

Draft, September 23, 2004

**PUBLIC FINANCIAL MANAGEMENT IN  
WORLD BANK OPERATIONS:  
A STRENGTHENED APPROACH TO ENHANCE  
DEVELOPMENT AND FIDUCIARY OBJECTIVES**

This draft note has been prepared to provide participants in the *Public Financial Management (PFM) - Prospective Workshop* with background information on the emerging strengthened approach to PFM work in the World Bank. This is a draft document. Please use this for your reference and information only and do not quote from this draft note.

## ABBREVIATIONS AND ACRONYMS

AFR	Africa Region
BP	Bank Procedures statement
CAS	Country Assistance Strategy
CFAA	Country Financial Accountability Assessment
CPAR	Country Procurement Assessment Review
DFID	Department for International Development, United Kingdom
DGF	Development Grant Facility
EAP	East Asia and Pacific Region
ECA	Europe and Central Asia Region
ESW	Economic and sector work
FY	Fiscal year
HIPC AAP	Highly Indebted Poor Countries Assessment and Action Plan
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDF	Institutional Development Fund
IMF	International Monetary Fund
MDB	Multilateral development bank
MIC	Middle income country
OECD-DAC	Development Assistance Committee of the Organisation for Economic Co-operation and Development
OP	Operational Policy statement
PEFA	Public Expenditure and Financial Accountability initiative
PER	Public Expenditure Review
PFM	Public financial management
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
QAE	Quality-at-Entry review
QAG	Quality Assurance Group
ROSC	Report on Observance of Standards and Codes
SPA	Strategic Partnership for Africa
SWAp	Sectorwide approach

**PUBLIC FINANCIAL MANAGEMENT IN WORLD BANK OPERATIONS:  
A STRENGTHENED APPROACH TO ENHANCE DEVELOPMENT AND  
FIDUCIARY OBJECTIVES**

**CONTENTS**

	<b>Page</b>
<b>I. Introduction.....</b>	<b>1</b>
<b>II. Recent Experience.....</b>	<b>1</b>
<b>III. Toward a Strengthened Approach .....</b>	<b>7</b>
<b>IV. Implementation Issues .....</b>	<b>10</b>
<b>V. Conclusion .....</b>	<b>12</b>

**Annexes**

- A. Coverage of CFAAs, CPARs and PERs**
- B. PFM Performance Indicators**
- C. Illustrative Examples of PFM Analytic Work**

# PUBLIC FINANCIAL MANAGEMENT IN WORLD BANK OPERATIONS: A STRENGTHENED APPROACH TO ENHANCE DEVELOPMENT AND FIDUCIARY OBJECTIVES

## I. INTRODUCTION

1. Public financial management (PFM) is an essential part of the development process.<sup>1</sup> Sound PFM ensures accountability and efficiency in the management of public resources, which are critical to the achievement of public policy objectives, including achievement of the Millennium Development Goals (MDGs). In recent years, the Bank has greatly expanded the attention it pays to PFM in client countries, and PFM has become one of the most prominent issues in the broader donor harmonization initiative. Support to country PFM reform programs has increased through both investment and adjustment lending, as well as through the Institutional Development Fund (IDF) grant program. Project- and country-level analytic work has increased, and now underpins all lending operations.

2. **Objectives.** The Bank has two main objectives with respect to PFM: (a) to improve country PFM performance as a key contributor to successful development; and (b) to apply appropriate fiduciary arrangements to the financial support the Bank provides.

3. **The strengthened approach to PFM work.** The strengthened approach to the Bank's PFM work (i) places primary emphasis on enhancing country PFM performance; (ii) provides for customizing PFM analytic work to country PFM reform needs, and the size and nature of the Bank's lending program; (iii) provides for applying a results framework to monitor PFM performance over time; and (iv) emphasizes improving collaboration within the Bank and among donors (Box 1).

---

<sup>1</sup> Public financial management includes all phases of the budget cycle, including the preparation of the budget, internal control and audit, procurement, monitoring and reporting arrangements, and external audit. The broad objectives of public financial management are to achieve overall fiscal discipline, allocation of resources to priority needs, and efficient and effective allocation of public services. See *Harmonizing Donor Practices for Effective Aid Delivery – Good Practice Papers – A DAC Reference Document*, OECD, 2003.

**Box 1. Strengthened approach to PFM work—what this means in operational terms**

The strengthened approach to PFM work calls for:

- **a greater focus on assisting clients to implement reform programs.** Developing capacity and improving performance (rather than diagnostic/analytic work alone) would be the principal focus of the Bank’s PFM work. Country ownership and commitment, appropriate sequencing of reforms, alignment of donor-support behind the country’s program, and a multi-year perspective are emphasized.
- **a more integrated approach to PFM work within the Bank.** An integrated approach (covering all aspects of the PFM cycle) would be followed in aspects of PFM work – analytical work, dialogue, PFM operations, and PFM in development policy lending. PFM work would be carried out by country PFM teams that include staff from the financial management, procurement and PREM sectors. Similarly, the programming of PFM analytic work would adopt an integrated approach, and integrated products could increase.
- **increased collaboration with other donors.** The approach emphasizes coordinated and integrated support by donors to the country’s reform program, including joint-donor PFM teams and joint products where possible.
- **a more flexible and need-based approach to PFM analytic work programming.** Analytic work would be driven by country-specific circumstances and requirements (as contrasted with the hitherto uniform mandated core ESW).
- **measuring results.** Tools (e.g., PFM performance measurement indicators) are being developed to provide objective and consistent information on the performance of country PFM systems, including progress over time.

## II. RECENT EXPERIENCE

### A. Analytic Work

4. In the past several years, the Bank has invested heavily to obtain an unprecedented understanding of the performance of country PFM systems. The knowledge obtained has underpinned a significant increase in Bank support for country PFM reform programs. It has also informed assessments of the risks to the use of Bank funds, and measures to mitigate these risks. Over the same period, the Bank has worked closely with other development partners, for whom PFM has also become a more prominent area, and with relevant international and regional organizations.

