Ethiopia
Country Financial Accountability Assessment
(In Two Volumes) Volume I: Main Report

June 17, 2003
### Abbreviations and Acronyms

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>ACCA</td>
<td>Association of Chartered Certified Accountants</td>
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<tr>
<td>AIA</td>
<td>Association of Internal Auditors</td>
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<tr>
<td>ASC</td>
<td>Audit Services Corporation</td>
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<tr>
<td>BDA</td>
<td>Budget, Disbursements and Accounting System</td>
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<tr>
<td>BI</td>
<td>Budgetary Institutions</td>
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<tr>
<td>BIS</td>
<td>Budget Information System</td>
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<tr>
<td>BoFED</td>
<td>Bureau of Finance and Economic Development (Region)</td>
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<tr>
<td>CAD</td>
<td>Central Accounts Department</td>
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<tr>
<td>CAS</td>
<td>Country Assistance Strategy</td>
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<tr>
<td>CBE</td>
<td>Commercial Bank of Ethiopia</td>
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<td>CBO</td>
<td>Community Based Organisation</td>
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<td>CFM</td>
<td>Country Financial Accountability Assessment</td>
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<tr>
<td>CIDA</td>
<td>Canadian International Development Association</td>
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<td>CPAR</td>
<td>Country Procurement Assessment Review</td>
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<td>CPPR</td>
<td>Country Portfolio Performance Review</td>
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<tr>
<td>CRDA</td>
<td>Christian Relief and Development Association</td>
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<tr>
<td>CIDA</td>
<td>Civil Service Reform Programme</td>
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<tr>
<td>DAP</td>
<td>Development Action Plan</td>
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<tr>
<td>DBS</td>
<td>Direct Budgetary Support</td>
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<tr>
<td>DFID</td>
<td>Department for International Development</td>
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<td>DPPC</td>
<td>Disaster Prevention and Preparedness Commission</td>
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<tr>
<td>DSA</td>
<td>Decentralization Support Activity</td>
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<tr>
<td>EAAFA</td>
<td>Ethiopian Accountancy and Finance Association</td>
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<tr>
<td>EBF</td>
<td>Extra Budgetary Funds</td>
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<td>EFY</td>
<td>Ethiopian Financial Year</td>
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<tr>
<td>EMCP</td>
<td>Expenditure management and Control Programme</td>
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<td>EPAAA</td>
<td>Ethiopian Professional Association of Accountants and Auditors</td>
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<td>FGE</td>
<td>Federal Government of Ethiopia</td>
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<tr>
<td>GAAP</td>
<td>Generally Accepted Accounting Principles</td>
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<td>HIPC</td>
<td>Highly Indebted Poor Countries</td>
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<tr>
<td>IAS</td>
<td>International Accounting Standards</td>
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<td>IFMS</td>
<td>Integrated Financial Management System</td>
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<tr>
<td>IIA</td>
<td>Institute of Internal Auditors</td>
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<tr>
<td>INTOSAI</td>
<td>International Organization of Supreme Audit Institutions</td>
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<tr>
<td>ISA</td>
<td>International Standards on Auditing</td>
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<tr>
<td>LAN</td>
<td>Local Area Network</td>
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<tr>
<td>MEDaC</td>
<td>Ministry of Economic Development and Co-operation (now part of MoFED)</td>
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<td>MoE</td>
<td>Ministry of Education</td>
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<td>MoF</td>
<td>Ministry of Finance (now part of MoFED)</td>
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<td>MoFED</td>
<td>Ministry of Finance and Economic Development</td>
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<td>MoH</td>
<td>Ministry of Health</td>
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<td>MoU</td>
<td>Memorandum of Understanding</td>
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<td>MTEF</td>
<td>Medium Term Expenditure Framework</td>
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<td>NGO</td>
<td>Non-Governmental Organization</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
</tr>
<tr>
<td>OFAG</td>
<td>Office of the Federal Auditor General</td>
</tr>
<tr>
<td>PAC</td>
<td>Public Accounts Committee</td>
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<tr>
<td>PEM</td>
<td>Public Expenditure Management</td>
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<tr>
<td>PEP</td>
<td>Public Expenditure Programme</td>
</tr>
<tr>
<td>PER</td>
<td>Public Expenditure Review</td>
</tr>
<tr>
<td>PESA</td>
<td>Public Enterprises Supervision Authority</td>
</tr>
<tr>
<td>PIP</td>
<td>Public Investment Programme</td>
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<td>PRSP</td>
<td>Poverty Reduction Strategy Programme</td>
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<tr>
<td>RAG</td>
<td>Regional Auditor General</td>
</tr>
<tr>
<td>SNP</td>
<td>Southern Nations, Nationalities and Peoples Region</td>
</tr>
<tr>
<td>SQL</td>
<td>Structured Query Language</td>
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<tr>
<td>WAN</td>
<td>Wide Area Network</td>
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PREFACE

1. The Country Financial Accountability Assessment (CFAA) for Ethiopia was undertaken between April 2001 and November 2002, culminating in the in-country mission carried out over a three-week period in September and early October 2002 by a joint team of Federal Government of Ethiopia officials, World Bank staff, and a number of donor-funded consultants. The exercise covered nine modules set out in Section 2 of the Initiating Memorandum prepared and distributed in May 2002 to establish the groundwork for this exercise. Areas covered included those in the public sector at both Federal and Regional level, the private sector including the accountancy profession, and non-governmental organisations.

2. An Inventory Study consultancy was commissioned by the European Union, as the first step to the CFAA information gathering, to take stock of the current knowledge on budgeting, reporting and accounting processes in the public sector in Ethiopia. In particular, due to the Public Expenditure Reviews (PERs) that have been carried out continuously for eight years in cooperation between the Ethiopian Government and the donor community, much was known of the strengths and weaknesses of public expenditure management in the public sector. In addition, a comprehensive reform of the budgeting, reporting and accounting procedures had been embarked on by the Government since 1997 with the objective of improving the effectiveness and transparency of financial management.

3. Against this background, the main task of the CFAA was to assess how effective the reforms were at both Federal and Regional level and how far they have gone in addressing weaknesses identified in previous assessments. The CFAA exercise also had to take stock, albeit in a short and transitional period, of the impact of the Government's decentralization plan to transfer responsibility for service delivery, as well as very large financial resources, from Regional Governments to the next lower tier - the Woreda.

4. The Government Counterpart Team was led by W/o Almaz Abebe and consisted of W/o Aster Haile Sellasie, Ato Getachew Negera, Ato Taddese Birbirsa, Ato Alem Kifle, W/o Senait Melesse and W/t Konjit Zeleke. Other Government officials who worked with the teams, which travelled to the regions, were Ato Degu Lakew and Ato Negussie Teferra.

5. The multi-donor mission comprised of Brighton Musungwa (Task Team Leader, World Bank), Eshetu Yimer (World Bank), Mike Frazer (DFID Consultant), Edna Elliot-McColl (DFID Consultant), Giovanni Caprio (EU Consultant), Ian Bolton (EU Consultant), Jens Claussen (NORAD Consultant), Jerker Thorvaldsson (SIDA Consultant), Albert de Groot (Royal Netherlands Embassy Consultant), Anthony Bennett (Ireland Aid Consultant), Stewart Maugham (Ireland Aid Consultant). There were also national consultants from the firm of Getachew Kassaye and Co. These were Ato Akalu Nuriye, Ato Abraham Meshesha, Ato Tesfaye Gashaw, Ato Fikremariam Adal and Ato Tesfaye Alemu.

6. A one-day meeting was held on November 26, 2002 to discuss the draft findings and recommendations and to provide further inputs prior to the preparation and finalization of the draft report. The meeting was chaired by Ato Getachew Gebre, the State Minister, Ministry of Finance and Economic Development and was attended by about twenty-five stakeholders (including donors).

7. The work of the draft CFAA was validated in March 2003, during a two day workshop involving more than one hundred and twenty officials from all levels of Government and attended by the State Minister of MoFED, Ato Getachew Gebre, and donor representatives. This workshop confirmed the acceptance of the CFAA by the Government and all other partners in the process and helped to lend additional shape, prioritisation and substance to the actions, which will follow the completion of the CFAA process. These initiatives include a drill down and refinement of the Development Action Plan (DAP) to
further prioritise initiatives in more detail, including initial bench marking and timetabling. This refined DAP will be brought before the Public Institutions Committee and the Public Management Group who will then address the moving forward of the initiatives in consultation with the Government.

8. Peer Reviewers were Brian Falconer, Iraj Talai, Edward Olowo-Okere (AFTQK, World Bank); David Shand (Financial Management Anchor, World Bank); Michael O. Stevens, Navin Girishankar (AFTPR, World Bank), Duvvuri Subbarao, William James Smith (AFTP2, World Bank), Nicola Smithers (PRMPS, World Bank), Simon Gill (DFID, London)

9. Ishac Diwan (Country Director, World Bank, Ethiopia), Oliver Blake (Governance Advisor, DFID London), and Anthony M. Hegarty (Financial Management Manager, World Bank) supported the process throughout and provided the major guidelines.

11. The team wishes to pay special thanks to the Federal Government of Ethiopia, and particularly Ato Getachew Gebre, W/o Almaz Abebe and members of the counterpart team who worked closely with the mission. Special thanks are also extended to the representatives in Ethiopia of the EU, SIDA, NORAD, Ireland Aid, NORAD, the Netherlands for their active involvement in the CFAA process. The team also wishes to thank staff of the World Bank Country Office in Ethiopia, DFID, and, in particular, Ato Menbere Tesfa, for logistical support during the mission.
EXECUTIVE SUMMARY

1. A Country Financial Accountability Assessment (CFAA) is a diagnostic tool designed to enhance knowledge of financial accountability arrangements in the public and private sectors in client countries, to be used by the government of the country concerned, and other donors. It supports both the exercise of fiduciary responsibilities and the achievement of development objectives - fiduciary responsibilities, by identifying the strengths and weaknesses of accountability arrangements in the public sector and the risks that these may pose to the use of government own funds as well as those provided by donors; and development objectives, by facilitating a common understanding by the government, and development partners of the country's financial management arrangements in both the public and private sectors, thus facilitating the design and implementation of capacity building programs. However, it is not intended to, and does not, provide assurance on the specific uses to which government, and donor funds have been or may be applied.

2. The Ethiopia CFAA was carried out against a backdrop of a number of initiatives being undertaken by the Federal Government which have significant impact on financial management and accountability arrangements. At the heart of this transformation is a Woreda' decentralisation policy that transfers financial and human resources to the local government sphere in an attempt to encourage democratic decentralisation, downward accountability, and more responsive service delivery consistent with the broad fiduciary objectives of Ethiopia's expenditure management system. While ambitious and rapid, the Woreda decentralisation strategy is being managed pragmatically, primarily through commonsense approaches undertaken by Regions.

3. The CFAA, and specifically its Development Action Plan, has attempted to provide a strategic analysis of how devolution is in effect providing the lens through which public sector capacity building and Ethiopia's institutional development prospects should be viewed. As part of the assessment, visits were made to four regions, Amhara, Tigray, Somali and SNNP Region. The work focused on the effects of this devolution program and identified measures, in particular training and capacity building programs that could help to strengthen the accountability environment. These findings with regard to the devolution process are of a tentative nature as the process is still ongoing.

4. The overall conclusion is that considerable progress has been made in the rationalisation and strengthening of budgeting processes at the Federal level. The activities carried out in SNNP Region under the Budget Reform Program have made some progress, thanks to the determination of the management team at the Regional Bureau of Finance and Economic Development (BoFED), the effectiveness of the Decentralisation Support Activity (DSA) Project and the training programs organized in conjunction with the Regional Management Institute in Awasa and other locations. However, the rollout to other regions is still underway and support for this initiative is essential.

5. In spite of the foregoing, more needs to be done and a number of prioritised recommendations are highlighted in the Development Action Plan, which has been developed mainly within the context of reform initiatives already in existence or planned. These include the Expenditure Management Control Programme (EMCP), the Public Service Delivery Capacity Building Program (PSCAP), the Capacity Building for Decentralised Service Delivery (CBDSD) and the Civil Service Reform Program (CSRP). As detailed plans are developed, there may also be a need for additional 'stand-alone' initiatives.

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1 A Woreda is the lowest full-time government covering roughly 100,000 people and consist of an elected council and a set of sectoral offices.
6. However, in all of these initiatives it is critical that the Federal Government of Ethiopia maintain ownership and work together in a more harmonised approach with donors to establish realistic and achievable targets for implementation. There are many models for doing this and one of the encouraging aspects of this CFAA process was the willingness of donors to work together with the Government in establishing common ownership of this report. The work of the Strategic Partnership for Africa (SPA) mission in September 2002, which overlapped with this CFAA, has already begun to address the harmonisation of budget support for the Poverty Reduction Strategy. This alignment of donor approach compliments and enhances many of the recommendations arising from the CFAA.

Key Issues

7. The following provides, in a summary format, the key issues arising from the modules covered under the CFAA.

- Currently, the totality of Government funds or public money is not comprehensively covered within the existing financial reporting structures. Some progress has been made, but issues with regard to medium term financial planning, completeness, sequencing of the budget calendar and resource/capacity constraints in budget preparation and monitoring need to be quickly addressed if momentum previously gained in budget preparation is not to be reversed.

- It was too early in the process to determine completely the success of preparation of financial information under the new chart of accounts, and while there have been improvements, current accounting and reporting systems are weak in terms of delay and their incomplete nature. The focus on accurate end-of-year figures needs to be balanced with management accounting and in-year information. Initiatives for information systems may mitigate some of these concerns, but the existing planned IT initiatives should also be reviewed in the context of an overall Information Systems Strategy.

- The organisational and financial devolution to Regions/Woredas has the potential of reducing the previous ‘above average’ evaluation for financial integrity. There is urgent need to ensure that internal audit and other functions of internal control start to operate effectively at both the Regional and Federal level in this changing environment.

- There is currently a backlog in the presentation of audited accounts. This needs to be addressed along with the role of the various institutions in public oversight, including Parliamentary committees. The capacity and reach of the Federal Ethics and Anti-Corruption Commission needs to be strengthened. Proposed legislation to enhance public access to information needs to be translated into practice.

- With regard to Regional Governments, the present devolution process is currently posing short-term challenges in the practical implementation. There appears to be a trade-off between devolution of spending on the one hand and a strong financial accountability environment on the other. The problems are amplified by staff skill shortages at Woreda level, which need to be resolved. While innovative aspects of ‘block grant’ application have been introduced during implementation, fiscal decentralization still poses important challenges for informed expenditure management. A common feature of all Regions visited was that there was pressure on the timeliness of accounting and reporting information creating a potential problem in the financial management system. There was

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2 Ethiopia is one of the two pilot countries identified for harmonisation of donors' procedures using government systems. The introduction of a harmonised system of aid administration would reduce the burden of fulfilling conditionality by implementing agencies, and enhance transparency and trust in accounting for the support provided.
considerable variation in the fiduciary risk status in the four Regions visited demonstrating the importance of not creating a generalised view of Regions in Ethiopia.

- With regard to the private sector and Non-Governmental Organisations (NGOs), there is a shortage of resources for enforcing the law and monitoring compliance for NGO’s. The development of the private sector financial accountability is relatively low but the regulatory framework is extensive enough to provide for good corporate governance, with the exception of the Commercial Code of 1960. On the issue of the audit/accountancy profession, there is no national accountancy body or ‘standard setting’ body and the academic and practical training capacity in the Private Sector needs to be enhanced.

- As part of the implementation and follow-up of the CFAA and Development Action Plan, an integrated three-year rolling plan for Public Expenditure Management indicators should be identified.

**Risk Assessment**

8. The diagrams on the next two pages have been created to illustrate in a composite way the current levels of fiduciary risk and the impact that intervention may have. The ‘darkness’/depth of the shading reflects the seriousness of the perceived risk; consequently, the goal is to make the right hand side, or third year, as ‘light’ as possible. The diagrams demonstrate that, with sufficient impetus given to the planned and proposed interventions, most of the elements of weaknesses identified from the CFAA assessment could be reduced to the Moderate Risk (or lower) classification within a three-year time horizon. This should obviously take into account the absorption capacity for this level of initiative by the Government at both Federal and Regional levels. Also, the analysis only addressed the four Regions examined in the CFAA process, and while there were crosscutting issues common to all, there were also those specific to particular Regions. This may be the case with those Regions not covered by the CFAA. The nature of such diagrams makes them partially subjective and they cannot be a direct interpretation of the conclusions in the main text of the CFAA report; nevertheless, they do give a snapshot of the situation. The descriptions used to quantify the risk are as follows -

<table>
<thead>
<tr>
<th>KEY</th>
<th>Description</th>
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<tbody>
<tr>
<td></td>
<td>High Fiduciary Risk</td>
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<tr>
<td></td>
<td>Substantial Fiduciary Risk</td>
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<tr>
<td></td>
<td>Moderate Fiduciary Risk</td>
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<tr>
<td></td>
<td>Negligible or Low Fiduciary Risk</td>
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</table>

This also helps to place the evaluation in an international benchmark context and, while similar diagrams do not exist for other countries in sub-Saharan Africa, Ethiopia is above the modal point in nearly all areas in comparative terms.

9. Underpinning these diagrams is the Development Action Plan (DAP) that follows them. The second bar chart diagram is cross-referenced to the various initiatives in the Development Action Plan and how they should impact on the situation. These initiatives and actions are drawn from the work undertaken by the CFAA team and existing plans in the documentation supplied. Further details of the analyses are in Volume Two of the report. The two diagrams, Development Action Plans and the detailed text in the two volumes of this report provide some basis for the implementation by the Federal Government of Ethiopia.

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3 See Annex 1
under the direction of the Ministry of Capacity Building with assistance from the international community.

10. Apart from the first 'Key Action', no donor or project references have been included in the Development Action Plan. This is because in some areas there are planned initiatives/concept papers that have in some cases been overtaken by the impact and speed of devolution. In addition, some initiatives such as PSCAP are not yet sufficiently advanced to enable detailed matching. One of the priority issues in item one is the development of an integrated three-year rolling plan for PEM which should include appraisal of existing plans for projects and initiatives on any gaps that come to light. Figure 2 on the next page gives a visual overview of the effect that these DAP initiatives if implemented should have on the fiduciary risk level.
**Figure 1 – Fiduciary Risk Overview as assessed under initiatives already approved, financed and programmed for three years**

<table>
<thead>
<tr>
<th>PUBLIC SECTOR</th>
<th>SIMPLIFIED FEDERAL</th>
<th>FINANCIAL REPORTING</th>
<th>INFORMATION SYSTEMS</th>
<th>INTERNAL CONTROLS</th>
<th>RECORDS MANAGEMENT</th>
<th>INTERNAL AUDIT</th>
<th>EXTERNAL AUDIT</th>
<th>PUBLIC SECTOR OVERSIGHT</th>
<th>REGIONAL (SUMMARY)</th>
<th>AMHARA REGION</th>
<th>TIGRAY REGION</th>
<th>SOMALI REGION</th>
<th>SNPP REGION</th>
<th>PRIVATE SECTOR/OTHER</th>
<th>NGO/CBO's</th>
<th>PRIVATE SECTOR</th>
<th>ACCOUNTING PROFESSION</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>g11</td>
<td>g12</td>
<td>g13</td>
<td>g14</td>
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<td>g11</td>
<td>g12</td>
<td>g13</td>
<td>g14</td>
<td></td>
</tr>
</tbody>
</table>

**COMMENTS**
- Currently good budget discipline, but weaknesses in preparation, completeness and planning.
- Recognises improvements made, and validity checks in place.
- Currently not high risk, but as other components develop, it will become more critical.
- Currently not high risk, but as more sophisticated work develops, it will need to be addressed.
- Present function does not meet FGE guidelines or international standards.
- DFAG strong, but backlog of audits and problems with reporting arrangements.
- Impact of Anti-Corruption Commission positive, difficulties with PAC role and communication.
- Current impact of organizational changes and capacity problems.
- Current position related to capacity and organisational issues. But impact being addressed.
- Major organisational, capacity and logistical issues.
- Progress already underway in tackling issues of concern, ahead of other regions (NYT).
- Recognises that NGOs are generally OK, but that infrastructure needed for CBOs.
- Need reform of legislation, and implementation.
- Issues with regard to professional body and training need addressed.
Figure 2 – Fiduciary Risk Overview – with additional intervention planned or proposed implemented

