

Public financial management for universal health coverage

Why and how it matters

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Introduction

Public Financial Management (PFM) gains greater significance as governments respond to the COVID19 pandemic. This policy note is intended as a primer on why public financial management in the health sector matters in support of progress toward universal health coverage. The note was produced by the Financial Management Technical Working Group¹ of UHC2030 and will serve as a broad consensus document among member countries and development partners working toward UHC. At a broad level, there is a consensus that PFM Systems could facilitate improved health outcomes, if they are configured with the right balance of control with flexibility needed for health sector. However, development partners and governments often have divergent expectations from PFM systems, and not aligned internally, leading to sub-optimal reform efforts. Further, there is lack of clarity on the role of PFM in health sector, and this can affect the ability to obtain the required support of leadership. This note seeks to address this gap and share commonly agreed broad expectations from PFM systems. The note supports health and PFM experts to sensitize and build momentum for a focused approach among UHC2030 members on PFM for health in the pursuit of UHC. The first section defines public financial management (PFM), objectives and related processes. The second section outlines the relationship of PFM and health and the importance of PFM for reforms towards UHC. The third section focuses on the challenges to reforming PFM systems to support improved service delivery and the fourth and final section suggests key principles for action for national authorities and partners to accelerate the implementation of reforms and optimally tailor PFM systems to the health sector's requirements for achieving UHC objectives.

1 The financial management technical working group of UHC2030 is composed of representatives from multilateral and bilateral partners involved in the financial management of health operations, as well as country representatives involved in public financial management issues and technical experts working at the nexus between health policy and public financial management. The working group also facilitates coordination of the public financial management work by the Sustainable Financing for Health Accelerator under the SDG3 Global Action Plan that also supported the development of this policy brief. The bilateral and multilateral partners include Gavi Alliance, The Global Fund, GIZ, UNICEF, AfDB, CWGH, European Union, IPPFARO, KfW, OECD, UNFPA, USAID, WHO, and World Bank. The initial draft was contributed by Helene Barroy (WHO) and Srinivas Gurazada, Manoj Jain, Frans Ronsholt, Moritz Piatti, and Maxwell Dapaah (World Bank) and was finalized with valuable contributions from several other members.

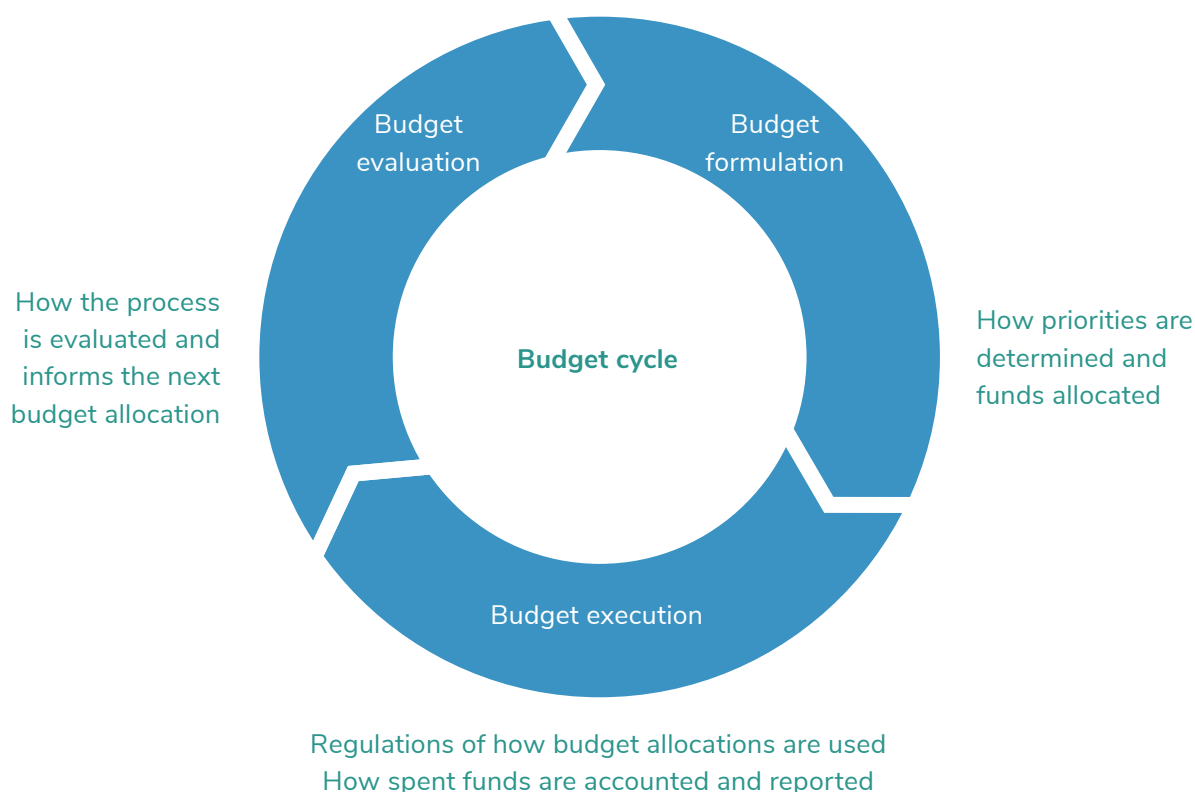
1. What is public financial management?