5. **Analytic work at the project level.** In 1998, the Bank introduced a requirement to assess the financial management and procurement capacity of all implementing agencies for investment operations.<sup>2</sup> Reviews by the Quality Assurance Group (QAG)

---

<sup>2</sup> See *Assessment of Financial Management Arrangements in World Bank-financed Projects: Guidelines to Staff*, Financial Management Sector Board, October 15, 2003; Bank Procedures (BP) 11.00, *Procurement*, July 2001; and Office Memorandum *Assessment of Agency’s [Procurement] Capacity*, Procurement Policy and Services Group (OPCPR), July 15, 2002.

have shown that the quality of this work has been generally high.<sup>3</sup> For sector investment operations, such as sectorwide approaches (SWAs), the scope of these reviews has been expanded to cover the sector institutions concerned. The Bank increasingly conducts and shares these reviews with other donors.<sup>4</sup>

6. ***Analytic work at the country level.*** Public Expenditure Reviews were introduced in the early 1980s; and Country Financial Accountability Assessments (CFAAs) and Country Procurement Assessment Reviews (CPARs) formally became Bank ESW products from July 1, 2001.<sup>5</sup> CFAAs, CPARs and PERs represent three components of the “core” economic and sector work (ESW) to support Bank lending. Management committed to putting in place current (i.e., not more than 5 years old) PERs, CFAAs, and CPARs for all active Bank clients by the end of FY04.<sup>6</sup> As of June 2004, all but about 10 active Bank clients had current PERs, CFAAs and CPARs, with variations across these products and reports. The IDA-13 agreement also included targets for analytic coverage in IDA borrowers. These targets have been exceeded.<sup>7</sup> By the end of FY 2004, a total of 80 CFAAs (in 76 countries), 86 CPARs (in 78 countries), and 97 PERs (in 72 countries) had been delivered since FY00 (see Annex A for a full list)]. The quality of these products as measured by QAG improved over the period.<sup>8</sup>

7. ***The link to adjustment lending.*** These products have become underpinnings for Bank adjustment lending. The new policy statement for development policy (previously adjustment) lending requires the Bank to “review the country’s public financial management arrangements through diagnostic work, and through reports prepared by the borrower and others...”<sup>9</sup>

---

<sup>3</sup> The percentage of assessments rated satisfactory or better by QAG Quality at Entry (QAE) Reviews for FY00-01, FY02 and FY03 were: Financial Management 97%, 92% and 92%; and Procurement: 91%, 95% and 94% respectively. About 200 such assessments are carried out annually.

<sup>4</sup> Examples include the Nepal Education for All Project and the Malawi Multi-sectoral AIDS Project.

<sup>5</sup> Earlier versions of CFAAs and CPARs existed since the 1990s. PERs both analyze the size and composition of public expenditures, and assess the effectiveness of public expenditure management processes (budget formulation, implementation, and reporting) in achieving fiscal discipline, linking budget allocations to the government’s strategic policy priorities, and enabling cost-effective provision of public services. CFAAs diagnose a country’s financial management systems, assess the strengths and weaknesses of accountability arrangements, help identify risks to the use of public funds, and support the government in designing and implementing capacity-building programs. CPARs analyze a country’s public sector procurement structure, and establish the need for and guide the development of an action plan to improve a country’s system for procuring goods, works, and services.

<sup>6</sup> See *Fixing ESW: Phase II – Challenges and Next Steps in the ESW Reform Process* (SecM2001-0431), June 28, 2001.

<sup>7</sup> See *Additions to IDA Resources: Thirteenth Replenishment, Final Text* (IDA/SecM2002-0488), September 17, 2002. Deliveries vis-à-vis IDA targets were: 51 CFAAs (against a target of 40), 42 CPARs (target of 38) and 42 PERs (target of 40).

<sup>8</sup> CPARs and CFAAs were first assessed by QAG in a pilot review in FY01 at the request of the sector boards. Thirty tasks were reviewed, of which 67 percent were rated satisfactory or better (70 percent for CPARs and 60 percent for CFAAs). As part of the FY02 ESW review, the proportion rated satisfactory or better increased to 85 percent. All PERs reviewed by QAG in FY01 and FY02 were rated satisfactory or better.

<sup>9</sup> See *OP 8.60, Development Policy Lending*.

8. *Adapting to meet changing conditions.* The three core products have evolved to reflect lessons of implementation experience and to meet the needs of diverse country programs and conditions. In a number of countries, they have been combined into a single, integrated review (see Box 2). Reviews are now also undertaken at the sub-national level where the Bank plans significant (in particular, adjustment) lending at those levels. Periodic updates have been prepared in response to program needs. The information from country-level analytic reviews is beginning to be used to inform the assessments of sector institutions (for example, in the case of SWAs), although they often need to be supplemented for this purpose to address sector-specific issues. They are also one of the important factors taken into consideration in determining whether to make increasing use of country systems in investment lending.

**Box 2. Recent examples of integrated PFM analytic work**

In Uganda, a Country Integrated Fiduciary Assessment (CIFA) has been prepared involving various development partners, to provide an integrated and holistic assessment of the PFM system. This consolidates the results and recommendations of the PER, CFAA, CPAR, the tracking poverty reducing spending assessment, and the local government integrated fiduciary assessment. The CIFA led to the preparation of a Government-led integrated action plan.

In Vietnam, the Bank conducted a Public Expenditure Review and Integrated Fiduciary Assessment (PER-IFA) which includes aspects covered in the CFAA, CPAR and PER. This report has paid particular attention to strengthening the links between public spending and poverty reduction and growth goals and strengthening the institutional framework for public expenditure management, transparency and accountability, including at the sub-national and sector levels, to ensure an integrated view of public expenditure management and fiduciary risk. This also included a review of recent public financial accountability reforms. The integrated approach has facilitated policy dialogue. Recommendations of the PER-IFA were incorporated into the Bank's third PRSC to Vietnam.

9. *Need for further adaptation.* The requirement for coverage of all active Bank clients has placed a burden on the administrative budgets for small country programs, and rigidities in planning and implementation of three separate but linked products has limited their integration and overall impact. In middle-income countries (MICs), concerns have been raised about the need for more flexibility in tailoring the types and frequency of ESW instruments to reflect country circumstances; for more focused analytical products that provide practical, expert and timely advice to clients as contrasted with general, supply-driven reports; and for increasing the Bank's ability to respond effectively and in a timely manner to client requests for free-standing AAA assistance (i.e., in countries with little or no lending programs, such as in some MICs with good market access and good performance).<sup>10</sup> A recent study of donor assessment instruments identified unnecessary transaction costs for clients arising from overlaps between the three Bank products, opportunities for improved coordination within the Bank and with other donors, and the importance of greater country ownership of PFM action plans.<sup>11</sup>

<sup>10</sup> See *Enhancing World Bank Support to Middle Income Countries*, SecM2004-0071/1, April 20, 2004

<sup>11</sup> See the PEFA report *Assessing and Reforming Public Financial Management*, Allen, Schiavo-Campo, Garrity, World Bank, 2004.