<table>
<thead>
<tr>
<th>PUBLIC SECTOR</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Comments/Action References in Development Action Plan</th>
</tr>
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<td>FEDERAL BUDGET</td>
<td><a href="3.1">2</a></td>
<td><a href="3.1">2</a></td>
<td><a href="3.1">2</a></td>
<td>(2) Intervention to enhance capacity, planning and systems at Federal Level</td>
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<tr>
<td>ACCOUNTING</td>
<td><a href="3.2">2</a></td>
<td><a href="3.2">2</a></td>
<td><a href="3.2">2</a></td>
<td>(3.1) Further support for introduction of DSA approach</td>
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<td>FINANCIAL REPORTING</td>
<td><a href="4.1">2</a></td>
<td><a href="4.1">2</a></td>
<td><a href="4.1">2</a></td>
<td>(3.2) Development of Management Accounting/other financial reporting initiatives</td>
</tr>
<tr>
<td>INFORMATION SYSTEMS</td>
<td><a href="5.1">2</a></td>
<td><a href="5.2">2</a></td>
<td><a href="5.2">2</a></td>
<td>(4.1) Systems Strategy Developed, (4.2) Systems Strategy implemented</td>
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<tr>
<td>INTERNAL CONTROLS</td>
<td><a href="5.1">2</a></td>
<td><a href="5.2">2</a></td>
<td><a href="5.2">2</a></td>
<td>(5.1) Capacity building and internal control initiatives introduced</td>
</tr>
<tr>
<td>RECORDS MANAGEMENT</td>
<td><a href="6.1">2</a></td>
<td><a href="6.1">2</a></td>
<td><a href="6.1">2</a></td>
<td>(5.2) Capacity building in Records Management introduced</td>
</tr>
<tr>
<td>INTERNAL AUDIT</td>
<td><a href="7">2</a></td>
<td><a href="7">2</a></td>
<td><a href="7">2</a></td>
<td>(6.1) Plans for Internal Audit Initiatives Introduced</td>
</tr>
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<td>EXTERNAL AUDIT</td>
<td><a href="8">2</a></td>
<td><a href="8">2</a></td>
<td><a href="8">2</a></td>
<td>(7) CIDA project about to commence, but backlog issues to address</td>
</tr>
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<td>PUBLIC SECTOR OVERSIGHT</td>
<td><a href="9">2</a></td>
<td><a href="9">2</a></td>
<td><a href="9">2</a></td>
<td>(6.1) CIDA project on Parliamentry Oversight revised, (8.2) Support for Anti-Corruption Commission, (8.3) Initiative taken in Public Access area</td>
</tr>
<tr>
<td>REGIONAL (SUMMARY)</td>
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<tr>
<td>AMHARA REGION</td>
<td>(9.1)</td>
<td>(9.2)</td>
<td>(9.2)</td>
<td>(9.1) Capacity Building Programme Introduced, impact affected by starting position</td>
</tr>
<tr>
<td>TIGRAY REGION</td>
<td>(9.1)</td>
<td>(9.2)</td>
<td>(9.2)</td>
<td>(9.1) Capacity Building Programme Introduced, impact affected by starting position</td>
</tr>
<tr>
<td>SOMALI REGION</td>
<td>(9.1)</td>
<td>(9.2)</td>
<td>(9.2)</td>
<td>(9.1) Capacity Building Programme Introduced, impact affected by starting position</td>
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<td>SNIP REGION</td>
<td>(9.1)</td>
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<td>(9.2)</td>
<td>(9.1) Capacity Building Programme Introduced, impact affected by starting position</td>
</tr>
<tr>
<td>PRIVATE SECTOR/OTHER</td>
<td>(10)</td>
<td>(11)</td>
<td>(11)</td>
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<tr>
<td>NGOs/CBOs</td>
<td>(10.1)</td>
<td>(11.1)</td>
<td>(11.1)</td>
<td>(10) Development of standards and monitoring for CBOs</td>
</tr>
<tr>
<td>PRIVATE SECTOR</td>
<td>(11.2)</td>
<td>(11.2)</td>
<td>(11.2)</td>
<td>(11) Support for Legislative update and standards bodies</td>
</tr>
<tr>
<td>ACCOUNTING PROFESSION</td>
<td>(11.3)</td>
<td>(11.3)</td>
<td>(11.3)</td>
<td>(11.2) Support for Accountancy profession to raise standards and training</td>
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## DEVELOPMENT ACTION PLAN

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<tr>
<th>Key Action</th>
<th>Sub-Activity</th>
<th>Responsibility</th>
<th>Timing (Fiscal Year)</th>
<th>Expected Benefits/Comments/CFAA Section Links</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Development of detailed and co-ordinated implementation Plan for CFAA areas</td>
<td>Co-ordinate fiscal decentralization efforts in parallel with budget planning by MoFED</td>
<td>Lead MoFED Others Regions</td>
<td>✓️️ 2003/04 ✓️️ 2004/05-2007/08 ✓️️ 2007/08 +</td>
<td>Effective and timely resource allocation, planning and monitoring. Need for support management of change process in MOFED for Budget and BOFED areas to ensure budget generation has sufficient capacity and sequencing is correct. Possible support PSCAP, EU. (CFAA Section 2.1)</td>
</tr>
<tr>
<td>Creation of a Financial Information Systems Strategy and implementation timetable</td>
<td>Lead MoFED Others Line Ministries, Regions</td>
<td>✓️</td>
<td>Establishes an IT framework within which initiatives at Federal and Regional level can be implemented in a co-ordinated, structured and sustainable way. Needs to address where IFMS fits in new Regional/Federal relationships and that sequencing is correct. Also they are of local support capacity. Possible PSCAP. (CFAA Section 2.3)</td>
<td></td>
</tr>
<tr>
<td>Development of Three year rolling integrated Plan for PEM</td>
<td>Lead MoFED Others Line Ministries, Regions</td>
<td>✓️</td>
<td>Establishes a strategic framework within which initiatives can be taken in response to changing needs. Where required perhaps under auspices of Public Finance Management Committee (PFMC) to take forward the issues in the Development Action Plan. (CFAA - Executive Summary).</td>
<td></td>
</tr>
<tr>
<td>1. The PGE comply with the existing legislation and strictly apply the budget calendar, in terms of budget creation and reporting. Budgets</td>
<td>Reinforcement and support for existing rules and regulations in the budget calendar and budget process</td>
<td>Lead MoFED Others Line Ministries, Regions</td>
<td>✓️</td>
<td>Confirms that funds are reaching their intended purpose, and that all Public Money received or collected is properly budgeted and accounted for by Federal and Regional Governments. (CFAA Sections 2.1 and 5)</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>Priority</td>
<td>Medium Term</td>
</tr>
<tr>
<td>are also made comprehensive with capital and recurrent combined. Multi-year planning is introduced and support for budget function at Regional Level.</td>
<td>Development of Medium Term Budget Planning at Federal level, with emphasis on comprehensiveness and completeness of the budget</td>
<td>Lead MoFED Others Line Ministries</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Support for budgetary process at Regional Level. Resources to back up initiatives of the DSA project and to assist in the development of medium term financial models at Regional level</td>
<td>Lead BoFED Others Woredas</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>3. Improve FGE accounting and financial reporting standards</td>
<td>Develop a road map and realistic time bound action plan for the introduction of double entry modified cash system across the entire government</td>
<td>Lead MoFED Others Line Ministries, Regions</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Improve speed and accuracy of financial reporting supported by capacity and infrastructure investment</td>
<td>Lead MoFED Others Line Ministries, Regions</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Key Action</td>
<td>Sub-Activity</td>
<td>Responsibility</td>
<td>Timing (Fiscal Year)</td>
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<tr>
<td></td>
<td>Introduction of new management and financial reporting mechanisms</td>
<td>Lead MoFED Others Line Ministries (particularly those with Sectoral approach)</td>
<td>Priority Medium Term Long Term</td>
<td>Development of alternative but integrated financial reporting mechanism, which emphasises the value of speed of reporting to enable decisions to be made in-year, thus improving effectiveness of the targeting of funds. (CFAA Section 2.2 and 5)</td>
</tr>
<tr>
<td></td>
<td>Investigate the possibility of introducing integrated treasury and cash management, supported by simplified banking arrangements</td>
<td>MoFED Regions</td>
<td>✓ ✓ ✓</td>
<td>Minimizes workload, irregularities and speeds up reporting requirements. (CFAA Section 2.2 and 5)</td>
</tr>
<tr>
<td>4. Agree Information Systems approach and standards, and implement in a sustainable way at Federal and Regional Level</td>
<td>Introduction of suitable IFMS system at Federal level and if appraised possible at Regional level, with appropriate supporting intermediate technology</td>
<td>Lead MoFED Others Line Ministries, Regions</td>
<td>✓ ✓ ✓</td>
<td>Next step development from DSA initiatives, building on that success, capturing information in a faster, more accessible and accurate way. Thus creating better core data for budget planning, financial reporting and audit. (CFAA Section 2.3)</td>
</tr>
<tr>
<td>5. Internal control and records management, capacity building at Federal Level</td>
<td>Development of capacity in terms of skills, availability and tools to enhance the financial management process in a coordinated way in MoFED and line ministries</td>
<td>Lead MCB Others MoFED, Line Ministries</td>
<td>✓ ✓ ✓</td>
<td>Enhancement of internal control and integrity of the financial systems. (CFAA Section 2.4)</td>
</tr>
<tr>
<td>Key Action</td>
<td>Sub-Activity</td>
<td>Responsibility</td>
<td>Timing (Fiscal Year)</td>
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<td></td>
<td>Priority</td>
<td>Medium Term</td>
</tr>
<tr>
<td>Records management initiative to overcome current shortfalls in records storage arrangements. Also to address the implications and requirements for IT backup and security as those systems develop. Establishment of government wide standards for records management</td>
<td>Lead MCB Others MoFED, Line Ministries</td>
<td></td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Internal audit development at Federal Level</td>
<td>Implement an initiative to consolidate the organisational structure, redefine the work and duties of the internal audit function to better address the needs of the FGE</td>
<td>Lead MoFED Others Linc Ministries</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>External audit support and development</td>
<td>Enhancement of the skills, capacity and tools available for the OFAG. Development of stronger institutional linkages to internal audit, ASC, and private sector auditors</td>
<td>Lead OFAG Others Parliamentary Committees</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>Oversight functions, anti-corruption and public access</td>
<td>Enhance the skills and capacity of Parliamentary oversight committees.</td>
<td>Lead Parliament Others OFAG</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>Key Action</td>
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<td></td>
<td>Support for the further development of Federal Ethics and Anti-Corruption Commission</td>
<td>Lead Parliament</td>
<td>Priority: 2003/04</td>
<td>Improved financial integrity and anti-corruption initiatives in place. (CFAA Section 3.4)</td>
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<tr>
<td></td>
<td></td>
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<td>Medium Term: 2004/05-2007/08</td>
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<td>Long Term: 2007/08+</td>
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<tr>
<td></td>
<td>Improve public access to information</td>
<td>Lead</td>
<td>Priority: -</td>
<td>Improved transparency of information allowing stakeholders to ask informed questions and promote the appropriate responses. (CFAA Section 3.5)</td>
</tr>
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<td></td>
<td></td>
<td>MCB Others Media Civil Society Donors DFID</td>
<td>Medium Term: -</td>
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<td>Long Term: -</td>
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<td></td>
<td>Regional initiatives to enhance the capacity of Bureaux and Woredas in Public Expenditure Management. Ensuring that the previous levels of internal control standards in the FGE are maintained at Regional level.</td>
<td>Capacity building initiatives at Regional/Woreda level, to support the devolution of budgetary and financial responsibility. Skills training, organisational development and appropriate technology</td>
<td>Priority: 2003/04</td>
<td>Progress dependant on the Region and the current status of PEM. Expectation that SNNP and Tigray from those visited by the CFAA team will move at a faster pace than Amhara and Somali. (CFAA Section 5)</td>
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<tr>
<td></td>
<td></td>
<td>Lead</td>
<td>Medium Term: -</td>
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<tr>
<td></td>
<td></td>
<td>BOFED Others MoFED Donors Regional Specific</td>
<td>Long Term: -</td>
<td></td>
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<tr>
<td></td>
<td>Re-appraisal and reorganisation of the work of the internal audit and inspectorate function at Regional Level</td>
<td>Lead</td>
<td>Priority: 2003/04</td>
<td>This should be cross-referenced to DAP 6 above. But the increased Regional autonomy means that the role of the internal audit and inspectorate functions in different Regions should be reviewed and supported. Differences in approach are already starting to take place between regions (CFAA Section 5)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>BOFED Others MoFED Donors Regional Specific</td>
<td>Medium Term: -</td>
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<td>Long Term: -</td>
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<th>Timing (Fiscal Year)</th>
<th>Expected Benefits/Comments/CFAA Section Links</th>
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<tbody>
<tr>
<td></td>
<td>Development of records management policy and its implementation to support</td>
<td>Lead BOFED Others</td>
<td>✔️  ✔️  ✔️</td>
<td>This should be cross-referenced to DAP 5, and this issue needs to be considered from both Regional and Federal perspectives as regional records are the primary documents supporting the expenditure of Federal grants. (CFAA Section 5)</td>
</tr>
<tr>
<td></td>
<td>initiatives particularly in Information Technology and financial</td>
<td>MCB Donors</td>
<td></td>
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<tr>
<td></td>
<td>accounting/reporting</td>
<td>Regional Specific</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10.  Strengthen private sector accounting and auditing standards</td>
<td>Appoint a committee to recommend a suitable and legal institutional</td>
<td>MoFED EPAAA IIA</td>
<td>✔️  ✔️  ✔️</td>
<td>This work will create a more professional accountancy and auditing entity which will strengthen both public and private sector, with potential to ease existing capacity constraints (CFAA Section 8)</td>
</tr>
<tr>
<td></td>
<td>framework for the strengthening of the profession</td>
<td>Donors</td>
<td></td>
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<tr>
<td></td>
<td>Establish twinning arrangements between the institute in Ethiopia with</td>
<td></td>
<td>✔️  ✔️</td>
<td>This work will support the enhancement of the profession and open up opportunities for practical learning using placements etc. (CFAA Section 9)</td>
</tr>
<tr>
<td></td>
<td>well-established institute</td>
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<tr>
<td>11.  Strengthen/expand accountancy programs at tertiary educational</td>
<td>Prepare a comprehensive implementation plan to guide future direction of</td>
<td></td>
<td>✔️</td>
<td>This compliments the enhancement of professional skills as detailed in DAP 10 above (CFAA Section 9)</td>
</tr>
<tr>
<td>institutions</td>
<td>the diploma/graduate accountancy education</td>
<td></td>
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<tr>
<td></td>
<td>Support provision of courses by qualifying institutions, including private</td>
<td></td>
<td>✔️</td>
<td>This area will be the practical out working of the plan. (CFAA Section 9)</td>
</tr>
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<td></td>
<td>training institutions</td>
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<tr>
<td>Key Action</td>
<td>Sub-Activity</td>
<td>Responsibility</td>
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<tr>
<td></td>
<td>Carry out a study on the supply and demand of accountants and auditors both in the public and private sectors.</td>
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<td>Further development of a skills base to meet capacity that is required. (CFAA Section 9)</td>
</tr>
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1. INTRODUCTION

1. The CFAA examined the means by which the Federal Government of Ethiopia intends to improve the management of resources to enhance sustainable economic growth and reduce poverty. There are many challenges but the likelihood that Ethiopia will receive substantial assistance in the coming years means that, in order to maximise this opportunity, financial accountability issues and the exercise of fiduciary responsibilities in line with development goals are a priority.

2. A key theme in the exercising of this fiduciary responsibility is to ensure that not only are the issues addressed at Federal level, but with the increasing devolution of fiscal responsibilities to 'Regions of Responsibility', that strengthening of financial accountability systems also occurs at the Regional level. Of particular emphasis will be the human capacity issues that decentralisation initiatives have emphasised, which are in addition to technical considerations in systems for budgeting, accounting and financial reporting.

3. Progress has been made in some areas over the last two years, particularly through the MoFED Expenditure Management Control Programme with the support of USAID. However, in the context of wider needs, there is still a considerable series of initiatives and tasks ahead for the Government. The CFAA was undertaken at a point in time when major transition was underway within the public expenditure management process in Ethiopia. Some of the issues identified are undoubtedly influenced by the fact that this change was taking place.

Organisation of Report

4. The CFAA is presented in nine chapters. Following this introduction, Chapter 2 focuses on the work of the Federal Government and looks at Public Sector Budgeting, Accounting and Reporting, and Internal Controls. Chapter 3 addresses Public Sector Oversight Arrangements and looks at the Office of the Federal Auditor General, Parliament and the newly established Federal Ethics and Anti-Corruption Commission. There is also a very brief examination of the issue of Public Access to Information. Chapter 4 analyses the fiduciary risks at Federal level. With the increasing autonomy of Regional Governments, Chapter 5 focuses exclusively on this area using the assessments undertaken in four Regions as a basis. This is followed by an analysis of the fiduciary risks at Regional level in Chapter 6. Chapter 7 deals with Non-Governmental and Community Based Organisations (NGOs/CBOs) and Chapter 8 the Private Sector. Finally, Chapter 9 addresses the skills and structural issues with regard to the Accountancy Profession in Ethiopia.

5. The main recommendations - already highlighted in the Executive Summary - are presented in a matrix, focusing on the key ones with an indicative timeframe. The risks are analysed according to DFID and OECD/DAC guidelines for managing fiduciary risks when providing direct budget support. These are based on the IMF Code of Good Practices on Fiscal Transparency, the IMF/World Bank reviews of 25 HIPC Countries and IFAC/PSC International Public Sector Accounting Standards. Developmental benefits are defined by implication in terms of pro-poor expenditures in line with methodologies that have been used in other similar assessments.

6. The CFAA report is presented in two volumes: Volume One is the consolidated shorter summary; Volume Two contains the detailed individual reports of each specific component and Region.
2. PUBLIC SECTOR – FEDERAL GOVERNMENT

2.1 BUDGET PREPARATION, IMPLEMENTATION AND MONITORING

1. The CFAA team noted that much work had already been undertaken on Public Sector Budgeting in Ethiopia in recent years. There was, therefore, a considerable amount of current and relevant information available. This report does not seek to reiterate previous knowledge, which is extensive, but focuses on recent developments and assesses their significance in the context of a move by donors to direct budgetary support. As part of the review process, relevant historic and current reports and papers were analysed.


3. Proclamation 57/1996 directs the Ministry of Finance and Economic Development (MoFED) to establish the format for the annual budgetary submissions and to set the ceiling on which the budget requests are based. The proclamation also makes the Council of Ministers responsible for ensuring that Regional Governments remain accountable for subsidies and that they have a financial management and reporting system that is consistent with the proclamation. The proclamation does not however establish any procedures by which the Council of Ministers can enforce their responsibility. Regulation 17/1997 sets out the following procedures relevant to this report:

- The annual budget should include all capital and recurrent expenditures arising from taxation, external assistance and external loans;
- Once the budget has been approved it is the responsibility of the heads of each public body to provide information to enable the Government to maintain necessary central control over budgetary funds; and
- The MoFED prepares an annual set of consolidated accounts to show actual revenue and expenditure against the approved budget, which should be submitted to the office of the Federal Auditor General for audit.

4. The general feedback indicated that the legislation was broadly sound. However, core legislation on budgeting and accounting needs to be updated to incorporate recent changes in procedures such as the new Chart of Accounts and the Budget Calendar, issues connected with the decentralisation of budgetary management to the Regional Governments and to strengthen the role of the new MoFED in connection with its responsibility for setting the rules, regulations and procedures for public sector fiscal management.

5. Considerable work has been undertaken as part of the Civil Service Reform Programme at Federal level of Government on the development of budgeting and accounting systems. This initiative by the Government, with the assistance of the USAID-funded Decentralisation Support Activities (DSA) project, has had a positive reform impact. Changes in both the structure and processes of the budget have been introduced and culminated in the elaboration of a high quality budget in the Ethiopian Fiscal Year (EFY) 1994 (2001-2002). Unfortunately, the progress made in the production of that year's budget was not maintained in the EFY1995 (2002-2003) budget and the team were concerned about the sustainability of the budget reform at Federal level. We understand that problems occurring in the use of the Budget Information System (BIS) have now been resolved and allocations have been made for additional staff in the budget departments (Note: They have not yet been recruited and this
might be a problem since qualified staff are difficult to find). While these represent positive steps, the team believes that caution is still needed and that it must be ensured that staff have a correct understanding of the system. As the reform is rolled out to Regions and Woredas and resources have moved to this initiative, the experience at Federal level raises issues of sustainability in the medium term and the speed with which rollout can be applied in a sustainable manner.

6. An important outcome of the DSA project has been the introduction of a new Chart of Accounts. This constitutes a set of revenue and expenditure codes that applies consistently across recurrent and capital expenditure from the Federal to Regional levels of administration. This was introduced at the Federal level in EFY 1994 (2001/2002) and is being rolled out to the first four Regions. It was introduced in the SNNP Region for the current EFY 1995 (2002-2003). The Chart will eventually apply down through all the Regions as the decentralisation process rolls out. A further outcome of the DSA project was the introduction of a new indicative Budget Calendar. It defines the financial planning and budgeting cycles, establishes time frames, and specifies the stages in each cycle. Also defined are institutional responsibilities from the bottom (Woreda level) upwards. This has not yet been fully tested in practice.

