

## Appendix H: Management Response

**COUNTRY FINANCIAL ACCOUNTABILITY ASSESSMENTS AND  
COUNTRY PROCUREMENT ASSESSMENT REVIEWS:  
HOW EFFECTIVE ARE WORLD BANK FIDUCIARY DIAGNOSTICS?**

**MANAGEMENT RESPONSE**

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## ABBREVIATIONS AND ACRONYMS

CAS	Country Assistance Strategy
CFAA	Country Financial Accountability Assessment
CPAR	Country Procurement Assessment Report
DPO	Development policy operation
GAC	Governance and anticorruption
FM	Financial management
IEG	Independent Evaluation Group
PEFA	Public Expenditure and Financial Accountability
PFM	Public financial management
PR	Procurement
QAG	Quality Assurance Group
SWAp	Sectorwide approach

## COUNTRY FINANCIAL ACCOUNTABILITY ASSESSMENTS AND COUNTRY PROCUREMENT ASSESSMENT REVIEWS: HOW EFFECTIVE ARE WORLD BANK FIDUCIARY DIAGNOSTICS?

### MANAGEMENT RESPONSE

1. Management welcomes this Independent Evaluation Group (IEG) evaluation of Country Financial Accountability Assessments (CFAAs) and Country Procurement Assessment Reports (CPARs) that were undertaken between July 1999 and December 2004.

#### **A. Support for the Broad Thrust of the Analysis and Recommendations**

2. Management supports the broad thrust of many of the observations and recommendations contained in IEG's evaluation. Management notes the evaluation's conclusions that these specialized assessments have contributed positively to partner countries and thereby to the Bank's development objectives. Management notes that in addition to generating a significant knowledge base on public financial management (PFM) issues, the CFAA and CPAR instruments have helped initiate dialogue on PFM issues, generate country ownership, and catalyze reforms in many countries.

3. *Reinforcement of Broad Direction of Planned Actions.* Several findings of the evaluation confirm Management is thinking on strengthening the Bank's PFM work. Management agrees on the need for (a) increased attention to prioritizing and sequencing PFM reforms; (b) continued emphasis on disseminating PFM analytic work findings; (c) provision of more empirical data and sharper analysis in some PFM analytic work; (d) better linkages with corruption issues in all PFM work; (e) continued emphasis on supporting partner countries' PFM reform programs in an integrated and harmonized manner; (f) more staff guidance on internal processes and mechanisms for coordination on PFM issues among Bank sectors; (g) continued staff training on PFM issues, building on the substantial past and ongoing efforts, and (h) work with partners to increase the timely public availability of CFAAs and CPARs. However, two important developments since 2005 are worth noting: CFAAs and CPARs are no longer mandatory and the rollout of the Public Expenditure and Financial Accountability (PEFA) framework. The PEFA assessments inherently require joint efforts, thus ensuring better coordination on PFM work.

4. *Work Already Undertaken.* Management is already acting on many of the recommendations of the evaluation. Drawing from lessons of implementation experience, in July 2005 Management issued a memorandum to staff to strengthen the Bank's PFM work. The memorandum emphasized (a) country ownership of PFM reforms; (b) prioritizing and sequencing of PFM reforms; (c) better measurement and

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monitoring of PFM performance and progress, using the PFM Performance Measurement Framework developed by the PEFA partnership program; (d) coordinated work by the three Bank operational teams (Financial Management, Procurement, and the Public Sector Governance Unit in Poverty Reduction and Economic Management); and (e) coordination with other development partners.<sup>1</sup> These measures are being implemented, and Management will continue to emphasize these aspects.

### B. Areas of Divergence

5. In spite of the usefulness of IEG's review, Management has observations and comments on some of the analysis and recommendations.

6. ***Relevance of the Instruments for the Bank's Fiduciary Objectives.*** Management does not agree with the IEG review's conclusions that CFAAs and CPARs are less relevant for the Bank's fiduciary objectives than for its development objectives, and that they have made only a limited contribution to the design and arrangements of Bank assistance. These assessments have been among the main sources of country-level PFM knowledge, including information on procurement (which is not covered under any other type of assessment). This knowledge has proved invaluable for the Bank's fiduciary work in development policy operations (DPOs) and investment lending.

