provides an overview of a subnational government structure, including main functional responsibilities, fiscal and budgetary systems, and institutions. It is not intended to provide a comprehensive explanation of intergovernmental financial relations. The profile may make reference to more detailed information from other reports.

Only one (possibly combined) subnational profile should be prepared per report, even if multiple subnational entities are covered.

This profile should be included as an annex to the subnational PEFA report.

1. Subnational government structure

- What higher-level government legislation and regulations define and guide the subnational government structure?
- What is the number of government levels or administrative tiers, and what is the average size of the population they serve?
- What is the year of the subnational government law, decentralization law, or last major reform of intergovernmental fiscal structure? What is the name of the law or reform?
- How does the entity, or entities, focused on by the assessment compare with other jurisdictions at the same level of government in terms of population size, density, economic activity, total and per capita expenditure, and own-source revenues?

Please fill out table A, which details the structure of the subnational government.

Table A. Overview of subnational governance structure in <country x>

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	40	80	0
State	Yes	Yes	No	10	1 million	15	5	80
Local	Yes	Yes	Yes	100	100,000	45	15	30

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

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.

2. Main functional responsibilities of the subnational government

- Which subnational government level is the most significant in terms of its public service delivery and public expenditure, as measured by the value of expenditure and coverage?
- What are the main expenditure functions or responsibilities of the government level under consideration? Where are these functional assignments defined (e.g., in law or a constitution)? Are these functional assignments generally accepted, clear, and followed in practice? Are the functions devolved, delegated, or shared with a higher-level government?

3. Subnational budgetary systems

- To what degree do central or higher-level laws and regulations guide the subnational budget cycle?
- What are the main features of the subnational financial management process: for example, do entities hold their accounts in the national treasury or in bank accounts in their own name?
- What is the composition of the subnational government, by economic classification, for the latest year for which actual expenditure data are available? (Complete the top section of table B.)
- Does the subnational government have its own budget, adopted by its own approval body (such as the legislature) without subsequent modification by a higher-level government (other than approval processes)? If not, please explain.
- Does the subnational government hold and manage its own accounts within a financial institution of its choice, within applicable legislation or regulation? Alternatively, is it required to hold accounts in a central bank or national treasury?
- Does the subnational government have the authority to procure its own supplies and capital infrastructure within the context of applicable procurement legislation or regulation? Is

higher-level or external approval required for subnational procurement, or is there a limit to the procurement authority of the subnational government?

4. Subnational fiscal systems

- What is the composition of financial resources collected and received by the subnational government in the latest full year for which revenue data are available? (Complete the bottom part of table B.)
- What are the main own-revenue sources assigned to the subnational level? What tax and nontax revenue sources are the most significant?
- What are the main intergovernmental fiscal transfers, including revenue sharing and intergovernmental grants, provided to the subnational government?
- Is the subnational government allowed to borrow? If so, what mechanisms for borrowing are available? What legislative or regulatory restrictions are imposed on subnational borrowing?

Table B. Overview of subnational government finances <year>

Item	Total value ($)	Value per capita ($)	Percent of total %
Wage and salary expenditure	100	10	77
Nonwage recurrent administrative expenditure	10	1	8
Capital expenditure	20	2	15
Total expenditure	**130**	**13**	**100**
Own revenue	50	5	38
Intergovernmental fiscal transfers	70	7	62
Other revenue sources	0	0	0
Total revenue	**130**	**13**	**100**
Borrowing	**0**	**0**	**0**

Note: Additional breakdown may be provided for main expenditure and revenue items.

5. Subnational institutional (political and administrative) structures

- Does the relevant subnational level have a directly elected approval body or legislature? If not, please explain. Is the elected body involved in approving the budget and monitoring finances?
- Is the local political leadership, executive, or approval body able to appoint its own officers independent of external or higher-level administrative control? Are the chief administration officer, the chief financial officer, internal auditor, and other subnational finance officials appointed and hired by subnational authorities?
- Is there any asymmetry in political, fiscal, and administrative arrangements in the country? If so, this should be captured in the narrative of the PEFA report.

3. Performance indicators

Subnational PEFA assessments use the same indicators as the national government, 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.

Pillar 1. Budget reliability

PI-1. Aggregate expenditure outturn

PI-1.1. Aggregate expenditure outturn

Aggregate expenditure "originally approved" is the total amount of expenditure approved by the subnational legislature (including expenditures funded by transfers to the subnational government and approved by the national legislature) presented in government budget documentation and fiscal reports.