Medium-Term Expenditure Planning

7. Progress was made within the MoFED towards medium term financial planning by designing a Public Investment Programme (PIP), covering capital expenditure over a three-year period. The last PIP exercise was carried out in 2002 after the budget was prepared. A Public Expenditure Programme (PEP) covering recurrent and capital expenditure for a three-year period was also designed with USAID-funded technical assistance. However, the PEP exercise has not yet been carried out.

8. There has been some progress in bringing together capital and recurrent budgets, although the merger of the Ministry of Economic Development and Co-operation (MEDaC) and Ministry of Finance (MoF) in October 2001 to form the MoFED took place too late in the cycle for a convergence of functions during the EFY 1995 (2002/2003) budget preparation process. Some progress has been achieved in incorporating off-budget funds in the presentation of Public Money – for example, the EFY 1994 (2001/2002) budget included an annex for the Food Aid. This was not carried through into the following year and a number of off-budget funds operate outside the main budget structure. These funds have their own budgeting and accounting processes and prepare their budgets to timetables different to that of the central budget. Donor funding is directed through three channels: Channel 1 funds are managed through accounts held by MoFED and are incorporated into the budget process; Channel 2 funds are managed through deposit funds held by ministries and Regional Governments and are fully captured by the central budgeting process; Channel 3 funds are paid directly to projects and bypass Central and Regional Government financial control and budgeting processes. This is not, however, an issue unique to Ethiopia.

Assessment of Risk

9. One of the major risks is the lack of ownership in the MoFED for the reform of the federal budget as well as the decentralisation process. Although the team was not able to assess accurately how long this risk would last, it is believed that it is transitional because of a genuine commitment to the reforms at the technical levels. However, there is the underlying risk that new staff to be employed in the departments are not fully cognisant of the decentralisation reform process and the impact this has on the preparation of the budget. Other related risks are those resulting from the weak organisational structure of the MoFED.
(after the merger of the two ministries) and the resultant, incomplete understanding of the decentralisation reforms with reference to the specific role of the MoFED. This uncertainty extends to the PIP and PEP within MoFED with the late production of PIP also viewed as a risk. Predictability of funding at Regional and Woreda levels is also seen as a risk to smooth service delivery. There is also the necessity to ensure that resource allocation is clearly linked to the objectives of the Poverty Reduction Strategy Program (PRSP).

Ongoing Reforms

10. The USAID and Ireland Aid-funded DSA project implemented by Harvard University started in 1997 with the detailed design of the reform. Changes in both the structure and processes of the budget have been introduced at the Federal level.

11. Within the MoFED, there are currently activities related to the Public Investment Programme (PIP) and to the Public Expenditure Programme (PEP) programmed to be carried out in the course of EFY 95 (2002-2003). As far as the PIP database management system was concerned, MoFED would like to strengthen and expand it and intends to look for technical assistance and funds in this area. In addition, the ownership of the database management system will be transferred to MoFED and the existing system revised, strengthened and expanded in conformity with the new MoFED structure. For the PEP, the MoFED also intends to look for technical assistance for the implementation of a PEP project and move forward in this area.

12. A Tax System Reform project will be implemented at the new Ministry of Revenue. It is worth mentioning this project because of the positive impact it is expected to have on the budget accountability and transparency. The project is expected to encourage capital investment and development, improve tax revenues and ensure equity and fairness in the tax system through a comprehensive overhaul of the current legislation; it will also develop a modern tax administration system capable of executing the Government's revenue policy initiatives and to collect effectively revenues that the economy generates.

13. There are plans for an Integrated Financial Management System (IFMS) supported by the European Union to be piloted in five institutions at the Federal level during the coming two years although, as indicated in the IFMS section of this report, there are issues associated with the sequencing of activities, particularly related to the budget process. It is also important that the project builds on previous developments such as the Budget and Accounting components of the Expenditure Management and Control Programme (EMCP). The Budget, Disbursement and Accounting (BDA) system has been introduced at the level of the Federal Government and all Regions and the BIS at the Federal level. The BIS has been rolled out this year (EFY 1995) to the SNNP Region and this process will continue gradually to the other Regions.

Conclusions and Recommendations

14. Considerable progress has been made in the rationalisation and strengthening of budgeting processes at the Federal level. This culminated with the elaboration of a comprehensive and high-quality budget for EFY 94 (2001-2002), with the design of both the PIP and the PEP and with the preparation of PIP on a yearly basis. However, the failure of the Federal Government to approve the PEP/PIP and its indicative planning figures, with the

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4 The Ministry of Finance and Economic Development (MOFED), the Ministry of Education, the Ministry of Health, the Ethiopian Road Authority, the Federal Civil Service Commission.
result that Regions were not informed early enough about their resource envelopes, undermines the objectives of decentralisation. Regions are, therefore, handicapped with an unpredictable resource envelope over the medium-term, and relegated to an incremental budgeting scenario in the interim. This has the effect of transferring the costs of unpredictability downwards. In considering the introduction of direct budget support in the near future, Federal budgeting achievements need to be balanced against these remaining weaknesses and a time frame set for addressing them.

15. The following recommendations reflect the growing need to improve public sector budgeting, transparency, and accountability in general:

- MoFED needs to re-define its responsibilities and competencies paying particular attention to its role regarding the Regions and the consolidation of the budget and financial accounts; it would also benefit from a structural reorganisation outlining a better exchange of information within the ministry. A study to identify these needs is recommended;

- Although the team understands that staffing issues have been addressed since the CFAA took place we recommend that, together with the study for the reorganisation of the MoFED, an assessment of staff capabilities as regards the budget consolidation and decentralisation process should be undertaken and training needs implemented accordingly;

- For the preparation of the EFY 1996 (2003-2004) budget, it is essential, as a minimum, to get back to the EFY 1994 (2001-2002) status. This means producing the budget through the BIS system (which we understand is now being done) and using account codes. The intention should be to have all Public Money accounted for. The consolidated presentation should take into consideration the plans of all extra budgetary operations (if possible, at all levels of Government but at least at the Federal and Regional levels). Planned activities of the Disaster Prevention and Preparedness Fund (DPPF) need to be integrated in budget planning and management together with the operations of the Ethiopian Social Rehabilitation and Development Fund (ESRDF). Extra budgetary funds should be at least annexes to the budget and presented to the Public Accounts Committee and Parliament for consideration with the annual budget;

- MoFED should examine the PIP and PEP exercises and plan a future direction. There is need at least to clarify the status, and the exact plan for carrying out related PIP and PEP activities in the future;

- MoFED should review the proposed financial calendar, responsibilities and, particularly, the activities (and related timing) of the planning cycle. Availability of information on revenues (domestic and external) also needs to be looked at. Predictability of revenues and of disbursement of funding to Regions is an issue holding back the delivery of services and needs to be addressed adequately. There should be a strict adherence to the deadline for notifying the subsidies to the Regions to avoid delays in their budget preparation process;

- Donors should coordinate their activities and provide projected three-year aid forecasts to the authorities and to do so on time. This information is indispensable for the budget preparation process in general.
2.2 ACCOUNTING AND FINANCIAL REPORTING

1. The Ministry of Finance and Economic Development (MoFED) is responsible for accounting and financial reporting of the Federal Government. Within MoFED, the Central Accounts Department (CAD) prepares the accounts for the ministry itself and consolidates the monthly, quarterly and annual financial statements of the 153 Budgetary Institutions (BI's) and the 11 Regions. The Regions are funded by a grant from the Federal Government as well as Channel 2 and 3 aid and their own revenue-raising abilities as set down by Parliament. BI's are funded by the Federal budget as well as Channel 2 and 3 aid5.

2. The preparation of financial statements for the Federal Central Accounts Department is governed by Parliamentary Proclamations, which were last revised in 1996/1997. Internationally recognised accounting standards are not consciously followed as the Accounts Department follows Ethiopian regulations and generally accepted accounting practices.

3. The Federal Government is implementing a series of reforms, one of which is the Expenditure Management and Control Programme (EMCP). USAID, through the DSA Project, is funding part of this to assist in the upgrading of accounting and financial reporting systems. Under this project a new Chart of Accounts was introduced into the preparation of the Federal and consolidated accounts with effect from 8 July 2002. SNNP Region has also started on the process of adopting this system. In the meantime, all other Regions are using the old Chart of Accounts and a translation table has been produced by DSA for the use of MoFED CAD to incorporate old codes into the consolidated accounts. New accounting manuals have also been introduced and staff trained in their use. The system also has the facility to enable a record of commitments to be kept.

4. At the Federal level, the current system uses the new Chart of Accounts introduced at the start of the EFY1994 (2001-2002). The collection of accounting data is generally done manually, providing summary batch processing information, which is entered to 'stand-alone' personal computers (PCs) for report production and consolidation purposes. The project has significantly improved the accounting process in international comparative terms over the past two years, by introducing a limited double entry system and also enhanced capacity with the provision of manuals, training support and some low level computerisation.

5. The new manual accounting system is to be commended for its simplicity as staff without computer knowledge are able to prepare primary documents and collate returns in batches. Computer-skilled staff are needed for batch input and for preparation of adjustments.

6. Bank reconciliation at the CAD was up-to-date. However, there was no information at CAD as to the timeliness of reconciliation at BI's or Regions as these are not required to be presented to CAD. At the end of each year, all bank accounts are blocked and funds remaining flow back to the Treasury. This is a good system of control to ensure that no expenditure, which is unaccounted for, takes place after the year-end from previous year’s funds. However, bank statements are used as the primary source for cash registers and consequently all disbursements and receipts are reconciled to them. This is not ideal.

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5 Channel 1 funds are managed through accounts held by MOFED and are incorporated into the budget process. Channel 2 funds are managed through deposit funds held by ministries and regional governments, and are fully captured by the central budgeting process. Channel 3 funds are paid directly to projects and bypass central and regional government financial control processes.
7. Although the MoFED CAD has seven staff members with degrees out of twenty-seven, the department is operating under capacity. Staff are able to maintain output by working extra hours and, primarily, because many Regions and BI’s are between two and twelve months behind in submission of monthly accounts. However, it is unlikely that staff would sustain this level of overtime over a long period of time. Neither would the department cope once accounting systems in the Regions are upgraded and start submitting information more efficiently. Capacity constraints are restricting the pace of changeover to the new Chart of Accounts and process. The low salary scale means that the Government has difficulty in attracting and retaining skilled employees.

8. About 100 of the 153 BI’s have managed to prepare their financial statements using the new Chart of Accounts since July 2002 and are, at most, only two months behind. This is a significant proportion given the manual preparation of accounts and low levels of capacity across all BI’s. However, of those Regions and BI’s which have not delivered financial statements on time, some are up to twelve months behind in processing. Even though there are some high level monthly reports from Regions, the lack of completeness and timeliness mean that management information is not prepared in time to assist planners and managers. The delays were due to the manual accounts system and lack of skills and capacity at these BI’s and Regions. In some instances, BI’s were awaiting details from other departments or Regions and were not prepared to release information until figures could be accurately verified. There are heavy penalties for producing inaccurate information. The amount of detail required in reports for consolidation purposes also takes a considerable length of time to accumulate and is not always necessary for management purposes. Regions and outlying areas of line ministries face added difficulties in obtaining information due to the lack of infrastructure in rural areas. There is also a problem in the Treasury Department. Current legislation states that no advance should be made to a public body until previous advances have been accounted for. However, and of necessity to make urgent expenditures, this is sometimes flouted and as a result, there is a backlog of unsettled advances.

9. Recognition should be given to the well-disciplined culture that exists in the Government, with a significant level of validation of payments and financial control. This validation environment does however have the effect of slowing down the speed of financial reporting. Sectoral programmes in Health and Education also had problems of late reporting and accounts closure.

10. A common theme identified in the accounting and financial reporting area was the limitation in skills and capacity. There is some duplication in the ongoing organisational structural change, but in general terms strategic choices need to be made and capacity needs identified so that service delivery can be improved with the limited resources available. As the situation currently stands, the country’s macro fiscal situation and the effect of the budget and expenditure on poverty alleviation may not be accurately or completely captured on a timely basis. There is a need for clear definition of what financial reports should disclose and a strict adherence to a timetable set for delivery of these reports. The last audited set of financial statements available at the time of assessment was for the fiscal year 1999/2000. This compares very well with backlogs of audited financial statements within the region, especially given the size and complexities of the Federal system and the capacity constraints alluded to above. There is, however, no legislation that sets the time in which MoFED should submit accounts to the Office of the Federal Auditor General for audit. At the time of assessment, the last set of financial statements prepared but not audited were for the fiscal year 2000/2001.
11. Aid expenditure is not always accounted for. Aid disbursed through Channel 3 is unlikely to be brought to account as the departments responsible for Federal and Regional budgets are usually unaware of the funding. No reference is made to Channel 3 expenditure in reports to the MoFED. There is also the possibility that some Channel 2 aid is not brought to account since there is no record of aid kept centrally and checked to the budget. In the case of external assistance channelled through BI's, it is the receiving institution's responsibility to notify MoFED to ensure that funding is included in the Federal Budget but this does not always happen. The Aid Co-ordination section of MoFED negotiates aid funding with donors but even this department may not be aware of all sector aid, aid-in-kind, technical assistance or direct procurements for projects as there is little integration of the various Government information systems for finance, budgeting and planning purposes. Food aid is substantial in Ethiopia and is also not incorporated in the budget or actual expenditure figures, which will have important macroeconomic effects.

Assessment of Risk

12. The current accounting and reporting systems highlight a problem of delayed and inaccurate management information as well as the fact that not all funds are included in the budget and financial statements. The risk is that the country's macroeconomic situation and the effect of the budget and spending on poverty alleviation may not be captured accurately. Donor aid, as well as Government's own resources, may not be targeted in the most effective manner.

Ongoing Reforms

13. Existing plans for the next three years are for the continued rollout of the new Chart of Accounts system to other Regions. It is expected that Amhara, Somali and Oromia will be trained in using the new system from next year. Thereafter, other Regions and cities will be covered.

14. The European Commission has prepared a financing proposal for IFMS within the Federal Government. Improvements in Government accounting is one of the seven components of the Civil Service Reform Programme. It consists of accounting, budgeting, legal framework, financial information systems, fees and charges, public investment programmes, internal audit, asset management, procurement, aid management, cash management, external audit and development of the accountancy profession.

Conclusions and Recommendations

15. There is a high degree of budgetary discipline in Ethiopia and there is no problem with unauthorised expenditure and Government arrears. The risk of corruption and diversion of funds is low. There are two main problems effecting public accounting and reporting. The first stems from the perennial difficulty of developing countries to be able to pay skilled staff sufficiently attractive salaries to encourage them to make a career in the public sector. The second arises due to the wide and diversified rural areas making infrastructure difficult and expensive to put in place and maintain.

16. There is also a problem of communication of aid funds from donors to Government and between Government departments. Although aid is being accounted for in a satisfactory manner to donors, this does not necessarily mean that aid fund flows and expenditure on projects funded by aid is reported to the budget and CAD at MoFED. Until such time as these can be satisfactorily resolved, management information will continue to be incomprehensive.
17. The following actions are recommended to improve the availability and accuracy of financial management information:

- There should be a reappraisal of the detail required from BI's and Regions to assist in faster production of financial and management accounting reports. This may involve the use of estimated figures based on disbursements where Regional infrastructure prohibits the timely collection of data;

- There is need to fill strategic vacancies and to mentor and train upcoming staff. There should be a nation-wide training of accounting staff. Following on from the above, consideration should be given to ways of attracting and retaining staff;

- There is need to harmonise donor aid policies and strategies by introducing a system for communication of all aid flows to Budget and CAD.
2.3 INTEGRATED FINANCIAL MANAGEMENT SYSTEM

1. The current financial information systems in operation in the Federal Government of Ethiopia are based on locally developed software running at Personal Computer (PC) level. As noted in the previous section, the latest development at Federal level is the use of a double entry system to record summarised financial expenditure against the budget. The system operates using the new Chart of Accounts introduced under the USAID-funded DSA project. The previous system which was based on the old single entry approach has now been replaced at Federal level by this new Budget Disbursement Accounting (BDA) system.

2. The new system has been a significant step forward in terms of budgeting and financial reporting. However, it is not an integrated financial system operating in line with internationally accepted best practice. The fundamental difficulty is the dependency on summarised information from manual systems. This means, therefore, that the core of the public expenditure management is not computerised and raises the question of data integrity, as well as the accuracy and speed of reporting facilities. However, the lessons of the progress made to date under the DSA project need to be taken into account in moving towards a more fully functional integrated financial system.

3. The design phase and broad objective were developed and completed in May 2001 for an Integrated Financial Management System (IFMS) that addressed many of the issues. However, since that plan was developed there have been significant organisational changes with the merger of the former MoF and MEDaC into MoFED and Cooperation and the increased financial autonomy of Regions. At the time of the IFMS preparation, the focus was on Federal needs and, while this may still be necessary, the devolution to Regions in particular means that IFMS may not be a complete solution.

4. The key issues, which any IFMS initiative must address, are those of:

   - Suitability to local circumstances as well as functional requirements;
   - Sustainability taking into account local capacity, ease of scaling up of system to meet future requirements; and
   - Scheduling and ability to adapt to changing organisation and sequencing.

   It is understood that this IFMS initiative is now being reviewed to address these issues among others.

5. The existing IFMS plans are more than 18 months old and focused on the Federal level introduction. The IFMS plan confirms that the system may not be acceptable to Regions. The documentation also does not deal with local capacity and the effect that devolution and other matters may have on scheduling. Previous experience in other African countries suggests that the introduction of large scale IFMS systems needs to be very carefully managed or results may well be below Government and donor expectations.

6. There is also need for the IFMS approach to build upon the experience and lead of the DSA project, which is well accepted and has used an evolutionary approach, building on ownership and existing capacity. Given the Federal nature of Ethiopia and the importance and identity given by language, the IFMS system needs to address the use of multilingual financial and budget operation; while this was not covered in the initial documentation, it is

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6 The Constitution gives all Ethiopian languages equal state recognition. Amharic is the working language of the Federal Government. Regions may by law determine their own respective working languages.
understood that reference is made to it in the tender documentation prepared. There is also some concern that the scheduling in the applications is not specific enough and should start in budget, following the path of the DSA project and learning from the experience in other countries where starting in accounts has resulted in institutional and technical problems with the IFMS budget module implementation.

7. The increased financial/budget delegation to Regional and Woreda level places the IFMS approach as it currently stands as being a Federal initiative. It also introduces many infrastructure and communications issues that need to be assessed before moving along the route of enhancing Federal systems. The scheduling and rollout plans for Local Area Networks (LAN) or Wide Area Networks (WAN) should be for Regional as well as Federal systems.

8. It is also recognised that the introduction of IFMS at levels other than Federal and Regional Headquarters in the short to medium terms may be impractical, but the need for capacity building to complement any new Information Technology (IT) systems is essential. The current base to which such a system would be introduced is very low in technical terms, with the current usage of IT low and at the PC level. The volume of training, capacity building and infrastructure change required to introduce a more complete integrated financial system is significant and there are doubts as to the ability of the Government to absorb such change in anything other than an incremental way over the medium term. This capacity building should include training, skills enhancement, infrastructure improvement, communications improvement and the introduction of intermediate technology as required to support any IT initiatives.

9. In addition to the core IFMS system needs, other IT issues identified included the lack of a payroll system with the necessary human resource linkages, as well as the need to link and reconcile any IFMS system to other planned systems in revenue collection. However the core information technology initiative impacting on the CFAA is the planned Integrated Financial Management System.

Conclusions and Recommendations

10. The enhanced systems introduced under the DSA project are an improvement but are not a comprehensive financial information system. The planned IFMS initiative is to be reviewed in light of organisational changes at Federal and Regional level, experience of DSA, level of system required, language and sustainability.

11. The impact of organisational changes suggest that the development of a Financial Information Systems Strategy that encompasses the needs of the different levels of Government and ensures that both IT and intermediate technology solutions integrate would be a valuable initiative. The key-overriding caveat on all initiatives should be the assurance that the capacity to absorb and sustain the new technology is created in the Government and with local suppliers.
2.4 INTERNAL CONTROLS AND RECORD MANAGEMENT

1. The legal framework requires reporting from all levels (Federal, Regional, Zonal, Woreda) on a monthly, quarterly, semi-annual and annual basis. However, in practice, there are delays in collating the data. All the relevant reports checked, and subsequently confirmed, indicate that bodies are behind schedule in preparing reports due. The delays are caused by a variety of reasons including lack of resources, lack of training, difficulties in obtaining information from remote regions, problems with data accuracy and increasing workload at Regional/Woreda levels as a result of budget delegation.

