

## Strengthening Public Financial Management Systems to Maximize Development Effectiveness

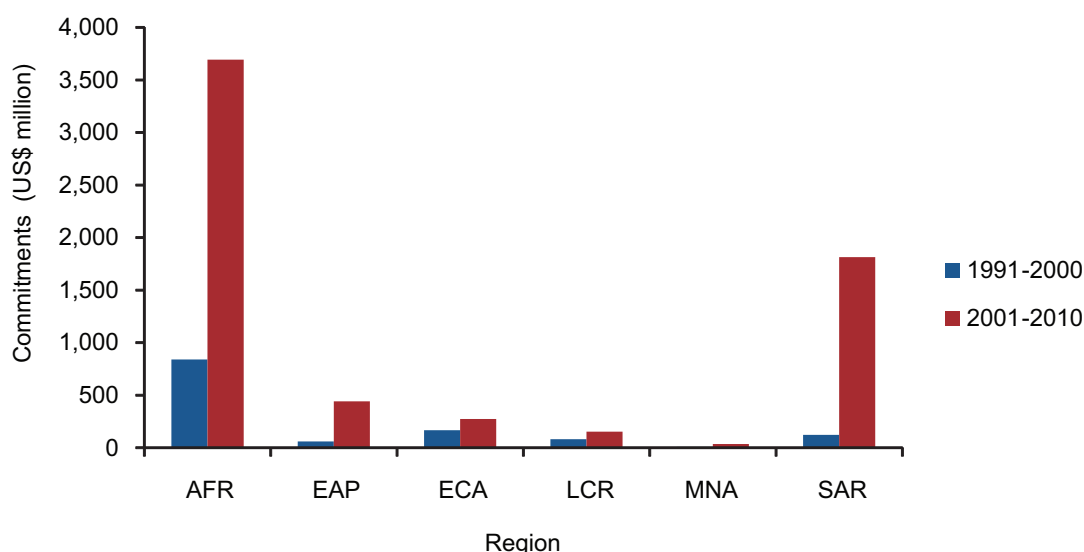
**S**trengthening public financial management (PFM) has been a core International Development Association (IDA) objective for over a decade. This objective is being achieved by supporting country-led reforms and institution building; fostering the harmonization of donor analytical and technical assistance around government-led strategies; providing global leadership and applying internationally accepted monitoring frameworks and assessment tools to measure performance. Loan commitments for projects with public expenditure, financial management or procurement components increased from US\$1,280 million in the period 1991–2000 to US\$6,410 million in the period 2001–2010, with an increase in every region

### **Challenge**

Public financial management (PFM) is an essential part of the development process, underpinning all public sector activities in a nation's economy. PFM supports the efficient and accountable use of public resources; helps underpin both macro and fiscal stability and guides allocation of resources to address national priorities. Since resources can leak whenever systems are weak, PFM covers all phases of the budget cycle including budget preparation, internal control and audit, budget execution, procurement, and monitoring and reporting arrangements.

Strengthening PFM has been a core IDA objective for over a decade (see figure 1). This objective is being achieved by supporting country-led reforms and institution building; fostering the harmonization of donor analytical and technical assistance around

**Figure 1. Loan Commitments for Projects with a Public Expenditure, Financial Management, or Procurement Components**



Source: World Bank Business Warehouse October 2010.

government-led strategies; providing global leadership and applying internationally accepted monitoring frameworks and assessment tools to measure performance. Over the years, IDA support has evolved from helping analyze the level and composition of spending to an increased focus on measuring the quality of PFM systems and developing indicator-based diagnostic tools to measure country performance.

## Approach

IDA focuses on using and strengthening country PFM systems to help member countries create long-term sustainable PFM capacity. This approach allows IDA to scale up development impact by helping to improve the efficiency of all government expenditures (not just those financed by IDA and the management of all resources (not just those of projects),

and to reduce transaction costs through the use of country systems. Furthermore, IDA's overall public financial management strategy emphasizes country ownership and a harmonized and coordinated approach to reform.

At the project level, IDA provides assessment, design, and implementation support services to ensure that, for IDA financed operations, partner countries have appropriate PFM arrangements in place to support achieving the project development objective, provide for compliance with World Bank PFM requirements, maintain financial integrity, and support the development of sustainable PFM capacity. IDA actively seeks to use country PFM systems where they are assessed as adequate, while also strengthening the system.

