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Alignment of Performance Based Financing, Direct Facility Financing and Public Financial Management Reforms in Tanzania

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Introduction

The health sector in Tanzania has traditionally been input oriented and financed against a historical budget. Council health management teams were responsible for the implementation of activities at the district level, including what was needed at lower level facilities. This situation is changing rapidly: Tanzania has decentralized its budget structure to the facility level who are already receiving funds from a joint donor basket fund. The government has recently committed to supplement these basket funds by financing facilities directly from its own budget. Furthermore, there has been a Performance Based Financing (PBF) pilot that was reimbursing facilities directly against service outputs.

Such changes in the financing system present both opportunities and challenges for the sector to move towards an output-based payment system in a coherent manner, enhance accountability to results and increase value of money. The government is committed to paying facilities directly, using modalities developed under the basket fund under the direct facility financing (DFF) initiative. The objective of this note is to discuss how PBF can be aligned with this and what reforms may be necessary to facilitate alignment.

The discussion is centered around the following four themes:

1) **Basic practical concerns:**

PBF requires facilities to be autonomous and recognized as government spending units. The DFF has gone a long way to facilitate this and the government has provided the institutional structure in the budget to support it. As such a critical first step to recognize the facility as a spending unit has been taken.

Under PBF facilities need access to banking services. Does this conflict in any way with the PFM laws and regulations? Presently under DFF facilities do have accounts, but is this threatened given other reforms in the PFM space?

2) **The provider payment mechanism:**

How is the budget for facilities determined? With PBF facilities are reimbursed ex-post after a set of services is delivered. This is a significant departure from setting ex-ante budget ceilings as is currently the practice. While the budget has become output oriented it ironically still controls strictly against line items.

3) **Flexibility in expenditure:**

PBF necessitates the use of quarterly business plans, which is a departure from the annual budget. How may this be reconciled? How can PBF activities be integrated into the annual budget? Are quarterly business plans really necessary or can we do without them?

Expenditure against quarterly business plans allows for greater flexibility, than strict commitment control against an annual budget. How can commitment control in the annual budget be relaxed? Some virement is already acceptable to government – could this be extended even further and perhaps even across broad spending categories (e.g. wages and OC)?

Accounting and reporting through regular FFARS and Epicor is difficult as PBF is not subject to the same commitment controls. PBF does not use FFARS in the same way it is used for the govt budget or basket. One potential talking point could be whether this is a problem and how this could potentially be aligned?

4) Verification of results

PBF necessitates close verification of results as these inform quarterly budget allocations. This is contrast to the audit function of government, which tends to be compliance rather than performance driven. What will it take for government to step it up?

An assessment of the alignment of the various stages in budget management is outlined in the table below:

Table 1 Comparing PBF to DFF: Where is there alignment and what needs to be done

	PBF project	DFF Processes	Alignment	Discussion
1	Facility is spending unit	Facility is spending unit	✓	Both PBF and DFF require the facility to be the spending unit. There is no conflict.
2	Facilities have bank accounts	Facilities have bank accounts	✓	Access to banking services is required for both DFF and PBF. There is no conflict
3	Quarterly business plan	Budget planning and formulation	X	With PBF facilities are required to produce quarterly business plans, under the guidance of a governance committee. This is in contrast to DFF, where an annual plan is developed that becomes a binding budget. This may be difficult to change.
4	Facilities get reimbursed against performance	Facilities request expenditures against budget	X	PBF budget ceiling is a function of previous' quarter performance. With DFF the facility budget depends on annual budget law and the facility needs to request against the approved annual plan. PBF is major departure from this model.
5	Large flexibility of spending	Subject to annual budget law and enforced by ex-ante commitment control	X	PBF facilities execute budget against business plan, with flexibility to adjust to changing priorities with approval from governance committee. Under DFF facilities execute against annual budget law