2. In theory, controls used for disbursement are tight and no budget is disbursed without the appropriate evidence of expenditure and without funds being available. The reality expressed in various reports is somewhat different with funds being released out of necessity before financial reports are received. Another issue highlighted in discussions with the Ministry of Education (MoE) officials was the change that the sector program has made to disbursement. Funds are released to Regions directly from the MoFED, bypassing the MoE. Resources used previously to check and verify proper use of the Federal element of Regional funds have not been moved to Regional level and, while Federal resources for control are still in place the extent and impact of checks in the system at ministry level have been lessened.

3. Previous analyses of public expenditure management have concluded that in comparison to other Sub-Saharan countries, financial control in Ethiopia was above average. In terms of internal control, there was one issue which dominated the background of the financial system, that of the “single entry” accounting system. While this was an inherent weakness in internal control terms in comparison to international norms, the use of the Internal Audit as a 100 percent inspection tool for all payments had previously ensured an adequate level of integrity in financial transactions.

4. The current process of change underway has the potential of reducing the effectiveness of this compliance testing at Federal level. The devolution of budgetary and financial responsibility to Regions means that the Federal 100 percent validation check, which was one of the main internal control mechanisms, has been marginalized. The Federal Internal Audit does not validate payments at Regional level, even though an increasing percentage of the Regional expenditure is Federally funded. Some check is made on capital expenditures, but the previous 100% level of verification which mitigated against the shortfalls of the single entry system are no longer in place. The previous confidence in financial transactions under a single entry approach cannot now be considered valid unless the previous level of payment validation at Federal level is put in place at Regional/Woreda level.\(^7\)

5. Financial reporting can be slow particularly when Regional information is involved, and as the validation checks are all “after the event”, the combination of slow reporting and less direct validation, unless addressed, will have a continuing detrimental effect on internal control at the Federal level. The slowness of reporting also has an impact on the internal controls associated with budgets. Budgets for practical reasons tend to be a ‘roll-over’ of the previous year rather than based on planned needs, and the use of external financing outside the budget has an added detrimental effect on the overall internal control mechanism. Slow reporting also means that disbursement takes place before reporting the use of previously allocated funds.

\(^7\) See the Chapter 4 - Regional Governments, which highlights variations in the standards being applied.
6. Through the DSA project, manuals and standards have been improved. However, the creation and application of systems, procedures and documentation which could be used at the "office instruction" level, particularly if available in all the necessary languages would enhance the standardisation and application of internal controls.

7. With regard to records management, the treatment of record storage is currently basic with the legal fulfilment to store records for at least 10 years being observed. However, the methods used consist of the physical storage in a basement or other such facility. Specialised storage, security against fire and floods, indexing/library controls are not considered a priority. Information systems backup and offsite security is also not a priority issue given the low level of IT infrastructure currently in place.

Internal Audit

8. At the Federal level, there are two entities which can be classified under the heading "internal audit". One is the Internal Audit Unit in each Federal ministry and the other is the MoFED Inspection Department. The Internal Audit units undertake a 100 percent compliance validation of all payments in their relevant ministry as part of the internal control check described above. This work, which mitigated against some of the weaknesses inherent in the previous single entry accounting system, is not the normally accepted role of an Internal Audit function using international comparison, or even based on the instructions issued by the MoFED.

9. The MoFED Inspection Department undertakes a role more akin to the traditional Internal Audit function, but with emphasis on budget utilisation. It covers all Federal ministries and also checks some Federal funds, particularly capital at the Regional level. The Inspection Department has an audit plan and a rolling program of inspections.

10. The Government's own definition of Internal Audit, and the international standards established by organisations such as the Association of Internal Auditors (AIA) are not being met by the current organisational structure and duties undertaken. An additional problem is that there are capacity constraints in the internal audit/inspection function with a shortage of staff having the appropriate qualifications or skills.

Assessment of Risk

11. In the past, the financial discipline exercised (particularly with regard to payment validation) gave Ethiopia an 'above average' evaluation in financial integrity compared to other Sub-Saharan countries. However, the organisational and financial devolution to Regions/Woredas has weakened this compliance testing at the Federal level and it remains to be seen whether or not the same level of compliance for Federal funds would be put in place in all Regions. The emphasis on financial compliance checking, while giving a confidence in one particular internal control area, also adds to the problem of timeliness of reporting and leads to possible gaps in internal control mechanisms with regard to fund release, budget planning and outcome assessment.

12. On the issue of records management, this is currently not a priority issue, but, as systems and processes develop, strategic plans will have to be put in place and implemented, particularly with regard to IT backup procedures.
Ongoing Reforms

13. Various reports, project designs and project concept notes have been prepared in the areas of internal control and internal audit, but most of these initiatives are yet to be started. Ireland Aid is addressing some training issues and preparation of a manual. The reasons for this lack of activity includes issues associated with the re-organisation of the Internal Audit and Inspection functions, more pressing initiatives getting priority and the changing nature of the structure and responsibility levels in the Government impacting on plans.

Conclusions and Recommendations

14. The impact of devolution to Regions/Woreda of budgetary and financial autonomy has reduced the level of internal control being exercised at Federal level. The previous integrity given by 100 percent validation of payments is no longer taking place for Federal funds at the Regional Level. However the current situation is one of flux with large-scale changes taking place both in organisational terms and in the introduction of a double entry approach. This means that there is an opportunity to address the situation and again increase the confidence level in the integrity of the Government financial system.

15. A positive aspect, which should be emphasized, is that the quality of many of the Government officials, their recognition of the difficulties and their commitment would indicate that any corrective actions and initiatives needed to correct the situation would be well received. Recommendations in this area include:

- The Internal Audit project under the EMCP should be updated to accommodate increasing financial and budget devolution to Regions/Woredas. It should also address the issue of the roles of the Inspectorate and Internal Audit and the organizational and capacity issues associated with Regional and Federal changes. In addition, the project should have links with wider audit initiatives, including the relationship with external audit.

- Issues associated with record management and IT handling capacity in the Government should be addressed;

- A detailed documentation of budget, expenditure and receipting activities should be undertaken, generating flow charts, descriptive analysis and other documentation which can be used for translation, training, office procedures, internal audit manuals, etc.
3. PUBLIC SECTOR – OVERSIGHT ARRANGEMENTS

3.1 INTRODUCTION

1. The work in this section covers four areas: Public Sector Auditing, the role of Parliament, the Federal Ethics and Anti-Corruption Commission and the access that the public has to public financial information. The activities of the CFAA team included a review of the existing legislation and documentation as well as visits and consultation with the relevant government departments. In the context of this section, work was all undertaken at Federal Level.

3.2 EXTERNAL AUDIT

2. The Constitution gives powers to the Federal Auditor General to audit and inspect the accounts of ministries and other agencies of the Federal Government and to report findings and recommendations to the House of Peoples’ Representatives. Proclamation number 68/1997 established the Office of the Federal Auditor General (OFAG). This requires the Federal Auditor General and Deputy Federal Auditor General to be appointed by the House of Peoples’ Representatives, and accountable to the House. The OFAG also has powers to audit the accounts involving budgetary subsidies and any special grants extended by the Federal Government to Regional Governments. Each Region has a Regional Audit Bureau, which has an Auditor General for the Region appointed by the Regional Council of Peoples’ Representatives.

3. There is a well-developed organisational structure for the OFAG. In addition to the headquarters based in Addis Ababa, there are five branch offices, which coordinate their work with the Regional Audit Bureaus. At the time of assessment, the OFAG had 313 employees, of whom 187 were audit staff and the rest administration and support staff. Only 6 are professionally qualified accountants, while the rest are either first degree or diploma holders.

4. There has been an increasing trend in staff turnover with audit staff leaving for better pay in the private sector. Over the past eight years, 182 audit staff have resigned, with only 35 being recruited. Recent salary revisions and the granting of an exception from the civil service salary scale for the OFAG have not been sufficient enough to attract new or stem the loss of audit staff.

5. The OFAG is a member of the International Organization of Supreme Audit Institutions (INTOSAI) and uses INTOSAI Code of Ethics and Auditing Standards in carrying out audits. The OFAG is currently in the process of adapting the Code and Standards to suit local conditions. It has also developed its own audit manuals for use in carrying out financial and performance audits as well as special investigations requested by appropriate bodies of the Government. A review of the approach and methodology used by the OFAG was recently carried out by USAID and was found to be acceptable.

6. The sophistication of the demands on the OFAG is increasing. A number of public bodies are either using or developing computerized accounting systems. This is also the case with the MoFED at Federal level, with a roll out expected in a number of other ministries. The OFAG does not have appropriate capacity to carry out computer audit techniques and audit work carried of such bodies often excludes Information Technology (IT) processes and integrity issues.
7. An annual work program is prepared each year to audit the accounts of Federal ministries, other Government agencies and Regions taking into account the numbers of staff available, the allocated budget to each public body and the level of internal control systems (from cumulative knowledge and experience). The OFAG each year covers 80% of the expenditure, 90% of revenue and 40% of subsidies. This arrangement ensures that resources are focused on those institutions with high budget allocations; however, it has the potential to continuously exclude those institutions with low levels of budget allocations from external audit and the benefits that may be derived from such an independent review of their operations.

8. The audit backlog has reduced in comparison with previous years, as well as with other countries within the region. At the time of assessment, the latest report available was for 1998/1999 and audit work was in progress for the Federal Government accounts for 1999/2000. There is therefore a two year lag in auditing the Federal Government accounts. This is mainly due to the late submission of draft accounts by MoFED to the OFAG. While, the Proclamation sets a limit on the OFAG to complete the audit work within four months of receipt of the accounts from MoFED, it does not, and neither do the Financial Regulations, set a time frame for MoFED to submit the draft accounts to the OFAG for audit.

9. The OFAG has consistently used best efforts to report its findings and recommendations for improving financial management. Firstly, it does issue an opinion on the Government accounts, which is often a daunting task especially when this may result in a qualification. Secondly, the report does provide a basis for any issues requiring follow up action. However, most of these recommendations do not get timely attention from either the Executive or the Legislature. In his annual report to the House of Peoples' Representatives, the Federal Auditor General emphasized the need for the House to take corrective actions on issues raised in the previous reports.

10. An issue of concern with regard to the work of the OFAG is the lack of adequate office space, sufficient vehicles and computers to carry out its work. There are only 32 computers for the whole OFAG staff. These logistical problems need to be resolved as they impact on the effectiveness and efficiency of the OFAG to carry out its mandate.

11. Under current legislation, the OFAG is also responsible for the issue, renewal, suspension and cancellation of certificates of competence for private auditors and accountants, who provide auditing and accounting services. This arrangement may have arisen from a lack of an effective national accounting body to regulate the accountancy and auditing profession. Nonetheless, this is a responsibility which could be properly handled through a well-structured national accountancy institute.

12. The Audit Services Corporation (ASC) and other private audit firms audit the annual accounts of public enterprises and donor-financed project on behalf of the OFAG. The Audit Services Corporation was established by Proclamation number 126/1977 to carry out the audit of the accounts of organisations of which the Government was the owner or majority shareholder. Currently, the ASC is the auditor of most of the public enterprises and donor-financed projects. ASC follows the International Standards on Auditing when carrying out the

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8 The report of the OFAG on the audited accounts of the Federal Government for the fiscal year 1998/1999 concluded that the accounts did not fairly state the Income and Expenditures of the government. Some of the qualification points mentioned in the OFAG's report included subsidies and grants approved and transferred to the regions not properly accounted with adequate documentation and reports; proceeds from foreign loans/credits during the year not correctly reflected in the accounts; proceeds from local loans and sale of treasury bills not correctly recorded in the accounts; additional expenditures during the year not approved by the House of Peoples' Representatives; and transfers from capital to the revenue expenditure.
audits of the accounts of its clients. However, it lacks expertise in computer audit techniques, and also has staffing shortages.

13. The accounts of the OFAG are not audited by an independent body, even though this is provided for in the Proclamation establishing the OFAG. The Federal Auditor General currently assigns internal staff to audit the accounts of his office and report their findings to him. There is also no external quality review to enhance and ensure standards.

Assessment of Risk

14. The office of the Federal Auditor General possesses many strong qualities including professional independence, strong leadership, dedicated staff, and a strong will to undertake its work diligently in spite of many difficulties. However the importance and relevance of the work depends on the timely submission of Government accounts by the Executive, and the willingness by the Executive to address any identified shortcomings and this is an area of concern as things currently operate. Capacity is still limited in relation to demand as well as increasing sophistication of the systems of the audited. The effectiveness and follow up on reports could also be improved upon.

Ongoing Reforms

15. An External Audit project, which is part of the Expenditure Management and Control Sub-Program of the Civil Service Reform Program, has been approved. The objective of the project is to build capacity at the OFAG and Regional Audit Bureaus in the areas of financial and performance audits and special investigations. The OFAG and Regional Audit Bureaus will co-ordinate the project and most of the preliminary studies have now been completed. Subject to the final review of the project documents, the proposals would be ready for implementation.

16. The Canadian International Development Association (CIDA) has signed a Memorandum of Understanding (MoU) with the Government to provide technical assistance to the OFAG and two Regional Audit Bureaus. The project will be effective from April 2003 and targets improvement of audit capacity and specific issues such as staff training and development; procurement of equipment, computers and vehicles; revision of audit manuals; and institutional linkages of the OFAG with other Supreme Audit Institutions.

Conclusions and Recommendations

17. In general terms, the performance of the OFAG in the context of resource and capacity constraints is impressive. However, there is need to address the capacity deficit, and also equip the OFAG with the tools, skills and support mechanisms necessary to address new challenges created through regionalisation and information technology. Some of the recommendations, which follow are to be addressed by new project initiatives shortly to commence, but at the point of time of the CFAA the following issues were noted:

- Need to strengthen the legislative framework for auditing with regard to the term of office of the Federal Auditor General and Deputy Federal Auditor General so as to give them reasonable assurance and time to discharge their responsibilities;

- A strategic staffing review for the OFAG should be completed and adequate financial resources made available to the Office to hire the required staff both in terms of quality and quantity;
• The role of the Audit Services Corporation should be clarified taking into account the long-term plan of the OFAG;

• Strengthen capacity in the area of computer audit and other techniques through recruitment of qualified staff and comprehensive training to meet these capacity requirements;

• Amend the legislation to set a time limit for the closing of Government accounts and submission of the draft accounts to the OFAG. Similarly, there should be formal rules for MoFED to report back on the resolution of audit queries;

• The OFAG should arrange for an international public auditing firm as external peer reviewer of its work to improve quality. Twining arrangements with other Supreme Audit Institutions elsewhere should also be considered.

3.3 PARLIAMENTARY OVERSIGHT

18. The Constitution provides the House of Peoples’ Representatives (the equivalent of Parliament) the central role of accountability. At its most basic, this requires the House to authorize the collection of Federal public funds (taxes and duties) and the expenditure of public funds, after due debate, consideration, and ratification of the Federal budget. The Constitution also provides the House with the authority to establish standing and ad-hoc committees as it deems necessary to accomplish its work.

19. One of these committees, which has relevance to, and a bearing on the CFAA work, is the Budget and Finance Affairs Committee. This committee is further divided into three sub-committees under its mandate; Public Accounts; Revenue; and Recurrent and Capital Budget Sub-Committees. The Budget and Finance Affairs Committee was established and begun working in 1998. In the present sitting of the House, the composition was changed in July 2002. There are now thirteen members drawn from both the ruling as well as opposition parties. The chairman and vice chairman of the main committee are both from the ruling party; all the three sub-committees are chaired by members from the ruling party with vice-chairman drawn from the opposition.

20. The Budget and Finance Affairs Committee appears to be more focused on the review of the budget before it is passed; the review after expenditure is incurred is less consistently applied. The ex-post reviews are only carried out after the Federal Auditor General has submitted his report to the House, and this may be years later. At the time of the assessment, the latest report submitted to the House by the Federal Auditor General was for 1998/1999. The delay obviously reduces the importance of the reviews as a deterrent as the people responsible may have moved on.

21. Although the committee holds hearings on the Federal Auditor General’s report, it lacks resources to properly carry out its work. The three Sub-Committees noted above have to share one conference room for their meetings. There are supported by one Secretary with limited computing facilities.

22. There is a knowledge gap in the area of accountability by members who have different backgrounds, especially in the case of the three Sub-Committees whose composition was recently changed. These members require support and training to ensure that they acquire knowledge on budgets and budgetary process. In addition, the committees should have power to engage external expertise to help them with their work.
23. Despite experiencing various difficulties, the OFAG has been able to perform to a fairly reasonable and commendable level, and reports portray a good understanding and grasp of issues affecting Government performance in the area of financial management. The relationship between the Federal Auditor General and Parliament emanates from the Constitution, and this should be balanced so that their roles and independence remain clearly defined and separate. The Federal Auditor General does provide fair and impartial audit reports and information to Parliament within a specified period of time following his receipt of the annual report from the Government. Parliament, through its standing committees such as the Budget and Finance Affairs Committee, and more importantly, the Public Accounts sub-committee, in turn is then required to enforce accountability.

24. There is, however, no evidence of a systematic follow up of issues raised by the Federal Auditor General. The collaboration between OFAG and Parliament in terms of following up accountability issues also appears to be limited to the provision of the annual report by OFAG to Parliament. In his recent report to Parliament, the Federal Auditor General highlighted the lack of adequate follow up on issues raised in his previous reports. This oversight mechanism the Federal Auditor General was referring to could be better addressed through an effective standing committee of Parliament charged with a clearly spelt mandate. The OFAG could then provide assistance and support through such a committee by attending its deliberations on the audited accounts.

Assessment of Risk

25. Parliamentary committees are essential tools of enhancing financial accountability issues, but only if they are properly funded, as well as constituted with clearly defined mandate. The oversight functions vested in the Legislature as a fundamental principle of separation of powers appears not to be effective, and there are high expectations from the public.

Ongoing Reforms

26. Under the Parliamentary Capacity Development Project, CIDA (Canada) is providing support to Parliament to ensure that the Federal Parliament and its Members are better equipped and more effective in law-making and overseeing Government and ensuring its accountability to the rule of law and other democratic principles. The project aims at assisting committees better understand –

- Best practices in oversight and legislative review;
- Policy issues and operations of ministries for which they have oversight arrangements; and
- Gender policy issues relevant to their mandates.

27. The project also expects the committees to adopt professional practices through broad pro-active public consultation; travel and consultation throughout Ethiopia; making greater use of research and information to balance that coming from the Executive; keeping consistent and complete records; and increase use of non-executive and non-partisan sources of advice and information, including civil society organisations and independent experts.

28. While the project has been in existence for some years it has not as yet been successful in addressing many of the intended goals. At the time of assessment, it had reached mid-term of implementation with only about twenty percent achievement of intended targets. The project will undergo a mid-term review soon to identify the bottlenecks preventing successful performance.
Conclusions and Recommendations

29. The role of Parliament goes beyond legislation and includes evaluation of Government activities. A comprehensive system of committees adds enormously to the effectiveness with which accountability is ensured. A system in which there is a committee with responsibility for each area of policy enables the legislature to develop groups of members and staff with specialist knowledge on activities of the Government. The following are the proposed recommendations in this area:

- Strengthen oversight mechanism to effectively hold the Executive to account for their activities. Consideration should be given to the strengthening of the Public Accounts Sub-Committee to focus on the reviews of the reports of the Federal Auditor General;

- There should be systematic and close collaboration between the Office of the Federal Auditor General and Parliament pursuant to the Proclamations under which they are created and appointed. In the area of financial accountability, this would normally be through the Public Accounts Committee. The presence of the OFAG during deliberations of the audited accounts would enhance accountability.

- Committees should be given power to draw on expertise from outside the House to assist them in carrying out their mandates.

- Members should acquire knowledge on budgets and budgetary processes. Training is therefore essential.

3.4 FEDERAL ETHICS AND ANTI-CORRUPTION COMMISSION

30. The Federal Ethics and Anti-Corruption Commission was established in May 2001 by Proclamation number 235/2001, as an independent Federal Government body capable of investigating and prosecuting, checking and preventing corruption and other improprieties, as well as fighting corruption through the promotion of ethical values in the society. The Commission is accountable to the Prime minister, but is free from intervention, interference, or direction by anybody with regard to the conduct of its operations.

31. The Commission is headed by a Commissioner supported by a Deputy Commissioner, both appointed by the House of Representatives upon nomination by the Prime Minister. Both have a term of office of six years, which may be renewed. Neither can be removed from office except if found guilty of an offence by the court of law, or can no longer carry out responsibilities on account of mental or physical illness.

32. The Commission has far reaching powers ranging from combating corruption through public awareness; preventing corruption and corrupt practices; and investigating suspected corruption. The Proclamation also gives the Commission the investigation and prosecution powers of the police and Public Prosecutor specified in the Criminal Procedure Code and other laws. The legislative framework under which the commission is established and operates appears to be sound.

