

Macro Financial Support to Mozambique

Nordic Consulting Group

Department for Africa

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Sida Evaluation 00/27

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Sida Evaluation 00/27
Commissioned by Sida, Department for Africa

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Registration No.: U11YMo 1.7 3/2
Date of Final Report: April, 2000
Printed in Stockholm, Sweden 2000
ISBN 91 586 8866 8
ISSN 1401-0402

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1 Executive summary

1.1 Background and objective

This report is the output from a mission commissioned by a group of seven donors (Denmark, Ireland, Netherlands, Norway, Sweden, Switzerland and United Kingdom) to formulate a joint framework for macro-financial support (ref. the enclosed terms of reference in Annex I). The mission has consisted of Mr. Ulrich Camen, Graduate Institute of International Studies – Switzerland, Mr. Stefan Sjölander, SAAC – Sweden, Mr. Grayson Clarke of Bannock Consulting – United Kingdom, Mr. Dag Aarnes and Mr. Jens Claussen (team leader), Nordic Consulting Group – Norway.

The mission is the third in a series of Joint Donor Review (JDR) missions, which have reviewed various aspects of macro-financial support (MFS). The first JDR mission in 1998 reviewed the operation of the foreign exchange allocation model from a macro-economic perspective with emphasis on recommendations to simplify and unify procedures relating to the use of foreign exchange. The second mission in 1999 focused on MFS as support to budget execution with an emphasis on recommendations to improve the transparency and accountability of the flow of funds from the donors to the budget. The main focus of this review mission has been the formulation of a joint framework for future MFS with common program objectives and outputs to be produced with a simplified and unified disbursement mechanism.

1.2 Rationale for continued macro financial support

Despite high level of economic growth fostered by political and economic stability, and structural reforms, the external financing requirement for Mozambique will continue to be high in the medium term. The internal and external economic deficits will remain high if needed investments and development is to be financed. Projected financing requirement in the medium term expected to be covered by grants and concessional lending is projected to remain at about 500–600 USD million.

A further high level of development assistance is justified to further promote the policy of poverty alleviating growth with emphasis on needed reforms and institutional development. Given the already high level of development assistance to domestic resources, the main rationale for continued support in the form of MFS is to ensure flexibility for the Government of Mozambique to allocate public resources to priority areas and provide an incentive for implementation of agreed policies and reforms.

To ensure that resources are actually utilised for priority areas it is recommended to specifically focus on reforms and capacity building in the area of Government financial management. While reforms in planning and budgeting including the introduction of a Medium Term Expenditure Framework has been implemented, actual implementation and monitoring in terms of public spending suffers from weaknesses both in terms of the current payment system, accounting and auditing.

1.3 Objective for support

To harmonise conditions for MFS associated with the above a joint donor MFS program framework is being proposed. The proposal will ensure a coordinated and consistent approach by donors and enable the Government of Mozambique to observe a common set of agreed benchmarks rather

than the multitude of donor specific conditions featuring in the various bilateral agreements (ref. JDR report in 1999).

MFS is untied support to the Government budget. Accordingly, future MFS should focus on the need to improve the efficiency in the utilisation of public funds. In order to do so it is recommended that continued MFS is not only linked to continued implementation of intended policies but also is linked to needed reforms and capacity building in the area of Government financial management.

The overall objective of the program is to promote the implementation of the Poverty Alleviation Strategy (PRS) as elaborated in the Poverty Alleviation Strategy Paper (PRSP). The immediate objective is to promote improvements in overall public sector financial management by linking MFS support to progress in this area. A proposed outline of such a programme is elaborated in Annex XI.

1.4 Disbursement mechanism

Under the current foreign exchange regime there is limited justification for a procedure that requires reporting on a donor by donor basis both in terms of foreign exchange sold in the inter-bank market (MCI) and conversion of donor grants to counter-value financing the Government budget. The important issue is the general development in the foreign exchange market which can be monitored by monthly statistics on the foreign exchange market and the audit reports that are prepared under the Exchange Control Regulation to be shared by the Banco de Mozambique with the donors. In terms of procurement, the general trade regulations imposes restrictions on imports for a number of commodities making donor specific negative lists with limited impact on foreign exchange utilisation and imports, however creates significant transaction costs for the Government.

A *disbursement mechanism* rather than an *foreign exchange allocation model* is proposed to significantly simplify the transaction costs associated with reporting on the utilisation of MFS. One important feature is to improve the predictability in flow of funds from donors through Banco de Mozambique to the Government. A common procedure for pledging and disbursement of funds from the donors is proposed to reduce transaction cost and improve liquidity planning for the Government.

Pooling of donor contributions through one foreign exchange account further simplifies reporting on the actual conversion of foreign exchange to local currency, and accounting and auditing of the flow of funds. Accordingly, the proposed disbursement mechanism meet the needs for more predictability in flow of funds, simplification of the disbursement procedure and in accounting for foreign exchange and counter-value.

1.5 A joint donor framework for MFS

A joint program outline has been elaborated in annex XI to the report which is combining the above two components;

- Common objectives, outputs and indicators for the support provided and
- A common disbursement mechanism,

Within the overall objective of supporting the Government of Mozambique efforts in implementation of a poverty reducing policy as guided by the Poverty Reduction Strategy (PRS) the program specifically focus on the issues of improving management of public finances which directly have an influence on the efficiency and monitoring of the utilisation of the MFS support (untied financing

of the Government of Mozambique budget). The MFS can either be linked to specific outputs as more formal conditions and benchmarks for support or be considered as areas of dialogue and review as basis for pledges of MFS.

Even if there is a limited scope to develop a consensus among donors on what specific areas to focus on, to agree on a common disbursement mechanism will at least reduce some of the transaction costs associated with future MFS support.

2 Rationale for continued macro financial support

2.1 Main objective – to reduce poverty

The objective of the joint donor programme is to support the Poverty Reduction Programme of Mozambique through flexible and timely macro financial (budget) support. The donors participating in this co-ordinated effort are Denmark, The Republic of Ireland, The Netherlands, Norway, Sweden, Switzerland and United Kingdom. The overall goals of the program is to contribute to and strengthen Mozambique's poverty reduction programme as is outlined in the interim Poverty Reduction Strategy Paper (PRSP) by:

- Supporting the overall macroeconomic reform programme and contribute to higher economic growth.
- Providing a financial basis for increased resource allocations to priority sectors. The government is in the process of determining the medium-term budgetary costs associated with the poverty reduction strategy and the outlook for external financing of the budget. This work, to be completed by September 2000, will be folded into a revised and extended three-year macroeconomic framework and a matrix of structural measures focusing on flood-related reconstruction, poverty reduction, growth-oriented policies, and the maintenance of a stable macroeconomic environment.
- Strengthening the dialogue on improved public financial management and increased domestic resource mobilisation. The government has announced that it is committed to achieve further progress on its program of social and structural measures and accelerating the process of public sector reform, particularly in the areas of fiscal transparency, governance, and accountability. In this context, the government intends to complete a review of fiscal management in relation to the Code of Good Practices on Fiscal Transparency.

2.2 Financing deficits and supporting economic growth

The economic reform programme in Mozambique, away from the state controlled economy started in 1987. Exchange rate and interest rates have been liberalised, quantitative and other restrictions on trade have been lifted and a privatisation programme implemented. Economic developments in Mozambique have been favourable since the beginning of the 90's. Economic growth, albeit from a very low level averaged almost 7 percent in the 1993–96 period, rose to more than 12 in 1997 and continued through 1998 and 1999 at a high level. Careful monetary and fiscal policies have reduced inflation to single digit levels and the metical has been relatively stable for the last 5 years. Mozambique is now one of the fastest growing countries on the African continent.

In spite of positive developments since the beginning of the 90's, Mozambique still faces enormous development challenges. Poverty is widespread with GDP per capita remaining among the lowest in the SSA region and life expectancy at birth is as low as 45 years. Primary school enrolment and access to basic services are all well below SSA average.

In macroeconomic terms, there are two fundamental reasons for the need of continued macro financial support to Mozambique. The first is the need to finance a large current account deficit in a situation where access to foreign financial markets is very limited and the deficit is likely to last for a considerable number of years. The deficit is the result of a very small export base and still insufficient capital inflows. The second is the low available savings in the economy to accommodate the needed resources for development expenditure including the acute need to rebuild the country's infrastructure.

Table 2.1 presents projections for the current account in the medium term. Exports of goods from Mozambique are very low by any standard but are projected to increase from a level of 230 million dollars in 1999 up to more than 500 million dollars next year based on among others growing export revenue from the Mozal aluminium smelter. Imports of goods are expected to decrease somewhat as the construction phase for the Mozal plant is concluded.

Table 2.1 External financing requirements in Mozambique. Million USD. Estimate for 1999 based on data for 1.–3. quarter.

	1997	1998	1999	2000	2001
Exports, fob	230,0	244,6	230,0	322,0	508,0
Imports, cif	760,0	817,3	1200,0	1110,0	1075,0
Trade balance, goods	-530,0	-572,7	-970,0	-788,0	-567,0
Services, receipts	342,3	332,5	349,3	373,6	402,8
Services, expenditures	423,0	502,2	550,0	653,9	620,4
Services balance	-80,7	-169,7	-200,7	-280,3	-217,6
Current account	-610,7	-742,4	-1170,7	-1068,3	-784,6
Private borrowing (No Gov. Guarantee)	90,0	81,4	200,0	341,2	110,7
Net direct investments	64,4	212,7	344,4	119,9	78,8
Private capital inflow	154,4	294,1	544,4	461,1	189,5
Current account after Priv. Cap. Inflow	-456,3	-448,3	-626,3	-607,2	-595,1
Debt service of government	-200	-226	-200	100	70
Financing requirement	-656	-674	-826	-507	-525

Source: Banco de Moçambique and IMF

Projected financing requirement expected to be covered by either grants from donors or by concessional lending from the international financing institutions is projected to remain at about 500–600 million in the medium term. In the last 5 years the financing requirement of Mozambique has been more than fully met from these two sources and the country has been able to build up foreign exchange reserves.

The other way of arriving at a figure for budget support requirements is to look at likely developments in government revenue and total spending. Table 2.2 shows the main government budget figures for Mozambique including projections for 2000 and 2001.

Table 2.2 Government finances, Mozambique.

	1997	1998	1999	2000	2001
In billion meticalais:					
Total spending	9498	10207	13200	13900	15100
Total revenue	4623	5311	6300	7500	8800
Budget deficit	-4875	-4896	-6900	-6400	-6300
As percentage of GDP:					
Total spending	25,9	22,1	25,0	23,1	22,3
Total revenue	12,6	11,5	11,9	12,5	13,0
Budget deficit	-13,3	-10,6	-13,0	-10,6	-9,3
Memo:					
Metical per dollar	11604	12366	12600	14000	14000
Budget deficit, USD	-420	-396	-548	-457	-450
Nominal GDP	36693	46134	52900	60200	67800

Source: Banco de Moçambique and IMF

The effects of the floods in Mozambique in February and March 2000 are not included in the figures in table 2.1 and 2.2 since little was known of the total effects of the floods at the time of writing. Table 2.2 shows that Mozambique even with significant increases in tax revenue will continue to have a large budget deficit with a continued requirement for external assistance to maintain its relatively high level of public expenditure for development purposes.

Based on the above there is a continued rationale for development assistance including macro-financial support to meet the foreign exchange deficit of the current account as well as the Government budget deficit. Financing these deficits relates directly to both the growth prospects and the development prospects for the country.

2.3 Economic policy challenges arising from budget support

Even though external support is clearly needed in Mozambique, both donors and authorities need to be aware of several important issues both in terms of stabilisation policies and longer-term structural policies. Research from several countries in the same macroeconomic situation as Mozambique indicate that there are in particular three challenges.

The first is the risk of having sustained periods of (often unintended) overvalued exchange rate. Many observers of the Mozambique economy point to observed small changes in import substitution, lack of export development and even periods of excess demand for foreign exchange as indicators that the Metical may have tended to be overvalued in recent years. The issue is difficult to assess but it is clear that it is of importance to avoid prolonged periods of overvaluation of the exchange rate. The foreign exchange market in Mozambique is presently characterised by an inter-bank market in early stages of development and by administrative regulations in parts of the market when the central bank sells foreign aid funds. The mechanism for the rate setting is, in the view of the team, not entirely transparent and the challenge for the central bank is to predict aid flows and meeting the reserve targets agreed with the IMF. Under such a regime it is very difficult to have specific targets for the exchange rate.

The second policy issue of importance in this regard is the risk of crowding out of private investments. Under normal circumstances a government budget deficit is met by borrowing from the private sector. When the private sector and the government sector compete for resources (savings) they face the same marginal cost of capital. In the case of Mozambique, the government can access savings in the form of counter value funds at no or very little cost whereas the private sector must

pay interest rates of up to 20 percent or more. For a country that needs to rebuild its infrastructure almost from scratch this is not necessarily a major problem, but over time, a situation can develop whereby sound private sector projects are not being realised because of overspending by the government. The combination of overvalued exchange rate and high cost of borrowing for investments in the private sector can therefore lead to a delay in the development of a larger export base.

The third policy issue to be aware of is the development of the tax system and total tax revenue. High and sustained budget support means that in the short run there is less need for tax revenue, and since taxes rarely are popular with the population the political system may not give enough priority to the tax system and the tax collection. To expand the tax base and improve tax collection are, however, of importance to Mozambique in the long run in order to reduce the aid dependency.