10. ***Increasing country ownership.*** Borrowers are playing a more active role in PFM analytic work. In Tanzania, the annual government-led public expenditure review process is managed by a working group with representation from the government, donors, and civil society. Each year, the PER reviews the budget, and selected policy and budget management issues. The secretariat is moving to the Ministry of Finance. In Vietnam, the government is assuming greater responsibility for managing and producing the public expenditure review in support of their own budget and decision-making process. In 2004, the review includes financial accountability and procurement issues. In India, the government of Andhra Pradesh led the state financial accountability assessment, with inputs from Bank and DFID staff. In a number of large borrowers, the central government has started to carry out fiduciary-type diagnostic reviews in support of fiscal transfers to sub-national entities using criteria agreed with the Bank, and reviewed on a sample basis by Bank staff.

## **B. Lending**

11. ***Supporting country PFM reform programs.*** Bank lending to support PFM has increased sharply. [New investment lending commitments in PFM rose from US\$80 million in FY00 to US\$204 million in FY04.<sup>12</sup>] The proportion of adjustment operations whose policy content is represented at least in part by PFM has grown from 10.1 percent in FY00 to 13.3 percent in FY03. Following the decision to make public expenditure and financial accountability a focus area of the IDF program, a total of \$13.2 million was made available through 56 individual grants (68 percent of total) in FY03, a threefold increase from pre-FY02 levels.<sup>13</sup> Many of these grants were designed to support recommendations from Bank analytic work.

## **C. Institutional Collaboration**

12. ***HIPC Assessment and Action Plan.*** In addition to the core ESW products, an indicator-based PFM performance monitoring framework has been in use since 2000, when the Boards of the Bank and the Fund requested staff of both institutions to assess how poverty-reducing spending would be tracked in 24 low-income countries benefiting from the Enhanced HIPC Initiative. In response, staff developed and applied an instrument for assessing public expenditure systems. It originally consisted of 15 key indicators of PFM system operation that were deemed essential for reliable tracking of public spending, including poverty-reducing spending. In addition to the indicators, an Assessment and Action Plan (AAP) includes a brief report providing context to the indicators, an action plan to remedy identified weaknesses, and identification of gaps in donor assistance to support reform implementation. The process involves joint Bank-Fund assessment missions, and agreement between the government, the Bank and the

---

<sup>12</sup> Based on investment lending approvals attributed to the public expenditure, financial management, and procurement thematic code [as at May 23, 2004].

<sup>13</sup> See *Institutional Development Fund Performance Review*, R2003-0052, April 14, 2004.

Fund on the assessment and action plans.<sup>14</sup> A reassessment of country PFM systems using a slightly expanded indicator set (the original 15 plus a procurement indicator) is currently underway, with a report to the Boards planned for November 2004.

13. ***Bank-Fund collaboration in other areas.*** The Bank and Fund have also worked to enhance collaboration in support of a Development Committee request to scale up and intensify efforts to assist countries to mobilize domestic resources and improve the quality of public expenditure.<sup>15</sup> A recent joint paper proposed a new framework for support to countries and more effective collaboration among development partners on public expenditure work anchored in the following key principles: (a) government articulation of a public expenditure reform strategy in PRSPs or other country-owned documents; (b) an integrated and well-sequenced program of analytic work by development partners; (c) well-coordinated technical and financial support from development partners; and (d) periodic reporting by countries of performance in public expenditure policy, financial management, and procurement.<sup>16</sup> The paper identified a number of specific measures for improving consultation, information-sharing, and cross-participation in missions. Collaboration between the IMF's Fiscal Transparency ROSC and the CFAA has improved, with coordination of schedules, sharing of background data, and staff sharing. The Bank has also agreed to use the IMF's Safeguards Assessment of central banks rather than introducing a similar review in its own diagnostic product.

14. ***Working with other donors.*** PFM analytic work, in particular at the country- and sector-levels, has been at the core of the global donor harmonization initiative over the past three years through the OECD-DAC, the MDB financial management and procurement harmonization working groups, and the SPA working group on public financial management.<sup>17</sup> The Public Expenditure and Financial Accountability (PEFA) program was created by a number of donors to support integrated and harmonized approaches to assessment and reform in the field of public expenditure, procurement and financial accountability.<sup>18</sup> More than half of all CFAAs are now carried out jointly with other donors. All MDBs use the same methodology for CPARs since March 2002, and all now involve joint teams or peer reviewers from other MDBs. At the High Level Forum on harmonization in Rome in 2003, the Bank and other donors endorsed the OECD-DAC Good Practice Paper on Measuring Performance in Public Financial

---

<sup>14</sup> See *Tracking of Poverty-Reducing Public Spending in Heavily Indebted Poor Countries (HIPC)s Revision 1* (IMF SM/01/16), March 28, 2001 and (IDA\SECM2001-51/1), March 30, 2001; and *Actions to Strengthen the Tracking of Poverty-Reducing Public Spending in Heavily Indebted Poor Countries (HIPC)s Revision 2* (IDA/SECM2002-30/2), World Bank March 22, 2002, and (IMF SM/O2/30), March 28, 2002; and See *Update on Implementation of Action Plans to Strengthen Capacity of HIPC)s to Track Poverty-Reducing Spending*, March 11, 2003, SM/03/90; and World Bank, March 13, 2003, IDA/R2003-0043.

<sup>15</sup> See Development Committee Communique, April 21, 2002.

<sup>16</sup> See *Bank-Fund Collaboration on Public Expenditure Issues*, R2003-0048/1, April 11, 2003.

<sup>17</sup> See [www.aidharmonization.org](http://www.aidharmonization.org).