33. It is too early to determine the effectiveness of the Commission to combat corruption as it has only been in existence for about one year at the time of assessment. In that time, focus has been on working on a number of logistical issues including staffing, preparation of the five year strategic plan from which the annual budget would be derived, and formulating regulation for approval by the Council of Ministers.
34. Despite its short period of operations, some progress especially in the investigative area has been made. At the time of the assessment, 541 corruption cases had been registered with the Commission. Of these, 15 criminal charges involving 101 officials as well as private citizens had been instituted. The test of the Commission’s effectiveness, however, would be determined by how successfully prosecution is carried out.

35. There was no evidence that the activities of the Commission were made available to the general public, or regularly published. For an institution which encourages transparency and accountability, information about its activities should be published to increase public awareness. Information on the number of cases filed with the Commission, their sources, inquiries, submission of charge sheets, penalties, acquittals, quantum of financial involvement, amounts recovered, etc should be made available to the public in some formalized publication (media, internet, annual reports). Similar information should also be available on the ethics side.

36. There appears to be no evidence of a systemic and widespread corruption in the Government sectors. In fact, a number of studies have alluded to the disciplined culture of the Ethiopian society, which does not encourage corruption. On one hand, the creation of the Commission may be seen as testimony to the desire on the part of Government to stem corruption before it becomes widespread. On the other hand, it may be seen as an emerging scourge requiring not the traditional institutions and mechanisms, but the establishment of an independent specialized anti-corruption agency. Either way, Ethiopia fairs very well in the Transparency International Index in relation to other countries in the region.

37. Strategic decisions will need to be made regarding what functions and focus the Commission should adopt. As indicated, the Commission has far reaching powers under the Proclamation giving rise to its establishment. Nonetheless, the approach adopted by the Commission should be based on the perceived areas where corruption may be rampant. Given the low level of corruption (in relation to similar countries in the region), the focus may be more on combating and sensitisation through public awareness. This would seem to suggest emphasis on the promotion of ethical values, building on the disciplined culture in society alluded to above. The fight for corruption also has to be approached on numerous levels, using specific knowledge or skills from a variety of disciplines (law, finance, economics, accounting, etc.), and the Commission’s recruitment process should include those disciplines identified as critical.

38. It was evident from discussions with senior staff that the Commission would require support in the form of resources to carry out its mandate. Obviously the effectiveness of the performance of the Commission could be persuasive in attracting support from the international community. The Commission is required to have a five year strategic plan under which the Government is supposed to approve and allocate the Commission’s budget.

Assessment of Risk

39. The level of corruption in Ethiopia is not as systemic nor widespread as in other countries in the region. Nonetheless, the establishment of the Commission is a testimony on the part of the Government to curtail the scourge however prevalent or otherwise it might be. The challenge facing the Commission is to determine the area of focus of their operations if it has to add value to fighting corruption. On one hand, it is to early to gauge the effectiveness

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8 Ethiopia is ranked 59 on the Transparency International Corruption Perceptions Index for 2002 with a score of 3.5 on a range of 10 (highly clean) and 0 (Highly corrupt). Only four Sub-Saharan countries (Botswana, Namibia, South Africa and Ghana) have a score higher than Ethiopia.
of the performance of Commission; on the other hand, this is the time for the Commission to make strategic choices regarding the focus of its operations.

Ongoing Reforms

40. None advised other than the recruitment process, preparation of the five year strategic plan, and the formulation of rules, regulations, and procedures.

Conclusions and Recommendations

- The Commission should make a strategic decision regarding the areas of focus in combating corruption given the perceived low level in the Government;
- Information should be made available to the public about the operations of the Commission to increase public awareness;
- Recruitment and training of staff should take cognisance of the various levels and disciplines of expertise required to combat corruption;
- The operations of the Commission should address the emerging issues of significant resource transfers and devolution of responsibilities to the Regional governments;
- The Commission should be adequately funded in order to effectively discharge its responsibilities.

3.5 PUBLIC ACCESS TO INFORMATION

41. The Constitution guarantees freedom of thought, opinion, and expression. This right includes freedom to seek, receive and impart information and ideas of all kinds. It also guarantees freedom of the press and other media and specifically includes prohibition of any form of censorship, and access to information of public interest.

42. In practice, the initial reaction regarding this freedom and availability of information is mixed. Information held by public authorities is not easily accessible to the public, and there is no comprehensive guidance on how to obtain such information. On one hand, information appears to be available in various forms and from various sources. Parliamentary debates are aired on television, albeit a few weeks after the fact, while the public can attend Parliamentary sessions upon request. On the other hand, there does not appear to be a concerted effort on the part of Government agencies to engage the media and civil society in the dissemination of information on Government activities. For example, the Federal Anti-Corruption Commission requires substantial and effective links with civil society, both to utilize citizens’ reports as a major part of their strategy, and to build up public support.

43. The sophistication of the media to widely report and circulate information of public interest is obviously something that will come with time given the necessary enabling environment.

Ongoing Reforms

44. The Department of International Development (DFID) of the United Kingdom is providing support to the Government on the introduction of Freedom of Information legislation. This is part of the Ethics sub-program and is aimed at strengthening the capacity of the media to be able to contribute towards improving ethics in Government and civil
society through fair and impartial investigation and reporting of cases of corruption and impropriety. At the time of assessment, terms of reference had been completed for the expected consultancy to assist the Government in the formulation of the Freedom of Information Legislation.

Conclusions and Recommendations

45. There is full support for Parliaments to be open to the media and the civil society as one of the tenets of ensuring effective Parliamentary oversight. Civil society and the media should therefore be encouraged to become actively involved in ensuring the accountability of Government. The first and most important audience for information on various aspects of public financial management should be the legislature at Federal, Regional and local levels. Woreda councillors should be encouraged to demand and utilize information more effectively. Citizens will need to do the same. To foster demand for this sort of information, the supply has to be efficient, accessible, and comprehensible.

46. Proposed legislation would provide the necessary enabling and organic legislative environment. However, there is need now and then to translate the application of law into practice and this requires the relevant public institutions to engage the media into their operations. One way would be to institutionalise an Ethiopia-wide Woreda and Municipal benchmarking system that, through publication of results, allows inter-jurisdictional comparisons and provides clear targets or benchmarks.

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10 In all well functioning democracies such as New Zealand, Parliamentary reports are open to the media and the recommendations of the Public Accounts Committee have been widely circulated leading to the successful prosecution of individuals.
4. ASSESSMENT OF FIDUCIARY RISK – FEDERAL LEVEL

1. From the analysis in Sections 2 and 3 it is now possible to complete a table that illustrates an overall Fiduciary Risk. The principles of Good Practice and Benchmark ratings used are in line with the following:\(^11\):
   - **A** = Substantial compliance with international Good Practice.
   - **B** = Significant weaknesses in compliance or that rules/procedures need to be changed.
   - **C** = Substantial failure to comply with the rules or that the system/process require major upgrade.

2. The analysis is by nature interpretive but it can be justified by the text above and the additional details in Volume 2 of the CFAA report.

<table>
<thead>
<tr>
<th>Objective</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. A clear set of rules governs the budget process</td>
<td><strong>B</strong></td>
</tr>
<tr>
<td>- A budget law specifying fiscal management responsibilities is in</td>
<td></td>
</tr>
<tr>
<td>operation.</td>
<td></td>
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<tr>
<td>- Accounting policies and account code classifications are published</td>
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<tr>
<td>and applied</td>
<td></td>
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<tr>
<td>2. The budget is comprehensive.</td>
<td><strong>B</strong></td>
</tr>
<tr>
<td>- All general Government activities(^12) are included in the budget.</td>
<td></td>
</tr>
<tr>
<td>- Extra-budgetary expenditure is not material</td>
<td></td>
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<tr>
<td>3. The budget supports ‘pro-poor’ strategies.</td>
<td><strong>B</strong></td>
</tr>
<tr>
<td>- Budget allocations are broadly consistent with any medium term</td>
<td></td>
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<tr>
<td>expenditure plans for the sector or for the overall budget</td>
<td></td>
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<tr>
<td>4. The budget is a reliable guide to actual expenditure</td>
<td><strong>B</strong></td>
</tr>
<tr>
<td>- Budget out-turns show a high level of consistency with the budget.</td>
<td></td>
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<tr>
<td>- Expenditure tracking is used on a regular basis.</td>
<td></td>
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<tr>
<td>5. Expenditure within year is controlled</td>
<td><strong>B</strong></td>
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<tr>
<td>- Reconciliation of fiscal and bank records is carried out on a</td>
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<tr>
<td>routine basis.</td>
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<tr>
<td>- A commitment control system is in operation</td>
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</table>


\(^12\) General Government should be defined as in the System of National Accounts (SNA, 1993) or the IMF Manual on Government Finance Statistics (GFS, 1986).
<table>
<thead>
<tr>
<th>Objective</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>6. Government carries out procurement in line with principles of value for money and transparency.</td>
<td>* Competitive tendering rules are applied to all major contracts</td>
</tr>
<tr>
<td></td>
<td>* Decision-making is recorded and auditable</td>
</tr>
<tr>
<td></td>
<td>* Effective action taken to identify and eliminate corruption</td>
</tr>
<tr>
<td>B1[^1]</td>
<td>Procurement assessment was carried out under a separate WB CPAR. This indicated that generally accepted procurement practices are only partially satisfied and improvements are necessary.</td>
</tr>
<tr>
<td>7. Reporting of expenditure is timely and accurate.</td>
<td>B</td>
</tr>
<tr>
<td></td>
<td>Reporting from 30% of budgetary institutions is considerably delayed. The last audited set of financial statements is for 1999/2000.</td>
</tr>
<tr>
<td>8 There is effective independent scrutiny of government expenditure</td>
<td>B</td>
</tr>
<tr>
<td></td>
<td>Audited financial statements are not submitted within the statutory period. The last statements also received an adverse audit opinion. As audited reports are significantly delayed, accountability of government agencies is diluted and evidence of systematic follow-up is lacking.</td>
</tr>
<tr>
<td>9. The budget process is transparent</td>
<td>B</td>
</tr>
<tr>
<td></td>
<td>Information held by public authorities is not easily accessible to the public and there is no comprehensive guidance on how to obtain such information.</td>
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5. PUBLIC SECTOR – REGIONAL GOVERNMENTS

5.1 INTRODUCTION

1. Ethiopia is a Federal State with 67 million people\(^{14}\). The Constitution of 1995 mandates a Federal structure with considerable autonomy to the Regions in administrative and fiscal matters. It consists of nine Regions and two City Administrations that enjoy the status of Regions. The main distinctive features of the current system include the heterogeneity of the Regions, the high degree of Regional autonomy, large vertical and horizontal imbalances, and the continuing evolution of the system with its impetus for decentralisation within Regions\(^{15}\).

2. Although the share of the Regions in the combined Federal-Regional revenue is only about 15-20 percent, they account for nearly 35-40 percent of the total expenditure. When only the anti-poverty intensive sectors such as Health, Education and Agriculture are considered, the Regions’ share in the combined expenditure is about 70 percent.\(^{16}\) In the Poverty Reduction Strategy Program (PRSP) context, therefore, the Regions are the ‘front line’ in the administration and monitoring of most anti-poverty programs.

3. Ethiopia is also attempting one of the most ambitious institutional transformation processes. At the heart of this transformation is a Woreda\(^{17}\) decentralisation policy that transfers financial and human resources to the local government sphere in an attempt to encourage democratic decentralisation, downward accountability and more responsive service delivery. While ambitious and rapid, the Woreda decentralisation strategy is being managed pragmatically, primarily through common sense approaches undertaken by Regions that are seeking to ensure that the Government’s historic attempt to expand the fiscal autonomy is consistent with the broad fiduciary objectives of Ethiopia’s expenditure management system. Myriad challenges remain and continue to stretch the limited capacities and resources of Ethiopia’s Federal and Regional Governments, as well as its Woredas and urban centres (or Municipalities). In helping the Government address these challenges, two strategic issues confronting Ethiopia’s Federal and Regional leadership should be recognized, particularly as they relate to the quality of Ethiopia’s public sector fiduciary framework.

4. Firstly, since the early 1990s, the Federal Government and its Regional states have sought to leverage the public sector’s widely acknowledged strengths (unique in Africa)—its ability to generate compliance and top-down administrative discipline—in order to address its weaknesses, which include the lack of a democratic approach in undertaking public action, excessively hierarchical management of civil servants, and the absence of a client or beneficiary-oriented approach to service delivery. This approach was first attempted during the creation of Regional states, and has proven to be an institutionally durable and fiscally sustainable exercise. It is being repeated as the Government seeks to create an accountable and efficient local government sphere. Therefore, the public sector fiduciary framework is being evolved as part of a larger transformation process that few countries would be in a position to attempt. Secondly, devolution-led transformation process, while rapid and ambitious from the vantage point of existing capacity constraints, also offers an opportunity for Ethiopia to focus, strategically sequence, and systematically benchmark progress. The assessment has attempted to provide a strategic analysis of how devolution is in effect providing the ‘lens’ through which public sector capacity building and Ethiopia’s institutional

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\(^{14}\) Based on estimates prepared by MEDAC for 2001/02 in the context of the Federal Budget Grant Formula.


\(^{17}\) A Woreda is the lowest full-time government covering roughly 100,000 people and consist of an elected council and a set of sectoral offices.
development prospects should be viewed. As part of the assessment, visits were made to four Regions, Amhara, Tigray, Somali and SNPP Region. The work focused on the effects of this devolution program and identified measures - in particular, training and capacity building programs - that could help to strengthen the accountability environment. These findings with regard to the devolution process are of a tentative nature as the process is still ongoing.

5. At the centre of the financial management structure in each Region is the Regional Bureau of Finance and Economic Development (BoFed) responsible to the Regional Council. The Regional Constitutions, in most cases exact replicas of the Federal Constitution, require BoFed to prepare annual budgets and accounts of the Regional bureaus and the consolidated accounts of the Region (including the accounts of Zones and Woredas). These should then be audited by the Regional Auditor General and submitted to the Regional Council. Like the Federal level, the financial management procedures are guided by Financial Regulations. These are basically sound but will require updating to incorporate changes that are currently being introduced.

6. Earlier studies describe the reputation of the Civil Service in Ethiopia as being well disciplined and committed. Fraud and absenteeism appear to be rare by any standard. This was confirmed during the mission. The BoFed in Regions visited were generally well managed and the Civil Service shows a serious commitment to complying with the existing budget execution regulations. Expenditure controls are effective and funds largely reach the purposes intended.

7. The present devolution process is posing some challenges in the practical implementation, at least in the short-term. There seems to be a trade-off between devolution of spending on the one hand, and a strong financial accountability environment on the other. The most immediate problem is that delays in re-assignment of staff to Woredas have hindered the final agreement of the financial year 2002/2003 budget at Zone and Woreda level, contributing to delays in accounting and reporting. Meanwhile recurrent funds are, of necessity, being advanced to Zones and Woredas. At best, the reporting delays are temporary and would be rectified soon after Woreda and Zone budgets are finalised. At worst, the delays could be signalling the inability of some Woredas to cope with the volume of administration work, resulting in a progressively worsening accounting and reporting position. This situation will need to be carefully monitored.

8. There are staffing problems at Woredas and an unspecified number of skilled staff have left the service rather than relocate. For financial operations, the main shortage of skills will be in the area of planning and budgeting, although there are also likely to be shortages of budget execution and accounting skills in some Woredas. On the existing manual system, accounting skills are relatively easy for staff to acquire, provided an experienced manager is available on site. The emphasis should be on training and capacity building rather than increasing staff numbers. Nevertheless, plans need to be developed to recruit replacements for those who have left and to attract suitable staff for training in planning and budgeting.

9. It was common to all Regions that the timeliness of accounting and reporting was a potential weakness in the financial management system. There are two distinct issues. Firstly, Regions report to MoFed only once per year, with the annual Regional accounts; consequently, there are no monthly or quarterly reports. This is not the responsibility of BoFed, most of which indicated readiness to report more frequently. Secondly, for the current EFY 1995 (2002/2003), monthly reporting of accounts from Woredas was showing

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18 See Roberts (2001) and also the Public Expenditure Reviews of several years (World Bank).
significant delay. It was too early to tell whether the delays were temporary or whether longer-term backlogs were building up.

10. Budgeting is largely an incremental exercise. Strategic priority setting and reallocation seems to get less attention. For the financial year 2002/03 this was even more the case. The budget preparation process considers only a time period of one year. Any medium-term programming (i.e., a perspective of three to five years) has not been carried out so far. The current time span of one year is too short for the purpose of adjusting expenditure priorities. The feasibility of a medium-term perspective is greater if revenues were more predictable. This predictability remains poor for the Regions for as long as the Federal Government fails to provide indicative medium-term projections of the Federal subsidies (which is a major part of the revenues of the Regional authorities).

11. Cash management needs to be strengthened. There are separate bank accounts for Treasury funds for recurrent expenditure, Treasury funds for capital expenditure and for each donor/project. The total number of bank accounts is not known but runs into hundreds. Integrated Cash Management is not possible and the monthly labour of reconciling bank statements with the respective cashbooks is multiplied. The advantages of the Single Treasury Account system have not been realised. It is recommended that a study of bank accounts should be carried out bank accounts closed where they are no longer in use, and merged wherever there are no legal reasons not to do so. Donors should support this rationalisation of the Treasury function.

12. As a transitional measure pending Woreda staff and capacity build up, a number of Regions are using innovative methods and pragmatic approaches to address interim emerging issues. One of these relates to the issue of staffing at Woredas alluded to above. In the case of Tigray, for example, resources are set aside for ‘remoteness’ allowances to provide extra incentives particularly for finance staff to relocate to very remote Woredas. Another is the use of a ‘pool system’ for budget execution and accounting by Woreda sector offices. The objective of the pool system is to reduce administration costs by allowing accounting for a group of Woreda sector offices to be performed by one ‘pool representative office’ for the group. The system was observed to be working in Woredas visited.

5.2 AMHARA REGION

13. The Region of Amhara is in the middle of a major devolution process. Starting with the current fiscal year (EFY1995), the authorities of the Woredas have been made responsible not only for the budget preparation and execution of the recurrent expenditures but also for the capital expenditures. Zonal departments have been downgraded to branch offices of the Regional Bureau. Most of their staff (about 3,500) have been transferred to Woredas, except for a few administrative functions. The original intention was to shift a large number of Regional staff to the Woredas, but only about 300 employees had been relocated at the time of the assessment. This low figure was caused by vacancies in the Regional Bureau and skilled staff refusing to relocate and opting to leave the service.

Planning and Budgeting.

14. The Constitution gives Regional Governments the power to draw up and administer their own budget. For the fiscal year 2002/03, the preparation and approval of sub-national budgets has been severely delayed due to the uncertainty surrounding the decentralisation

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19 This has been adopted at the Federal level, but it is unclear whether it is intended to apply at the Regional and Woreda level.
process. As a consequence, the ability of the Federal Government to prepare a consolidated budget by the end of September 2002 has been severely compromised.

15. For the allocation of block grants to the 113 Woredas of Amhara, the Regional Authorities have developed and used an objective formula. The three components of this formula are population, a composite 'level of development' index and an element intended to reward revenue collection effort. The weights of these three components in the formula are 70 percent, 20 percent and 10 percent, respectively. A lack of reliable data for the other components seems to explain the high(er) weight for population in the formula.

16. The fine-tuning of the formula had caused some further delay in the budget preparation process. Therefore, the authorisation of the Regional and Woreda ceilings for the year took place only in July 2002. As a consequence, the sector Bureaus and Woreda offices had not received a formal notification of their ceiling for this financial year at the time of assessment (late September 2002). BoFED expects that all 113 Woredas in Amhara will have finalised their budget preparation by October 2002, with the consolidated budget for the Region expected to be ready by November 2002. As a result of the delays in budget preparation, capital spending is squeezed into the latter months of the year.

17. In a method similar to that applied at the Federal level, the Regional Authorities in Amhara have used a budget-offset mechanism to determine the overall divisible pool to the Woredas. Essentially, this mechanism combines the available resources for block grants to the Woredas with the registered external aid (loans and grants) flowing directly to the Woredas. In Amhara, these external aid flows for 2002/03 are estimated at only 7.4 million Birr, i.e. equal to 1 percent of the block grants. The Regional Authorities have used an offset of 15 percent for these aid resources.

18. Budgeting appears to be largely an incremental exercise. Strategic priority setting and reallocation seems to get less attention. The budget preparation process also considers only a time period of one year. Any medium-term programming has not been carried out so far. The current time span of one year is too short for the purpose of adjusting expenditure priorities. The feasibility of a medium-term perspective is greater if revenues are more predictable. This predictability is poor for the Regions as long as the Federal Government fails to provide indicative medium-term projections of the Federal subsidies. In general, budget out-turns at Regional level in Amhara tend to be very close to the totals appropriated, especially for the aggregates. For capital expenditure, substantial gaps exist between budgeted figures and out-turns

19. In the previous financial year (EFY 1994), and in preparation of this devolution, the Regional Authorities (in co-operation with the USAID-financed DSA project) had trained about 2,600 employees in two-week training courses on financial management. However, most Woredas still had difficulties in preparing their own budget. To date, most of the budgeting posts within the finance offices have not been filled with adequate staff, as these posts require candidates with a Bachelors degree.