2.4 Macro financial support and the policy dialogue

The terms macro-economic support and policy dialogue generally cover a variety of aid programmes and types of dialogue between the donor agency and partner country. The objective of macroeconomic support is to link the potentially positive economic effects of the transfer of resources to a policy dialogue that leads to a positive reform process. There is a wide consensus among donors that the potential for this type of support, both in terms of contributing to economic growth and reducing poverty, lies in achieving this link.

The policy dialogue related to macroeconomic support has traditionally concentrated on four overall policy issues:

- Stabilisation policies including fiscal and monetary targets
- Increased allocation of resources in the public sector to priority sectors
- Structural adjustment to reorient partner countries economies towards market based solutions through reduced subsidies, increased competition and more open trade and investment flows
- Governance and public sector reform issues to increase transparency and reduce misappropriations of public resources

In addition, the movement towards, and support for, a better enabling environment for poverty reduction in the general formulation and implementation of development policy has figured prominently in recent policy dialogue.

There is no clear definition of what constitutes a poverty-focused policy dialogue. Most donors argue that there is a link between poverty and economic growth and with economic stabilisation (reduced inflation). Therefore there is a link between structural adjustment that enhances growth, and stabilises the economy, and poverty reduction. A more narrow and operational definition, however, is to say that a policy dialogue is poverty oriented if it satisfies one or more of the following criteria:

- The dialogue actually leads to reallocations of public spending in favour of programmes and sectors that produce services that benefit the poor. In order to do that there is need for knowledge of who the poor are, what the main reasons for poverty is and how public spending can be altered to reduce poverty.
- The dialogue addresses policy issues that lead to increased income-generating possibilities for the poor.
- The dialogue leads to the establishment of safety net mechanisms that protect vulnerable groups in the structural adjustment process.

In addition to these criteria, there is general agreement that the policy dialogue needs to address the different institutional instruments, present or not, through which the participation of the poor in policy formulation and implementation can be facilitated.

Experience from many countries show that it is in the interest of both the partner country and the donor community in general to have a *co-ordinated approach* to the dialogue and to assess each donors strengths and weaknesses in terms of taking part in the dialogue and provide the technical capabilities and the long term commitment needed in many of the areas. An active dialogue to contribute to improvements in for example tax collection will inevitably take time and require input of technical assistance on different levels. A dialogue on tax policy issues also requires knowledge of the area. Donors in Mozambique should also pay attention to the lack of capacity on the Mozambique side to have what could be called parallel dialogues on the same issues.

The JDR mission feels that there could be scope for improved donor co-ordination in Mozambique in terms of carrying out a fruitful dialogue. Donors and the Mozambique government generally appears to share many of the same ideas of future development of the country, and agree on the overall objectives as spelled out in the Policy Framework Paper.

2.5 Choice of development assistance channels

The main focus of attention by the donors in providing macro-financial support has changed from attention to utilisation of individual donor foreign exchange allocations to the support provided in the form of counter-value for the government budget (Terms of reference page 1)¹. This support is considered critical to meeting the Government's financial requirement for development expenditure design to meet its poverty reduction objectives by among others increasing the provision of extra financial resources for the social sectors.

At the same time, the Government has indicated its desire that financial support should as far as possible be provided through general budget support because:

- It reduces transaction and compliance costs for Government and donors,
- It offers more flexibility over how to deploy funds within authorised budget limits and in accordance with agreed policy milestones.

From a donor perspective continued MFS is not only justified by meeting the external and internal financing gaps (the main rationale for development assistance in general) but to provide untied support to the budget as an incentive for implementation of an agreed policy. For both donors and Governments it reduces the transaction costs associated with other forms of development assistance which enables the partners through the dialogue to focus specifically on policy and reform issues rather than on administrative issues related to actual utilisation of the individual donor contribution.

¹ Mozambique has still one of the highest current account deficits in the world. The external gap rationale is accordingly still a highly valid justification for continued high level of support. The only difference between applying the different labels "BOP support" and "budget support" is that sterilized BOP support means that the public sector will have to pay the same marginal cost of accessing the foreign savings as the private sector.

3 Macro-financial support and financial management

3.1 Rationale for linking MFS to financial management

The present Government financial management systems give limited information related to actual utilisation of public resources. Consequently there is limited basis and information available to monitor use of Government funds including counter-value generated from MFS². Unless these systems are strengthened, there is a risk that donors will revert to administratively costly project support in the future. This is not considered a desirable outcome for the Government or donors.

The Government Financial management system has in the past not been able to provide reliable information in terms of actual expenditure outcomes. Accordingly there has been limited scope for monitoring counter-value fund utilisation based on indicators on expenditure outturns (like profile of expenditure, volume or distribution of expenditure by sector, composition of expenditure within sectors, etc.). However, the Government of Mozambique has indicated it will produce quarterly expenditure returns showing budget transfers and execution figures by Ministry and province. The information contained in these returns will need to be validated through an audit process. In annex X we have provided proposed terms of reference for such an audit.

Following the above observations, it is recommended that the provision of macro-financial support should be linked to further improvements in financial management system. Linking MFS support to the process of improving financial management may provide incentives to the Government to implement improvements so they in the future are able to provide more reliable information on actual public expenditure outcomes.

As the principal agent for translating policies into interventions targeting the poor, adequate Government financial management systems and capacity is equally important to ensure that any policy can actually be implemented and monitored. Financial management as such not only deals with an adequate system for planning and budgeting, but actual execution as intended as well as an accounting system that enables monitoring and audits that can give reasonable assurance of the information produced. Major efforts to address weaknesses in this area should accordingly be considered as contributions to the implementation of a policy for poverty alleviating growth.

3.2 Status of public financial management

Planning and Budget

Fiscal planning and budgeting is the area within the Ministry of Planning and Finance that have been developed most prominently the last years. The Medium Term Expenditure Framework (MTEF) seems to be unified and taking into account total resources available. Poverty parameters will increasingly be incorporated, broadening the medium term perspective to a Medium Term Development Framework. This emphasis on integration also affects the structure of planning instruments.

While as links between macro projections, resource projections and the MTEF seem to be consistent, targets and allocations in the MTEF do not seem, as yet, to link up with sector allocations (on multi-annual basis) or annual budget allocations. Sector allocation indicators used internally at the

² This was one of the main findings of the previous JDR mission.

Ministry of Planning and Finance do not seem to be adjusted to actual allocations to Sector Wide Approach Programs (SWAPs). However, a dialogue with concerned sector ministries will be introduced to modify total resources available, to make these figures coherent with MTEF planning projections.

Changes in donor reporting are one of several necessary changes to include present off-budget resources in the State Budget. New reporting routines, also applied at sector ministries, have however to be complemented by initiatives to map and control the structure of bank accounts available to Government expenditure as well as the introduction of intermediate consolidated accounts, to make it possible to register present off-budget resources.

Accounting

The Government has presented the 1998 State Annual Accounts to the Tribunal Administrativo and the Parliament. This is the first closing of the State Accounts since 1975 representing a significant effort by the Government, achieved through the introduction of comprehensive new legislation, broad package of computerisation and training of thousands of staff. The information flow to make Government State Budget accounts available also in the future should now be consolidated.

One indicator of the reliability of the system is the intention by the Government to report quarterly (with a 45-day delay) on actual budget execution as from year 2000. Information presented in these reports will be of much higher quality as compared to previous “budget execution” reports presented to donors, based on very uncertain figures on utilised liquidity. However, Government Accounts at present only answer to approx. 30–40 percent of all Government expenditure, making it necessary to present these liquidity based reports for several years ahead, to be able to include a projection of all expenditure executed

Partly due to this fact, the Government has started activities aiming at an introduction of a new accounting model at a five-year term. This model would facilitate different stakeholders with most wanted information concerning costs linked to activities or programmes. Equally important is the fact that a new accounting model would promote introduction reporting from areas within the Ministry of Planning and Finance where accounts at present are poor, e.g. the National Directorates of the Treasury, the Revenue and Fixed Assets.

The legislative framework in this area is outdated and the introduction of new legislation is required. It is also a need to decide on the intended Chart of Accounts given the fact that line ministries are introducing their own accounting models to facilitate donors and their own reporting requirements stipulated in the process of formulating sector programmes.

Treasury and the payment system

The Treasury system is still an area of concern even though action and activities are based on established norms and procedures. At central level, initiatives to map the bank accounting structure in the Treasury system have until now not been completed. It has not been possible as yet to present reconciled reporting routines of actual cash flow of donor or other funds in the central system, e.g. from forex accounts at the Banco de Mozambique to the central Treasury account that funds budget expenditure. As a result there is no comprehensive information available showing how all funds are actually being used or at what bank accounts it could be found.

An unknown number of bank accounts, mainly introduced by donors, are at the individual disposal of sector ministries, without authorisation of the Treasury and without any reporting on withdrawals. A complete picture of the structure of bank accounts in the central Treasury system has not been presented to donors.

With a Budget Execution system probably holding more than 1000 bank accounts, it is difficult to monitor liquidity. It is due not only to the high number of accounts but also the fact that the system is not computerised. It represents a major constraint for adequate cash-flow management, forcing Government to acquire short-term finance at high interest rates at the same time as money could be available in the system. The difficulties to actually channel money through the system also have an impact on the implementation of sector programmes. As a result of the Treasury not being able to guarantee the flow of funds in accordance with agreed mechanisms, donors hesitate to utilise the system and pledge further funding to the programmes.

Present and newly introduced external technical assistance has as yet not been able to tackle these problems. The proposals on institutional capacity building in financial management (Government of Mozambique and UNDP) only partly deal with these matters. The introduction of a new accounting model necessitates a reform of present bank accounting structure in the Treasury system.

Revenue (Taxes)

The Government of Mozambique has identified the need to reform present systems. The introduction of the VAT as of June 1999 has established collection of this tax at a level superior to that of taxes substituted. New policy and administrative structures to support the introduction of the VAT have also influenced the Government of Mozambique to look at other taxes, e.g. direct taxes, and the administration and collection of these.

There is limited information on actual conditions in the process of collection of taxes others than the VAT, but the comparison between these procedures and those introduced linked to the VAT, indicate the need of a reform of the system, including new legislation. More than 70 percent of all taxes are collected at tax offices in the provinces of Inhambane and Maputo.

The Government's interest to strengthen initiatives in this area – partly based on an international comparison of administrative systems and actual taxes in relation to GDP – comes at a point when external assistance is terminating. The IMF support to introduce the VAT has ceased. The UNDP has presented proposals on necessary activities as part of their programme on institutional capacity building in financial management, but currently funds to introduce these activities are not available.

Auditing

Public auditing institutions in Mozambique still suffers from limited capacity. At the Inspeccao Geral das Financas (IGF) institutional changes have been introduced and staff reinforcement announced together with higher salaries, however, progress in actual working capacity is slower than expected. It will still take time before changes in this area will result in increased capacity, especially outside areas where donors and IGF directly co-operate.

Technical assistance to the Tribunal Administrativo – the supreme audit institution in the country, submitting to Parliament – is being formulated and will commence during year 2000. Capacity to actually perform audits is however limited. Areas that need to be looked at include the responsibility for allocation of financial resources to the Tribunal and when and how accounting material should be submitted. The Tribunal will most likely not be able to fulfil its obligation to scrutinise the State Accounts of 1998 without external support. Any intention of reinforcement of the Tribunal would need to be reflected through increased financial resources from the Government of Mozambique.

Donors will still need to engage external auditors to receive reasonable assurance that donor funding is utilised as intended. This situation will continue for many years to come. Donors should as a result discuss with the Government ways to allow scrutiny of Government State Budget resources by

support of external auditors in collaboration with the public audit institutions. This would be even more significant, considering donor ambitions to increasingly utilise Mozambican financial management systems, e.g. through channelling of external funds through Government of Mozambique payment structures.

3.3 Program areas linked to MFS

The following constitutes the main areas to be considered for a new framework for MFS support in the area of Government financial management. The proposal for the program is based on the above assessment of the present status of Government financial management capacity, systems and procedures. An outline of a programme framework is provided in Annex II.

Budget execution and cash flow

While the introduction of a multiyear planning perspective has moved ahead rapidly, cash flow systems lack important features to ensure consistency and transparency. Further progress in the areas of Planning, Budgeting and Accounting is severely hampered by the limitations in the Treasury system.

The absence of transparent reporting on cash flow in the system should be of concern for the Government of Mozambique and donors since substantial amounts of programme aid is transferred through the system. In short term the structure of bank accounts in the central Treasury system should be recorded and audited followed by restructuring.

The Government has currently limited possibilities to measure actual liquidity in the system, severely affecting performance and service delivery in sectors on both central and local levels. Executing institutions and/or donors cannot get reliable information from the system to channel funds timely and in accordance with decisions made.

Accordingly, the Treasury system including mapping of state treasury accounts have been included as an area of focus for the MFS framework (ref. Annex II).

Public accounts

The Government is faced with the challenge to introduce a new accounting model based on international standards. Apart from off-budget sector expenditure, also other parts of economic activity at the Government of Mozambique have to be introduced in the accounts at full scale (primarily debt servicing, State Enterprise subsidies and guarantees, revenue and fixed assets).

A new legislative framework and a new Chart of Accounts for the new model needs to be presented. This issue has been introduced in the program framework (ref. annex II).