Public financial management (PFM) is the set of rules and processes that govern how public resources² are collected, allocated, spent, and accounted for. The objectives of PFM are

- **Strategic allocation of resources**, which involves planning and executing the budget in line with government priorities aimed at achieving policy objectives;
- **Efficient service delivery**, which requires the use of budgeted resources to achieve the best levels of public services with available resources;
- **Aggregate fiscal discipline**, which requires control of the total budget and management of fiscal risks; and
- **Financial transparency and accountability** of all public resources.

Most PFM systems follow processes that are based on the 'budget cycle' (Figure 1).

Figure 1. The budget cycle



Source: Cashin et al. 2017.

² Public resources include resources from development partners which are channeled through state entities.

The budget cycle evolves over three stages with key aspirations as follows:

- **Budget formulation:** budgets are prepared on the basis of government fiscal policies, strategic priorities, and macroeconomic projections.
- **Budget execution:** a system of effective standards, controls, and processes ensures funds are available and efficiently used, records are accurate and reliable, and information is produced and disseminated on time.
- **Budget evaluation:** public finances, including budget outturns and output performance, are reviewed both by the government and by an independent external auditor (usually the supreme audit institution), with follow-up actions for the next budget cycle.

2. Public financial management: why it matters for health

Many countries have adopted universal health coverage (UHC)³ as a national policy priority in recent years and have committed to directing government funds toward that goal. The move to UHC is expected to put greater pressure on government budgets because the commitment to achieving such coverage as part of the sustainable development goal (SDG) on health often means increasing public spending or redirecting existing resources toward achieving UHC. Several other multilateral initiatives, for example, the Global Action Plan Sustainable Financing Accelerator, aim at spending more and spending better, through development assistance better aligned with government systems as well as strengthening country systems while focussing on expenditure on health sector.

Efficient allocation and spending of public funds are important for making progress toward UHC. Governments need to become more efficient in allocating and using resources if they are to expand service coverage with the resources available (Barroy et al. 2019). UHC requires that resources are allocated for equity in access to and quality of services among all population groups. It also requires an appropriate balance between various health service streams in accordance with evidence-based impact and relative service costs. PFM systems that guide such allocation processes, manage the flow of funds to service providers, and promote efficiency and accountability therefore play a crucial role in achieving UHC goals (Piatti-Fünfkirchen and Smets 2019).

Improving the quality of PFM systems in the health sector can support the implementation of health financing reforms toward UHC in three main ways (Cashin et al. 2017).