<sup>18</sup> See [www.pefa.org](http://www.pefa.org). PEFA is a partnership between the World Bank, the European Commission, the UK's Department for International Development, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, the International Monetary Fund and the Strategic Partnership with Africa

Management. It called on donors to “support work on the development of...a comprehensive, internationally accepted performance framework in public financial management...with partner country government and donors [collaborating] in the setting and monitoring of country-specific performance indicators. Donor collaboration should take place within a government-led strategy for improving overall management of public finances that sees performance measurement fully integrated with analytic work and capacity building efforts.”<sup>19</sup>

15. **Global partnerships.** The Bank supports the work of several international and regional organizations active in PFM. It provides financial support and staff involvement in the work of the Public Sector Committee of the International Federation of Accountants in issuing international public sector accounting standards.<sup>20</sup> It is supporting an initiative to harmonize international public sector accounting standards with the IMF’s Government Financial Statistics, as well as private and public sector auditing standards on financial reporting. It is presently preparing a strategy on how the Bank can better support public sector auditing, in consultation with the International Organization of Supreme Audit Institutions and its member bodies.<sup>21</sup> The Bank has worked with the OECD to prepare a Budget Database that provides PFM system information for 44 OECD and developing countries.<sup>22</sup> It has also collaborated with the OECD Senior Budget Officials group in sharing lessons of reform.

#### **D. Overall Assessment**

16. Overall, the Bank has made substantial progress in advancing the PFM agenda. It has acquired an unprecedented understanding of country institutional performance in managing public finances. This knowledge has underpinned increased levels of lending to support PFM reforms. It has provided a better understanding of the risks to which Bank funds are exposed, and helped identify measures to mitigate these risks. Earlier problems with quality of analytic work have largely been addressed. There are signs of increased country engagement in PFM reform programs, and of improvements in collaboration with other donors. At the same time, there are several areas in which there is scope for improvements. These include (a) a clearer articulation of the relationship between development and fiduciary objectives; (b) more flexibility to adapt analytic work to country conditions and the scope and nature of the Bank’s program; (c) stronger incentives for collaboration and integration within the Bank, as well as with the Fund and other donors; (d) a framework for measuring results in terms of institutional performance; and (e) better integration of project- and country-level analytic work.

---

<sup>19</sup> See *Harmonising Donor Practices for Effective Aid Delivery*, DAC Guidelines and Reference Series, 2003, page 52.

<sup>20</sup> See <http://www.ifac.org/PublicSector/>.

<sup>21</sup> See <http://www.intosai.org/>.

<sup>22</sup> See <http://ocde.dyndns.org/>.

### III. TOWARD A STRENGTHENED APPROACH

17. The strengthened approach to PFM builds on the strong investment made in recent years, and provides for: (a) enhancing the support the Bank provides to implementation of country-led PFM reform programs, and harmonization with other donors; (b) introducing a framework for measuring results; and (c) adapting the Bank’s analytic work to adequately support country-led reforms programs and to better align it with the size and nature of the Bank’s planned lending program in different countries.

18. ***Stronger links between the development and fiduciary objectives of PFM work.*** As noted above, the Bank’s PFM work has two main objectives: improving country PFM performance, and ensuring appropriate fiduciary arrangements to the financial support the Bank provides. These two objectives are closely linked—the best fiduciary assurance on the use of the Bank’s financial support is well performing country PFM institutions. An increasing proportion of funds provided by the Bank are managed by country PFM systems—in addition to adjustment lending and debt relief, more investment lending is channeled through country budgets, consistent with the policy advice of the Bank and the Fund. Making country systems the primary focus of Bank PFM work both creates a community of interest between governments, the Bank and other donors on the performance of these systems, and allows for the assessment of risks posed by these systems to inform additional measures required to provide the Bank with the fiduciary assurance it needs.<sup>23</sup> As more investment loan funds flow through country systems, investment lending fiduciary work also becomes a contributor to improved institutional performance.<sup>24</sup> Country systems become the focal point of donor harmonization efforts.

19. ***Improving country PFM performance.*** The primary focus of the Bank’s PFM work will be to assist countries to develop their PFM capacity and improve performance. The Bank would support country-owned and led reform strategies, coordinating its support with that of other donors. The Bank’s PFM work program would include analytic work, policy dialogue, technical assistance and training, and funding. Country reform strategies would be informed by appropriately scoped and sequenced analytic work, including that carried out by the Bank. Bank support for reform programs would also draw on the full range of instruments—investment lending (stand-alone PFM-improvement projects or other investment projects with PFM-improvement components), adjustment lending, IDF and other grants, and WBI-led training. Recent efforts to simplify, modernize and harmonize operational policy have enhanced the potential for investment lending to contribute to better PFM in client countries.<sup>25</sup>

---

<sup>23</sup> Through financial management and procurement assessments of implementation arrangements in individual investment operations.

<sup>24</sup> Through increased focus on these systems in the Bank’s fiduciary assessments, and Bank support for associated capacity building through the investment lending operation.

<sup>25</sup> Examples include a fiduciary framework for SWAps, revisions to the Bank’s audit policy, the new policy governing expenditure eligibility, and commitments made on harmonization in the areas of financial management and procurement.

20. **Measuring results.** There is a need for objective and consistent information on the performance of country PFM systems, including progress over time. This would provide feedback on the results of the reform program to the government and other stakeholders.<sup>26</sup> In countries with relatively strong PFM capacity, many of whom are middle income countries, reasonably robust systems for measuring and monitoring results may already exist. In other countries, such systems may need to be progressively put in place. To facilitate this, the Bank and other donors have jointly developed an integrated PFM performance monitoring framework, that covers all aspects of the budget cycle including budget formulation and execution, procurement, accounting, auditing and internal and external controls. The framework includes a common set of indicators, and an accompanying analytic report. This PFM performance report would describe the country context and environment for reform, elaborate more fully on performance as measured by the indicators, comment on progress with the implementation of the reform program, and judge its likely impact.<sup>27</sup> It would be informed as far as possible by available analytic work on the country's PFM systems. A listing of the indicators is provided in Annex B. These high-level indicators could be supplemented as needed by detailed indicators on specific aspects of the PFM system (see Box 5 in Annex B for illustration of detailed indicators for procurement). The indicators and the report would be modified and adapted as needed based on field testing and implementation experience. To recognize diverse country conditions, some customization may be appropriate (including for sub-national levels, where required), although it is important that the indicators remain constant over time to allow progress to be monitored.