Auditing

Public audit institutions have operated with very limited impact for the administration. At present there is limited capacity by Government institutions to undertake audits by international standards. For the Tribunal Administrativo to independently perform financial and performance audit to international standards, there will be a requirement for substantially more human resource capacity as well as introduction of procedures and additional financial resources.

In the medium term, it will be important for the State Audit institutions to work in cooperation with private audit companies to achieve adequate level of coverage. In the past decade four of the major international firms have established franchise operations in Mozambique, together with a number of smaller firms. All these firms have to be registered with the Ministry of Finance and

have to demonstrate the capacity to deliver services to professional standards to achieve registration. However, there is no ongoing review of the standards by Ministry of Finance.

The experience and training in public finance of the companies have been very limited which is also reflected by some of the audits for Government and donor clients. To strengthen the standards of audit companies, discussions are currently ongoing between World Bank and the major firms to create an Accountancy Institute in Mozambique. It may also be suggested that the Government and donors consider supporting an Accounting and Auditing Training Institute. In addition repackaging audit assignments into larger volumes will give an incentive to encourage the firms to invest in training of staff in public finance and reduce transaction costs.

Both Government and Parliament audit authorities in Mozambique are subject to capacity building initiatives. It will however take many years before these institutions will be able to perform audits independently and with the capacity required. In the mean time both the Government of Mozambique and donors have to seek competence through external auditors; increasingly important in support channelled through national systems. These auditors will (therefore) need access to Government accounts; a feasible alternative in relation to present legislation that needs the cooperation of Government of Mozambique and donors to initiate a more permanent structure of procedures to realise this.

Both the issue of overall capacity by state audit institutions and the option to utilise the opportunity for cooperation with private audit firms are proposed as components in the program framework (ref. Annex II).

Revenue

Domestic resource mobilisation is a key issue for long-term financial sustainability and in reducing the public sector deficit. Donor funding to the State budget by counter value from MFS support may act as a disincentive for Government efforts to mobilise domestic resources through revenue collection. Accordingly, efforts in revenue collection should be linked to future MFS support with emphasis on initiatives to reinforce the collection VAT as well as other taxes. MFS support should accordingly be linked increased revenue collection.

While considerable effort has been devoted to indirect taxes, there has been limited focus on the areas of direct taxes. In 1999, employment and profits taxes contributed only 14% of total revenue. As the economy grows, there will be a need to review taxation policy and collection methodology so that part of increasing national wealth can be made available to fund sustainable improvements in essential services.

There are a number of areas that need to be explored including:

- Tax exemption policies
- Expansion of the tax base and subsequent adjustment of taxation law
- Efficiency issues comparing tax yields against cost of collection
- Capacity of staff to assess taxes due from businesses and self-employed individuals
- Payment methods and the transfer of funds from bairrios to Central Treasury
- The future of provincial revenues and the collection of taxes on behalf of the autarchies
- Organisational and funding issues relating to the operation of the tax offices (requiring a review similar to that carried out for Customs)
- Staff salaries and incentives

Some progress has been made – for example the extension of the single taxpayer identification number to businesses and the issue of registration cards. The Government also intends this year to begin consultation with the private sector over the reform of the direct tax system.

However apart from the recent requirements elaborated as part of the Government's second five-year plan in capacity building in economic and public financial management, no specific project proposals have yet been developed.

The Government of Mozambique and the donors should find means to cooperate on needed additional assistance with the donors agreeing on a lead donor to substitute support being phased out (this is an area where Switzerland has already provided some assistance). Any engagement has to be long term and include all levels of the tax administration. The introduction of an autonomous revenue authority should also be included as an option in this work.

3.4 An integrated program approach

MFS is a form of support, which provides incentives for improvements but do not by itself provide technical assistance and capacity to undertake reforms. The existing level of technical assistance is insufficient in many of the program areas. Accordingly, Government of Mozambique in collaboration with the donors should consider the formulation of a *sector wide programme* in Government Financial Management.

Capacity was highlighted already in last year's JDR. To facilitate any intention to move forward in this area, a matrix has been elaborated, that links previously discussed financial management areas with necessary initiatives to improve capacity. The matrix is attached as Annex IV. The matrix could be used as a point of departure for a dialogue between the Government of Mozambique and donors to formulate a capacity building programme to implement public financial management reforms.

Both the Expenditure Management Reform Strategy and the recent Ministry of Planning and Finance planning initiative funded by the UNDP on institutional capacity building in the Public Finance sector, identify a large number of training and system requirements in various programme areas, as well as lists of mostly highly relevant activities. However, limited attention has been given to:

- linkages and inter-dependencies between different activities in the various programme areas (e.g. between the introduction of the new accounting system and the rationalisation of budget execution bank accounts)
- genuine prioritisation of tasks that reflect such linkages and urgency of solution, and
- identification of necessary (as opposed to already committed) technical assistance, and potential overlaps/duplication between existing technical assistance.

Taking into account the knowledge in both these documents, there is a scope to develop a sector strategy in the public finance area. This will pull together the large number of individual technical assistance projects in the sector (located in Ministry of Planning and Finance and the line ministries), identify key priorities and provide a detailed rolling implementation plan. In discussion with the Ministry of Planning and Finance it was given the understanding that they would welcome the introduction of this kind of approach to the development of the sector. The former Minister of Finance undertook recently initiatives in this respect towards an involved group of donors.

The present structure of the Ministry of Planning and Finance built on a large number of national directorates at the top administrative level, means that there has been no focal point for drawing up

an overall strategy of this kind in the Ministry. A Secretary-General at the Ministry of Planning and Finance has recently been appointed and would be an important step to provide leadership on sector-wide issues. This is a step to improve the overall capacity as well as the donor dialogue on the issue of financial management, guide donor support to key areas and serve as the focal point for donor dialogue concerning the proposed MFS program.

A proposal is made to appoint an adviser to the Secretary General to assist in the development and implementation of a sector strategic plan, in the dialogue with donors providing support to this the area and accordingly act as a focal point for donors on key issues related to future MFS. This will serve as a mechanism to strengthen the Government capacity and create a more conducive framework for a dialogue linked to the proposed program framework. It may serve to improve the flow of information between the Ministry and the Banco de Moçambique on the one side and the donors on the other.

A draft terms of reference for such a position is given in Annex IV.

Government financial management systems and procedures has for some years been at the centre of attention in Mozambique, not only related to MFS but also other forms of support including budgeting, accounting and auditing of the utilisation of donor funding and Government counterpart contributions to programs and projects. Since these issues appear to pose a specific challenge for donors to Mozambique there may be a scope to strengthen the donor capacity to monitor the progress in the proposed program area for future MFS support. Each donor (or one lead donor) may consider strengthening their own capacity in the area of financial management by employing a financial management specialist to monitor progress and advise on future milestones and targets to be linked to the MFS program.

A proposed Terms of Reference for such a position is provided in annex IX.

4 The foreign exchange market in Mozambique

4.1 The inter-bank market

According to last Policy Framework Paper 1999–2002, the Government of Mozambique is seeking to develop the money market in order to allow for a move towards indirect instruments of monetary control. The aim has been to discontinue the system of bank-by-bank credit ceilings and to replace the current system of sporadic central bank money market operations by a regular system of Treasury bill auctions as needed for monetary control and debt management purposes. This process needs to be supported by the development of the Treasury's cash and debt management including liquidity management and forecasting.

An inter-bank foreign exchange and money market has in principle been established in Mozambique and the bank supervisory authorities are trying to enforce prudential ratios with regard to foreign exchange exposure. Presently, Mozambique has a wholesale foreign exchange market, the Mercado Cambial Interbancário (MCI), and a retail foreign exchange market. The MCI is the foreign exchange market that is used for selling foreign exchange obtained through macro-financial support. Participants in the MCI agree to a foreign exchange transaction in general on the phone. Once an agreement has been reached the transaction is confirmed by fax or through the on-line

foreign exchange information system that exists in Mozambique. Seven commercial banks participate currently in the MCI.

In the past, Banco de Moçambique sold donor funds primarily to commercial banks on a transaction basis. Commercial banks bought foreign exchange from the Banco de Moçambique for each transaction for which they needed foreign currency. This approach has been applied less frequently in the recent past. Instead of buying foreign exchange for individual transactions commercial banks may now buy large tranches of foreign exchange from the Banco de Moçambique, which they then use for their retail operations. This approach helps commercial banks to increase the efficiency of their foreign exchange operations.

According to the MCI Regulation authorised dealers in the MCI are required to provide the following principal information to Banco de Mozambique:

- Ex-post information on all foreign exchange transactions on a daily and weekly basis.
- Information on the use of donor funds on a monthly basis.

The Exchange Control Regulation requires financial institutions to verify the veracity and nature of a transaction and its compliance with applicable legal and regulatory provisions prior to carrying out their part of the transaction and to furnish the required type of proof. Foreign exchange transactions are subject to compulsory exchange registration. From this rule are excepted purchases of foreign exchange below USD 5000.- and purchases of foreign exchange that is used for the importation of goods or services. In the latter case, commercial banks are required to keep the standard trade documentation. Foreign Exchange Allocation Models have specified additional requirements for sales of donor funds such as procurement requirements.

The reporting requirements for commercial banks regarding foreign exchange transactions derive from the regulation of the MCI (Banco de Mozambique Note No. 16/GGBM/97 of September 29, 1997) and the Exchange Control Regulation (Banco de Mozambique, Law No. 3/96, January 4). The Bank Supervision Department of Banco de Moçambique and external auditors supervise the application of these regulations.

The foreign exchange market in Mozambique is presently characterised by a transition from a divided market with a mix of administrative controls according to source of foreign exchange, into a proper unified inter-bank market. The plans, which the government announced in the Policy Framework Paper, have not yet been fully implemented. This is also true for the Treasury bills market.

While the basic infrastructure for a foreign exchange market exists in Mozambique the MCI is highly fragmented with limited trading taking place between financial institutions participating in the MCI. Financial institutions in general keep their 'free funds' instead of selling them to other participants in the MCI. This is due to the general scarcity of foreign exchange which affects practically all financial institutions. Foreign exchange transactions between financial institutions are likely to occur only when some financial institutions have excess foreign exchange over a period of time while other financial institutions need foreign exchange.

The foreign exchange market in Mozambique is mainly fed from three sources, the foreign exchange bureau's that sell meticaïs to visitors, the proceeds from exports and the central bank sale of donor funds in the market. The banks in Mozambique refer to the first two sources of foreign exchange as "free" foreign exchange, and the latter source as "tied". The reasons for this are the regulations and administrative controls tied to the donor funds, including among others the MFS provided through the current "foreign exchange allocation model".

Free funds are seen as valuable resources by the commercial banks since they can be sold as travellers' cheques for good rates including bank commissions. There is an excess demand in this part of the market and the banks are very reluctant to trade "free" foreign exchange with other banks.

The elimination of requirements regarding the procurement of goods or services at the level of sales of foreign exchange has reduced the administrative costs for commercial banks. However, requirements regarding the origin of goods appear to still be applied as criteria for allocating foreign exchange in some cases. This practice imposes additional administrative costs for financial institutions and leads to inefficient allocation of funds.

Banks contacted during the mission, however, were not concerned about the use of a negative list as such at the level of allocating foreign exchange for imports. Additional administrative costs arise for banks primarily because they have to observe different negative lists associated with different sources of funding.

Administrative costs for financial institutions arise specifically from the use of several Foreign Exchange Allocation Models and the requirements, including reporting and auditing requirements, that derives from it.

Finally, the lack of information regarding the activities in the MCI is noticeable. Although Banco de Moçambique collects information on all foreign exchange transactions little information is available on the level of transactions in the foreign exchange market.

The mechanism for setting exchange rates is not clear to anyone outside the central bank. Officially, the central bank uses an average of the reported rates from the banks and foreign exchange bureaux the day before. How and on what statistical basis this is done is not clear to the traders in the market outside the Central Bank. Many observers of the market in Mozambique feel that the central bank is attempting to prop up the exchange rate in order to avoid inflationary pressures.

The central bank faces a challenge in predicting aid flows and meeting the reserve targets agreed with the IMF and at the same time trying to maintain the exchange rate inside certain limits.

A further unification of the foreign exchange market and introduction of a regular Treasury bills market will be important steps in Mozambique. Even though the Policy Framework Paper is clear on both issues, the government seems reluctant to take the last necessary steps.

4.2 The current Foreign Exchange Allocation Model

The Foreign Exchange Allocation Models used in Mozambique specify the procedures that are applied by Banco de Moçambique and Ministry of Planning and Finance for handling macro-financial support and the respective reporting and auditing requirements. Their core features have been that foreign exchange, which is credited by donors to an account in the name of Banco de Moçambique, is sold by Banco de Moçambique through the MCI to commercial banks, which use the foreign exchange to pay for imports. The local currency equivalent of the macro-financial support, in turn, is made available to the Government of Mozambique.

Previous JDR missions noted that requirements specified in the Foreign Exchange Allocation Models regarding the sale of foreign exchange distort the allocation of funds and unnecessarily increase administrative costs of commercial banks. They recommended therefore several changes to the Foreign Exchange Allocation Model to eliminate potential distortions of the allocation of foreign exchange. The main changes proposed included:

- Discontinue procurement requirements at the level of the sale of foreign exchange.
- Discontinue requirements regarding the origins of goods to be funded through the foreign exchange.
- To remove all requirements regarding the eligibility of goods and services for funding.