				and are subject to ex-ante commitment control which is very rigid. A dialogue should be held with MOF/PORALG on how/to what extent this can be relaxed.
6	Salary top ups possible	Predetermined budget for econ functions	X	PBF facilities are able to incentivize staff through providing funds for salary top ups. This is on the negative list for DFF basket funds. For incentive purposes it is important that this constraint in the basket fund will be relaxed.
7	Rigorous verification	Internal and external audit	X	PBF facilities must evidence progress against indicators, which are verified by a third party. Their funding depends on it. In contrast, under DFF there is no verification. Funds are audited periodically on compliance. Execution of funds is subject to internal audit and at year end subject to assessment against external audit. Performance audits do usually not happen and if so only as per donor request. Internal and external audits do generally not inform allocations in the next budget cycle.
8	Accounting and reporting *posted* in FFARS	Accounting and reporting *integrated* in FFARS	X	For DFF, budgets are loaded into FFARS and locked. Requests for spending is done against the loaded budget and there is limited flexibility. Accounting and reporting functions are integrated into FFARS and done as an integral part of budget execution. PBF does not allow for loading a budget into FFARS at the beginning of the fiscal year as it needs to be periodically adjusted. Transactions are executed outside the FFARS and not subject to the same system internal controls. Instead, transactions using PBF are posted to the ledger on an ex-post basis (i.e. after the transactions has occurred).

9	External project audit	External recurrent expenditure audit	X	As the PBF project goes through the budget both are subject to external compliance audits. For PBF compliance is against project protocol, whereas for DFF facility budget expenditures it is compliance against the general government expenditure management protocol.

Areas that require attention:

1) **Basket fund funds and government budget will need to become aligned.** Otherwise we have a situation where facilities receive funds from the government against government guidelines and from the basket against basket guidelines and need to plan and report separately which entails inherent inefficiencies. Funds from government and basket should be pooled at a higher level and sent directly to facilities as part of their recurrent budget allocation. Currently funds from the basket are treated administratively as development expenditures, and funds received from the government as recurrent expenditures. This could take form of de-facto sector budget support with condition that a certain share of the funds is channeled directly to facilities.

2) **The provider payment mechanism would need to be reformed to a mix of capitation and fee for service.** This happened de-facto before already through the various different facility income streams but has never been formalized in government or the health financing strategy. While de-facto this would not entail a significant departure from the current status quo of what facilities are already doing, it would entail significant efficiency gains as various budget management functions and incentives are aligned.

3) **Alignment at the planning stage.** Quarterly business plans as currently done for PBF may be difficult to maintain. It may be necessary for PBF to give up the practice of quarterly business plans and alignment with the annual budget process. This would however require that a mechanism be developed that allows for sufficient flexibility during budget execution such that facilities can adjust spending and be held accountable for the delivery of outputs.

4) **Flexibility in spending will need to be improved.** There are currently various rules in place that govern how facilities can spend funds, including a negative list of items that may not be spent on for basket funds, and strict input based commitment control for the government budget. Integration of PBF into the general budget would require that some of these rules would be relaxed. Given that this would constitute the entirety of the facility budget a negative list of spending would likely have to be abandoned, and

facilities given the opportunity to also invest in small scale infrastructure and be allowed to pay salary bonus payments. Some control against spending categories will likely still be necessary. For example, it will likely be important to protect PE expenditures and utilities as these are quasi statutory. However, within categories – especially within goods and services, greater flexibility should be granted.

5) **Accounting and reporting will use full FFARS functionality.** If there is alignment in the planning process and increased flexibility in spending, full use of FFARS should be possible. FFARS functionality will have to be updated to reflect updated rules and regulations.

6) **Verification and budget evaluation.** Verification for PBF is rigorous and non PBF funds are not subjected to the same level of scrutiny. Verification in itself is administratively not in conflict with DFF PFM processes, but likely to be prohibitively expensive in a nation-wide scale up. Details of reporting against outputs, verification of reporting and costing implications will have to be worked out. All funds would however be subject to regular annual compliance audit and value for money audit to adjust mechanisms for the subsequent b