21. **Fiduciary work.** The Bank's fiduciary policies would remain unchanged. The Bank would continue to require that the fiduciary capacity of the institutions to which the Bank plans to transfers resources be reviewed, documented, and disclosed to Executive Directors; and that actions needed to address identified weakness be agreed with the government, with additional risk mitigation measures as appropriate. Consistent with current practice, each lending operation would be continue to be underpinned by an assessment of the institutional environment into which the Bank proposes to transfer resources (as appropriate, at the national, sub-national, sector or individual entity level). This would inform assessments of the risks to which Bank funds are exposed, and judgments on the measures needed to mitigate these risks (see Box 3). Sources of information may be analytic work carried out by the Bank, other donors, or the borrower, and reports such as the annual audit reports of the government and central bank.

---

<sup>26</sup> Such information could also provide donor with information for their fiduciary requirements in countries with high levels of lending and adjustment lending.

<sup>27</sup> Country-specific issues e.g., extractive industries, or aspects of the PFM system requiring special attention could also be covered

### **Box 3. Fiduciary work in Bank lending**

In investment lending, financial management and procurement assessments of the institutions implementing Bank projects will continue to be carried out (at the entity or sector level depending on the type of operation). This work may be done by Bank staff, or, increasingly, jointly with other donors. Project reviews will be informed by country-level analytic work, as appropriate. The Bank will encourage countries to undertake self-assessment in these areas, or for assessments to be carried out by credible oversight institutions of the country; where they do so, the Bank reviews such assessments to determine their acceptability and whether they form a reliable basis for the planned operation, with disclosure to Executive Directors in the project documentation. In adjustment lending, the focus will be on overall PFM systems at the national (or, as appropriate, sub-national) levels. The Bank's review of these systems will inform decisions on the amounts of development policy lending, tranching, program content, conditionality, and where appropriate, risk mitigation measures (see OP 8.60, *Development Policy Lending*, paragraph 19). Linkages between the analytic work for both investment and adjustment lending will be enhanced. The project- and sector-based analytic work in investment lending (i.e., project financial management and procurement assessments) often provides insights on national PFM arrangements; reviews of country systems provides valuable information on the overall PFM environment within which investment projects are implemented.

22. ***Approach to PFM analytic work.*** The approach to PFM analytic work would shift from the current uniform mandated core ESW to one that provides flexibility to adapt to country-specific circumstances. PFM analytic work would be programmed on a country-by-country basis, depending on the type and level of Bank engagement, client priorities and circumstances, and the availability of relevant knowledge from partners and the country. The Bank would carry out analytic work to support the design and implementation of government-owned reform strategies, as needed. This may involve, as appropriate, focused reports/notes on specific topics of interest to the government, e.g., on the level and composition of public expenditures, efficiency and equity of public expenditures, budget formulation and execution, procurement, accounting and reporting, and internal and external controls. The Bank's analytic work for fiduciary purposes would be based on the size and nature of the Bank's lending program, and would focus on the institutional environment into which Bank resources are proposed to be transferred as noted above. The assessments for fiduciary purposes would take into account the analytic work to support the country's PFM reforms, with additional reviews by donors to fill any gaps.

23. ***Programming of PFM analytic work.*** The PFM analytic work program would be determined at the country-level, summarized in the CAS, and regularly updated during the annual country business planning exercises.<sup>28</sup> The responsibility for formulating the

---

<sup>28</sup> See *Improving the Bank's Analytic and Advisory Services: Progress Report* (OM2004-0047/1), August 12, 2004, and *Programming of Diagnostic ESW*, E-mail of James W. Adams, Vice President and Head of Network, Operations Policy and Country Services, August 8, 2004. The proposed diagnostic ESW program is expected to ensure the availability of sufficient country knowledge on macroeconomic, structural, and public sector management and institutions to support key internal processes such as the preparation of the CAS and CPIA ratings. The role of country- or sector-wide fiduciary analyses to underpin development policy lending and SWAs should be also maintained and further strengthened. However, if Bank lending to a country is limited to a few investment projects, fiduciary diagnostic

PFM analytic work program, and ensuring that adequate resources are allocated for each task, rests with the Country Director, following consultation with the relevant sector/thematic specialists. The proposed PFM analytic program would be endorsed by the Operations/Quality Director in each Region. It would be designed following consultation, as appropriate, with the government and other donors active in PFM, and would take into account their planned and available analytic work and reports. Analytic work undertaken by the Bank could be current Bank ESW products (CFAA, CPAR, PER) or an appropriate combination of these and other products designed to meet country circumstances. In countries in which the Bank's lending program requires an integrative view of PFM, such as those on which adjustment lending is planned, the PFM performance report described above could be used.<sup>29</sup> Annex C provides illustrative examples of how analytic work might be planned under such an arrangement. The trend towards integrated products is expected to continue. The use of the PFM performance report as the integrated analytical report on the PFM system and "just-in-time" policy notes on specific aspects of the PFM system to support country reforms could grow over time.

24. ***HIPC-AAP work.*** The HIPC-AAP exercise is proposed to be integrated into this strengthened approach, after consultation and agreement with the Fund. The PFM performance monitoring framework (indicators and report) would replace the current HIPC-AAP indicators and report. The PFM performance indicators and report would be applied in the 28 countries currently covered under the HIPC-AAP exercise. Transition arrangements would be developed to ensure continuity and to ensure that the substantive features of the HIPC-AAP work including Bank-Fund collaborative arrangements are integrated into the strengthened approach.

25. ***Policy implications.*** This approach to PFM work does not require changes to Bank operational policies. The approach is consistent with the OP 8.60, *Development Policy Lending*. It is also consistent with the Bank's policies on financial management and procurement in investment lending. It is supportive of the Bank's ongoing program to modernize and simplify its operational policies, and to harmonize them with other donors, including the move towards the greater use of country systems where capacity permits, and making greater use of country-level analytical work to support individual investment project analysis.

26. ***Implementation responsibilities.*** This approach would establish an enabling framework for the Bank's PFM work, providing country teams with the flexibility to adapt work programs to country circumstances and requirements. Regions and country teams would implement the new approach, including working with clients and partners to

---

work may be handled in the context of project preparation, with findings clearly spelled out in the loan documentation presented to the Board.