**Budget Execution**

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20 The preparation of a consolidated budget by the end of September has been agreed as one of Ethiopia's Completion Point Triggers under the HIPC debt initiative.

21 At the Federal level a similar formula has been used. The last version of this Federal formula includes as a fourth component, a poverty index with a weight of 10%. The weights for the other three components are 55% for population, 20% for level of development and 15% for revenue raising effort (see PER, 2001, Volume II).

22 The delay in notification of budget ceilings from the Federal to Regional Government also contributed to this delay.

23 These finding are based on the budget and out-turn figures for 2000/01.
20. The disbursement system in the Amhara Region has generally been effective in controlling expenditure without the need for cash rationing. Disbursement processes at the Federal and Regional Government are similar. Disbursements are made on request, and for salaries the Treasury assumes a cash flow of one twelfth of the annual allocation with some flexibility for 'higher than average' cash flow requirements in specific months.

21. Cash management at the Regional level is sub-optimal due to the large numbers of bank accounts. This makes it difficult to manage overall liquidity efficiently. In the Sector Bureaus in Amhara that were visited, the number of bank accounts varied from 7 for the Bureau of Health, 14 for Education to more than 20 for Agriculture. Most Bureaus had two Treasury bank accounts (one for capital and for recurrent expenditures) while the others were all donor accounts. A rationalisation of the treasury function should take place. The processes and mechanisms to provide banking facilities also requires amendment. The issue of full inclusion of donor funding into the budget, whilst providing adequate assurance and information for donors from using those funds within the Government system, must also be addressed.

22. Many remote Woredas do not have banking facilities near their base, as the Commercial Bank of Ethiopia (CBE) does not have a branch office in each Woreda. Therefore, cashiers from these Woredas need to physically transfer large amounts of money from the nearest CBE to the safe in their finance office. In the Zone North Wollo, for instance, there is only one CBE office, while there are 9 Woredas.

**Accounting and Financial Reporting**

23. The Amhara Region is still using a 'single entry' system, while the Federal Government has introduced a 'double entry' system this financial year. The expenditure reporting in Amhara is fragmented. Regional Bureaus and Woreda finance offices issue separate reports for each source of funding (Treasury funds and separate donors). The Disbursement and Account Department in BoFED has the responsibility for the accounting and reporting for Treasury funds. Government financial statements for revenue and expenditure are prepared monthly and annually. The annual statements contain a comparison of the actual expenditures with the budget figures.

24. There are delays in financial reporting. The increased responsibilities of the Woredas and their capacity problems are causing delays in the preparation of monthly expenditure reports. These delays in accounting might also increase the backlog concerning the consolidation of financial accounts in Amhara. At this stage it is difficult to assess how long the delays would last. To deal with the lack of financial support staff and to optimise the use of its existing staff, Woredas have set up a 'pooling system' for their financial and other support staff.

**Internal Control and Audit.**

25. The Internal Audit function in Amhara has an ex-post nature in line with the financial regulations and is organised in the same way as at the Federal level. There is an Internal Audit department within each Regional Bureau while BoFED has its own Inspection and Government Procurement Department. The Internal Audit departments or units in each Bureau are in charge of ex-post control of vouchers and checking on a daily basis whether the payments are made correctly.

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24 For a detailed description of the processes at the federal level see Public Expenditure Review 2001, Vol. II.
26. The Inspection and Government Procurement Department within BoFED is responsible for the internal financial auditing (of transactions and property) of the expenditures of the 21 Regional Bureaus. Other tasks are internal control (supervision of internal audit departments in other bureaus) and Government procurement. It reports internally to the Head of BoFED and also informs the audited of its findings. The staffing structure has 10 positions, of which only 4 were filled. The staff reduction (shifted to Woredas) at the Regional Bureau in Amhara had led to a serious weakening of the internal control and internal audit function. In response to the staff shortage, the Inspection Department was taking smaller samples to prevent a large build-up of backlog.

**External Audit and Public Accountability.**

27. The Bureau of Audit, also called the Regional State Office of the Auditor General (RAG), is responsible for auditing the financial accounts of all Government institutions using Government funds in the Amhara Region. The RAG in Amhara was established in 1995 and has four main objectives: ensuring the proper use of public resources and property through auditing (financial audits, investigation audits and value for money audits); ensuring compliance with laws and regulations regarding financial and property activities; ensuring the existence of adequate auditing systems; and helping in the development of the audit profession in the Region. In practice, the main task is carrying out financial and compliance audits. The RAG has developed an awareness of good audit practices, appears to fulfil its audits quite satisfactorily and has built up a good reputation. It carries out audits in accordance with the standards set by the International Organisation of Supreme Audit Institutions (INTOSAI).

28. The main problem affecting the operation of the RAG is the lack of adequate staff. The RAG has difficulties in hiring qualified staff on the labour market and its turnover rate is high. Only 97 of its 181 staff positions are filled. Out of these, 67 are auditors (for 131 positions) and 30 are administrative supporting staff. The educational background of these 67 auditors is mainly accounting: 26 have at least a Bachelor’s degree (for 62 positions); 24 have a Diploma (for 69 positions); the others have lower qualifications. The lack of manuals, systems and training facilities are other constraints. The RAG has its own manual, but its quality is weak. Given these weaknesses, the RAG has neither the capacity nor the expertise to carry out ‘value for money’ audits.

29. The RAG is basically an independent public institution with its own legal charter and is treated differently from other Regional Bureaus. The Regional Council appoints the RAG and decides on its regulations and its budget. The Proclamation requires that the Regional Council has the right to audit the accounts of the RAG, but this is currently not done. The RAG submits its two reports to the Regional Council: a consolidated report of its findings for all audited institutions, and a public finance consolidated audit report (Consolidated Fund).

30. The RAG gave a disclaimer as the overall audit opinion for the consolidated regional accounts for 1997/98, largely because supporting documents were not available at the Regional level. BoFED explains these weaknesses as being due to lack of staff and to past confusion concerning compliance with procedures. The consolidated Regional accounts for EFY 1991 are now under audit.
Risk Assessment

31. Decentralisation leads almost inevitably to a temporary weakening of financial management. There are no quick and easy solutions to prevent the emerging weaknesses identified in Amhara and they are largely related to a learning process. Nevertheless, the Federal Government should take effective action that will lead to gradual recovery of financial management at sub-regional level. Practical solutions need to be found for the capacity problems at Woreda level related to the lack of staff resources and the low educational/skills base. A re-assessment should also be made of the number of staff actually required at Woreda level. Increasing the number of staff seems less urgent than the training of the existing staff.

Ongoing Reforms

32. In the coming years, the Amhara Regional authorities have to roll out the budgeting and accounting reforms that are piloted in the Federal Government in the current financial year. The authorities in Amhara have expressed their intention to implement this new budget system in the next fiscal year and they are considering implementing the new accounting system in the same year.

33. Although the rollout of these reforms might contribute to solving some of the weaknesses identified in earlier surveys, most authorities at Woreda level do not seem ready to implement them. Moving at too fast a pace could lead to problems and careful thought and planning is required to avoid the real risk of a further breakdown of the accounting system.

5.3 TIGRAY REGION

34. Tigray is one of the smaller Regions of the nine Regions of Ethiopia (population 3.8 million, 80,000 km²), bordering onto Eritrea. The border is still closed after the war of 1998-2000. Approximately 85 percent of the population is rural and engaged in subsistence agriculture. It is administratively divided into six Zones, including Makele, the Regional capital, and 47 Woredas, of which 35 are rural and 12 urban. Woreda populations range from 80,000 to 150,000.

35. Tigray is also in the midst of the devolution process alluded to above and common to all the Regions, which is intended to shift resource allocation powers to the Woredas, considered to be the key level of local Government. This assessment was made at a time when Woreda staffing, allocation of responsibilities and training in their expanded functions, were only partially completed. This was evidenced by the lack of any monthly expenditure reports from the Woredas on either recurrent or capital expenditure, since the change came into effect in July 2002 (EFY 1995).

36. However, there is good understanding and leadership at the Regional Bureau level, and an administrative culture of compliance with regulations wherever feasible - the control environment is good. A comprehensive set of reforms in public financial administration is planned. With technical assistance from the EMCP, and the DSA project in particular, and the additional resources expected from the World Bank funded Public Sector Capacity Building Project (PSCAP), there is every expectation that Tigray will successfully absorb the planned reforms and that the benefits of Woreda devolution will be realised.

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25 See, for instance, the annual Public Expenditure Reviews from the World Bank.
Planning and Budgeting.

37. Budgeting for the new structure started in late 2001 for the current year EFY 1995. The process suffered from the late notification of the Federal subsidy, which had been targeted for January 2002. This was not decided until June 2002, only one month before the start of the fiscal year (for EFY 1994, it was similarly notified late, in June 2001). The Regional budget for EFY 1995 was approved by the Council in July 2002. This experience emphasises the need for the budget timetable to be planned and implemented consistently, so that the Council receives the recommended budget in January, and, consequently, has time to debate and approve it before the fiscal year starts on 8 July.

38. The merger of the Bureaus for Finance and Planning was intended to facilitate the integration of recurrent and capital budgets. However, these remain as separate departments of the new BoFED, in different locations, one examining recurrent budgets and the other reviewing capital budgets and action plans. It is too early to judge the impact, but it is unlikely that the benefits of integrated resource planning will be apparent until BoFED prepares a medium-term public expenditure programme. This will depend on a PEP at the Federal level (showing the projected subsidy to Tigray each year), and more dependable projections of donor flows, such as firm commitments for the next year and indicative figures for the following years, being notified in good time.

39. The ‘offsetting’ of external resources given directly to Woredas is intended to mirror the procedure at the Federal level and ensure that Woredas get an equitable share of total resources according to the subsidy formula. This is a revenue issue and an equity issue rather than a fiduciary risk issue. In EFY 1995, IDA credits, assistance from Ireland Aid (multi-sectoral programme), UNICEF, UNFPA and technical assistance were 100 percent offset. Ireland Aid (food security) and aid to NGOs such as REST were excluded. The actual impact has not been assessed as this is only the first year of application at this level and the formula has not been fully applied. Nevertheless, it is clear that the offset is a disincentive to Regions and Woredas to try to increase aid flows and the overall resource envelope, and also a disincentive to reveal their true extent. A Woreda increases its share of the Regional subsidy by concealing its projected external inflows. It can easily justify this by the argument that these flows are very uncertain. If offset is continued, it would be more equitable to base it on actual flows in the previous year.

40. Regional budgets (and accounts) do not include a number of extra-budgetary funds, either in the Regional Government accounts, or the Consolidated Regional accounts. Some of these are very significant, such as Tigray Rural Roads Authority revenues and expenditures, and food aid. For example, an EC study estimated that the value of (unbudgeted) food aid to Tigray over the five years to 2000 was equal to 52 percent of the budgeted expenditure. It is intended that food aid and other extra-budgetary resources will be made more transparent in

26 Ministry of Capacity Building had proposed for EFY 1995 that there be no offset of external flows in determining woreda subsidies.
27 The PER (2001), Vol. II, p. 46, points out that Regions should not be penalized for expanding the total resource envelope. They are encouraged to increase revenue collections, which are not offset. A MEDaC study over FYs 1998-2000 (country-wide) showed that only 55% of budgeted external loans and 67% of budgeted assistance was actually disbursed. There is no mechanism for adjusting subsidies where foreign aid does not materialize. Some ad hoc adjustments have been made in the following year. Regions much prefer Treasury flows to aid flows, as the former are more reliable. Reducing offset to a percentage of commitments reduces the disincentive to disclose them, but does not create a positive incentive to transparency.
28 This was recommended by the World Bank (2001b), PER Vol. II, para. 7.10
the Federal budget and accounts (EMCP budget reform component). It would be preferable for all aid to be budgeted and accounted at the level at which it is disbursed (Region or Woreda) rather than the level at which it is negotiated (normally the Federal level). This would match resource inflows and beneficiary areas.

41. Another omission from the budget and accounts is the contribution of local unskilled labour to community-supported projects. There is a strong tradition of direct participation of communities in almost all sectors in the identification of problems, planning of interventions, and contribution of money and labour to the construction of facilities in agriculture, water and soil conservation, health centres, schools, feeder roads, etc. dating back to the suspension of Government services during the war of 1974-91.

Accounting and Financial Reporting.

42. Tigray is still using the traditional ‘single entry’ system. BoFED, each Regional Bureau, Zonal department and Woreda finance office, and each Woreda administrative pool, keep a cash book and a general ledger for each source of finance and issue the reports required by each source (Treasury funds, and each donor). There is no integrated expenditure reporting. There is a proliferation of bank accounts, budget ledgers (data on the budget for each line item) and general ledgers (data on revenues and expenditures). This is mainly due to the donor paradigm of relying on parallel accounting and reporting systems. The result is that expenditure reports on programs and projects are fragmented; they report only expenditure from the source of funds to which the report is sent.33

43. The finance offices of Regional Bureaus and Woredas keep track of their expenditures by means of manually written budget cards. In the Woredas, administrative pools similarly should be keeping track of the expenditure of the Sectoral offices they serve and reporting expenditure monthly to the Woreda Finance Office.

44. Reports on revenue and expenditure are prepared by the Regional Bureaus and Woredas on a monthly basis and submitted to BoFED, normally within 15 days. At the time of assessment, the Woredas and Zones were not functioning properly, and the last reports received were for the month of May 2002. None of the Woredas had reported on June 2002 by late September 2002. It is expected that this was only a temporary delay, which would be corrected as Woreda staff obtained clarification of their duties and BoFED/DSA training.

45. There is no monthly financial reporting by BoFED to MoFED, despite a Federal Proclamation requiring it. This is an administrative and political issue, reflecting Federal/Regional relationships. On the sectoral development programmes, reports on performance (outputs and physical progress) are submitted quarterly by sectoral offices to sectoral Bureaus and from sectoral Bureaus to sectoral Ministries. On other activities, there is no systematic reporting to the Federal level. There is no integration of expenditure and performance into 'value for money' reports.

46. There are separate bank accounts for Treasury funds for recurrent expenditure, Treasury funds for capital expenditure, and for each donor/project. The total number of bank accounts is not known, but runs into hundreds. Integrated Cash Management is not possible

31 At the Federal level, the objective is 100% comprehensiveness of the Public Expenditure Programme and annual budget. However, some donors cannot give reliable commitment data disaggregated by Region and project, even for the year ahead. Actual disbursements depend on many uncontrollable variables. In EFY 1994, an annex to the consolidated Federal budget valued expected food aid, but this was not repeated in EFY 1995.

32 The cash book is often confusingly called a general ledger, and the general ledger is called a subsidiary ledger.

33 EC (2001b) gives examples of this in Annex D. For instance, actual expenditure on the Arba Minch Water Technology Institute in EFY 2001 was 14.2 million birr, but the Ministry of Education reported only 4.8 million birr.
and the monthly labour of reconciling bank statements with the respective cashbooks is multiplied. The advantages of the Single Treasury Account system have not been realised. It is recommended that a study of bank accounts should be carried out and bank accounts closed where they are no longer in use, and merged wherever there are no legal reasons not to do so. Donors should support this rationalisation of the Treasury function.

**Internal Audit**

47. Following the new policy of discontinuing ‘pre-audit’, BoFED internal auditors have been transferred into accounts work and no longer 'sign off' on payment vouchers. The discontinuance of pre-audit does not pose a risk because of the division of labour in the preparation, certification and approval of payment vouchers. Some Regional Bureaus, such as Agriculture, still have their internal audit units undertaking pre-audit. They also verify cash balances, especially at the end of the financial year. Internal audit reports are sent to management and the Bureau Head, who is accountable to the Executive Committee. The only Internal Audit work in the Woredas to date is pre-audit.

48. Apart from Internal Audit, both MoFED and BoFED have an Inspection function. These are more independent than Internal Audit, but less independent than External Audit as they report internally within the Executive. The MoFED Inspection Department does a compliance audit on Regional accounts after closure, but because of staff shortage and language problems, coverage of Regional Bureaus, departments and offices is limited.

49. BoFED has an Inspection and Procurement Department with 8 staff. They check financial statements of bureaus, departments and offices after closure (100 percent coverage to ensure that unspent balances are returned at the end of the year), and audit transactions in selected months for their compliance with regulations, particularly procurement transactions. Reports are sent to the audited and to the Head, BoFED. There is some co-ordination in work planning with the Regional Auditor General (RAG), but no formal exchange of reports.

50. Apart from payroll preparation, computers are used only for word processing. Little training has been received so far in computerised data processing.

**External Audit**

51. The Federal Auditor General has the right to audit all Regional expenditures that are funded by the Federal subsidy. In fact, due to shortage of staff, he audits only a small number of Regional capital projects. There is no co-ordination between his office and the office of the Regional Auditor General.

52. The Proclamation on audit makes no mention of control (systems) audit, performance audit, special investigations or audits of donor-assisted projects. At present, the RAG undertakes only regular financial audits (conformity of accounts with the transactions and evidence and conformity of revenue and expenditure with budgets), and is starting to undertake performance audits. The RAG’s coverage includes donor-assisted projects, but donors require parallel audits by private firms. The RAG is trying to apply INTOSAI...
standards. An opinion is given on all financial audits as to whether they correctly reflect the revenues and expenditures for the year. There is no external peer review, only internal quality assurance arrangements. It is planned to organise peer review by other RAGs.

53. The RAG has 62 staff, including 38 auditors, out of an approved cadre of 85. In the last year, 8 auditors left for the private sector and only 5 were replaced. The vacancies cannot be filled for lack of candidates with the minimum qualifications, viz. degree or diploma, speakers of Tigrigna, and at least 10 years’ experience in audit or accounts work. Public sector salaries do not attract or retain such staff.37

54. The RAG has no financial or personnel management autonomy, and is treated by BoFED and the Civil Service Bureau in the same way as other bureaus. The Constitution provides that the annual budget of his office should be submitted to the Regional Council and approved by it. This has been interpreted by Finance Bureau as requiring that it be declared (approved) by the Regional Council only after its own scrutiny and approval. A study by the external audit project of EMCP has recommended strengthening the independence of RAGs by applying the Constitutional provision.

55. The RAG is appointed by the Regional Council on the recommendation of the President. There are no qualification requirements, nor provisions on tenure, remuneration or removal. The external audit project of EMCP recommended that the Constitution be amended to include a full description of the method of appointment, remuneration and removal of the RAG and a clear statement on the independence of the office from the Executive. Appointment should be for a period of seven years. This should not coincide with the election of a new Council (to avoid the RAG being seen as supporting a particular regime). The RAG should be removable only by a resolution of the Council on one of the following grounds: permanent incapacitation, inefficiency, neglect of duty, malfeasance or conduct involving moral turpitude. These recommendations are in line with the INTOSAI Lima Declaration.

56. The RAG’s office is not audited. The Proclamation requires that an independent qualified auditor be appointed by the President to audit the RAG’s Office but it is not done. It is important that the RAG’s office should be above suspicion and quite transparent, and the legal requirement should be met.

5.4 SOMALI REGION

57. The Somali National Regional State has a population of 3.4 million, based on the latest census records of 1997, and ranks as the fourth most populous Region in Ethiopia. It is sub-divided administratively into 9 Zones consisting of 51 Woredas. Many of the Zonal Headquarters and Woredas are difficult to access because of poor infrastructure. This has a direct impact on financial reporting and the execution of public expenditure management functions. For example only five of the nine Zonal Headquarters are in an area with some form of banking service, and only Woredas in the locations of these Zonal Headquarters have access to banks, making cash-based resource transfers the ‘norm’ with associated challenges and risks.

58. The Region receives a relatively higher share of Federal subsidy per capita compared to the average for the other Regions (the Region had an estimated 6 percent of total population, but received 9 percent of total Federal subsidy in 1994). This is due to the fact that the Region’s poverty indicators and level of development are less favourable and,

37 A newly graduated accountant would get 760 Birr/month - about half to two thirds what he could get in the private sector (1000-1500/month). With experience or professional qualifications the disparity widens. A professionally qualified accountant starts at about 3,000/month in the private sector and, consequently, has no interest in a public sector job.
consequently, the composite index applied by the Federal authority gives the Somali Region a relatively higher weight. In addition, it also receives 'off budget' resources, particularly in the form of Extra Budgetary Funds (EBF) and emergency relief assistance.

59. Recent reforms undertaken in Ethiopia in the area of financial management have not extended to the Somali Region. The computerised BDA system implemented in several other Regions to assist in more timely reconciliation has not yet been fully implemented in the Somali Region. The software has been installed but without sufficient training, the system has not been put into use. Currently, four staff are on additional training and it is expected that on their return BoFED will start applying the system. Budgeting, budget execution and accounting is, accordingly a manual process.