Since then, procurement requirements are not anymore applied at the level of the sale of foreign exchange. They are now imposed only at the custom level and goods that do not fulfil the procurement requirements can not be imported. The origin of goods, however, is still used as criteria for the allocation of funds in some cases according to information provided by commercial banks. Also, the application of negative lists is still required by some donors.

While the standardisation of Foreign Exchange Allocation Models has made some progress, no formal agreement has been reached on the use of the Foreign Exchange Model proposed by Banco de Moçambique in August 1998. Currently, a number of different Foreign Exchange Allocation Models are still in use. The models differ mainly with respect to the disbursement of funds and the reporting as well as auditing requirements.

Principal differences between Models include:

- While several donors started to use a common foreign exchange account, which has been established in the name of Banco de Moçambique at a bank in Frankfurt, not all donors use this account.
- Some donors appear to require the creation of counterpart funds when the foreign exchange is sold by Banco de Moçambique instead of when the foreign exchange is credited to a foreign exchange account.
- No common practice exists with respect to the use of negative lists although there appears to be a general opinion that a negative list is not anymore needed.
- Differences in reporting and auditing requirements exist, which lead to a multiplication of reports and high administrative costs. Also, the reporting and auditing are in many cases not according to the requirements of the Foreign Exchange Models in use.

Most of the differences that still exist between the Foreign Exchange Allocation Models are however relative minor and no major obstacles should exist to establish common procedures for the disbursement of funds. Standardised procedures would increase transparency, reduce administrative costs for all institutions involved and support the development of an inter-bank foreign exchange market.

4.3 From forex allocation model to disbursement mechanism

The current “forex model(s)” applied as disbursement mechanism for donor MFS was reviewed in the previous JDR with some specific recommendations for change. The main change recommended was to abolish regulations on imports in the allocation of forex. At present, donor funds can only be sold to commercial banks in the forex inter-bank market, subject to information on the end use of funds. In practice, this means that an importer needs to present documentation on adherence to standard World Bank procurement guidelines to the commercial bank, which then presents this documentation to the Banco de Moçambique when purchasing specific forex provided by donors. This involves considerable transaction costs.

As long as forex provided by donors are tied to the end use in any manner, the Banco de Moçambique will need to trace the use of forex to the specific imports by any importer, including private importers. As such, the forex provided by donors cannot be treated in a manner similar to that of

the ‘free funds’ (forex obtained through export receipts). This poses a constraint on the development of a forex inter-bank market.

Specific conditions on the sale of forex provided by donors does not give any influence on the use of forex as long as ‘free funds’ exist nor does it influence composition of imports. An importer can switch to free forex for imports of items not eligible under the “forex model” (negative list). Rather than tracking and monitoring the procurements made with the use of funds provided by each donor, donors may instead use statistics on imports provided by customs showing trends in the composition of imports as well as balance of payments statistics as means of assessing utilisation of foreign exchange. Regular import regulations are in any event stricter than the negative lists used as guidance for eligibility of imports under the “forex models” (ref. annex VI).

From a donor perspective the focus should be on the general developments in the foreign exchange market in Mozambique rather than on the specific utilisation of individual donor contributions. Monitoring of this development can be made by review of the Banco de Mozambique Monthly statistics on the foreign exchange market and by Banco de Mozambique sharing with donors the audit reports that are prepared under the Exchange Control Regulation.

The important issue in terms of the forex market is that a unified exchange rate is applied without Government of Mozambique resorting to preferential treatments in terms of specific companies or institutions, i.e. that forex is sold in the inter-bank market and not directly allocated with retrocessional agreements or other similar interventions in the market.

Rather than continuing an approach (and using a term) of forex allocation we propose to move towards a procedure compatible with a market based foreign exchange regime further promoting an inter-bank foreign exchange market, with a simplified and more transparent disbursement procedure that reduces transaction costs.

5 Joint Framework for support

5.1 Co-ordinated approach

The seven donors; Denmark, Ireland, Netherlands Norway, Switzerland, Sweden and United Kingdom all provide some form of “macro-financial support” but through a variety of approaches and conditions. Donors jointly consider progress under the PFP (and the proposed PRSP) framework as important indicators for further MFS but with emphasis on different areas.

To reduce the transaction cost for the Government of Mozambique and to ensure consistency, donors should consider a coordinated approach in providing MFS. A co-ordinated approach would include the following elements:

- A *common set of indicators* for the medium term to review overall implementation of policy and institutional reforms within the framework of PFP/PRSP. The specific focus on poverty alleviation can be monitored by reports from annual household surveys to be introduced to Mozambique based on the standardised questionnaire CWIQ (Core Welfare Indicator Questionnaire)³ and/or the monitoring procedures and indicators that will be applied to the implementation of the Poverty Action Plan and the PRSP.
- A *common set of program milestones/outputs* which in this report is proposed to focus on the area of financial management. The outputs need to be clearly defined, achievable and easily verifiable within an agreed timeframe so it does not create lengthy ex-post discussions on what was to be achieved by the Government of Mozambique. Achievable means agreed performance criteria/outputs should be within the Government of Mozambique level of capacity.
- A *common procedure for disbursement* to reduce transaction costs for both Government of Mozambique and donors. The above mentioned outputs may be associated with disbursement as an incentive for Government of Mozambique in implementing agreed reforms in the area. The disbursement mechanism should ensure a more predictable cash flow both in terms of foreign exchange (external gap) as well as counter-value for budget execution (deficit financing) to enable improved cash-flow management. The disbursement mechanism should also be designed to accommodate various donor procedures in terms of disbursements and agreements.

The following provides a framework for such facility that can meet the above criteria.

5.2 Program areas

The use of total public funds (donor and domestic revenue) is one core issue for poverty alleviating growth. Linked to this is the issue of increased mobilisation of domestic revenue for more sustainable development in the longer term. Management of public resources is linked to the process of allocating resources in line with the policy objectives as well as monitoring its utilisation.

Macro-financial support under the proposed new framework is designed to provide *incentives for improved public sector financial management* as means of implementing agreed policies and reforms. It falls under the overall objective of supporting poverty alleviating growth through more efficient utilisation of public funds. The proposal is therefore that this program will be related to evidence of improved public sector financial management.

The program is not intended to add to already agreed outputs to be produced but clearly define achievable outputs within the *ongoing* efforts to improve overall financial management within the PRSP/PFP framework.

5.3 The Programme

The *objective* of the programme under this joint framework will be to support the policy of poverty alleviating growth with a focus on two key areas:

- Government Financial management
- Domestic resource mobilisation

³ Planned to be introduced in year 2000 with a sample of some 15 000 households and producing annual statistics from January 2001. The questionnaire is a standard format and will be using the same strata to provide time-series to monitor development in core indicators of welfare at household level.

The first area addresses the need to improved efficiency and effectiveness in the utilisation of public resources. The second relates to the sustainability of the fiscal framework.

In the programme matrix annex II the programme framework is presented with outputs listed under the assumption that the programme would be operational already in year 2000 and are thus to be considered for illustrative purposes only. The specific outputs to focus on each year will need to be determined following further discussions between donors and with Government of Mozambique.

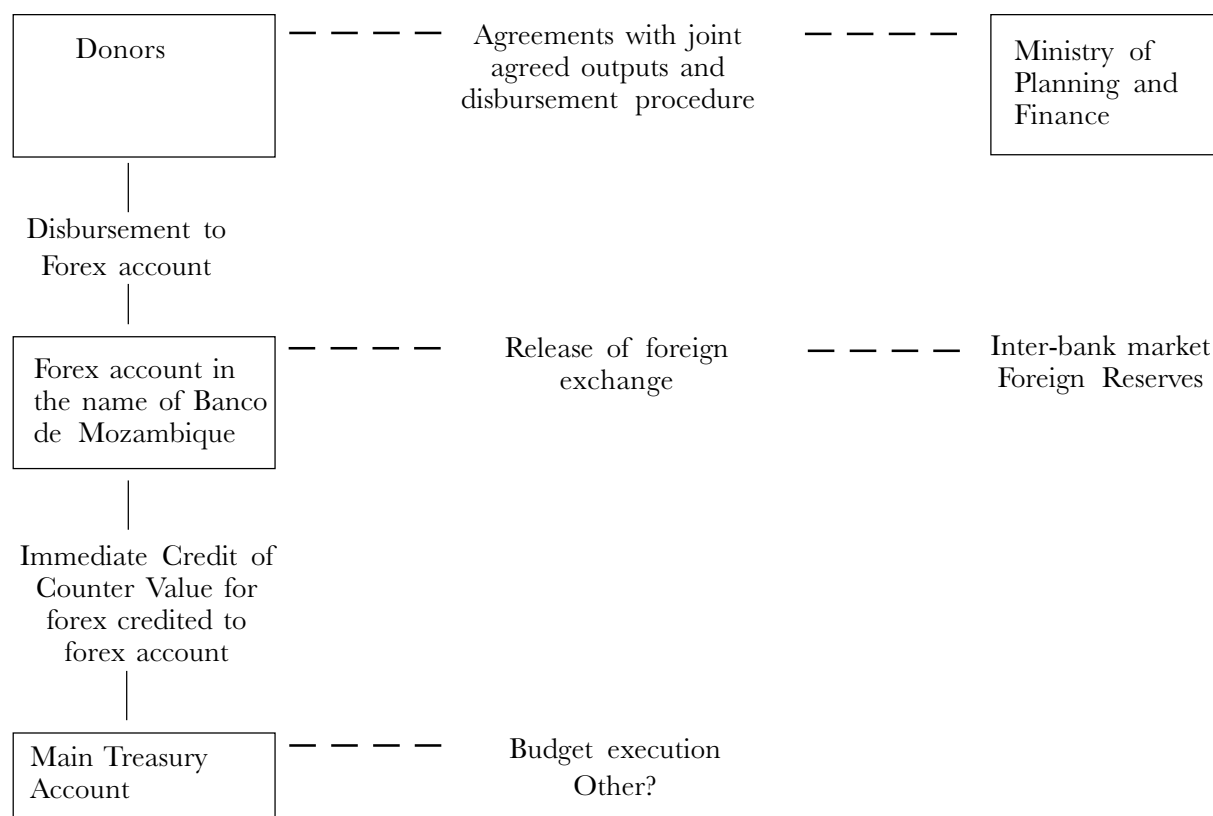
Related to the areas of Government Financial Management and domestic resource mobilisation, the programme will consist of some clearly defined and achievable outputs. These outputs are considered achievable within a given timeframe. Progress in this area is proposed to be associated with *replenishment* of MFS support for next budget year. Thus MFS support is anticipated to be disbursed in advance while replenishment of funds for the following year will be determined based on program achievements in the preceding year. The outputs may be used as formal conditions for support and/or as indicators subject for review by donors in their dialogue with Government on progress made.

5.4 Disbursement mechanism

A disbursement mechanism for the program has been elaborated in annex III. The proposed disbursement mechanism consists of the following features (ref. figure 5.1 below):

- Each donor enters into annual/multiyear agreements with the Government *prior* to the year of budget execution to be supported by counter-value funds from donor Macro Financial Support.
- The agreements will specify outputs to be produced according to a joint donor program framework (ref. annex II). Funds will be disbursed following a common disbursement mechanism (ref. proposal in Annex III).
- Any specific conditions to be made by individual donors other than what is agreed upon in the joint program framework must be considered as preconditions by the individual donor before disbursing to a common account.
- Banco de Moçambique opens one foreign exchange account to be maintained for the sole purpose of the donors disbursing Macro Financial Support under the program.
- All disbursements from the respective donors will be made to the common forex account prior to or during the first quarter of the concerned budget year. This will ensure that the Banco de Moçambique and Ministry of Planning and Finance have needed information to plan foreign exchange flows and counter-value from MFS support for the coming budget year.
- Immediately upon receiving funds in the Forex account, the Banco de Moçambique will credit the Main Treasury account with the local currency equivalent to be used for budget execution.
- The Ministry of Planning and Finance in collaboration with Banco de Moçambique will produce statement giving a financial reconciliation of flow of funds from donors through to the Main Treasury Account. The statements shall be presented to donors on a quarterly or semi-annual basis.
- Replenishment of the forex account with additional MFS for the next budget year will be based on an ex-post review of performance according to the program framework and with a joint agreement between donors on outputs or areas to focus on in the next budget year.

Figure 5.1 Disbursement mechanism



The above mechanism reduces the number of accounts to be maintained and is a simplification in terms of flow of funds compared to the current “Forex allocation models”. The MB10 account has been maintained to collect all counter-value funds with a special accounting model developed to trace contributions made by donors through multiple agreements. This account will not feature as part of this model.

The core issue is to ensure that the FOREX from the donors are disbursed into a forex account prior to or in the beginning of the budget year ensuring a more predictable cash-flow in terms of forex and counter-value for budget execution. The counter-value will be credited the Treasury account immediately upon forex disbursed by donors are credit the common forex account.

An important principal feature is that Banco de Moçambique can sell the foreign exchange at its own discretion to ensure that the sale of foreign exchange is consistent with monetary policy objectives and existing benchmarks for foreign reserves.