<sup>29</sup> The Bank would look in the first instance to information on PFM institutional performance available in the country itself. In countries in which PFM capacity is stronger, such as many MICs, this information is more likely to be readily available. In countries with weak PFM capacity that are in receipt of budget support and debt relief, staff from the Bank and other donors could prepare a PFM performance report. Where countries choose to self-assess using the proposed indicator framework, the Bank, and other donors as appropriate, would review and form a judgment on the assessment.

develop and implement PFM work programs. Network anchors (financial management, PREM and procurement) would support implementation including on providing guidance, promoting learning and knowledge-sharing, quality assurance, and coordination with partners. To facilitate implementation, staff would be provided with guidance and tools on the strengthened approach. This would include aspects such as development and implementation of country PFM improvement programs, measuring results, and PFM work programming.

**Annex A –Coverage of CFAAs, CPARs and PERs for Countries Eligible for IBRD/IDA funds as of July 1, 2004<sup>30</sup>**

Region/Country	FY of Delivery		
	PER	CPAR	CFAA
<b>AFR Region</b>			
Angola	FY04	FY03	FY04
Benin	FY04		FY02
Botswana			
Burkina Faso	FY04	FY01	FY02
Burundi		FY04	FY04
Cameroon	FY02	FY01	FY03
Cape Verde	FY04	FY04	FY03
Central African Republic			
Chad	FY03/04	FY01	FY04
Comores			
Congo, Democratic Rep. Of	FY04	FY04	
Congo, Republic of			
Côte d'Ivoire	FY04	FY04	
Equatorial Guinea			
Eritrea		FY03	
Ethiopia	FY00/02/04	FY03	FY03
Gabon			
Gambia, The	FY04		FY03
Ghana	FY04	FY03	FY01/04
Guinea	FY04	FY02	FY03
Guinea Bissau	FY04		
Kenya			FY02
Lesotho			
Liberia			
Madagascar		FY03	FY03
Malawi	FY01	FY04	FY02
Mali		FY04	FY03
Mauritania	FY04	FY02	FY03
Mauritius	FY03	FY03	
Mozambique	FY02/03	FY02	FY02
Namibia			
Níger	FY00/04	FY04	FY04
Nigeria	FY01	FY00/04	FY01/04
Rwanda	FY03	FY04	equivalent
Sao Tome and Principe			
Senegal		FY03	FY03

<sup>30</sup> Of the population of eligible borrowers, core ESW coverage was tracked and reported only for active Bank clients. Shaded countries indicate inactive borrowers. Active Bank clients are those for which a full set of core diagnostic ESW is essential to carrying out the Bank's operations in the country, taking into account individual country circumstances. For example, countries engaged in civil war/conflict, or emerging from conflict, are usually classified as "inactive" due either to a lack of readily available data, or client capacity constraints.

Region/Country	FY of Delivery		
	PER	CPAR	CFAA
Sierra Leone	FY04	FY04	FY02
South Africa		FY02	
Sudan			
Swaziland			
Tanzania	FY00/01/02/03/04	FY03	FY01
Togo		FY04	
Uganda	FY00/02/03/04	FY01/04	FY01/04
Zambia	FY02/03	FY03	FY03
Zimbabwe			
<b>AFR Sub-Total 31 (of which IDA 31)</b>	<b>40 reports in 27 countries (of which 40 /27 IDA)</b>	<b>27 reports in 25 countries (of which 27/25 IDA)</b>	<b>27 reports in 24 countries (of which 27/24 IDA)</b>
<b>EAP Region</b>			
Cambodia	FY03	FY03	FY03
China	FY02	FY03	
Fiji			
Indonesia	FY00/03	FY01	FY01
Kiribati			
Korea, Rep of			
Lao PDR	FY02	FY02	FY02
Malaysia	FY00		
Mongolia	FY02	FY03	FY03
Papua New Guinea	FY03		FY04
Philippines	FY02	FY02	FY02
Thailand			
Timor Leste	FY04	FY03	FY02
Tonga		FY03	
Vietnam	FY00	FY02	FY02
<b>EAP Sub-Total(7 active countries of which 5 IDA)</b>	<b>8 reports in 7 countries (of which of which 6/5 IDA)</b>	<b>7 reports in 7 countries (of which 5/5 IDA)</b>	<b>6 reports in 6 countries (of which 5/5 IDA)</b>
<b>ECA Region</b>			
Albania	FY01	FY01	FY02
Armenia	FY02	FY03	FY04
Azerbaijan	FY03	FY02	FY03
Belarus	FY03		
Bosnia and Herzegovina	FY02	FY02	FY03
Bulgaria	FY00	FY00/04	FY03
Croatia	FY01	FY00/04	FY04
Czech Republic	FY01		
Estonia			
Georgia	FY02	FY01	FY03
Hungary			
Kazakhstan	FY00	FY00	FY02

Region/Country	FY of Delivery		
	PER	CPAR	CFAA
Kyrgyz Republic	FY03	FY03	FY03
Latvia	FY01	FY01	
Lithuania			
Macedonia, FYR	FY00	FY02	FY04
Moldova	FY02	FY03	FY03
Poland	FY03	FY01	FY04
Romania	FY00	FY02	FY03
Russian Federation	FY00/01/04	FY01	FY02
Serbia and Montenegro	FY03	FY02	FY02
Slovak Republic	FY02	FY01	FY00
Tajikistan	FY04	FY03	FY03
Turkey	FY01	FY01	FY02
Turkmenistan			
Ukraine	FY02	FY01	FY02
Uzbekistan	FY04	FY02	FY04
<b>ECA Sub-Total(20 active countries of which 9 IDA)</b>	<b>23 reports in 20 countries (of which 9/9 IDA)</b>	<b>22 reports in 20 countries (of which 9/9 IDA)</b>	<b>20 reports in 20 countries (of which 9/9 IDA)</b>
<b>LCR Region</b>			
Argentina	FY03	FY02	FY02
Belize			
Bolivia	FY04	FY01	FY04
Brazil	FY00/02	FY03/04	FY02
Colombia	FY04	FY01	FY04
Costa Rica			
Dominica	FY04	FY03	FY03
Dominican Republic	FY03	FY04	FY04
Ecuador	FY04	FY00	FY04
El Salvador	FY04	FY04	FY04
Guatemala	FY00	FY00	FY02
Guyana	FY00/03		FY02
Haiti			
Honduras	FY01	FY04	FY03
Jamaica	FY04	FY01	FY01
Mexico	FY01/02/04	FY02/04	FY03
Nicaragua	FY02	FY03	FY03
Panama		FY01	
Paraguay		FY03	FY04
Peru	FY02	FY00/02	FY02
Trinidad and Tobago			
Uruguay	FY00	FY00	FY04
Venezuela			
<b>LCR Sub-Total: (15 active countries of which 3 IDA)</b>	<b>17 reports in 14 countries (of which 3/3 IDA)</b>	<b>18 reports in 15 countries (of which 3/3 IDA)</b>	<b>15 reports in 15 countries (of which 3/3 IDA)</b>
<b>MNA Region</b>			
Algeria		FY03	