60. The key difference between Somali and some of the other Regions visited is that the implementation of the decentralisation process is being undertaken on a gradual basis. However even this staged approach, which proposes 19 out of 51 Woredas, is considered a high target given the capacity to absorb this change. The fundamental issue affecting all of the financial management work in this Region is the lack of capacity, both physical infrastructure and human resource, to perform financial management functions. The effect of decentralisation along with these two serious capacity constraints will undoubtedly increase the risk associated with cash management, and financial accountability and reporting.

Planning and Budgeting

61. The difficulties in Somali Region are considerably greater than those in other Regions visited by the CFAA team. The budget preparation process is still a centrally generated Regional activity, with information flow from BoFED to Zones and Woreda based on a monthly ceiling for salaries and gross operational expenditure. The detailed budgets for each Woreda are therefore not applied as a management tool at Woreda level and, consequently, financial reporting is rendered irrelevant.

62. The budget institutions prepare the recurrent budget with an incremental adjustment on previous year with estimated inflationary change in salaries and other operating costs. For the capital budget, all projects and programmes 'on budget' are funded from Federal subsidy (including external grants and loans), and none by Regional resources. Almost 95 percent of capital expenditure is tied up in ongoing projects and only 5 percent is available for new activities to reflect changes in policies/strategies. It is for this 5 percent (approx. 12 million Birr) that the various budget institutions compete.

63. Some donor-funded projects and extra-budgetary resources are not captured at the Federal level, nor do they feature in the Regional consolidated budget. The volume of this form of funding cannot easily be determined since it is negotiated and disbursed directly to Regional Sector Bureaus and, occasionally, directly to Zonal departments. There is limited incentive to disclose these resources in the consolidated budget since it would then be offset against Federal subsidy.

64. There is no fixed budget calendar and process, nor any legally prescribed time for closure of the budget discussions in the Council. This has led to substantial delays in the final approval of the budget. The EFY 1995 budget preparation process had not yet been finalised at the time this assessment (already two months in the fiscal year which commenced on July 8, 2002). For EFY 1994, the budget was approved only three months before the end of the fiscal year. The previous year budget (EFY 1993) was accordingly used as the legal framework for expenditure management for a total of nine additional months in the following year (EFY 1994).
Accounting and Financial Reporting

65. Accounting of expenditure for the Somali Region is based on the standard ‘single entry’ cash-based accounting system that still prevails, pending the introduction of ‘double entry’ accounting system including the new Chart of Accounts. All accounts are in Somali, are maintained manually by all budget institutions and are prepared on a monthly basis based on payment requests from Woredas, Zones and Regional Bureau. The lack of a fully functional computerised system at BoFED makes reconciliation a challenging task and closing of accounts a time-consuming effort that is difficult to implement. There are no financial reports produced on a regular basis to show actual utilisation across budget institutions, or functional or economic classifications, since this would demand a significant reconciliation effort in the current manual system. There has been a steady increase in the accumulated amount of unsettled advances that need to be investigated and cleared. Many staff members lack qualifications for their posts and, consequently, there are frequent mistakes in reporting. A fixed assets register is not maintained nor are all liabilities brought to account due to the cash based accounting system.

Internal Controls

66. The Internal Audit units of the budget institutions conduct a pre-audit function. Budget institutions, including Zones and Woredas have vacant positions for the internal audit function. This is a post filled at Regional and Zonal level, less so at Woreda level. The pre-audit function primarily consists of checking authorisation for payment against approved budget and that sufficient evidence is presented according to the financial regulations.

67. Post-audits are undertaken by the 5 Inspectors of the Inspection and Procurement Department with a mandate to cover all the 51 Woredas, 9 Zones and 41 Regional budget units. They focus entirely on recurrent expenditure and domestic revenue since the Inspection Department of MoFED is assumed to cover the capital expenditure, which is entirely funded by Federal subsidy. The Regional Inspectors stated that they cover approximately 10 Woredas per year, which would, on average, mean that all Woredas are subject to inspection once every five years.

68. The report from an inspection is submitted to the Head of the BoFED. The most frequent problem areas observed in the various budget institutions from the inspections included unsettled claims for advance payments and low level of capacity and limited qualifications in accounting leading to frequent errors with transactions being charged to the wrong budget heads.

External Audit

69. The Regional Audit Bureau (RAB) has two departments: Social and Administration Audit department and Economic Development department, headed by one department Head who reports to the Regional Auditor General. The Regional Auditor General has been appointed by the Council and reports to the Council. There is no specific Accounts Committee charged with the task of reviewing the reports, which are presented to and discussed by the full Council. Each department is supposed to have five teams consisting of three staff, in total 30 staff. However, at the time of assessment, only 10 including the Auditor General were on board. The reasons for the understaffing included lack of sufficient funds and lack of incentives to attract qualified staff to work in the bureau compared to the private sector.
Assessment of Risk

70. The overall assessment is that Somali demonstrates one extreme of the ranging disparities in public financial management processes across the Regions. The problems are significant in terms of fiduciary risk and the inclusion of Somali in the CFAA exercise has illustrated the dangers of generalisation or averaging of opinion in the context of the evaluation of public expenditure management across the whole of the Federal Government.

71. The low capacity in financial management, especially at the Woreda level, the low capacity in BoFED and fragmentation in undertaking control functions poses some of the risks. The risk will increase with decentralisation of financial management functions and allocation of financial resources from Regional and Zonal levels to the Woreda level unless it is backed with more efforts in building human resources capacity and training of personnel in the fields of budgeting, accounting and cash management, as well as strengthening of the main control and audit functions in the Region.

Ongoing Reforms

72. There are two main areas were there are planned and/or ongoing activities to strengthen financial management capacity:

- The decision by the Regional authorities to apply a gradual and phased approach to implement decentralisation to the Woreda level. As previously mentioned, two Woredas in eight Zones have been selected in addition to three in the Jijiga Zone, which is also the Regional headquarters. By identifying and training personnel to be seconded from Regional and Zonal offices as well as recruiting and training new staff, the Region has chosen an approach to decentralisation which may reduce the fiduciary risk. This is planned for the current fiscal year.

- Training of BoFED staff to implement the BDA program for budgeting, budget execution and accounting. It is hoped that this will significantly improve the reconciliation process and expenditure management.

5.5 SNNP REGION

73. Southern Nations, Nationalities and Peoples Region (SNNPR) is sub-divided into 13 Zones containing 96 Woredas. In addition there are 8 special Woredas (municipal Woredas), making a total of 104 Woredas. Since the Region covers a number of different nations, nationalities and peoples with greatly differing populations, there are wide variations between both the number of Woredas in a Zone (from 3 to 13) and the population of each Woreda (from 6,600 to 444,400).

74. In 2002, SNNPR attempted two simultaneous major administrative reforms. With the help of the Decentralisation Support Activity (DSA) Project, the Civil Service Budget Reform Program, already introduced at the Federal level, has started on a full rollout basis to all Woredas. This involves budget preparation and execution under a new Chart of Accounts and the consolidation of the budget on the new computer-based Budget Information System (BIS). Since March 2002, decentralisation of staff, duties and accountability to Woreda level has been carried out in all Zones and Woredas.

75. The activities carried out under the Budget Reform Program have been highly successful, thanks to the determination of the management team at the Regional Bureau of Finance and Economic Development (BoFED), the effectiveness of the Decentralisation
Support Activity (DSA) Project and the training programs organised in conjunction with the Regional Management Institute in Awasa and other Regional locations. The budget for the Region was appropriated by the Regional Council on 15 August 2002. It integrates capital and recurrent budgets and is based on the new Chart of Accounts, including cost centre analysis. At Regional level, the budget has been recorded and consolidated using the new computerised BIS. The first draft of the Regional Budget Reform Manual has been produced.

76. If Somali was at one and lower end of the scale, SNNPR could be considered to be at the other and upper end. It was deemed to be of sufficient readiness to cope not only with the impact of decentralisation of staff and duties to Woredas, but also to introduce the first phase of the Budget Reform Programme at Regional level. To a large extent, SNNP has achieved major success in both of these initiatives.

77. Nonetheless, and as in other Regions, the decentralisation program has suffered from problems associated with staff moving to Woredas. In particular, the common difficulty results from a reluctance of senior staff to move from Zonal/Regional level to Woreda. The impact of this has been delays in accounting and reporting, budget finalisation, and consequently through necessity, funds being disbursed without the corresponding accountability. It is too early in the process to definitely make a judgement on this, but given the leadership of the BoFED in SNNPR and their commitment, if these delays continue in this Region it could be a signal that systems breakdown will occur in other Regions.

78. The common theme in many of the difficulties in SNNPR is the issue of capacity, both in terms of numbers and skills, at Woreda level. One of the issues highlighted specifically in SNNPR was that some higher-grade staff have left the service rather than relocate. This particularly affects the budget area and raises questions with regard to the sustainability of the Budget Reform Program. However, despite these concerns the overall view of the Region in financial management terms is positive. The BoFED have taken strong leadership and developed longer-term plans and initiatives to improve the capacity of finance staff through training, and are also planning to introduce a Medium Term Financial Framework (MTFF). Nonetheless, there are issues that do need to be addressed, and which take on added importance because of the lead role SNNPR is playing in many areas. These include improving communication/relationships between MoFED and BoFED, clarification of the duties and responsibilities of Regions and Woredas, and a reorganisation of the internal audit/inspection/checking functions undertaken by various Regional and Federal entities.

Planning and Budgeting

79. With the help of the DSA project, the Civil Service Budget Reform Program, already introduced at the Federal level, has started on a full rollout basis to all Woredas in SNNPR. An assessment report prepared by BoFED describes the successes and challenges experienced. The strategy has been to improve the budget systems and Chart of Accounts during the first half of 2002, leaving improvements to the planning process (including MTFF and PEP) to start from December 2002. Bearing in mind the extremely tight timescale (4 months) for implementing the new Chart of Accounts and systems, and the fact that decentralisation to Woredas came into effect soon after the team had prepared the first budget structure, this project has been highly successful so far.

80. There are a number of outstanding problems in the budget preparation process, relating to the current (EFY1995) budget and to future budgets. Zone and Woreda EFY 1995 budgets had still not been finalised because of the delays in reallocating staff. Revisions to Woreda budgets were therefore still being negotiated. The deadline for staff reassignment was supposed to be 30 September 2002 but had been missed. It was unclear when some of
the budgets would be finally agreed. The formula for allocation of the Regional subsidy to Woredas needs to be revised as there are currently inequities in the system.

81. The budget is prepared in two cycles. Cycle 1 relies on forecasts made from previous trends and contains no estimates of donor funds. Cycle 2 can only be started when the Regional subsidy is confirmed by the MoFED and estimates of donor funds are provided. This means that budgets are still being prepared using the incremental basis. Ideally, BoFED would like these to be communicated by December, particularly now that the three-year MTFF is to be prepared. A budget calendar that is backed by legislation would assist. If firm figures cannot be given, a reasonable estimate would suffice. Also, donor funds using Channels 2 and 3 are not captured in the budgeting process. This is hindered by the set-off system which further encourages 'under budgeting' of Regional revenue.

Accounting and Financial reporting

82. The Region reports its accounts to MoFED only once per year. This is a weakness in the national accounting system that is outside the control of SNNPR BoFED, which, it is claimed, could realistically report quarterly if required to. All public bodies had submitted their monthly accounting returns for the whole of EFY 1994, and BoFED was in the process of consolidating these accounts. The SNNPR consolidated accounts for EFY 1994 would be completed by October/November 2002. Financial reporting is on the cash basis but will move to the 'double entry' modified cash system next year. Fixed asset registers are, therefore, not maintained and neither is there full recording of liabilities. There are a large number of suspense accounts that need to be better controlled and investigated. A Public Accounts Committee to which Regional accounts are given would provide a useful oversight arrangement.

83. At the time of assessment in September 2002, all Regional sector bureaus had submitted accounting reports for July and August; no Zones had submitted any accounting reports for July or August and 6 Woredas had submitted accounting reports for July 2002 but none for August 2002. The prompt submission of accounting reports by Regional sector bureaus was attributed to BoFED’s strict policy of withholding budget funds until proper accounting reports and budget request forms were received. It was expected that there would be delays in accounting by Woredas and that consolidation would be more difficult, because accounting to BoFED was being performed by 104 Woredas for the first time and skill levels were lower than at Zones. In addition, accounting and reporting was on the new Chart of Accounts, the most significant effect of which was that public bodies had to analyse their expenditure by cost centre. Also, a sizable amount of the capital budget is not reported through the accounting system but directly to donors.

Internal Audit

84. There is a strong culture of internal control over the disbursement of Government funds. Financial regulations and directives appear to be well understood and authority for payments up to different threshold limits is clear. There is division of duties between accountants and cashiers and cheques are correctly signed by two authorised signatories. The role of internal auditors is still, largely, that of pre-audit checking of vouchers before payment; they also verify cash balances and do a 100 percent reconstruction of bank reconciliation. There is also an Inspection function at BoFED and at Zones and Woredas, which perform post-audit checks. This is effectively another tier of auditors, which appears to be excessive. Understaffing at most offices may lead to a weakening in internal control.
85. There are internal auditors at most of the 1,833 public bodies in the Region. They report directly to the head of their public body and have no jurisdiction outside the public body. It can be argued strongly that the pre-audit function is unnecessary, since all transactions are authorised by appropriate personnel and an audit sample would reveal irregularities as effectively as a 100 percent check. There is, therefore, scope for taking at least some of the internal audit staff and re-training them in more appropriate audit techniques. Others may be reassigned to external audit and accounting jobs.

External Audit

86. The Regional Auditor General (RAG) is responsible for auditing every public body in the Region and reports to the Council of SNNPR (though this has only recently started - i.e. the RAG has reported on EFY 1993 annual accounts). The EFY 1993 report gives no overall audit opinion. The RAG understands the concepts of external audit, including systems audit and evaluation of internal control systems. There is an audit manual in use (the Federal Auditor General’s manual - written in EFY 1988). The RAG appears to understand the concepts of risk assessment for audit planning. Staff are of a relatively high educational standard. Out of a total 53 auditors, 1 has a Masters degree, 14 have Bachelor of Accountancy (BA) degree, and 32 have College diplomas (of whom 7 are attending summer school at Makele University to upgrade to BA) and 6 others. There is strong liaison with the work of other audit bodies: the branch office of the Federal Auditor General sends all their reports to the RAG when they audit in this Region; the RAG sees the reports of Regional, Zone and Woreda internal auditors and inspectors, in order to evaluate the system of internal control at each public body.

87. Despite the RAG’s awareness of good audit practice, it is not applied. The annual plan includes assessing audit risks of all public bodies but, in practice, the audits concentrate on high-budget nearby locations and geographical coverage is minimal. The plan for EFY 1995 is to audit only 70 high-spending public bodies. Auditors rarely go to Woredas or Zones. Audit reports do not state an audit opinion. Audits are too time-consuming, probably resulting from duplication of work carried out by internal auditors and inspectors. The office is understaffed. There are 53 staff and 46 vacancies for auditors. However, given proper practical training and effective audit planning, a much greater Regional audit coverage could be obtained with the existing staff.

88. In summary, progress in improving public expenditure management in the Region was significantly ahead of other Regions in many areas. The common thread of capacity and human resource difficulties at Woreda level in particular was also evident in SNNPR, but despite these difficulties progress was being made on a number of fronts and with the necessary support there is cause for optimism. It is too early to determine whether the failure in reporting from Woreda level and budget finalisation delay at Woreda level is a temporary setback due to the structural reorganisation, or is a sign of deeper problems.

Conclusions and Recommendations

89. While ambitious and rapid, the Woreda decentralisation strategy is being managed pragmatically, primarily through common sense approaches undertaken by Regions that are seeking to ensure that the Government's historic attempt to expand the fiscal autonomy is consistent with the broad fiduciary objectives of Ethiopia's expenditure management system. Myriad challenges remain and continue to stretch the limited capacities and resources of Ethiopia's Federal and Regional Governments, as well as its Woredas and urban centres (or municipalities). The following are some issues deserving special attention:
• There should be predictability in the resource availability down the chain from the Federal Government. Regions should be notified of the subsidies in ample time to enable them prepare their budgets in time;

• The need for a medium-term perspective in budget preparation should be looked into; however, this would depend on the predictability of resources as noted above;

• Staffing problems at Woreda level need to be addressed in various ways. These should include support to the innovative approaches such as pooling arrangements, incentives and rationalisation of existing staff;

• Cash management needs to be strengthened through the rationalisation of the Treasury function. This may involve a critical review of the number of bank accounts;

• There should be an improvement in the comprehensiveness and timeliness of reporting;

• Internal controls and internal audit functions should be reviewed both in the methodology, as well as the functions of the various tiers of internal audit arrangements.
6. **ASSESSMENT OF FIDUCIARY RISK – REGIONAL LEVEL**

1. A Fiduciary Risk assessment has already been detailed for the Federal level (Section 4). However the autonomy and increasing devolution being given to the Regions mean that a comparison between the different Regions visited is useful to illustrate the range of differences that can occur. There is a need to highlight the danger of over-generalisation, and Regional differences should be recognised in the context of the overall CFAA.

2. The grading principles are the same as those used at the Federal level, and can be justified by the analysis above and the additional details in Volume Two of the CFAA report.

<table>
<thead>
<tr>
<th>Objective</th>
<th>Amhara</th>
<th>Tigray</th>
<th>Somali</th>
<th>SNNP</th>
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<tbody>
<tr>
<td>1. A clear set of rules governs the budget process</td>
<td>B</td>
<td>B</td>
<td>C</td>
<td>A</td>
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<tr>
<td>• A budget law specifying fiscal management responsibilities is in operation.</td>
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<td>• Accounting policies and account code classifications are published and applied</td>
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<td>2. The budget is comprehensive.</td>
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<td>• All general government activities are included in the budget.</td>
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<td>• Extra budgetary expenditure is not material</td>
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<td>3. The budget supports pro-poor strategies.</td>
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<td>A</td>
<td>B</td>
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<tr>
<td>• Budget allocations are broadly consistent with any medium term expenditure plans for the sector or for the overall budget</td>
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<td>4. The budget is a reliable guide to actual expenditure</td>
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<td>A</td>
<td>C</td>
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<td>• Budget outturns show a high level of consistency with the budget.</td>
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<td>• Expenditure tracking is used on a regular basis.</td>
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<td>5. Expenditure within year is controlled</td>
<td>B</td>
<td>B</td>
<td>C</td>
<td>B</td>
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<tr>
<td>• Reconciliation of fiscal and bank records is carried out on a routine basis.</td>
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<tr>
<td>• A commitment control system is in operation</td>
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<tr>
<td>• Competitive tendering rules are applied to all major contracts</td>
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<tr>
<td>• Decision making is recorded and auditable</td>
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<td>• Effective action taken to identify and eliminate corruption</td>
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<td>7. Reporting of expenditure is timely and accurate.</td>
<td>C</td>
<td>C</td>
<td>C</td>
<td>B</td>
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<tr>
<td>• Reconciliation of fiscal and bank records is carried out on a routine basis</td>
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<tr>
<td>• Audited annual accounts are submitted within the statutory period</td>
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<tr>
<td>8 There is effective independent scrutiny of government expenditure</td>
<td>B</td>
<td>B</td>
<td>C</td>
<td>B</td>
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<tr>
<td>• Government accounts are independently audited and the reports submitted to Region 12 months of the end of the fiscal year.</td>
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<tr>
<td>• Government agencies are held to account by the responsible parliamentary Committee and act on criticisms and recommendations made by the auditors</td>
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<tr>
<td>9. The budget process is transparent</td>
<td>B</td>
<td>B</td>
<td>C</td>
<td>B</td>
</tr>
<tr>
<td>• Information on the fiscal activities is available in the public domain</td>
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<tr>
<td>• Information is presented in a way that facilitates policy analysis and promotes accountability</td>
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7. NON-GOVERNMENTAL ORGANISATIONS

1. In the last few years, non-governmental organisations (NGOs) have proliferated and developed, becoming a driving force in the lives of local communities, a shield for basic rights and freedom, and a vital counterweight to state activities. Despite their diversity, there can be little doubt about the role these organisations play as partners to Government institutions in resolving social problems and providing social services. This process establishes new requirements on activities and management of NGOs.

2. The regulatory framework for the registration and establishment of NGOs and Community-Based Organizations (CBOs) in Ethiopia is embodied in the Civil Code of 1960; Regulations Number 321/66; and Proclamation Number 4/1995. The Civil Code requires the Office of Associations to keep a register of associations. It further requires each association to submit its balance sheet approved by its general meeting to the Office of Associations. The Associations Registration Regulations Number 321/66 requires annual financial statements of all NGOs to be audited and an annual report submitted to the Office of Associations within a prescribed period. The penalty for non-compliance can be loss of license.