Current versions of the Foreign Exchange Allocation Model require Banco de Moçambique to announce the receipt of foreign funds in newspapers. This requirement is not retained in the proposed disbursement mechanism as such announcements may give misleading signals to the foreign exchange market. Announcements of receipts of foreign exchange suggests to the market that Banco de Moçambique is ready to sell these funds even in a situation where Banco de Moçambique cannot because this would be inconsistent with its foreign exchange reserves or monetary policy goals. Instead of announcing the receipt of funds it is recommended that Banco de Moçambique publishes on a monthly basis statistics on its foreign exchange reserves and provides information on transactions in the MCI.

In the past it has been argued that the local currency equivalent of interest earned on foreign exchange funds should be transferred by Banco de Moçambique to the Government of Mozambique since the funds have been given to the Government and the Banco de Moçambique acts only as agent of the Government. Although this is included as a procedure in the proposed disbursement mechanism (since Banco de Moçambique will charge a commission for management of Forex on behalf of Ministry of Planning and Finance), the Banco de Moçambique Law includes a provision that profits of the bank are shared with the Government. The practice has been that approximately half of Banco de Moçambique's profits have been passed on to the Government. As this practice of profit sharing between Government and Banco de Moçambique exists Government receives part of the interest earnings.

5.5 Program monitoring

In the enclosed program matrix (annex II) means of verification of program outputs have been indicated. The main feature of the monitoring would be through the submission of reports to the donors presenting the outputs that have been produced. The Budget Working Group would be the focal point for presenting the reports on program outputs. As an ex post review of performance, but prior to replenishment the forex account, the Government of Mozambique and donors will review the program outputs and determine new outputs to be included in the program for the next year. This review may be supported by external assistance commissioned by the Government of Mozambique and donors.

The procedure for monitoring of disbursements (availability and flow of funds) has been elaborated in annex III. Basically, with only two accounts – the FOREX account and the Main Treasury account – the financial report to be produced on a quarterly basis need to show:

- balance of the FOREX account at beginning of each period,
- specification of all inflows and outflows of the FOREX account,
- balance of the FOREX account at the end of the period,
- inflow of counter-value funds to the main treasury account, and
- a statement reconciling the outflow of forex from the FOREX account with the inflow of counter-value to the main treasury account.

The above financial report should be supplemented with a copy of bank statements for the FOREX account and the Treasury account. A proposed format for the report is provided in Annex IV.

There will no longer be any system for tracing utilisation of donor contributions in the foreign exchange market as previously explained. However, Banco de Moçambique publish monthly statistics on the foreign exchange reserves as well as on the level of foreign exchange transactions in the MCI during the period. The publication of this information is important for improving the transparency of the MCI and a such will serve as a tool for monitoring of developments in the foreign exchange market.

Audit of the above financial statements should be made on an annual basis covering the total flow of funds from source of funding (donor) to the FOREX account and from the FOREX account to the treasury account including balance remaining on the FOREX account (special purpose audit). The audit would take place after all counter-value for the FOREX disbursed for the concerned budget year has been credited the Treasury account. A proposed terms of reference for the audit is provided in annex V.

Annex I – Terms of Reference

Terms of reference

Macro-financial support Mozambique

Joint study on common procedures

1 BACKGROUND

Following the change in economic policy in the late 1980s Mozambique has received considerable amounts of programme assistance from a number of donors, ranging from commodity support to untied budget support. In the early days the main bottleneck was seen as the lack of foreign exchange, and support was therefore provided to imports of essential inputs to the productive sectors. The focus of the Mozambican Authorities as well as of the donors was therefore on the external deficit. Mozambique has, however, over the years built up international reserves corresponding to more than six months of imports and lack of foreign exchange is no longer seen as the main problem. As a consequence the focus has shifted from the external balance to the state budget, to which the counter value funds are transferred. Most macro-financial donors⁴ now see their programme assistance as support for the state budget and hence to the Government policy, with a focus on increased allocations to the social sectors, especially health and education, and minimum defence spending.

In order to adapt to the emerging market conditions some donors agreed to adopt a more liberalised forex allocation model at the end of 1995, the so-called MCI (Mercado Cambial Inter-bancario). An increasing part of the entire forex transactions is now channelled via the MCI (1998: about two thirds). According to the MCI model, foreign exchange is sold by the Banco de Moçambique to private banks acting on behalf of the importers through announcements in the newspapers. The buyers have to give certain information, such as what the currency is intended for, the country of origin of the goods and the importer. Specific procurement rules are to be followed, and there are a number of commodities (listed on a negative list) which cannot be imported using forex provided by the donors. The counter value funds are transferred to the state budget via the Treasury from an intermediate account in the Banco de Moçambique in local currency.

A number of donors have increasingly tried to harmonise their macro-financial support, e.g., by adopting the same principles on conditions, mainly using the Policy Framework Paper (PFP) matrix as the basic instrument. As a result of this increased co-operation on the donor side, two joint donor reviews (JDR) were conducted, the first one in May 1998 and the second one in February 1999, with the objective of rendering macro-financial support more efficient and effective. The JDRs recommended that the donors should continue macro-financial support, justified by Moçambique's overall good macroeconomic performance as well as advances in recent policy reforms.

The 1999 JDR focused on budgeting and financial management in relation to the state budget. These are currently seen as the most critical issues since untied macro-financial support is de facto a co-financing of the entire state budget. The donors are therefore concerned with how the total available resources are used as well as the outcome in terms of improved services to the public. The main findings of the 1999 JDR as regards financial management were: i) low capacity for providing adequate reporting and control, especially in relation to areas such as cash flow manage-

⁴ Macro-financial support is defined for the purpose of this study as being untied general budget support in line with the recommendations of the last joint donor review (see below)

ment, accounting and auditing; ii) no increase in revenue generation, which is needed to ensure long term financial sustainability of the state budget; and iii) inadequate progress in some areas of the public service/civil service reform, especially related to training and the legal and ethical framework.

The 1999 JDR also found that there is much scope for donors to harmonise and develop joint procedures for the delivery of macro-financial assistance to the state budget, in order to minimise bureaucracy and improve transparency and accountability. This would imply pooling of funds, such as through the creation of a single facility; a multi-year approach with release of tranches against agreed benchmarks; and common reporting requirements and conditions. The review also recommended revision of the forex model, especially with respect to the negative list and the procurement requirements.

The 1999 JDR presented an outline proposal for a common system for macro-financial support. This study should build upon progress made to date on agreeing common mechanisms for channeling and accounting for budgetary support. To this end, the study will also help the Government review its progress in implementing its Expenditure Management Reform Strategy, dated May 1997.

The donors involved in this study, Denmark, the Netherlands, Norway, Sweden, Switzerland and the UK, want to build the mechanism around government systems, rather than establishing their own procedures. The mechanisms should also take account of the present state of the Government's accounting and auditing systems and the processes underway to strengthen these. The mechanisms could therefore include progressively seeking better accountability from government systems.

2 OBJECTIVE

The main objective of the study is to make recommendations to the Mozambican Authorities and the like-minded donors on a common system for efficient and transparent management of macro-financial support to the general state budget, as well as offering a concrete proposal for such a mechanism in the form of a single facility.

3 OUTPUT

The main output of the study shall be a model programme document describing in detail all procedures and reporting requirements for future macro-financial support by the six donors consisting of:

A draft model programme document proper for a single facility for multi-year agreements. This shall include a description of objectives; methods; procedures; reporting and auditing requirements; conditionalities; and milestones to be achieved. The proposal should be closely linked to the PFP/PRSP (Poverty Reduction Strategy Paper) cycle.

The proposal shall include clear formats and/or manuals for reporting requirements in such areas as:

- implementation of the PFP/PRSP,
- budget execution
- cash flow of countervalue funds, and
- audit reports.

A revised forex model based on the 1998 JDR recommendation and the proposal by the Banco de Moçambique. The proposed model should aim at reducing transaction cost to a minimum but allowing full transparency in reporting on the in- and outflow to and from the forex account, generation of counter value funds and flow to the treasury accounts.

Clear recommendations on medium term donor requirements for financial management and audit of the state budget shall also be part of the model programme document, with a suggested and realistic timeframe.

A brief discussion paper is to be prepared summarising discussions on the points in Section 4.

4 SCOPE OF WORK

4.1 General Aspects and Justification for Macro-Financial Support

The team shall acquaint itself with the framework in which macro-financial support is provided, with emphasis on such aspects as the human resource situation, the public sector reform process and on-going reforms in budgeting and accounting. On this basis the team shall appraise themselves and briefly present key findings of the following aspects:

- Overall government economic policy and main issues in the PFP/PRSP.
- Policies and trends in revenue generation, with a view to increasing government financing of the state budget; and planned actions in this field such as the tax policy review, an inventory of exemptions and a strategy for non-tax revenue from concessions, dividends and royalties.
- The MTEF, including recent trends in sectoral budget allocation with emphasis on social sectors.
- Results from the poverty assessment study and status of the on-going work on the Poverty Action Plan.

Based on the findings, and related to justification of macro-financial support, the Team shall prepare a proposal for monitoring the performance of government policy:

- Definition of indicators to assess the output and impact of macro-financial support (understood as an integral part of the state budget), with a special emphasis on monitoring policies conducive to poverty alleviating growth. In this context the system of indicators developed within the framework of the Strategic Partnership for Africa (SPA) should be taken into consideration. It is likely that part of any such monitoring should be carried out within specific sectors, (e.g., education, health, and water supply).
- Possible obstacles for assessing progress in government policy, i.e. the impact of support (in the broad sense), such as lack of data and time lag between the macro-financial support and its impact, should be identified.

4.2 Reporting Requirements

In May 1997 the Government published its Expenditure Management Reform Strategy, describing the actions to be taken in the area of financial management. The Team shall build on the work already undertaken in the area of financial management by various groups, such as the JDRs, the suggestions made by the Norwegians at the time of their 1999 Annual aid talks, the work behind the PROAGRI sector budgetary support mechanism, and recent work for the Ministry of Planning and Finance on Coordination of Sector Planning and Budgeting (MTEF), in undertaking the following tasks and recommending future reporting requirements:

- Prepare a brief up-date on the status of the general financial management system, encompassing budgeting, cash flow management, budget execution, accounting, internal auditing and independent auditing by Tribunal Administrativo. It is to be noted that improvements or other changes to this system will be brought about by the introduction of the new accounting model. The up-date must be both in terms of systems developed and actual progress in the Ministry of Planning and Finance.

- Consider suitability of an early external independent sample audit to check the reliability of releases and expenditure returns data. If found appropriate, prepare draft terms of reference (TOR) for this work.
- Identify main bottlenecks and constraints to achieving a modern financial management system, responsive to the demands of Government and donors.
- Follow up recommendations made by the 1999 JDR and the Norwegian proposal on improved reporting based on the existing system, looking at flow of funds; reconciliation of accounts; a common bank account; interest accruing; bank fees; financial reports based on bank statements; and reports on budget execution.
- Definition of the format for future reporting requirements, intervals with which reports should be presented to the donors, and outline procedures for reviewing reporting requirements.
- Consequences of non-compliance with reporting requirements either related to content, format or timing.

The Team shall present proposals for donors' reporting requirements with a view to obtaining transparency and accountability in the use of macro-financial assistance in the state budget, both in the short term and the long term. Regarding the short term, clear and realistic requirements should be defined. Long term development efforts in the area of financial management would probably imply an integrated approach to budgeting, accounting, auditing and cash flow management with clearly defined goals and objectives. This part of the study is therefore designed to help Ministry of Planning and Finance review the Expenditure Management Reform Strategy. The Team shall on this basis present a plan to bring forward financial management reforms with an agreed implementation timetable, possibly in the form of a sector programme approach at Ministry of Planning and Finance level.

The Team shall also make recommendations on independent external audit of a sample of government expenditures, notably the criteria by which the sample should be selected, the size of the sample and how value could be added by involving government auditors in the process as on the job training. Draft TOR should be presented for such recurrent sample audits, if found appropriate.

4.3 Common procedures for disbursement

The study shall define common procedures for disbursement and use of macro-financial support by the state budget, based on a comparative description of each donor's macro-financial assistance. This would include:

- Definition of a common donor facility, such as a trust fund, consisting of a multi-annual agreement; pooling of funds into a single account; release of funds in tranches to the Banco de Moçambique; and common conditionalities and reporting requirements.
- Definition of disbursement and trigger mechanisms in a common funding facility, e.g. a joint foreign bank account solely for the use of donors providing macro-financial support. For donors disbursing on a reimbursement basis, specific criteria must be defined. In either case the release of funds in tranches must be defined, with respect to both size and interval.
- Definition of conditionalities and consequences of non-compliance.

4.4 Foreign Exchange Model

Despite the change in focus of macro-financial support to the state budget, further liberalisation of the forex model is needed in order to reflect the changes in the capital market. In late 1998 the

Banco de Moçambique prepared a proposal based mainly on the recommendations of the 1998 JDR. The Team shall take this proposal as point of departure in preparing an up-dated version. In doing so the Team shall assess the following points:

- Existing foreign exchange allocation systems and the functioning of the inter-bank market.
- The current forex allocation model used in the inter-bank market (MCI), and the proposed but not yet approved model prepared by the Banco de Moçambique.
- Identification of possible bottlenecks and obstacles to adoption of a common up-dated forex model.
- The order of magnitude of the external financing gap, including seasonal variations in demand, the Government's demand for forex, e.g. for debt service costs, and the Banco de Moçambique's demand for building up reserves.