Region/Country	FY of Delivery		
	PER	CPAR	CFAA
Djibouti		FY04	FY04
Egypt		FY04	FY04
Iran	FY03/04		
Iraq			
Jordan	FY00/04		FY01
Lebanon			
Morocco	FY00/02	FY00	FY03
Tunisia		FY04	FY04
Syrian Arab Republic			
Yemen	FY00/04	FY01	FY04
<b>MNA Sub-Total (9 active countries of which 2 IDA)</b>	<b>9 reports in 5 countries (of which 3/2 IDA)</b>	<b>5 reports in 5 countries (of which 2/2 IDA)</b>	<b>6 reports in 6 countries (of which 2/2 IDA)</b>
<b>SAR Region</b>			
Afghanistan			
Bangladesh	FY02	FY00	FY01
Bhutan			FY02
India (sub-national level)			FY03
Maldives	FY02		FY01
Nepal	FY00	FY01	FY02
Pakistan	FY01/03	FY00	FY01/03
Sri Lanka		FY03	FY03
<b>SAR Sub-Total(5 active countries of which 5 IDA)</b>	<b>4 reports in 3 countries (of which 4/3 IDA)</b>	<b>4 reports in 4 countries (of which 4/4 IDA)</b>	<b>6 reports in 5 countries (of which 6/5 IDA)</b>
<b>Grand Total (86 active countries, of which 55 IDA)</b>	<b>72 active countries covered, of which 45 IDA)</b>	<b>78 active countries covered, of which 49 IDA)</b>	<b>76 active countries covered, of which 48 IDA)</b>

## Annex B – PFM Performance Indicators

1. The PFM performance measurement framework includes a set of indicators, and an accompanying analytic report (the PFM performance report). It is intended to provide objective and consistent information on the performance of country PFM systems, including progress over time. This integrated framework covers all aspects of the budget cycle including budget formulation and execution, procurement, accounting, auditing and internal and external controls. The indicators, the measurement scale, and the PFM performance report would be modified and adapted as needed based on field testing and implementation experience. To recognize diverse country conditions, some customization of the indicators and the report may be appropriate (including for sub-national level, where required), although it is important that the indicators remain constant over time to allow progress to be monitored.

2. **Preliminary draft set of PFM indicators.** The proposed set of indicators focuses on the operational performance of the systems, processes and institutions of PFM. Each indicator would be measured using an appropriate scale (based on country circumstances and needs). Examples include: (i) a four point ordinal scale A-D (with possibility of intermediate scales e.g., B+), (ii) narrative scale (e.g., highly satisfactory, satisfactory, marginally satisfactory, unsatisfactory), or (iii) narrative without a scale. The indicators seek to assess performance against a set of critical objectives, as follows:

- (a) **Budget realism.** The budget is realistic and implemented as intended in a predictable manner.
- (b) **Comprehensive, policy-based budget.** The budget captures relevant fiscal transactions, and is prepared with due regard to government policy.
- (c) **Fiscal management.** Aggregate fiscal position and risk are monitored and managed.
- (d) **Information.** Adequate fiscal, revenue, expenditure, procurement, and accounting records and information are produced, maintained and disseminated to meet decision-making, control, management and reporting purposes.
- (e) **Control.** Arrangements are in place for the exercise of control and stewardship in the use of public funds, including on procurement.
- (f) **Accountability and transparency.** Arrangements for external transparency and scrutiny of public finances (including procurement) are operating.

3. The proposed indicators draw upon the 16 HIPC expenditure tracking benchmarks. The preliminary set of indicators is summarized below (Box 3).

**Box 3 : PFM performance indicators**

<b>A. PFM OUT-TURNS</b>
<ol style="list-style-type: none"> <li>1. Aggregate fiscal deficit compared to the original approved budget.</li> <li>2. Composition of budget expenditure out-turn compared to the original approved budget.</li> <li>3. Aggregate revenue out-turn compared to the original approved budget.</li> <li>4. Stock of expenditure arrears; accumulation of new arrears over past year.</li> </ol>
<b>B. KEY CROSS-CUTTING FEATURES : COMPREHENSIVENESS AND TRANSPARENCY</b>
<ol style="list-style-type: none"> <li>5. Comprehensiveness of aggregate fiscal risk oversight.</li> <li>6. Extent to which budget reports include all significant expenditures on central government activities, including those funded by donors.</li> <li>7. Adequacy of information on fiscal projections, budget and out-turn provided in budget documentation.</li> <li>8. Administrative, economic, functional and programmatic classification of the budget.</li> <li>9. Identification of poverty related expenditure in the budget.</li> <li>10. Publication and public accessibility of key fiscal information, procurement information and audit reports.</li> </ol>
<b>C. BUDGET CYCLE</b>
<b>Medium term planning and budget formulation</b>
<ol style="list-style-type: none"> <li>11. Extent of multi-year perspective in fiscal planning, expenditure policy-making and budgeting, including procurement.</li> <li>12. Orderliness and participation in the budget formulation process.</li> <li>13. Coordination of the budgeting of recurrent and investment expenditures.</li> <li>14. Legislative scrutiny of the annual budget law.</li> </ol>
<b>Budget execution including procurement</b>
<ol style="list-style-type: none"> <li>15. Effectiveness of cash flow and procurement planning, management and monitoring.</li> <li>16. Procedures in operation for the management and recording of debt and guarantees.</li> <li>17. Extent to which spending ministries and agencies are able to plan and commit expenditures in accordance with original/revised budgets.</li> <li>18. Evidence available that budgeted resources reach spending units in a timely and transparent manner.</li> <li>19. Effectiveness of internal controls, including on procurement.</li> <li>20. Effectiveness of internal audit, including on procurement.</li> <li>21. Effectiveness of payroll controls.</li> <li>22. The existence of a transparent procurement system as an integral part of the overall PFM system which is supported by a clear regulatory framework that provides for competition, value for money and effective controls.</li> </ol>
<b>Accounting and reporting</b>
<ol style="list-style-type: none"> <li>23. Timeliness and regularity of data reconciliation.</li> <li>24. Timeliness, quality and dissemination of in-year budget execution reports.</li> <li>25. Timeliness and quality of the audited financial statements submitted to the legislature.</li> </ol>
<b>External accountability, audit and scrutiny</b>
<ol style="list-style-type: none"> <li>26. The scope and nature of external audit.</li> <li>27. Follow up of audit reports by the executive or audited entity.</li> <li>28. Legislative scrutiny of external audit reports.</li> </ol>