7. ***Development Policy Operations.*** The IEG review gives little coverage to the important contribution of CFAAs and CPARs to the Bank's fiduciary work on DPOs:

- a) All DPOs are underpinned by an understanding of the country's PFM system, and CFAAs and CPARs have been central contributors to this knowledge base: more than 85 percent of DPOs approved from September 2004 to March 2006 drew on PFM knowledge from CFAAs, and 100 percent of knowledge of country procurement systems came from CPARs.<sup>2</sup> Moreover, CFAAs and CPARs have provided the platform to initiate PFM (including procurement) dialogue with partner countries, build government commitment, and catalyze reforms supported under DPOs. This is corroborated by the Quality Assurance Group's (QAG's) Quality at Entry assessment for FY04-05, which looked at whether DPOs had adequately drawn on PFM analytic work and whether this had resulted in appropriate PFM conditions and triggers, and assessed all of the projects reviewed as satisfactory or highly satisfactory in these regards.<sup>3</sup>
- b) IEG's evaluation notes that the Bank provided budget support to countries regardless of whether the fiduciary risks were assessed to be high or low, and on this basis concludes that CFAAs and CPARs were not a primary driver of the Bank's choice of

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<sup>1</sup> See *Strengthening the Bank's PFM work*, July 25, 2005, Memorandum issued by the Vice Presidents of the PREM and OPCS Networks.

<sup>2</sup> See *Development Policy Lending Retrospective* (SecM2006-0319), July 13, 2006.

<sup>3</sup> See *Quality at Entry in FY04-05 (QAE7)* (CODE2006-0011), February 10, 2006.

instruments—specifically, investment support versus DPOs—in Country Assistance Strategies (CASs). Management does not agree with this conclusion, and notes that the basis IEG used to arrive at this conclusion is at variance with the Bank’s policy for DPOs.<sup>4,5</sup> The Bank has not set any specific PFM performance standard as a precondition for DPOs. Instead, it looks at the relevance of DPO support relative to the country objectives the Bank is supporting. If a DPO is the best option, the Bank works with the authorities to design the DPO to take into account country conditions. DPOs may be extended to countries with weak PFM systems, provided there is credible government commitment to reform and evidence of improvement over time. The Bank’s PFM analysis informs decisions on DPO amounts, tranching, program content, conditionality, and risk mitigation. The DPO retrospective, discussed recently by Executive Directors, concluded that this approach is generally working well.<sup>6</sup> Drawing on lessons of experience, Management is taking steps to further improve implementation by better assessment of the strength of the supported program, and tracking of progress over time.

8. **Investment Lending.** Management does not agree with the IEG evaluation’s findings that CFAAs and CPARs have had little influence at the project level:

- a) CFAAs and CPARs are intended to provide the country context for financial management (FM) and procurement (PR) assessments that are mandatory for all projects. The extent to which these instruments are relevant to the design of investment project fiduciary arrangements per se depends on the nature of the operation. They are strongly relevant for the design and improvement of fiduciary arrangements in projects that operate through country FM and PR systems, for example, most sectorwide approaches (SWAs). CFAAs are not appropriate instruments to support improving FM arrangements of Bank-financed projects and programs administered through ring-fenced FM systems separate from the country PFM system, since the nature of such project arrangements often varies widely across different institutions and sectors. Management does not agree, however, that this reduces the relevance of the CFAA to the Bank’s fiduciary objectives. To the contrary, country PFM knowledge, drawn largely from CFAAs and CPARs, has provided the country context for project FM and PR assessments, which factor in country-level risk; analysis of country-level

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<sup>4</sup> See OP 8.60, *Development Policy Lending*, and “Good Practice Note: Financial Management Issues in Development Policy Operations,” OPCS.

<sup>5</sup> IEG observes that the methodology used in this evaluation can be viewed as consistent with that reflected in OP 8.60 and the CFAA Guidelines, using the following reasoning: OP 8.60 states that the “appropriateness of providing development policy lending to a country is determined in the context of the Country Assistance Strategy.” Para. 5 of the CFAA guidelines states: “The results of this assessment inform the preparation of the Bank’s Country Assistance Strategy (CAS), particularly the sections dealing with the size of the support program, the sectors to be supported, selection of lending instruments, and approaches to risk management.” It is on this basis that IEG assessed the influence of CFAAs on the choice of instruments as reflected in CASs. Management notes that, in accordance with Bank policy and guidelines, the choice of instrument is a wider issue that is informed but not determined by CFAA or CPAR findings; notably, that choice takes into account PFM performance over time and possible special measures where necessary.

<sup>6</sup> See *Development Policy Lending Retrospective* (SecM2006-0319), July 13, 2006.

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FM and PR issues and risks is presented in most Project Appraisal Documents.<sup>7</sup> This is also corroborated by Quality at Entry ratings for FM and PR, which have consistently been rated high in recent assessments.<sup>8</sup> This said, Management fully accepts the need to continue to raise the standard of FM aspects of investment operations and has produced a revised Operational Policy/Bank Procedure (OP/BP) 10.02, *Financial Management*,<sup>9</sup> issued in March 2007.