This shall be used as a basis for preparing a draft final Foreign Exchange Allocation Model adapted to the present and foreseeable market conditions. Special attention shall be given to disbursement mechanisms; the size of tranches; a joint forex bank account (exclusively for the use of donor funds); procurement rules; the negative list; and reporting and auditing requirements seen in the light of the on-going liberalisation process. The possibility of establishing a Metical donor account between the joint forex account and the MB-10 account should be considered.

4.5 Process Issues

Working closely with the World Bank and the IMF, the study team should make recommendations on a supportive process of dialogue between the Government and donors. This should seek to build on existing GoM/donor fora and should cover:

- Annual dialogue on budget priorities and revenues: lessons should be drawn from the new style public expenditure reviews that have been undertaken in, for example, Uganda and Tanzania, involving donors in discussions over priorities and assumptions underlying the MTEF.
- Regular dialogue over budget out-turn: this should specify the type of data and its format, and make recommendations for the level and nature of dialogue should actual expenditure deviate significantly from that budgeted.
- Regular dialogue over GoM progress against agreed, time-bound improvements to its accounting and audit systems and to reach agreement on new targets and/or possible donor assistance in identified areas of weakness within an overall agreed framework (see 4.2 above).
- Definition of the role of the JDR and timing, especially in relation to the PFP/PRSP cycle.
- The Team shall assess the relevance and need of hiring a macro-financial sector advisor to be overall responsible for monitoring of the reporting, analysing expenditure data, etc. A joint implementation/steering committee should also be contemplated and assessed. If the Team finds these proposals appropriate, TOR should be drafted.

5 METHODOLOGY, TIMETABLE AND REPORTING

The team shall build on existing work and studies carried out in this field, especially the outcome of the two joint reviews. It is estimated that a 3 week mission in Mozambique is needed to undertake the study and to ensure sufficient co-operation with the relevant Mozambican Authorities. The mission is scheduled for February/March 2000 (21/2 – 10/3).

The team should present a first draft report at the end of their stay. The report will consist of a short discussion paper and a model programme document. The final draft will be ready not later than by

14 April 2000. The Government and the involved donors will then have one month to comment on the draft reports. A follow-up mission consisting of donor representative both from headquarters and embassies is tentatively planned for May 2000. The purpose of the follow-up mission will be to discuss the precise scope of harmonisation and come to an agreement with the Mozambican Authorities on the future modalities and conditions for future macro-financial support. Comments and suggestions are to be incorporated within one month of receipt. Ten copies of the final report and model programme document will be presented to the Mozambican Authorities and the donors by end June 2000. The main body of the report should be no longer than 20 sides of A4 paper, excluding annexes and excluding the model programme document.

A Reference Group will be established with a view to creating full transparency and ensuring that realistic procedures and milestones be designed and established. The Ministry of Planning and Finance, the Banco de Moçambique and Tribunal Administrativo will appoint members to the group. Representatives from the six embassies will also be part of the group. The group will facilitate contacts whenever needed.

6 STUDY TEAM

The team will comprise the following professional categories:

Macroeconomist, specialised in donor procedures: Jens Claussen

Certified auditor/Public Financial Management Specialist, Grayson Clarke

Certified auditor/Public Financial Management Specialist, Stefan Sjølander

Balance of Payment Specialist: Dag Aarnes

Central Bank Specialist: Ulrich Camen

Mr. Jens Claussen will act as the team leader during the mission and also be responsible for reporting.

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Sixth revision, 29 January 2000

Final version, 11 February 2000

Annex II – Program matrix

Long term objective

Goal	Implementation of the poverty reduction action plan and the PRSP. Allocate appropriate resources in the seven areas of Education, Health, Social Safety net, Agricultural and Rural Development, Employment generation and Infrastructure
Areas of dialogue/ Outputs	Establishment of a joint government-donor monitoring framework for the implementation of programme. Improved planning of available resources through MTEF, capturing all Government of Mozambique expenditure, all external (donor) resources aimed at public expenditure and all domestic Government of Mozambique revenue. Ensure that the poverty programme is adequately funded.
Indicators/means of verification	The government has developed a set of indicators that will be used for monitoring of the poverty reduction strategy/ programme. Macroeconomic indicators of the PRSP. Quarterly reports from Ministry of Planning and Finance on budget execution.

Annual program outputs/indicators

Increased domestic resource mobilisation

Justification	To achieve long-term fiscal sustainability in Mozambique it is necessary to raise overall tax revenues. Over the last year there has been stagnation of domestic revenue and there is today no TA to support capacity improvements of direct tax collection.
Objectives	Increase tax revenue as percent of GDP
Areas of dialogue/ Outputs	Introduction of Tax Commission to provide outline plan and options for expansion of tax base and improving capacity for tax collection. Agreement on TA consultancy at DNIA to improve revenue collection. Exploration of the establishment of a independent revenue authority.
Indicators/means of verification	Report from director of DNIA

Public Accounting

Justification	Broad specification of new accounting system established and medium term implementation plan drawn up
Objectives	All economic activity by the Government of Mozambique reflected in the State Accounts by the implementation of an accounting model according to GAAP principles, including accrual and double-entry accounting, facilitating presentations of accounts in activity and programme structures as well as assets and liabilities.
Areas of dialogue/ Outputs	New legislative framework and proposal for a new Chart of Accounts presented. Working groups set up by Ministry of Planning and Finance and accounting system implementation plan approved by Minister. Selected “mapas” (presenting budget execution figures for the current year) produced and distributed to donor working group.
Indicators/means of verification	Report from Director of DNCP

Treasury and payment systems

Justification	The structure of State Treasury accounts is today essentially unknown. Audit trail of counter-value through to budget execution accounts cannot be established.
Objectives	All financial resources on all bank accounts authorised through Government of Mozambique representatives, included in the Treasury system. Liquidity projection system implemented, facilitating daily reports on liquidity in the Treasury system. All bank accounts used to fund Government of Mozambique controlled expenditure or collect Government of Mozambique revenue included in the Treasury system.
Areas of dialogue/ Outputs	All Government of Mozambique bank accounts at central level registered and recorded in agreed database and presented to donors. Interim report on structure of Government of Mozambique bank accounts at central level, recorded on database. Ministry of Planning and Finance decision on new procedures for administration of all new bank accounts opened or owned by govt institutions.
Indicators/means of verification	Report from Director of DNT

Internal and external audit

Justification	There is not sufficient capacity by Government of Mozambique audit institutions to present audits by international standards to facilitate Government of Mozambique, Parliament and/or donor action.
Objectives	Ability by internal audit institutions, the IGF and the Tribunal Administrativo to independently perform financial and performance audit at international GAAP standards. Introduction of procedures to make it possible for external auditors to audit all Government of Mozambique expenditure and revenue (jointly with Government of Mozambique audit inst.).
Areas of dialogue/ Outputs	Audit of State General Accounts completed as per Budget Law. Increased budget resources (2001) to the Tribunal Administrativo to match new donor TA funding and increase number of audit staff in Tribunal since February 2000.
Indicators/means of verification	Report from Director of Tribunal de Administrativo on scope and coverage of audits conducted.

Annex III – Disbursement mechanism

Disbursement

Activity	Timing	Responsibility
Agreements between respective donors and Government of Mozambique on forex to be provided under the joint programme framework and disbursement mechanism. The agreements will have annual or multiyear perspective.	Agreements concluded by end of year preceding budget year(s) for which counter-value is to be made available.	Donors
Banco de Moçambique to open a FOREX account to be used solely for the purpose of MFS funds from donors.	Immediate upon the first donor entering into an agreement with Government of Mozambique.	Banco de Mozambique
Inform as soon as possible prior to the disbursement of funds the Government of Mozambique, with copy to Bank of Mozambique (Banco de Moçambique), about the amount of funding and the approximate date of disbursement.	Prior to disbursement into Forex Account.	Donors
Disburse funds into the FOREX account. Replenishment of FOREX account after review of outputs according to program matrix.	January to March in the budget year.	Donors
Release of funds by Banco de Moçambique including compounded interest earned on the FOREX account to the inter-bank market.	In accordance with monetary policy and reserve targets.	Donors and Ministry of Planning and Finance
Banco de Moçambique credits the Metical equivalent of all the funds received by donors to the Main Treasury account giving Banco de Moçambique the right of disposal of forex. The Metical equivalent is computed using the Central Bank (selling) rate at the date of receipt of funds, deducting agreed percentage commission at source.	Within 24 hours of receiving the forex.	Banco de Moçambique and Ministry of Planning and Finance

Monitoring and Reporting

Activity	Timing	Responsibility
The Ministry of Planning and Finance shall submit to all donors a single report. This will show: i) the balances at the beginning and the end of the period of the FOREX account with copy of bank account statement as supporting documentation ii) the cash flow in and out of the FOREX account iii) the inflow of the funds to the main Treasury account in Metical and FOREX equivalent (with the exchange rate used) supported by copies of bank statements showing Metical deposits iv) interest earned on the account v) the agreed commission retained by Banco de Moçambique.	Within one month after the last release of funds for the budget year from the FOREX account to the Main Treasury account.	Ministry of Planning and Finance
The Ministry of Planning and Finance shall provide the donors with quarterly execution reports of the general state budget, based on selected “mappas” produced by the current computer system and showing the source of finance for budget transfers.	Within 45 days of the end of each quarter (April, July, October and January)	Ministry of Planning and Finance

Auditing

Activity	Timing	Responsibility
Terms of reference for the annual audit are to be prepared by Ministry of Planning and Finance and agreed upon with the donors prior to undertaking the audits. The auditors are to be paid out of the funds provided under the Macro-Financial Support Facility or as otherwise agreed between donors and Government.	To be agreed upon and included in the agreements with the donors.	Ministry of Planning and Finance and donors
The above mentioned financial reports will be audited once a year by an internationally recognised company to be contracted by Ministry of Planning and Finance. The objective of the audit is to confirm the flow of funds from the moment funds are disbursed to the forex account of Banco de Moçambique to the transfer of the funds to the Main Treasury Account. The audit needs to permit the auditor to express his professional opinion on the reports prepared by the Ministry of Planning and Finance. The audit report will show the contributions made by each donor to the single macro-finance support facility.	The annual audit reports shall be submitted to donors within one month after the last disbursement of funds for the fiscal year. The audit reports will be presented to the donors and representatives of Banco de Moçambique and Ministry of Planning and Finance in one meeting.	Ministry of Planning and Finance

Annex IV – Format for financial reporting on MFS disbursements

a) Statement of Disbursements (in USD)

	Date	USD amount	USD amount
Opening Balance	xx/xx/xx		XX
<i>Contributions in Quarter /Half –Year</i>			
Donor country	xx/xx/xx	XX	
.....	xx/xx/xx	XX	
Total Contributions Received in period			XX XX
Interest accrued in period	xx/xx/xx	XX	XX
Total available for release in the period			XX
Forex disbursements during the period			
1. disbursement	xx/xx/xx	XX	
.....	xx/xx/xx	XX	
Total Forex sum disbursed for Counter-Value		XX	YY
Closing Balance		xx/xx/xxxx	XX

b) Schedule of Counter-Value generation

Date Counter- Value generated	USD Amount	Exchange Rate	Metical Amount	BOM Commission (Metical)	Released to Main Treasury account
xx/xx/xx	XX	MT/USD	XX	XX	XX
xx/xx/xx	XX	MT/USD	XX	XX	XX
Total For Period	YY ⁵		XX	XX	XX

⁵ Equals YY in schedule a) “Total Forex sum disbursed for Counter-Value”

Annex V – Terms of Reference for Audit of MFS disbursements

Objective

The objective of the audit is to provide assurance that all macro-financial support provided under the common facility has been accounted for in a manner consistent with the established disbursement mechanism and reporting arrangements.

Specific Tasks

- To confirm the receipt of all macro-financial support into the common forex account, by reference to individual donor-Government of Mozambique agreements and disbursement schedules.
- To confirm the mechanism for release of the funds – namely production of accurate financial statements on the disbursement and utilisation of all tranches has been complied with.
- To confirm that decisions on release of the funds have been properly authorised.
- To establish that the rate at which the counter-value is generated from the foreign exchange is ‘fair’ and consistent with the primary inter-bank rate.
- To establish that any commissions charged by the Bank of Mozambique for the generation of counter-value are in accordance with the facility’s agreement and are established by debit notes.
- To establish that all counter-value generated has been debited to the Central Treasury Account.
- To confirm that the interest earned on the forex account has been properly accrued, and that the conditions governing the type of forex account held (interest, notice period) reflect any conditions laid down in the common facility.
- To validate the closing balances on the forex account at monthly intervals.
- To confirm that there have been no movements on the forex account outside the release period, inconsistent with the common facility agreement.

To confirm all movements have been documented and an audit trail exists.

Annex VI – Extract of Trade Regulations in Mozambique

Goods whose importation is prohibited (article 23.1 of IPP)

- 01 Goods with false manufacturer's marks, trademarks or marks of origin and books and artistic works when they are counterfeit editions;
- 02 Objects, photographs, discs, sound and/or visual recordings and cinema tapes of pornographic or other material which is judged offensive to public morals and dignity;
- 03 Imitations of postage stamps used in the country;
- 04 Medicines and food products, which are harmful to public health;
- 05 Food products which are harmful to public health which cannot be reprocessed for other purposes;
- 06 Distilled alcoholic drinks which contain essence or chemical products recognised as harmful, such as: absinthe, benzoic aldehyde, badia, silicate ethers hyssop and tuinane;
- 07 Motor vehicles in tariff code positions 87 02 to 87 04 90, and motorcycles in position 87 11, which are more than 5 years old counting from the date of their first registration, unless they consist of baggage under the terms set out in the article 44 of IPP, or are imported temporarily under the terms of article 26 of IPP and other provisions which apply to this type of importation;
- 08 Intoxicating drugs and psychotropic substances except when imported for hospital use;
- 09 Other goods whose importation is prohibited by special legislation.