- Reliable public budgets, especially through the development of multi-year plans that are integrated into and inform the annual budget process, may improve predictability in the sector's resources. This increases the likelihood that plans will be translated into actions.
- If budgets are better defined in terms of sector priorities and output targets as well as linked to implementation capacity, budget execution can improve. Underspending, which is common

3 The World Health Organisation (WHO) defines UHC as "ensuring that all people have access to needed health services (including prevention, promotion, treatment, rehabilitation and palliation) of sufficient quality to be effective while also ensuring that the use of these services does not expose the user to financial hardship" (https://www.who.int/healthsystems/universal_health_coverage/en/)

in low-income countries, can be reduced, and the budget can be implemented according to national priorities.

- A health budget that is formulated and executed according to service goals will allow a certain degree of spending flexibility and will make budgets more responsive to sector needs.

These reforms need to be complemented with the necessary strengthening of internal controls, financial management information systems (FMIS), procurement processes, and internal and external oversight. After doing so, the sector could provide a better return on investments.

2.1 Budget formulation

A well-prepared budget proposal, supported by evidence and a detailed execution plan, is key to making the case for an increased budget allocation. Health ministry proposals, which might lead to the allocation of resources to the sector, must be clear and logical to receive support from the finance ministry. Unreliable or unsupported budget submissions weaken the case for extra resources.

Resource determination should start with the health ministry's strategic plan. A strategic plan presents the overall vision, direction, focus, and priorities of the sector over the medium term, given a country's current level of development. The strategic plan should be costed and accompanied by a financing strategy. With a medium-term horizon the strategic plan should be aligned with the broader national vision and the long-term development plan for the country's health sector. A comprehensive and well-formulated plan, with actions that are adequately phased, should make the case for more resources to the sector from domestic sources, including the national budget. A comprehensive plan also reduces the inefficiencies of fragmentation at the planning stage. However, comprehensiveness requires that external resources from development partners are incorporated in terms of activities and financial planning, irrespective of whether the resources are channeled through the national budget or are planned and reported off-budget.

The classification and organization of a budget are central to the preparation of sector budget proposals. Budget classifications serve to categorize public expenditure in the annual budget law and thereby structure the budget presentation. They provide a normative framework for policy development and accountability (Barroy et al. 2018).

Input-based budgets, based on economic classification (see Table 1), satisfy budget control requirements but have limitations which affect the health sector more acutely than other sectors. Holding an institution or an official accountable for results has clear limitations when resources are allocated and monitored on the basis of detailed inputs at disaggregated levels. Such inputs might include fuel for ambulances, stationery for health facilities, or training sessions. In light of these constraints, several countries have changed the way budgets are formulated and executed. While countries have introduced budgeting reforms for different reasons, many have tried to move the focus away from inputs ("What does the money buy?") toward measurable results ("What can the sector/entity achieve with this money?").

Table 1. Main types of budget classification and their application in health

Budget classification	Application in health
Economic	Classifies expenditure by economic categories (for example, salaries, goods, and services). To be consistent with the Government Finance Statistics Manual (GFSM) 2001 economic classification. Economic classifications are often associated with inputs-based or line-item budgets.
Administrative	Classifies expenditures by administrative entities (for example, agencies and health facilities) responsible for budget management.
Functional	Categorizes expenditures by sector (for example, health and education). Within each sector, sub-functions of expenditure (for example, outpatient services and public health services) are further divided into classes (for example, outpatient services include general medical services, specialized medical services, dental services, and paramedical services). Categories have been predefined internationally for comparison.
Program	Classifies and groups expenditure by policy objectives or outputs for the sector (for example, maternal health, primary health care, and quality of care), irrespective of their economic nature. Unlike other classifications, it is meant to be country specific. Activity-based classification (for example, provision of supplementary food) has also been introduced in some countries before—or supplementary to—larger budgetary programs, as an effort to group expenditure into coherent policy actions.