- b) CFAAs and CPARs have also provided very useful information to assist in assessing whether country FM and PR systems can be used in Bank-financed investment projects. Where Bank-financed investment projects have used country PFM systems (as in SWAs in many cases), information from CFAAs and CPARs has played a major role in the assessment and design of the projects' FM and PR arrangements.

As part of the continuing improvements of the Bank's fiduciary work, Management is working on providing guidance to staff on formulating and articulating a clearer linkage between country context and project-specific FM/PR design and supervision interventions.

9. ***Dual Objectives of CFAAs and CPARs.*** The IEG review states that tension between the development and fiduciary objectives of these instruments reduces their relevance. Management does not see this tension and notes that the development and fiduciary objectives usefully complement one another. Management also does not agree with IEG's comments that the development objectives of CFAAs and CPARs would be better served by focusing on a few sectors or selected functions. Partner countries have found the coverage of the entire PFM cycle useful. Management considers that the appropriate mix of objectives and the scope and depth of coverage are best determined in the specific country context in consultation with the government. Currently, in most countries PEFA assessments have replaced CFAAs, which cover the entire PFM cycle; thus the issue of focusing CFAAs on a few sectors or selected functions has become secondary.

10. ***Integrated Fiduciary Risk Analytic Framework and Corruption Risks.*** The IEG review recommends that Management develop an integrated risk analytic framework that considers the risks posed by corruption and includes a standardized methodology for aggregating country-level PFM risks, and that it guide staff on how these risks should influence the design of Bank assistance. Management has the following comments:

- a) ***Treatment of corruption issues in the design of Bank assistance.*** PFM is an integral part of a country's governance architecture. Management's view is that the issue of

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<sup>7</sup> See "FM Practices Manual," Financial Management Sector Board, November 2005 (previously "Assessment of Financial Management Arrangements in World Bank-Financed Projects, Guidelines to Staff," June 30, 2001); and "Revised Instruction for Carrying out Assessment of Agency's Capacity Assessment to Implement Procurement, Setting of Prior-Review Thresholds and Procurement Supervision Plan," OPCPR, July 15, 2002.

<sup>8</sup> QAG Quality at Entry (QAE) ratings for PR and FM have consistently scored over 90 percent satisfactory in QAEs 4, 5, 6, and 7.

<sup>9</sup> See *Financial Management and Disbursement Arrangements for Investment Lending Operations* (SecM2006-0466), November 27, 2006.

corruption risk should be addressed within the framework of the Bank's ongoing work to implement a strengthened approach to governance and anticorruption (GAC).<sup>10</sup> The Bank's GAC strategy, unanimously approved by the Board of Executive Directors in March 2007 after wide consultations, incorporates a systematic and disciplined approach that will be applied to the treatment of corruption and governance issues in CASs, drawing on national plans to ensure that the Bank's strategy is matched to the risks and challenges that governance and corruption pose for growth and poverty reduction in the country. CASs will give explicit consideration to governance and corruption issues, drawing on diagnostic work (including on PFM), and to the risks that they pose for development and Bank-funded operations. These findings will be used in working with the country authorities to develop the CAS and the program of Bank activities in the country. This approach offers an appropriate framework that will factor all relevant aspects, including country PFM performance, into the design of Bank assistance. As noted above (see paras. 7 and 8), the Bank's operational policies and guidelines provide guidance to staff on taking into account country PFM performance and fiduciary risks in decisions on and design of development policy operations and investment lending.<sup>11</sup> To ensure a wide understanding of the new framework, the Bank undertook consultations on the Implementation Plan for the GAC strategy. Now 26 countries are piloting a country-level process for strengthening World Bank Group engagement on governance and anticorruption—the "CGAC process"—that will fundamentally inform the CAS.

- b) ***Coverage of corruption issues in PFM diagnostic work.*** CFAAs and CPARs typically identify aspects of the PFM system that might facilitate corruption (such as off-budget accounts, inadequate FM and PR information systems, weak regulatory environments, inadequate systems of internal control and internal audit, poor capacity of implementing agency staff, excessively complex financial administration rules leading to poor enforcement, and "cash rationing"). Management considers this coverage of corruption issues appropriate. Given the complexity and multifaceted dimensions of the corruption issue, neither corruption diagnostics nor the development of anticorruption strategies can be undertaken as part of the CFAA or CPAR per se. As part of the overall work on the new GAC strategy, Management will look at how to establish better linkages with corruption issues in the Bank's PFM work, recognizing that PFM systems are an important instrument in a country's anticorruption agenda, and also that PFM performance is affected by the overall corruption environment.
- c) ***Integrated fiduciary risk analytic framework.*** As noted above (see para. 4), Management has already taken measures to adopt an integrated approach to PFM work and encourage use of the PFM performance measurement indicators developed by the PEFA partnership program. These indicators help provide an integrated view of country PFM performance and risk, covering all dimensions of the PFM system. Management suggests that the emphasis now should be on further

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<sup>10</sup> See *Report of the Executive Directors: Strengthening World Bank Group Engagement on Governance and Anticorruption* (DC2007-0005), March 28, 2007.