4. In addition to indicators of country PFM performance, this framework also includes two indicators of donor practices which impact country PFM systems. Through these indicators (Box 4), donor performance and the extent of the negative impact of donor practices, are also measured.

**Box 4. Indicators of donor practices**

<ol style="list-style-type: none"> <li>1. Completeness of donor information provided on aid flows, and comparison of actual donor flows with donor forecasts.</li> </ol>
<ol style="list-style-type: none"> <li>2. Proportion of aid that is managed using national procedures.</li> </ol>

5. These high-level indicators could be supplemented as needed by detailed indicators on specific aspects of the PFM system (Box 5).

**Box 5. Illustration of detailed indicators for procurement**

These detailed procurement indicators provide a tool to be used to assess the elements of a procurement system against a defined set of standards. The indicators include the following:

**Pillar I. Legislative and Regulatory Framework**

1. Procurement legislative and regulatory framework complies with applicable obligations deriving from national and international requirements.
2. Availability of implementing regulations, documentation and tools to support implementation.

**Pillar II. Central Institutional Framework and Management Capacity**

3. Degree of mainstreaming and integration into public financial management system
4. Existence of a functional management/regulatory body
5. Existence of institutional development capacity

**Pillar III. Procurement Operations and Market Performance**

6. Efficiency of procurement operations and practices
7. Functionality of the public procurement market
8. Existence of contract administration and dispute resolution provisions

**Pillar IV. Integrity of the Public Procurement System**

9. Existence of effective control and audit systems
10. Existence and efficiency of the appeals mechanism
11. Degree of access to information
12. Existence of ethics and anti-corruption measures

### **Annex C - Illustrative Examples of PFM Analytic Work**

**Country A** is a small country (population 2 million) and an IDA borrower. Over the next three years, the Bank plans four investment operations in three sectors for an aggregate amount of \$40 million. No adjustment lending is planned. The fourth investment operation is planned to be co-financed with the regional MDB, for whom the project is a follow-on operation, and a bilateral donor.

*Planned analytic work:* For three of the four investment operations, the Bank will prepare financial management and procurement assessments of implementing agencies during project preparation. For the fourth, the Bank has agreed that the financial management and procurement assessments be carried out by the MDB, with review by Bank staff. The Bank plans a PER in FY06 to support its macroeconomic engagement. It does not intend to conduct a CFAA or CPAR.

**Country B** is a large middle income borrower (population 60 million people, per capita annual income of \$2,600). The Bank is presently preparing a four year CAS, for which the base case is \$2 billion of IBRD lending over the period, of which 30 percent is expected to be provided in two adjustment operations. A further 20 percent will be provided through 2 investment lending SWAs in the social sectors at the sub-national level. The government has asked the Bank to maximize the use of country systems during the CAS period. The regional MDB has a lending program that approximates that of the Bank in size, and there are several bilateral donors active in the country. One of the objectives of the CAS is to improve public financial management performance, for which the government has developed an ambitious reform program, informed in part by Bank fiduciary ESW carried out 2 years ago, and which is intended to be supported by the adjustment program.

*Planned analytic work:* The Bank, the regional MDB, and a large bilateral will prepare an integrated Public Expenditure Management and Financial Accountability Review this FY, in advance of the first planned adjustment operation next FY. The review will focus on the central government, with Bank staff taking the lead in upstream budget management issues and procurement, and staff from the MDB and bilateral on the budget execution element. The government is developing a series of indicators, informed by the common set prepared by the Bank and other donors, by which institutional performance can be measured over time, and will propose base-line measures of performance for discussion. A large proportion of funding for the sub-national SWAs will come from the central government. The government has indicated to the Bank and other donors that it wishes to increase the accountability over the use of all fiscal transfers it makes to sub-national levels. As a starting point, it has agreed with the donors that it will carry out the fiduciary assessments of the entities that will receive donor funds using an approach agreed in advance with donors, with targeted donor involvement in the first few assessments, and with donor ex-post review of later assessments. Of the planned 8 investment operations, the Bank expects that two of these will be implemented through central government

*ministries that will have been reviewed during the PEMFAR, and proposes to use this review for these operations. For the remaining six, it will carry out financial management and procurement assessments of implementing agencies as it has been doing for some years.*

**Country C** is an IDA borrower, with a population of 20 million people. Five years ago, it emerged from a prolonged period of stagnation, from when it has enjoyed growth rates of 6% annually. Poverty remains high, but is falling. The country is receiving strong donor support (more than 20 are active in the country), who provide more than 40 percent of the annual budget. It reached the HIPC completion point six months ago. Capacity, including in public financial management is weak, and there are persistent reports of corruption. IDA lending of \$800 million is planned over the next 4 years, of which 50 percent will be through annual PRSCs.

*Planned analytic work: Annual PERs are carried out to support the macroeconomic dialogue between the government, the Bank and other donors. As economic management capacity in the finance ministry improves, the government, with donor support, plans to take over leadership of the PER process. A large bilateral donor is supporting the implementation of a new treasury system and a program to strengthen the supreme audit institution. As part of preparation of this project, it carried out extensive analytic work of these functions, which it shared with the Bank. The Bank carried out a joint review of country procurement and financial management (excluding those areas reviewed by the bilateral) performance last year, in a process that had extensive involvement from other donors. The Bank and the Fund will jointly, and on behalf of all donors providing budget support, prepare a PFM performance report every two years, supported by a complete set of PFM indicators. This report will also provide the information needed by the providers of debt relief.*