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 this way, 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 deviations, as major capital projects are often delayed until resources become available.

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). An *Excel* spreadsheet that may be used to calculate PI-1 is available at www.pefa.org.

PI-2. Expenditure composition outturn

PI-2.1. Expenditure composition outturn by function

This assesses the variance in expenditure composition by program, administrative, or functional classification compared to the budget allocations originally approved by the subnational legislature (including expenditures funded by transfers to the subnational government and approved by the national 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. An *Excel* spreadsheet that may be used to calculate PI-2 is available at www.pefa.org.

PI-2.2. Expenditure composition outturn by economic type

This assesses the variance in expenditure composition by economic type compared to the budget allocations originally approved by the subnational legislature (including expenditures funded by transfers to the subnational government and approved by the national legislature). An *Excel* spreadsheet that may be used to calculate PI-2 is available at www.pefa.org.

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.

PI-3. Revenue outturn

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 include:

- Revenue collected by subnational governments directly[3] and retained by them
- Shared revenues collected and retained by subnational governments[4]

[3] 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.
[4] 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).

- Subnational revenues that are collected on behalf of the subnational government by a higher-level tax authority (these are neither transfers nor shared revenues)[5]

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 and other shared revenues collected by higher-level governments are not covered by this indicator and should not be taken into consideration when evaluating PI-3 at the subnational level. An *Excel* spreadsheet that may be used to calculate PI-3 is available at www.pefa.org.

PI-3.2. Revenue composition outturn

This dimension encompasses all revenue belonging to the subnational government, including transfers. Measuring any change in revenue composition applies the same methodology as that found in the PEFA 2016 Framework document for budgetary central government revenue.

Pillar II. Transparency of public finances

PI-4. Budget classification

PI-4.1. Budget classification

This dimension assesses the classification system used for formulation, execution, and reporting of the subnational budget.

Assessors should analyze the existing legal and regulatory context for budget classification(s) for the public sector in general and for higher-level governments and subnational governments in particular. Attention should be given to any significant differences between the classification systems used at the higher and subnational 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 a central government. However, at the subnational level not all of the 10 main functions and 69 subfunctions of COFOG may be applicable (e.g., defense, public order and safety, and environmental protection may be outside subnational government responsibility), where these are managed by the higher-level government.

PI-5. Budget documentation

PI-5.1. Budget documentation

This dimension assesses the comprehensiveness of information included in the documentation surrounding the subnational budget (as submitted to the subnational legislature, and **not** to the higher-level legislature).

[5] 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.

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 will 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 additional elements are available:

  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 additional elements are available:

  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

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.

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 be comprehensive and provided in a timely manner consistent with budgetary subnational reporting requirements (see PI-28).

PI-7. Transfers to subnational governments

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.

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 determining the layers of subnational governments, their expenditure responsibilities, and revenue-sharing arrangements.

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. Every fiscal transfer from a higher-level government to the relevant subnational government should be taken into consideration. If different formulae or criteria are used for different elements of transfer, the overall assessment may be made on a value-based weighted average.

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.

PI-8. Performance information for service delivery

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, which may include both unconditional and 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.

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.

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 service funded from all funding sources.

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.

PI-9. Public access to fiscal information

PI-9.1. Public access to fiscal information

Public access to fiscal information at the subnational level refers to access of the general public within the area and jurisdiction of the subnational government to the nine elements listed in PEFA 2016, PI-9.

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 III. Management of assets and liabilities

PI-10. Fiscal risk reporting

PI-10.1. Monitoring of public corporations

Public corporations are those established under the laws, control, and ownership of the subnational government. The dimension applies only if the subnational entity has direct ownership of the public corporation.

To avoid any confusion, assessors will need to ascertain and clearly report which level of government has specific responsibility.

PI-10.2. Monitoring of subnational governments

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

The dimension applies only if there are subnational entities lower than the one being assessed, and if the assessed subnational government has responsibility for the lower-level subnational governments. In this case, reference should be made to the relevant levels of subnational government.

However, if governing legislation requires lower levels of subnational government to directly report to the central government instead of a higher level of subnational government, then this dimension would not be applicable.

PI-10.3. Contingent liabilities and other fiscal risks

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.

PI-11. Public investment management

PI-11.1. Economic analysis of investment proposals

This dimension covers major investment projects managed by the subnational government (including those funded from transfers and other external revenue sources). Economic analyses of subnational governments should be conducted in accordance with subnational guidelines. If subnational guidelines are not available, the analyses should be in accordance with relevant national guidelines. Inconsistencies between national and subnational guidelines, where both exist, 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 subnational projects from the point of approval and throughout implementation.