Source: Barroy et al. 2018.

A program structure can help to clarify the logical framework that connects inputs and activities to performance measures such as outputs and policy goals. A classification by program objectives serves to promote policy-based allocation decisions. However, it is also possible to provide allocations to ministries and make them accountable for results without programs, by linking policy goals and outputs to budgets for departments and agencies organized by means of an administrative classification.

The interplay between budget classification systems and systems for contracting and payment of service providers is a key issue in health financing. A change in budget formulation is likely to be a necessary precondition for implementing strategic purchasing that is, moving toward output-oriented contracts and payment mechanisms.

2.2 Budget execution

Budget execution is the process by which budgeted resources are directed and controlled toward achieving the purposes and objectives for which a budget was approved. The budget execution process generally follows five steps:

- Domestic revenue is collected according to relevant legislation; while other financing is mobilized as planned.
- Funds are released to budget entities in accordance with the approved budget.

- Budget entities initiate expenditures by hiring staff, procuring goods and services and so on.
- Payments are made for these expenditures.
- Transactions are recorded in the accounting system.
- Execution reports are produced periodically throughout the year.
- Annual financial statements are prepared and consolidated into national financial statements, which serve as the final execution report for that year.

Weaknesses in these steps are likely to affect health service delivery. Table 2 describes some of the challenges in budget execution.

Table 2. Service delivery challenges in budget management

Service delivery goal	Challenges (examples)
Efficiency	<ul style="list-style-type: none"> • Rigid internal controls limit flexibility of budget reallocations to meet emerging needs. • Insufficient and late budget releases can lead to arrears and price increases.
Equity	<ul style="list-style-type: none"> • Budgets that are insufficiently funded can compromise equitable access to services.
Quality	<ul style="list-style-type: none"> • Budgets that are insufficiently funded can compromise service quality. • Slow and irregular cash releases can compromise service quality.
Accountability	<ul style="list-style-type: none"> • Lack of financial accountability undermines the foundation for enhanced financial autonomy of service unit managers.

Source: Piatti-Fünfkirchen and Schneider 2018.

The approved budget may not be released to the sector and its service providers for spending in its entirety or on time. This can happen if the government's general revenue collection does not meet original estimates, if unforeseen circumstances lead to changes in allocations to sectors during the year, or if cash flow problems lead to the late release of funds. In such cases, budget execution becomes opportunistic rather than strategic and may force providers to prioritize urgent issues over important ones. As it is more difficult to cut salaries, budget cuts often skew the wage/non-wage balance in the budget. Consequently, health workers must manage with an insufficient operational budget, which results in inefficiencies and poorer quality of service. Similarly, the late release of funds may prevent service providers from committing funds to planned operations on time and can lead to an inappropriate mix of inputs.

The health sector's budget entities may be unable to absorb the funds they are allocated. Under-execution is an endemic problem in many low-income countries (Barroy et al. 2019). Cumbersome procedures for staff recruitment or procurement of drugs and medical supplies may contribute to low absorption capacity. Inadequate numbers of skilled administrative staff may also contribute to

the problem. In particular, under-execution of capital expenditure budgets is frequently observed and indicates unrealistic planning of often complex infrastructure projects in relation to capacity for implementation. Often this is linked to unrealistic planning and budgeting of project resources made available by development partners.

Even if budgeted funds are fully released to the intended spending units on time and the units have the capacity to absorb the funds, the units may have problems staying within their means and spending in a manner that creates optimum value for money. Internal control systems are established to check, among other things, that expenditure commitments are made against budget allocations, that recruitment and procurement follow established rules to ensure competition and transparency, that payments are made correctly with appropriate authorization, and that all financial transactions are correctly recorded. While such checks serve the purpose of central fiscal control, the use of funds must be monitored adequately to help service providers and the health ministry address waste and leakage and improve efficiency in operations.