Goods prohibited for export (article 23.2 of IPP)

- 01 Food products which do not satisfy the conditions set out in current legislation or which are in a poor state of conservation;
- 02 Cans manufactured with "terneplate", serving as packaging for other products which are not mineral oils;
- 03 Goods with false marks of manufacture, of trade or of origin, in contravention of current laws and treaties;
- 04 Ivory and works of ivory, except when their export is expressly permitted by special authorisation;
- 05 Notes and coins in legal circulation in the country within the limits defined by the Bank of Mozambique;
- 06 Collections of art works which form part of the national artistic or cultural heritage, except as provided for in the article 42 of IPP;
- 07 Other goods whose export is prohibited by special legislation.

Goods with a special regime – importation (article 24.1 of IPP)

- 01 Animals, animal residue and products which cannot be imported without authorisation from the Veterinary Services;
- 02 Plants, roots, tubers, bulbs, stakes, branches, shoots, eyes, buds, fruits, seeds, honey and other agricultural products, as well as their packaging, which are subject to phytosanitary inspection before being cleared by customs;

- 03 Playing cards, which must be sealed under the terms of the legislation in force;
- 04 Medicines, by authorisation of the Health and Veterinary Services, case by case, except for medicines transported by baggage for personal use;
- 05 Arms, explosives and fireworks, physical or chemical powders – by authorisation of the Mozambique Police (PRM)
- 06 Goods whose import is subject to conditions in the text of the Pauta
- 07 Goods whose exemption or special tax treatment is subject to conditions for their use and which could have other applications, under the terms of the legislation in force
- 08 Goods imported from countries with which there are commercial agreements or treaties which provide for special tax treatment
- 09 Fiscal or postage stamps and sums conveyed in stamps in use within the country, which may only be imported by the State;
- 10 Poisonous or toxic substances and intoxicating drugs or their preparations, which may only be imported by authorisation of the Health Services;
- 11 Second-hand clothes, previously fumigated, except when accompanied by a suitable certificate of disinfection;
- 12 Gold, silver and platinum in coin, bar or ingot, which may only be imported by the Bank of Mozambique under the terms of legislation in force;
- 13 Foreign notes and coins when imported by duly authorised banking institutions;
- 14 Mozambican notes and coins in legal tender within the country, which may only be imported by the Bank of Mozambique;
- 15 Goods destined for re-exportation which are going to receive some addition, improvement or repair within the country;
- 16 Used tyres, carcasses for retreading and other retreaded or uses tyres in tariff positions 40 12 10, 40 12 90 10, and 40 12 90 90, subject to authorisation from the Ministry of Transport and Communications

Goods with special regime – exportation (article 24.2 of IPP)

- 01 Animals, animal residues and products which may only be exported by prior authorisation of the veterinary services;
- 02 Manuscripts, stamps, coins weapons and other objects of historical or archaeological value, by authorisation of the Ministry of Culture;
- 03 Gold and silver in powder or bar form, which may only be exported by the Bank of Mozambique;
- 04 Poisonous or toxic substances and intoxicating drugs or their preparations, which may only be exported by the Ministry of Health;
- 05 Precious wood, precious and semi-precious stones, even when worked on, which may only be exported by prior authorisation of the competent authorities, with the exception of artefacts (artesanato) provided for in article 42 of IPP;
- 06 Goods subject to surcharge under the terms of the legislation in force;
- 07 Ore, under the terms of agreements made by the government and the legislation in force;
- 08 Other goods whose special export regime is determined by special legislation.

Annex VII – Framework for Capacity building in the area of Government Financial Management.

The following is a sample programme outline to support Government of Mozambique capacity in key areas of financial management. It may be used as an input and point of departure for a Logical Framework seminar to formulate an integrated reform programme at the Ministry of Planning and Finance and at financial administrations at line ministries.

Goal – To achieve sustained reductions in poverty levels in Mozambique through more efficient and effective planning and application of government expenditure and assets.

Purpose – To develop a viable public financial management function capable of providing efficient and effective public expenditure management, through independently undertaking all financial functions, defined by the laws and regulations of Government of Mozambique and international standards.

Areas	Institutional Development and Capacity Building	Fiscal Planning and Budget	Public Accounting	Treasury and Payment Systems	Internal and External Audit	Govt Tax Policy and Collection
Sector Goals	An organisational structure that facilitates sound economic and financial policy making, & ensures all directorates and sections work in a mutually supportive way to achieve sector goal. All key financial management positions are filled by trained Mozambicans.	Integrated Medium Term Development Framework, capturing all GOM expenditure, all external (donor) resources supporting public expenditure and all domestic GOM revenue.	Implemented accounting model according to GAAP principles, including accrual and double-entry accounting, facilitating presentations of accounts in activity and programme structures as well as assets and liabilities. All economic activity by the GOM reflected in the State Accounts.	All financial resources on all bank accounts authorised through GOM representatives, included in the Treasury system. Liquidity projection system implemented, facilitating daily reports on liquidity in the Treasury system	Ability by internal audit institutions, the IGF and the Tribunal Administrativo to independently perform financial and performance audit at international GAAP standards Annual audit review of 2/3 of State Budget and 1/3 of state institutions undertaken by IGF and TA.	Raised Govt revenue as % of GDP. Established independent revenue authority.

Areas	Institutional Development and Capacity Building	Fiscal Planning and Budget	Public Accounting	Treasury and Payment Systems	Internal and External Audit	Govt Tax Policy and Collection
Proposed Medium Term Outputs (by December 2003)	Pay differentials between comparable finance staff in public and private are narrowed. Public finance institute established Pilot in service training programme established by institute, linked to proposed professional accountancy qualifications	Three year commitment period in all planning instruments. Presentation of three year budget projections to the Government.	New Computerised Accounting Model operational in five pilot ministries and two provinces.	All bank accounts used to fund GOM payments or collect GOM revenue included in the Treasury system Partial rationalisation and electronic linkage of existing number of bank accounts, using offset principles to improve cash management	Introduction of procedures to make it possible for external auditors to audit all GOM expenditure and revenue (jointly with GOM audit) Development of viable audit function within Tribunal Administrativo	Steady increases in real tax income and a rising ratio of total tax revenue to total Government expenditure A revised organisation and pay structure for direct tax collection

Areas	Institutional Development and Capacity Building	Fiscal Planning and Budget	Public Accounting	Treasury and Payment Systems	Internal and External Audit	Govt Tax Policy and Collection
Short-Term Activities (to December 2001)	MPF assesses additional staffing needs at DPPF level and produces a costed proposal for future budget submission Study commissioned to assess current pay differentials and submit proposals Design and partial implementation of crash training programme	Development of unified MTEF/ macroeconomic model New procedures to adjust SWAP allocations to MTEF projections agreed with line ministries New standard project format developed for capturing financial contributions for donor projects	Establish and operationalise working groups for implementation of accounting model in pilot ministries Produce costed implementation plans for pilot ministries. Produce and distribute selected “mapas” (presenting budget execution figures for the current year) to donor working group Elaborate proposal for legislative framework and a new Chart of Accounts	GOM provides donors with interim report on structure of GOM bank accounts at central level, recorded on database MPF designs & implements new procedures for administration of all new bank accounts opened or operated by GoM institutions	Increase number of audit staff in Tribunal Administrativo by 10, compared to June 2000 position Development of crash training programme for audit staff at Tribunal Administrativo Development / revision of procedures to allow for external companies to audit all GOM expenditure and revenue	Establish and operationalise Tax Commission to provide outline plan and options for expansion of tax base and improving capacity for tax collection Undertake initial 2 field studies on housing rents and inward investment concessions Examine transmission of revenues from the barrios to main Treasury Account Agreement on TA consultancy at DNIA to improve revenue collection

Areas	Institutional Development and Capacity Building	Fiscal Planning and Budget	Public Accounting	Treasury and Payment Systems	Internal and External Audit	Govt Tax Policy and Collection
Proposed Indicators for Short-Term Activities	Extra staff at DPPF level in Dec 2001 compared to June 2000 Introduction of special pay supplements included in 2002 budget Crash accountancy training programme delivered for at least 50 staff at MPF and DAF.	MTEF resource envelope consistent with resource envelope from macro-economic model. MTEF provides hard budget ceilings for sector ministries & provinces for 2002 budget round New standard agreement format used by International Cooperation Dept.	Cabinet Decree concerning “Re-form of the Financial Administration” issued New Chart of Accounts produced in outline form and in detail for pilot ministries.	All GOM bank accounts at central level registered and recorded in agreed database and presented to donors. External Audit program for Financial Year 2000 to GoM accounts recorded in database.	Audit of State General Accounts completed as per Budget Law % of external audit work on State General Account contracted to private audit firms	Tax Commission established Revenue mobilisation project established
Means of Verification	Reports from Secretario-Geral at MPF.	Report from Director DNPO. Presentation of SWAp adjustment procedures.	Report from Director DNCP. Presentation of working group decision and new Chart of Accounts.	Report from Director DNT. Presentation of bank account structure and MPF decision on handling of new bank accounts.	Presentation of budget proposal for the Tribunal Administrativo.	Report from Director DNIA. Presentation of discussion paper and project document on new TA.

Areas	Institutional Development and Capacity Building	Fiscal Planning and Budget	Public Accounting	Treasury and Payment Systems	Internal and External Audit	Govt Tax Policy and Collection
Risks, Constraints and Dependencies	MAE reform initiatives on public administration & development of private sector market proceeds Improved domestic resource mobilisation to sustain short-term measures, plus Parliament approval, plus availability of secondary school graduates	Cabinete do Estudo, BOM, sector ministries share macro model Sector ministries and donors provide usable information Improved control and transparency of GOM bank accounts	Legislation passes through Parliament. Active participation and submission of information from others (eg line ministries) on Chart of Accounts requirements. Inclusion of information from other parts of the MPF (Revenue, Fixed Assets). Nationwide capacity	Information needed from BoM, commercial banks and sector ministries Possible need to increase consultancy resources in relation to the magnitude of the tasks. Nationwide capacity	Need for increased domestic institutional capacity (including external audit firms) No audit structures in provinces and districts	Need to clarify status of revenue handling outside Customs. Nationwide capacity GoM must consider (as for VAT/ Customs) significant personnel changes

Annex VIII – Terms of Reference for Strategic Adviser in Financial Management

Reporting to:

Secretario – Geral of the Ministry of Planning and Finance (MPF)

President of the Tribunal Administrativo

Liaising with:

The National Directors of the MPF

The Provincial directors of the MPF

The Secretario-Geral in line ministries

The heads of directorates of administration and finance in line ministries

The heads of financial TA projects in the MPF and line ministries

The Public Financial Management Working Group

Main Purpose of Post

To pull together the different elements of Financial Management capacity building and help construct a coherent programme framework

To act as the liaison point between the MPF and donors over the implementation of the programme, the relevant information requirements concerning the provision of macro-financial assistance.

Key Objectives

To support the development of a Finance Sector Strategic Plan, integrating the implementation plans of existing TA projects in the MPF and line ministries

To advise on additional technical assistance support to the sector, and to assist the Secretario-Geral and national directors in the formulation of project logframes and budgets and the identification of possible financing

To advise on the inclusion of any milestones in the programme of macro-financial support, and to advise on their achievement or otherwise

To provide reports on the effectiveness of existing TA projects, at the request of the Secretario-Geral and the President of the Tribunal Administrativo.

To initiate the development and implementation of government wide financial management training in association with MAE

To examine as part of the Strategic Plan, the pay and conditions of financial staff in the Government of Mozambique and the current career structure, and to assist in the formulation of proposals for changes.

To examine the organisational structures for National Directorates and DPPFs in the MPF, the DAFS in the line ministries and the Tribunal Administrativo, and to assist in the formulation of proposals for change. These organisational structures will include consideration of the number and grading of posts, reporting lines, recruitment, promotion and rotation arrangements

To liaise with the Tertiary Sector and Accountancy firms over the provision of 'degree' level financial management training

To act as a focal point for donors on key issues related future MFS to create a more conducive framework for a dialogue linked to the MFS program framework

Ensure adequate flow of information between the Ministry and the Banco de Moçambique on the one side and the donors related to programme milestones.

Key Indicators of Achievement

An annually updated Finance Sector Strategic Plan

Clearly identifiable progress towards meeting key Finance indicators in the PFP/PRSP and Macro-financial programme indicators

The design and implementation of a government financial management qualification under the auspices of SIFAP

Reporting Requirements

Quarterly and annual progress reports to the Secreatrio-Geral of MPF, President of Tribunal Administrativo, and the Public Financial Management Group. Ad hoc special subject reports as requested. Monthly financial reports

Qualifications

The person shall be a highly experienced and well qualified public financial manager, who has several years of experience at senior level in a Ministry of Finance or a large public sector organisation.