PI-12. Public asset management

PI-12.1. Financial asset monitoring

This dimension refers to the monitoring of financial assets held by the subnational government. Records should be maintained by the subnational government or a higher-level government. If held by the higher-level government, records should be accessible to the subnational government—or this dimension is not applicable.

PI-12.2. Nonfinancial asset monitoring

This refers to nonfinancial assets held by the subnational government.

The register of holdings may be maintained by the subnational government or a higher-level government. If held by the higher-level government, records should be accessible to the subnational government—or this dimension is not applicable. The range and categories of nonfinancial assets held by the subnational government will vary by country and across subnational systems and constitutions.

PI-12.3. Transparency of asset disposal

This dimension refers to financial and nonfinancial assets held by the subnational government. Procedures and rules for the transfer or disposal of financial and nonfinancial assets are established either by the subnational government or higher-level government.

PI-13. Debt management

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.

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 IV. Policy-based fiscal strategy and budgeting

PI-14. Macroeconomic and fiscal forecasting

PI-14.1. Macroeconomic forecasts

If applicable, this dimension relates to macroeconomic forecasts prepared by the subnational entity only. This dimension will not be applicable at the subnational level if such data are already included in higher-level budget documentation or where collection and analysis of such data are not feasible or appropriate given the size, scope, or structure of the subnational government.

If macroeconomic assumptions are prepared by the subnational government, this dimension 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.

PI-14.2. Fiscal forecasts

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

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

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

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

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 or departments. 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

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. The subnational government may be required to follow the calendar of the higher-level government (MOF, Ministry of Local Government). The implications of subnational adherence to the budget calendar of the higher-level government should be clearly analyzed 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. 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.

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 in the narrative section of the report.

PI-18. Legislative scrutiny of budgets

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 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 V. Predictability and control in budget execution

PI-19. Revenue administration

PI-19.1. Rights and obligations for revenue measures

This dimension is applicable to only those subnational governments that raise revenue according to their own administrative arrangements (including for taxes, customs, and social security contributions).

This dimension does not apply in the following situations:

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

Assessors should examine the extent to which these subnational collecting entities provide payers with easy access to comprehensive and up-to-date information on the main revenue obligation areas and on rights, including, at minimum, redress processes and procedures.

PI-19.2. Revenue risk management

Assessors should measure the extent to which a comprehensive, structured, and systematic approach is used by subnational revenue administration entities to assess and prioritize compliance risks.

PI-19.3. Revenue audit and investigation

The assessor should look at whether subnational revenue administration entities have put in place sufficient controls to deter evasion and ensure that instances of noncompliance are revealed. Robust 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, actions are taken to minimize revenue leakage.

PI-19.4. Revenue arrears monitoring

This dimension assesses how revenue entities manage arrears, by focusing on the level and age of revenue arrears. It is only applicable to subnational governments that raise revenue according to their own administrative arrangements.

PI-20. Accounting for revenue

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. This dimension is applicable to only subnational governments that raise revenue according to their own administrative arrangements (including for taxes, customs, and social security contributions).

This dimension does not apply in the following situations:

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

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

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[6] 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, 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 forecast 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.

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

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.

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.

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.

PI-22. Expenditure arrears

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.

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), to creditors (short-, medium-, and long-term loans), and to a subnational entity if applicable.

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

PI-23.1. Integration of payroll and personnel records

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 the central (or other high-level) government, the assessment of the indicator will cover only that part of the payroll for which the subnational government is responsible (either in full or in part).

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 responsibilities should be included (including for funding and for payment).

PI-23.2. Management of payroll changes

This dimension assesses the timeliness of changes to personnel and payroll data managed at the subnational level. Any amendments required to data on subnational personnel should be reported in a timely manner and result in an audit trail.

PI-23.3. Internal control of payroll

This dimension assesses the controls that are applied to adjustments of subnational personnel and payroll data.

PI-23.4. Payroll audit

This dimension examines the integrity of the subnational payroll audit processes.

Although the subnational government may be responsible for personnel and payroll management, auditing the payroll system may be the responsibility of a higher-level institution. Such an arrangement may affect the scope and frequency of subnational payroll audits. The narrative should clearly explain any such arrangement and any adverse impact it may have on the score for this dimension.