3. There are currently approximately 1,200 NGOs registered with the Ministry of Justice (MoJ). However, the ministry does not register CBOs, which mainly operate in Regions, and there is no indication that these are registered and regulated at all. All registrations are handled manually. MoJ states that the number of NGOs is increasing every year, and this should be taken into account when considering the future activities of supervision of NGOs. NGOs may be international, local or religious affiliated. Those with international and religious connections are generally better organized and financially stronger than the local ones.

4. There are two Government bodies responsible for regulating the NGOs: the Ministry of Justice, and the Federal Disaster Prevention and Preparedness Commission (DPPC). The Guideline issued by the DPPC in 1999 requires NGOs to prepare financial statements that show a true and fair view in all material respects in line with generally accepted accounting principles. The law does not require internal audits and audit committees. However, the DPPC Guideline provides for an Audit Review Committee to be established by both the NGOs and DPPC.

5. There are at least two NGOs working on capacity building of other NGOs. One is the Christian Relief and Development Association (CRDA), established by other NGO’s. At present, it has some 213 members and an additional 80 NGOs are in the process of joining. The Association particularly assists the small local NGOs and provides them with a forum to address common problems. The local NGOs, for the most part, do not have skilled or professional personnel and, therefore, generally use part-time accountants. As a result, audit reports are not presented within a reasonable time after the financial year-end, and this in turn creates a problem with the annual license renewals. The CRDA offers training in bookkeeping and accounting.

6. The other is PACT, an NGO which focuses on capacity building of small NGOs, providing, among other things, targeted accounting procedures manuals. PACT also contributes to the payment of salaries of accountants, audit fees, and project officers for a period of up to three years.
7. Stakeholders consult with each other, including the Government, to avoid overlap of the Government and NGOs interventions. According to CRDA, the interaction happens at meetings where the parties discuss three-year strategic plans. This forum and other informal consultations are used to discuss donor and Government priorities.

Assessment of Risk

8. The various pieces of legislation appear to address the fiduciary requirements of this growing sector of the economy. Unfortunately, resources appear to be inadequate to monitor compliance as well as enforcement. In the meantime, CBOs remain unregulated, an issue which should be addressed as a matter of urgency.

Ongoing Initiatives

9. The current initiative for reform and development has as a goal the revision of relevant articles of the Civil Code of 1960 with respect to Associations. The draft legislation is at an advanced stage. One of the proposals in the draft legislation is to assign the registration, regulation and monitoring of NGOs to one Government body.

Conclusions and Recommendations

10. The legislative environment appears adequate to regulate and monitor the NGO sector. However, there is a lack of resources for enforcing the laws and monitoring compliance from the Government bodies concerned. The full audit requirement may be onerous for the small NGO’s, and although the DPPC guideline refers to performance audit, no such audit is performed. The following are the suggested recommendations:

- The regulating and monitoring body for NGO’s should be assigned to a single Government body for better results and ease of administration.

- The Ministry of Justice should prepare for future computerization of all registrations. This includes updating the register, and the creation of a Federal register of CBOs.

- Training resources should be made available for Government officers dealing with the NGO’s concerning project preparation, project evaluation, and project monitoring.

- Consideration should be given regarding the audit of the smaller NGOs. One way may be to reduce the scope of the audit requirement for those NGOs with income below a prescribed threshold.
8. PRIVATE SECTOR

1. The regulatory framework for the registration of companies in Ethiopia is embodied in a number of pieces of legislation including the following:

- Commercial Code of 1960;
- Licensing and Supervision of Banking Business Proclamation No. 84/94;
- Licensing and Supervision of Insurance Business Proclamation No. 86/94;
- Public Enterprise Proclamation No. 25/1992;
- Public Enterprises Supervising Authority and the Industrial Development Fund Establishment Proclamation No. 277/2002;
- Federal Ethics and Anti-Corruption Commission Establishment Proclamation No. 235/2001; and

2. The framework is extensive enough to provide for good corporate governance, with the exception of the Commercial Code of 1960. This code does not express the responsibilities that businesses have as large stakeholders in society, such as employees, society as a whole or creation of wealth and jobs. This reflects the prevailing culture during the period when the code was written. Furthermore, the disclosure requirements in the Code with respect to measurement of performance and governance of the companies need revising.

3. The companies in the private sector are relatively small. There are probably some two dozen share companies and about two thousand private limited companies. Most of the share companies can be found in the financial, banking and insurance sectors. The private limited companies are mainly small family operated companies. There is no stock market in the country. It is from this point of view that the corporate governance regime of the private sector in Ethiopia should be examined.

4. The total number of corporate entities is unknown, since the company register has not been updated. However, data is now being collected from the Regions and a computer network built up for this purpose. The Ministry of Trade and Industry, and the Addis Ababa Trade, Industry and Tourism Bureau were asked to provide a number of incorporated entities registered during the previous three years. The latter agency was chosen because Addis Ababa is where most private companies operate. The number of registered incorporated businesses is found below. Place of registration for local companies is optional and can be done either at the Federal or Regional offices. Foreign companies must register only with the Ministry. No data exist regarding de-registered and insolvent companies.

<table>
<thead>
<tr>
<th>Year</th>
<th>Federal Level</th>
<th>Addis Ababa</th>
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<tbody>
<tr>
<td>2000</td>
<td>266</td>
<td>375</td>
</tr>
<tr>
<td>2001</td>
<td>228</td>
<td>364</td>
</tr>
<tr>
<td>2002</td>
<td>246</td>
<td>468</td>
</tr>
</tbody>
</table>

5. The Ministry of Trade and Industry, and the Regional Trade, Industry and Tourism Bureau are responsible for ensuring compliance with the statutory requirements. However, neither the Ministry nor the Bureau requires the filing of financial statements. Thus, the registrars of these two Government bodies do not enforce compliance through the maintenance and submission of proper accounting records.

6. The Commercial Code of 1960 requires the audit of the annual financial statements of share companies and private share companies with more than twenty shareholders. No such audit requirements exist for private limited companies, irrespective of their size and
shareholding. However, a number of private limited companies voluntarily audit their annual financial statements. The National Bank of Ethiopia monitors compliance with Proclamations 84 and 86/94, and regulates and monitors the banks and insurance companies.

7. The penalties for non-compliance are stated in the legislation. However, compliance with the Commercial Code is not monitored and information on incidence of penalty for non-compliance does not exist. The National Bank of Ethiopia has noted no penalty for non-compliance so far. The Federal Inland Revenue Authority does not require audited financial statements of companies as it undertakes tax audits and assessments no matter what the audited financial statements state.

8. Companies are required by law to adhere to the corporate governance framework as stipulated in the Commercial Code. It protects shareholders' rights and treats all shareholders equitably, including minority and foreign shareholders. Shareholders can obtain effective redress for violation of their rights. However, the law is not monitored. The concept of internal control and internal audit does not exist in the legislation; only organizational control is indicated. Audit committees are not common and probably not relevant given the relative small size of most of the companies.

9. The Public Sector Supervising Authority monitors the Public Enterprises to ensure that the accounts are closed and audited within a specified period after the end of their financial year. There are some one hundred and forty-five public enterprises that all have a rather well developed financial accounting system with specified accounting procedures manuals developed for use by each sector i.e., industry, agriculture, service, transport. The accountability of this sector is of interest to all interested parties because of their significance for the economy; all the major banks, the largest insurance corporation, most of the major manufacturing sector and businesses in other sectors are still owned by the Government.

10. Companies that maintain proper accounts for purpose of decision-making, financial management and reporting are limited. The large private and share companies maintain proper accounts. However, the accounting system and the quality of the accounts vary depending upon the particular entity’s background and also, whether it is associated with an international firm and thus required to follow that entity’s accounting system.

Assessment of Risk

11. Most of the provisions in the Commercial Code and other non-coded pieces of legislation seriously need to be updated as they do not provide the required legislative framework for the current demands.

Ongoing Initiatives

12. No information exists of any recent donor involvement by way of support, technical assistance, or studies in the area of corporate governance.

Conclusions and Recommendations

- The Commercial Code must be revised and modernized in a way appropriate for the circumstances and development situation of Ethiopia's private sector. The Ministry of Trade and Industry should monitor compliance with the Commercial Code and other pertinent laws.

- A workable system for monitoring the private sector should be developed. Adequate provisions to enhance and sustain the system after its introduction must be provided.
9. THE ACCOUNTANCY PROFESSION

9.1 STRUCTURE OF THE PROFESSION

1. In all countries, regardless of the level of development, many people, in addition to professionally qualified accountants, are involved in the accountancy profession. They possess diverse skills and function in various capacities e.g. clerks and bookkeepers, accounting technicians and information technology specialists. Such people work in both public and private sectors and all are important and each group has distinct and important competencies. However, sustained development of the accountancy profession is best achieved by the creation of a professional accountancy body that will have as its objective to represent professional accountants, look after the public interest in all matters relating to the profession, protect the interests of professional accountants and establish professional standards to be adhered to, especially standards of professional conduct.

2. Presently, there is no national accountancy body and/or standard body setting national accounting standards and/or recommending the adoption of existing standards. The weakness of the profession can be attributed to the political environment from 1974 to 1991, when the development of the private sector was not encouraged. The period from 1991 to date has seen an improvement; however, no active initiative or intervention has been taken to promote the accountancy and auditing profession by those expected to do so.

3. The Ethiopian Professional Association of Accountants and Auditors (EPAAA) was formed in 1971, but has been dormant for a long time. EPAAA has now started to show some initiative to contribute to the development of the profession. All licensed practicing auditors are members of EPAAA. The other associations are the Ethiopian Accountancy and Finance Association (EAFA), which is also presently dormant but had public sector members and former key members now in key positions in Government. There is also an Institute of Internal Auditors (IIA) Ethiopia Chapter. The last organization has shown some initiatives to develop the internal audit profession among its members who are from both the public and private sectors. As the EPAAA and IIA have very limited resources, their ability to influence the situation to great extent is limited.

4. Proclamation No. 68/1997, which established the Office of the Federal Auditor General (OFAG) gives this Office powers to promote the auditing profession. This includes the issue, renewal, suspension and cancellation of certificates of competence of private auditors. The Office issues a list with the names of audit firms and authorized auditors as well as a list of authorized accountants and the names of the firms.

5. At present, there are twenty-eight licensed auditors, including the Audit Services Corporation, practicing in the country. All of them are located in Addis Ababa. These are classified as large, medium and small by the OFAG, and using these criteria, there are five large, seven medium and sixteen small licensed auditors. All the audit firms are owned and run by their principals; no partnerships or corporate ownership exist. As a result, some senior individuals upon obtaining their licenses from OFAG, leave their employment and start their own small firms. This ownership structure causes pressure, a state of affairs that would by

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38 Authorized Auditors can audit and render opinion on those financial statements prepared by Authorized Accountants and/or organizations. Services provided by Authorized Accountants include bookkeeping, liquidation, tax advice, designing and installing accounting and internal control system, maintaining cost account records, preparing budget, maintaining and closing accounts, preparing financial statements, financial analysis reports and other related services. There are around 220 licensed Authorized Accountants.
necessity, reflect on the quality of audits. This problem is exacerbated by other structural
deficiencies of the profession including the absence of a monitoring regime for auditors. With
the current ownership structure, it would not be practical to build large audit firms similar to
the situation elsewhere in the world.

6. The Government-owned Audit Service Corporation (ASC) operates under a separate
proclamation. The Federal Auditor General is the chairman of the corporation. As he also
deals with the issuance of licenses for authorized auditors, there is a possibility of conflict of
interest.

7. No legal framework or practical guidelines have been set up by the Government or
professional body regarding the appointment of auditors in the private sector. A thorough
analysis of the appointment system shows that, as regards the public enterprises and NGOs,
competitive procurement is commonly accepted as the basis for appointment. Many of the
public enterprises are audited by the ASC and small audit firms through a tendering system
based on fee comparisons. This means, that the three internationally associated accounting
firms (one established and two associated) rarely qualify to take part in the auditing of public
enterprises or NGOs as the audit fees have been cut to a level far below what is acceptable to
their costing structure.

8. There are no Ethiopian auditing standards enforced by the Government and/or any
professional body. The Government expects the practicing licensed auditors to be governed
by the high standards of professional conduct and other regulations demanded by their
professional associations and institutes. Most of the audit reports issued by practicing auditors
state that the audit has been done in accordance with the Generally Accepted Auditing
Standards and some indicate that they have audited according to the International Auditing
Standards. However, because no monitoring mechanism is in place to ensure the quality of the
audits, it is very difficult to ascertain whether all the reports measure up to the standards they
refer to.  

9.2 EDUCATION AND TRAINING

9. The Addis Ababa University is the major player in the training of accountants in the
country. They informed the team carrying out this assessment that they had lost most of the
senior teaching staff to either the private sector or higher quality education and employment
abroad. The University also indicated that there was a serious shortage of teaching aid
materials, particularly computers. As a result, students graduate from the University without
knowledge of, or training in, the use of computers or other application software. The courses
themselves need revising as only one auditing course is offered to accounting degree
graduates.

10. Internship opportunities for students do not exist. Such internships would enable the
students to interact with the real world and help them build confidence when they seek
employment. On-the-job training is given to most accountants of larger private companies and
public enterprises. However, small company accountants may not get similar opportunities for
training, as there are few accountants in house with the capacity to train. In addition, small
companies are seldom willing to pay for staff training.

39 A review of the audit files of six audit firms indicated that, in general, the audits are of an acceptable standard. The extent of
the documentation of the audits varied from firm to firm. There was a need to improve the risk analysis and expand the audit
plan. Performance audit is carried out only in exceptional cases in the private sector.
11. Formal training is rarely given to external auditors due to work and fee pressure. However, on-the-job training exists for senior auditors and managers. Furthermore, students and members of professional associations such as the Association of Chartered Certified Accountants (ACCA) of the United Kingdom receive student and professional journals that enable them to update themselves with new developments within the profession.

12. Accounting diploma and degree courses can be pursued within Ethiopia. However, those who aspire for professional qualifications in accounting need to look abroad. Presently, ACCA courses are the most popular, and there were more than 800 registered students in Ethiopia.

13. At present, the gap between demand and supply of accountants of different levels and auditors, on face value, appears to be narrowing and a number are finding difficulty getting employment. One reason could be due to the fact that most would prefer jobs in Addis Ababa, and were therefore competing for jobs in a limited market. There is need to take stock of the current requirements in the country, building on work of the Accountancy and Audit Studies Consultancy report of 1997 on this subject. This should take into account the emerging issues of the decentralisation process being carried out by the Government and the increasing demand for various levels of accounting staff at Regional and lower levels.

14. As audits are not legally required for private limited companies with less than twenty shareholders, the number of licensed auditors covers the existing demands. However, a potential expansion of the audit requirement to other private companies and businesses would result in a gap between demand and supply. It is expected that already professionally qualified accountants starting their own audit practices will fill the shortfall in supply.

Assessment of Risk

15. The absence of legislation and an effective and well-established professional body to govern the accountancy profession has created serious drawbacks to the development of the profession in Ethiopia. This in turn has resulted in the absence of officially recognized private sector accounting and auditing standards. The quality of education and training needs improvement. The opportunity to pursue an accounting qualification is not within the financial means of those who have the interest and intellectual capacity to do so.

Ongoing Reform

16. The Capacity Building for Decentralized Service Delivery Project, a World Bank financed project has amongst its Accountability and Transparency activities the strengthening of mechanisms for fiduciary accountability including the development of the accountancy profession.

Conclusions and Recommendations

17. The following are the recommendations:

- Ethiopia needs national accounting and auditing standards to bring about a greater understanding of financial statements and bring the quality of audit work closer to the internationally accepted standards.

- As the accounting and auditing profession needs to be better governed and monitored, the Government should consider taking the initiative and set up an ad-hoc committee tasked with recommending a legal and institutional framework. It should also establish a
resource base for a well-structured accounting and auditing profession in Ethiopia with capacity to deliver. The strengthening of EPAAA and IIA must be considered of vital importance to improve accountability.

- The education and training of accountants must be improved and the weaknesses in the education system improved upon. Consideration should be made to include private training institutions for the delivery of this training;

- The students association of ACCA should receive assistance, at least in the short term, to help those who want to pursue their accounting qualification. In the long term, though, local accounting qualification systems should be implemented.

- There is need to take stock of the demand and supply of accountants in the country, taking into account the emerging issues of the decentralisation process.
ANNEX I

Comparative Matrix with other Sub-Saharan countries

Comparative CFAAs’ are not yet available for a significant number of sub-Saharan African countries, and those that are available are not formatted to enable a straightforward comparison of fiduciary risk assessment. The information in this matrix has therefore been obtained from other reports and analyses. It is not comprehensive, and by its interpretive nature is subjective, but the reforms identified and their status allow for a valuable comparison to be made.

<table>
<thead>
<tr>
<th></th>
<th>Budget Process Reforms</th>
<th>Financial Management Reforms</th>
<th>Planning Reforms</th>
<th>Expenditure Control Initiatives</th>
<th>Decentralisation</th>
<th>Governance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Uganda</td>
<td>Budget process redesigned and pro poor initiatives introduced</td>
<td>FMIS currently being implemented</td>
<td>Process, capacity and information issues</td>
<td>SWAP developing sectoral capacity.</td>
<td>Functions decentralised, but still difficulties in capacity to manage</td>
<td>Documentation relatively good. Lack of linkage between strategy, budget and service delivery. Budget law initiatives, and strong linkage to poverty, with large donor involvement</td>
</tr>
<tr>
<td>Malawi</td>
<td>MTEF introduced, but constrained by shortage of information, progress slow</td>
<td>CCA introduced to enhance discipline, arrears problems, IMFS introduction slower than hoped</td>
<td>Linked to MTEF, forecasting in place, but ex post reconciliation poor</td>
<td>PRSP introduced but not integrated into budget</td>
<td>No fiscal decentralisation as yet</td>
<td>Parliamentary participation limited, late budget submission common.</td>
</tr>
<tr>
<td>Ghana</td>
<td>MTEF introduced 1999, but reputation damaged by revenue shortfalls 2000, Budget process still has problems</td>
<td>Financial Management Reform Programme is behind schedule. Cash management and capacity problems</td>
<td>Forecasting problematic, particularly on Revenue.</td>
<td>SWAPS, PRRs widely used, some good tools, but usage damaged by lack of funding predictability</td>
<td>No recent reforms.</td>
<td>Parliamentary information weak, audit reports late, transparency difficulties because budget documentation and financial reporting complicated</td>
</tr>
<tr>
<td>Tanzania</td>
<td>MTEF introduced, PRSP process incorporates monitoring, Budget not complete</td>
<td>IFMS introduced, and being rolled out to regions. However supporting paper-based system weak, and capacity problems</td>
<td>Not as yet a priority</td>
<td>PRS, Budget support, some SWAP’s, but links to budget process vague.</td>
<td>Decentralisation reforms major element of Public Sector Reforms</td>
<td>PRSP process, capacity in governance institutions weak</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th>Country</th>
<th>Key Issues</th>
<th>Challenges</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ethiopia</td>
<td>PIP, strength of fiscal discipline, budget and expenditure, little divergence. Improvements made but further initiatives required</td>
<td>No Medium Term planning, lack of completeness in budget</td>
<td>Some initiatives in Parliamentary Oversight about to start, but early stages. Reporting late to parliament, but strong External Audit</td>
</tr>
<tr>
<td>Nigeria</td>
<td>Functionality of Budget Process low because of poor resource estimates. Project underway to reform budget process</td>
<td>Planning unpredictable on revenue, poor information flows to and from states</td>
<td>Problems with budget distribution/split to States, reporting mechanisms difficult. Initiatives underway at State level to address difficulties</td>
</tr>
<tr>
<td>Namibia</td>
<td>MTEF introduced in late 1990's, incorporates development and recurrent budgets</td>
<td>None identified</td>
<td>Little fiscal decentralisation</td>
</tr>
<tr>
<td>Mozambique</td>
<td>Medium Term Fiscal Framework and other documents prepared, but value limited. Budget is not complete, significant proportion not captured.</td>
<td>Tools introduced, but of limited impact given wider difficulties</td>
<td>Provinces, Districts and Municipalities, have capacity and reporting difficulties. Initiatives planned in CFAA</td>
</tr>
</tbody>
</table>
On the basis of this analysis Uganda and Tanzania are probably at a more advanced stage in the PEM Reforms cycle than the others. This reflects the initiatives that have been taken and progress made to date.

A second grouping of countries led by Ghana but including Malawi (and Ethiopia if the plans and initiatives discussed in this CFAA are implemented) are further back in the process, but each has some strengths/initiatives taking place.

The remaining countries are further back, although Nigeria has already started to tackle some of the issues highlighted, and it could be argued that it should join the middle group.
### List of People Met and Contacted

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Annex III

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