<sup>11</sup> See OP 8.60, *Development Policy Lending*; "Good Practice Note: Financial Management Issues in Development Policy Operations"; "FM Practices Manual"; and "Revised Instruction for Carrying out Assessment of Agency's Capacity Assessment to Implement Procurement, Setting of Prior-Review Thresholds and Procurement Supervision Plan."

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operationalizing these measures, including providing guidance on assessing fiduciary risks when using country PFM systems in Bank-supported projects. Management also notes that pilots were undertaken and evaluated (in the South Asia and Africa Regions) to test the viability and effectiveness of procurement fiduciary risk analytic tools in the context of individual projects, which will contribute to more robust work in this area. Given these actions, Management intends to give priority to implementing the measures already put in place.

11. ***Inclusion of Action Plans in CFAAs and CPARs.*** The IEG evaluation identifies the lack of costed and monitorable action plans in CFAAs and CPARs as a key weakness. Country ownership of action plans is paramount.<sup>12</sup> Management considers that country circumstances should dictate whether an action plan is included, and what its level of detail should be. In many cases, action plans that draw heavily on the recommendations of a CPAR or CFAA are developed as part of follow-up activities or projects supporting public sector management reform, and therefore are not included in the assessment.

12. ***PFM Concept Note as Part of the CAS Formulation Process.*** Management notes IEG's recommendation that PFM diagnostic work should be initiated through a PFM concept note, as part of the CAS formulation process. PFM issues and the Bank's proposed program to support the country's PFM agenda are now covered in most CASs, taking into account country circumstances and the results of consultation with partner countries.<sup>13</sup> This will continue to be case. Management considers that it would not be helpful to mandate a specific requirement to prepare a PFM concept note as part of the CAS formulation process for all countries. However, Management wishes to draw attention to the GAC Implementation Plan, which proposes that country teams undertake a country-level process (the CGAC), pursuing innovative ways of engaging partners and clients on governance, typically as part of CAS preparation.

13. ***Harmonization of Practices in Donor-Financed Investment Projects.*** Management does not agree with IEG's analysis of the harmonization of donor processes in investment projects (such as financial reporting procedures or development of harmonized bidding documents), or with its conclusion that transaction costs for clients have not been reduced. CFAAs and CPARs do not cover issues relating to procedures in donor-financed projects that typically operate outside the country's PFM system (although CPARs frequently recommend the development of standardized national bidding documents). These assessments are therefore normally not the right instrument to further the objective of alignment of processes in donor-financed projects. That objective is being addressed through other harmonization initiatives at the global, country, and

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<sup>12</sup> Good practice principles for PFM capacity development include (a) country leadership and ownership; (b) tailor-made capacity development design; (c) comprehensive program design and implementation; and (d) coherent and coordinated donor support; see *Harmonizing Donor Practice for Effective Aid Delivery, Volume 2*, OECD-DAC, 2006.

<sup>13</sup> See "Treatment of Procurement and Financial Management in Country Assistance Strategies: Interim Guidelines to Staff," Procurement and Financial Management Sector Boards, June 25, 2001.

project levels (such as the Paris Declaration provisions on implementation and monitoring, OECD DAC Joint Venture on PFM (cochaired by the Bank), PEFA Initiative, the Multilateral Development Bank FM Harmonization Working Group, the Multilateral Development Bank Heads of Procurement Working Group, and country-level donor organizational structures).

### **C. Conclusion**

14. Despite its reservations, overall Management warmly welcomes this evaluation from IEG. The evaluation confirms that this area of work contributes significantly to the overall development objectives of the Bank. It endorses the trend that the Bank has adopted of a more integrated approach to public finance management, bringing together colleagues from Financial Management, Procurement, and Poverty Reduction and Economic Management, to work together on an integrated agenda and to move more firmly beyond analysis to implementation. Management notes that, in that spirit, CFAAs and CPARs are no longer mandatory; the new strengthened approach is centered on a common PFM performance framework (in the form of PEFA assessments).