There is an inherent tension between control and flexibility in budget execution, but it can be managed effectively. Input control based on detailed economic line items are used in a centralized control environment. However, this can reduce operational efficiency because it does not give spenders any incentive to economize and does not relate the amounts spent to the outputs produced. Over time, many governments have consolidated line items into broader categories and have set up systems of internal control that give managers more discretion in spending appropriated funds (Schick 1998a, 18). While a comprehensive program-based budget may improve flexibility in the use of funds, if service demands change during the budget year, simpler solutions are available. For instance, allowing service providers or other decentralized budget holders to authorize transfers between certain line items, under a programmatic approach with defined outputs, can help to meet the needs of the health sector depending on the PFM environment in the country (Piatti-Fünfkirchen and Schneider 2018).

Accounting and financial reporting make up an important dimension of PFM, helping to enhance transparency and providing requisite, timely, and quality information for management decisions. FMIS are central to budget execution and monitoring and should apply to all spending units and transactions and ensure that actual spending is reported in the same format as the approved budget. Commitment and budget controls are usually embedded in the FMIS: purchase orders, payment vouchers, and cheques may be issued directly by the system, ensuring that financial reports generated by the FMIS have integrity. A multi-year commitment control in the FMIS, when implemented effectively, can ensure that large capital investments are provided adequate funding. Financial reporting requirements for different levels (service providers, the ministry of health, and the national government) vary by country. Increasingly, governments are moving from cash basis accounting to modified cash or accrual basis accounting, providing fuller information on assets, liabilities, accrued income, and expenditures. A particular challenge for many low-income countries is to include the—often substantial—resources provided by development partners in the financial accounting and reporting systems when those resources are not provided through treasury accounts. The multi-year commitment control in the FMIS, when implemented effectively, can provide a complete picture of expenditure and related liabilities.

2.3 Budget evaluation

Budget evaluation refers to the final stage of the budget cycle when an assessment is conducted into whether public resources have been used appropriately and effectively. Budget evaluation provides feedback for discussions on future budgets and should include explanations for deviations between approved budgets and actual expenditure. Budget evaluation may include an internal government process in which a central agency reviews financial documents and reports on activities and outputs, as well as an external audit typically undertaken by the country's supreme audit institution.

Financial audits serve to enforce accountability and promote confidence in financial reporting.

A financial audit provides assurance that management has presented a true and fair view of an organization's financial performance and position in accordance with well-defined rules and procedures. A rigorous audit process will, almost invariably, also identify areas where management may improve its control systems and processes. The audit function can enhance value by reviewing management information systems, payroll, procurement, and other systems that support the delivery of health services.

While compliance with controls in such systems is essential, service delivery results must also be evaluated against performance benchmarks or output targets agreed upon during budget formulation. Performance and value-for-money audits evaluate the way funds have been used to achieve the planned outputs and can identify bottlenecks in service delivery at all levels. Such an audit may be more difficult than simpler financial and compliance audits because it requires multidisciplinary expertise and adequate performance indicators to measure the impact of operations.

Transparency of the budget evaluation process is important for accountability. Scrutiny by the national legislature of performance outputs, outcomes, and use of resources forms part of the formal processes of holding the government at large and individual managers to account. Access to the information by the public helps—often through civil society organizations and the media—to understand what revenue is used for and to highlight areas of poor performance.

3. Challenges to reforming PFM systems for improved service delivery

International development partners have encouraged low- and middle-income countries (LMICs) to reform their PFM systems to ensure good governance, transparency, accountability, and the efficient use of public resources. In most countries, standard PFM features such as multi-year expenditure frameworks, treasury single accounts, FMIS, internal controls, internal audits, and audits by the supreme national audit institution have been in place for decades, with varying degrees of effectiveness in supporting service delivery.