PI-24. Procurement

PI-24.1. Procurement monitoring

This dimension analyzes the existing legal framework and institutions for procurement at the subnational level.

Various arrangements may be in place for procurement at the subnational level:

- A unified legal and regulatory framework for procurement at all levels of government.
- Regulation by central government legislation, which includes a separate section on procurement for subnational governments.
- A separate legal and regulatory framework for each subnational government.

Where either of the first two options are applicable, any interaction between the subnational government and a higher-level government should be clarified.

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.

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.

PI-24.4. Procurement complaints management

This dimension assesses the existence and effectiveness of an independent, administrative complaint-resolution mechanism for subnational procurement.

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

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.

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 the subnational government.

PI-25.2. Effectiveness of expenditure commitment controls

This dimension assesses the effectiveness of controls on subnational expenditure commitments. 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. 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

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. If it is applicable, but the function does not exist, the indicator and dimensions should be rated “**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.

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).

PI-26.4. Response to internal audits

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

Pillar VI. Accounting and reporting

PI-27. Financial data integrity

PI-27.1. Bank account reconciliation

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

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

The advances considered are those exclusive to a subnational entity.

27.4. Financial data integrity processes

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

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 MOF and line ministries (or equivalent bodies) will depend on the type of accounting and payment system in operation (centralized, deconcentrated, or devolved).

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

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

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.

PI-29.3. Accounting standards

This dimension measures the extent to which the basis of recording subnational operations—and the accounting principles and national standards used—is transparent. Higher scores require that the standards used for accounting are consistent with recognized international ones such as the International Public Sector Accounting Standards.

Pillar VII. External scrutiny and audit

PI-30. External audit

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 has its own audit office apart 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, then the relationship of the subnational government to the SAI should be explained, including how audit work is undertaken and how the audited accounts are submitted to the subnational legislature (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.

To assign an "**A**" or a "**B**" score for this dimension, in addition to the (minimum) required elements, there must be a clear delegation of authority across audit entities in legislation, agreements, or other official documents.

A "**C**" is assigned when there is no clear delegation of authority across audit entities, but the other requirements for a "**C**" are met.

PI-30.2. Submission of audit reports to the legislature

This dimension refers to audit reports submitted to the subnational or higher-level legislature.

If the subnational government has its own audit office, different from the SAI responsible for auditing higher-level accounts, the dimension reference should be made to the legislature of the subnational government, which could be a parliament, a council, or any equivalent body.

If the SAI responsible for the external audit of central entities is also responsible for the audit of subnational entities, then the assessor should specify whether:

- Audited financial statements of subnational entities are submitted to the legislature (central parliament), or
- Financial statements are considered first by the local legislature (council) and then submitted to the SAI for audit.

The SAI may also be required to submit subnational audit reports to the legislature of the higher-level government. In this case, details on the timeliness of submission are needed.

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.

PI-30.4. Supreme audit institution (SAI) independence

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

PI-31. Legislative scrutiny of audit reports

PI-31.1. Timing of audit report scrutiny

This dimension assesses the extent to which a legislature scrutinizes external audit reports. This may be undertaken at the national or subnational level.

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 or higher-level legislature conducts hearings on the findings of subnational audit reports. It assesses the level of legislative scrutiny (at the subnational or higher level) of audits performed by an SAI (whether at a subnational or higher level).

PI-31.3. Recommendations on audit by the legislature

This dimension covers recommendations made by a legislature—whether subnational or higher level—regarding subnational audits.

PI-31.4. Transparency of legislative scrutiny of audit reports

This dimension relates to the hearings conducted by the subnational legislature on audit reports (conducted at a subnational or higher level) 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 Country economic situation** **2.2 Fiscal and budgetary trends** **2.3 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** **Annex 4: Subnational government profile**

4.1. Introduction

The scope of the assessment should clearly specify which institutions are covered, and any of the main institutions that are excluded. Details of the sampling methodology and rationale should be provided where the assessment covers more than one subnational government unit.

The significance of national government policies and practices for subnational government PFM should be described, particularly where the subnational governments are highly dependent on central government.

4.2. 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.

4.3. 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 units should be presented in separate to make it easier to share them with the stakeholders of individual units.

4.4. Conclusions on the analysis of PFM systems

The conclusions section should distinguish which areas can be improved as a result of decisions made by the subnational government unilaterally, and which are bound by regulations or legislation at the national level (such as national accounting standards and classification systems prescribed by law).

4.5. 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+				