He / She will have several years international experience in developing public financial management systems at Central Government level, two of which should have been in one or more Sub-Saharan African countries

He / She will be able to demonstrate practical experience of implementing wide-ranging institutional change within a de-concentrated finance function

He / She shall hold a degree in public finance, accountancy or economics and/or an internationally recognised accountancy qualification

Annex IX – Terms of Reference for Donor Financial Management Specialist

Main Areas of Activity

- Supervising one or more technical assistance projects in the area of public financial management
- Providing technical support to the development of a Finance sector Strategic Plan
- Writing briefing notes on public financial management topics for senior Embassy and Headquarters staff
- Facilitating/acting as Secretary to the Budget Working Group or other successor body handling public financial management issues.
- Providing technical input on proposals submitted by the Government of Mozambique for financial assistance, including the design of facilities for macro-financial support and sector support
- Working with Government of Mozambique to develop budgetary or other financial reporting formats submitted to donors
- Facilitating and organising the work of technical assistance missions in the area, including drafting of terms of reference and project budgets
- Reviewing budgets and accounts of technical assistance and NGO projects, and assisting in the review of Embassy financial procedures
- Analysis of developments in all public financial management areas.
- Advising on the financial implications of SWAp programmes and plans, particularly with regard to the management of funds, the realism of cost estimates, and sustainability assessments

Qualifications

Degree in

- public administration, with specialisation in financial management; or
- in accountancy/financial management; or
- in economics with specialisation in public finance; or
- professional accountancy qualification (awarded by recognised international body)

Experience in public financial management issues, gained through

- work in public financial administration in home country (either on expenditure and/or revenue)
- as programme officer for international financial management projects
- as professional working as a consultant or audit on some public sector finance projects
- as academic with some exposure to practical public finance issues in consultancy role

Ability to work in addition on a majority of the following areas:

- analysing accounting standards and commercial law
- analysing public planning and budget procedures

- analysing public cash flow mechanisms and Government Treasury systems
- analysing public income and revenue systems in Customs and Taxes
- analysing State audit functions
- designing capacity building programmes, particularly in the area of financial management

Annex X – Terms of Reference for Audit of Expenditure Returns

Background

From the first quarter of 2000, the Ministry of Planning and Finance has decided to place on public record, up to 34 detailed budget execution reports (Mapas), based on the analytical matrix available under the budget classification system. It is likely that donors will seek additional assurance that these execution reports provide, within the limitations of the existing system, a fair view of budget transfers (paga) and budget execution (despesas liquidada) during the period for which the reports had been issued.

Objective

The overall objective of the audit is to assess and give opinion on the accuracy and completeness of Government of Mozambique expenditure reports, based on the computerised system operated by Contabilidade Publica of the MPF.

Scope of the Work

The work will consist of two parts

- An overall survey of the ‘accuracy’ of government budget execution reports and an assessment of the total amount of budget transfers made compared with revenue received (from domestic taxes and international sources in the year)
- An in-depth study of the accuracy of budget execution reports in sample line Ministries and departments
- A study of the reconciliation processes within 3 DPPFs

The sample Ministries should include MADR (Agriculture) and two other SWAp ministries and two non-SWAp ministries

Principal Tasks

For the Summary Analysis

- Compare the summary budget transfer and liquidated totals for each Ministry and provincial departments recorded in the MPF execution reports, and those compiled by each Ministry as its memorandum record. Establish the extent of the difference for Government of Mozambique as a whole.
- Ascertain the amount of revenue collected through the tax and counter-value system for funding the Government budget within the financial year to date.

For the detailed Analysis

- For the sample Ministries, to document and compare the timing of flow of funds to budget execution accounts and the flow of information on despesas liquidada from the Ministries to DPPF.

- Establish the differences between transfers and despesas liquidada n a bank account (department) basis, indicating as far as possible what was due to:
 - Timing differences between the compilation of the reports
 - Submission delays by the DAFs
 - Submission delays by departments not reporting through the DAFs
 - Processing delays by the DPPFs (failure to input quickly)
 - Disputes over vouching of expenditure records
 - Other specified reasons (lack of provincial Treasury liquidity)
- Establish for 3 DPPFs, the extent to which they have reconciled funds obtained from the Central Treasury and the Provincial Treasury, with funds disbursed for salaries and the budget execution accounts, and the returns made from spending units.
- For the sample Ministries, review their use of official documentation (e.g. balancete) and the accuracy of recording of budget transactions against the classification system.
- For the sample Ministries, review and comment on the maintenance of cash books, bank statements and a bank reconciliation process.
- Review the process for recording and controlling the financial transactions not made through the budget execution accounts (eg salaries and travel warrants).
- For a sample of selected payments for goods and services transactions and investment payments, check compliance with existing regulations. Check availability of regulations.
- Review the collection and transfer of non-tax revenue made by Ministries and departments, and the payment process of revenues from consigned Ministry funds. Assess the accounting records of those funds. Calculate the percentage of Government of Mozambique expenditure made through these funds.
- Assess the review and closedown procedures for the year-end of budget execution accounts, including the repayment of the initial 2/12 advance.

The auditor shall clearly indicate information gaps and what action was taken to close these gaps.

Conduct of the Assignment

Audit Staff will be expected to attend a detailed 2 day briefing at their own expense on the current Government financial system and the conduct of the audit.

It is expected that each proposal will contain a satisfactory level of supervisory time by qualified staff, including supervision in the field. The budget should reflect this.

It is expected that this audit shall be carried out in conjunction with staff from the Inspeccao Geral das Financas and the Tribunal Administrativo. The proposal should outline how the assignment could be used as an on the job training exercise.

(NB The costs of using IGF and TA staff will be taken care of separately and do not have to be included in your financial proposal).

Resource Requirements

The estimated time for this assignment is 65 person days, of which 10 days shall be high level supervision time, and 5 shall be devoted to pre-assignment training of IGF staff.

Timing of the Assignment

It is expected the assignment will be carried out from the end of November to end of December 2000.

Assignment Deliverables

A short report outlining the summary position on budget execution to the end of the third quarter, delivered no more than 15 working days after the start of the assignment.

A full report, delivered no more than 40 working days after the start of the assignment.

Annex XI – Draft Model Programme Document

1. Background

The following presents a program for a coordinated approach in providing Macro Financial Support (MFS) to Mozambique. The approach includes the following main elements:

- *A common goal to support the Poverty Reduction Strategy (PRS)* with common procedure for review PRS implementation.
- *Common objectives and outputs* in the area of Government financial management needed to implement the PRS.
- *A common procedure for disbursement* to ensure a more predictable cash flow in terms of foreign exchange (external gap) and counter-value for budget execution (deficit financing).

The MFS will be made available on an annual basis to the Government of Mozambique in due course of every budget year. Based on a joint review of performance according to goals and objectives, pledges will be made by donors for replenishment of support for the next budget year.

2. Programme objectives/outputs

The overall goal of the joint donor programme is to promote the implementation of the Poverty Reduction Strategy (PRS) of Mozambique through flexible and timely macro financial (budget) support.

The government has developed a set of indicators that will be monitored under the PRS in addition to macroeconomic indicators and quarterly reports from Ministry of Planning and Finance on budget execution as part of programme monitoring and implementation (ref. section 2 below).

An important element in the implementation of PRS will be the continuation of the reforms in the areas of fiscal transparency, accountability and domestic resource mobilisation. The immediate objectives of this program are to promote needed reforms in the areas of Government financial management with emphasis on the following:

- tax policy and administration to increase tax revenue as percent of GDP.
- state accounting system and procedures
- management of state liquidity
- state auditing

Expected outputs under respective area will be agreed upon annually between the Government of Mozambique and the donors including procedure and means of verification to be annexed to annual agreement (ref. proposed format in annex III). The outputs should be considered as areas for review and dialogue between Government and donors to assess progress as basis for decision on replenishment of MFS for the following budget year. The Government and donors will decide if these outputs are to be considered formal conditions for further MFS or as indicators for a general review of progress in the area of financial management.

3. Programme monitoring and reporting

The dialogue on the achievements of the programme will be structured around the Budget Working Group where participation donors meet quarterly with the Ministry of Planning and Finance. The dialogue will focus on the following issues:

- Quarterly review of the implementation (execution) of the budget including developments in sector allocations and total domestic revenue.
- Yearly review of the progress in the implementation of the poverty reduction strategy.
- Yearly review undertaken by an independent team of experts on the progress in the area of Government financial management.

Separate studies and reports on sector or cross-cutting issues will be undertaken in a schedule to be agreed between the donors and the government. Other studies or reviews that Mozambique and/or donors propose shall be agreed upon. Mozambique will participate and co-operate with donors in yearly joint donor reviews of the program. The share of the costs associated with the above reviews and studies will be agreed upon.

4. Disbursement of donor funds

The disbursement mechanism has been designed with the aim that it should facilitate the overall macroeconomic management, budget process and a further unification of the market for foreign exchange. In order to achieve this the following is agreed between donors and the Government of Mozambique:

- Donors will provide early notification or pledging of amounts so as to allow for a full integration of the resources in the budget for the preceding year.
- Donors will disburse resources into one foreign exchange account in the name of the Government of Mozambique.
- Donors will abandon all negative lists for imports and allow for the funds to be sold freely in the foreign exchange market.
- The Government will establish a common account denominated in the name of Banco de Mozambique in US dollars for donor disbursements.
- The main Treasury account in the name of the Ministry of Planning and Finance will be credited the corresponding metical amount the same date as the donor funds are credited the common foreign exchange account.

A detailed outline of the disbursement mechanism is provided in annex III and will constitute an integrated part of the bilateral agreements between the donors and the Government.

5. Financial reports concerning donor disbursements

A financial report will be produced by the Government of Mozambique within one month after the last donor disbursement has been made for the concerned budget year. The report will show

- balance of the FOREX account at beginning of each period,
- specification of all inflows and outflows of the FOREX account,
- balance of the FOREX account at the end of the period,

- inflow of counter-value funds to the main treasury account, and
- a statement reconciling the outflow of forex from the FOREX account with the inflow of counter-value to the main treasury account.

The above financial report should be supplemented with a copy of bank statements for the FOREX account and Treasury account. The format for the report is provided in Annex IV.

Audit of the above financial statements will be made on an annual basis covering the total flow of funds from source of funding (donor) to the FOREX account and from the FOREX account to the treasury account including balance remaining on the FOREX account (special purpose audit).

The audit would take place within one month after the above financial report has been presented. The terms of reference for the audit is provided in annex V.

Banco de Moçambique will publish monthly statistics on the foreign exchange reserves as well as on the level of foreign exchange transactions in the MCI during the period to be presented to the donors.

Donors may suspend the rights of Mozambique to withdraw the grant if the programme develops unsatisfactory, or if the documentations specified are not delivered as agreed.

Donors will reserve the right to claim repayment in full or in part of funds from the Grant if the funds or part of the funds are found to be misused or not satisfactory accounted for.

Before withholding any disbursements or claiming repayment the donors and the Government will consult with a view to reach a solution in the matter.

6. Matrix of Programme activities related to year T

Year	Month	Programme activity	Dialogue and expected output	Government input
T-1	June	Meeting of budget working group.	Formulation of common position on implementation of programme for year T. Pledging of donor support for coming 1 – 3 budget years	Presentation of budget execution figures for 1. Quarter.
T-1	September	Meeting of budget working group	Common position on budget implementation	Presentation of budget execution figures for 2. Quarter
T-1	October/ November	Individual donor decisions on programme for year T.		Presentation of budget execution figures for 3. Quarter.
T-1	December	Meeting of budget working group.	Signing of agreements for budget support year T.	Presentation of budget for year T
T	Jan–March	Disbursement of funds for year T to common forex account.		Immediate credit of counter-value to main Treasury Account equivalent to forex disbursed by each donor.
T	March	Meeting of budget working group	Common donor review of budget execution for previous year and developments in priority sectors.	Presentation of budget execution figures for all four quarters in previous year.
T	April	Joint donor missions to review implementation of programme and progress in main areas for year T-1.	Technical report on implementation of programme priority areas and a recommendation for adjustments in the focus of the programme.	Co-operate with mission and make available relevant information to carry out review including the report of the semi-annual IMF PRGF programme assessment.
T		Donor review of financial report for year T.		Financial Report submitted to donors reconciling forex received with counter-value generated for the main treasury account.
		Review of proposed terms of reference for audit of MFS support for year T.		Preparation of terms of reference for audit of MFS disbursements submitted to donors.

Year	Month	Programme activity	Dialogue and expected output	Government input
T	May	Donor review of audit report.		Audited report submitted to donors covering reconciliation of disbursements to forex account with counter-value credited the Main Treasury Account.
T	June	Meeting of budget working group.	Pledging of donor support for coming 1 – 3 budget years. Joint review of financial report year T. Joint review of audit report year T. Formulation of common position on implementation of programme for year T+1.	Presentation of budget execution figures for 1. Quarter. Comments to review mission findings. Presentation of financial reports.
T	September	Meeting of budget working group.	Common position on budget implementation.	Presentation of budget execution figures for 2. Quarter.
T	October/ November	Individual donor decisions on programme for year T+1.		Presentation of budget execution figures for 3. Quarter.
T	December	Meeting of budget working group.	Signing of agreements for budget support year T+1.	Presentation of budget for year T
T+1	Jan – March	Disbursement of funds for budget year T+1 to common forex account.		Immediate credit of counter-value to main Treasury Account equivalent to forex disbursed by each donor.

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