Most countries show evidence of the benefits of PFM reform, with some clear advances in the reliability of budgets, resource management, and overall accountability (Hadley and Miller 2016). However, challenges remain. Some countries, including (though not limited to) fragile states, face

broader governance issues and do not have the foundations required for more advanced reforms to be successful (Diamond 2013; Schick 1998b). Other countries have introduced advances such as program budgets but continue to struggle with incomplete transitions and reforms, resulting in more risk in resource management than under previous simpler systems (Fritz, Verhoeven, and Avenia 2017).

PFM reforms have often prioritized central-level concerns although many obstacles are at the local level. Local-level obstacles to PFM reform must be addressed to ensure that public resources are delivered promptly to health facilities and that payments to priority services are matched with appropriate financial incentives to increase efficiency, equity, and quality. For devolved settings, this also requires (a) integration of local planning and budgeting processes with the national level, (b) equitable and easy-to-understand formulas for allocating resources, (c) an effective system of financial transfers that supports poorer areas and priority needs, (d) budgeted transfers that are paid on time and in full, and (e) integration of devolved entities in the FMIS. Staff capacities in both numbers and skills are often seriously constrained at the local level, which limits the ability to implement and benefit from reforms.

Most LMICs continue to face serious challenges in moving to output-based budgeting systems. While program-based budgeting reforms have a long history in high-income countries (including Australia, France, the Netherlands, New Zealand, and the Republic of Korea) and have shown some success, the institutionalization process has generally been iterative and long and has required high capacities. Difficulties are often encountered when (a) defining appropriate programs, (b) identifying performance indicators that can be easily and reliably monitored, (c) building the compliance culture that gives the finance ministry confidence to increase the flexibility of in-year internal transfers that spending units are authorized to undertake without prior approval, and (d) integrating financial support from development partners into the program resource envelopes. Countries embarking on reforms of their budget structure must be aware that reforming budget performance and accountability requires a sustained effort lasting many years.

An integrated approach that links health financing with public sector reforms is likely to be more effective than single-issue intervention. Such an approach includes reducing fragmentation in the pooling of funds, focusing on strategic purchasing, and taking account of potential implications for the public sector overall. Misunderstandings often originate as a result of the different perspectives of ministries of finance and ministries of health regarding the importance of these issues and their relevance to service delivery outcomes (Cashin et al. 2017).

4. Key principles for action

The above discussion suggests a number of areas in which country authorities, particularly the ministries of finance and health, and their international development partners could accelerate the implementation of reforms and better tailor PFM systems to the health sector's requirements for achieving UHC2030 objectives.

The proactive engagement of ministries of health in the design and implementation of improved PFM systems is important. Such reforms are frequently considered to be the exclusive

domain of central budget authorities. However, PFM reforms are rarely effective without the active participation of spending units and their planners. Health and finance authorities can promote better interaction and engagement in several ways (Barroy et al. 2019):

- Strengthened interest in, and monitoring of, broad PFM reforms to improve predictability and sustainability in health financing (for example, multi-year budgeting)
- Proactive design and implementation role for PFM reforms that directly affect the health sector (for example, the definition of relevant budget programs or budget allocation formulas across regions and districts)
- Direct design and implementation function for health-specific PFM interventions, including with or for the government at subnational levels (for example, flexibility, transparency, and autonomy in financial management and accountability of frontline service providers)

Mainstreaming PFM issues in development partners' health operations and tailoring PFM interventions to suit the sector's requirements is also essential. This could be achieved by:

- Helping the health ministry to leverage its influence on PFM reform priorities to strengthen financing and facilitate service delivery operations;
- Supporting capacity building for financial management functions within the health ministry as well as at the levels of regions, districts, and service providers;
- Ensuring that operations align with the sector's strategic plan and with the government's budget structure, particularly through budget programs; and
- Using country systems for project implementation wherever possible.

In particular, bringing aid operations fully onto the budget helps bring more transparency to the allocation process. Disbursing aid through the government's treasury accounts reduces the inefficiencies of funding fragmentation and pooling. Finally, using government systems for reporting reduces the burden on the limited administrative capacity in the sector.

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