At the country level, IDA provides information on the overall fiduciary environment and

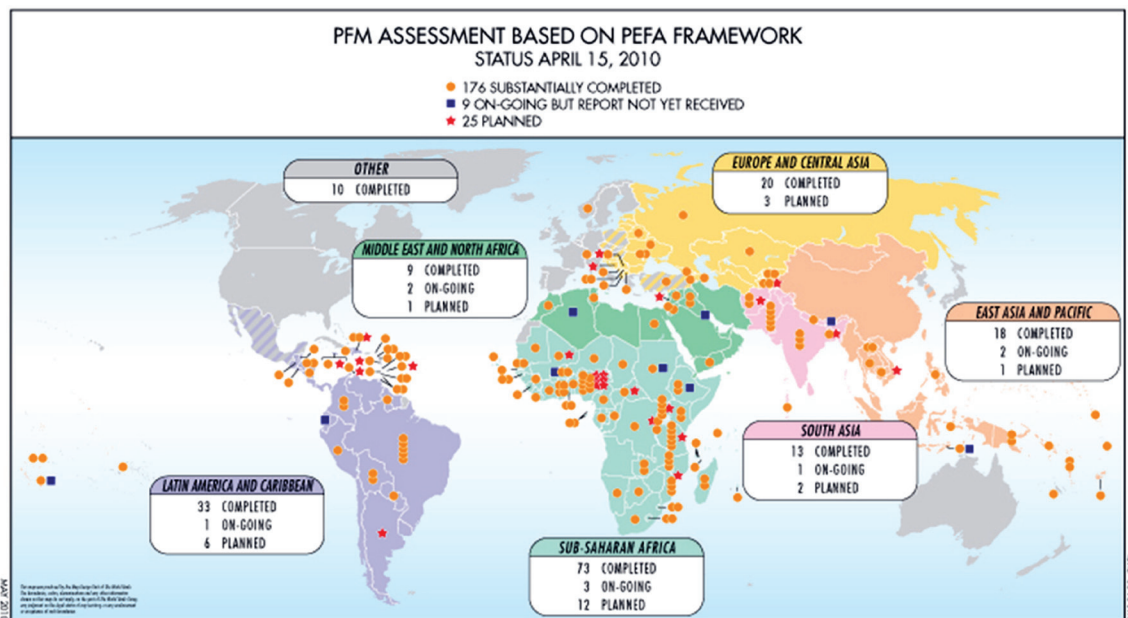
risks, and promotes and supports building PFM capacity based on each country's development priorities and institutional environment. IDA provides PFM diagnostics, policy and technical advice, advisory services, and technical and project assistance to partner countries; and facilitates PFM learning, knowledge exchanges, and access to relevant global expertise.

At the global level, IDA maintains relationships and builds partnerships with international accounting and auditing bodies; supports setting international standards and codes; promotes responsiveness to developing country needs; and builds regional practices. IDA also works with other development partners—bilateral donors, multilateral development banks, and United Nations family agencies—to harmonize PFM requirements and practices for improving aid effectiveness and building country PFM capacity.

## Results

**Strengthening Country PFM System Performance and Capacity:** IDA countries require strong PFM systems if they are to use their resources effectively and efficiently and report on the resource use. The World Bank and other development partners have developed a comprehensive indicator-based Public Expenditure Framework (PEFA) to track progress. This diagnostic has 31 indicators covering the entire PFM cycle and is linked to six main objectives: budget credibility; comprehensiveness and transparency; policy-based budgeting; predictability and control in budget execution; accounting, recording and reporting expenditure; and external scrutiny and audit. PEFA has been applied in 68 out of the 79 IDA countries as of April 2010 (see figure 2). Of these assessed countries, 24 have already completed one or more repeat assessments and 10 have utilized the frame-

Figure 2. PEFA Work in IDA Countries



Source: Public Expenditure Framework, World Bank.

work at a sub national level. PEFA-based assessments are becoming a standard input to many processes. They are used as the starting point for discussion of PFM reform plans in many countries, a reference point for donor and multilateral agencies to decide on use of country systems for individual operations, by researchers and aid evaluation departments for datasets needed in their work, and also by regional networks of government officials as a basis for peer learning. Box 1 presents the results from PFM projects in three countries.

**Improved Budget Management:** 19 countries improved their IDA Country Performance and Institutional Assessment (CPIA) score for their quality of financial and budget management between 2005 and 2008. This rating assessed links between budgets and policy priorities such as poverty reduction as well as the quality of financial management and fiscal reporting. (See figure 3 for CPIA Indicators on Public Sector Management and Institutions.)

**Public Expenditure Reviews:** Public Expenditure Reviews provide a basis for improving the efficiency and efficacy of resource allo-

cation and help countries establish effective and transparent mechanisms to allocate and use public resources. Since 2000, IDA has carried out 155 Public Expenditure Reviews.

**Design and implementation of Treasury System or Financial Management Information Systems (FMIS):** Since 1984, there have been 46 IDA-financed projects in 27 countries with the development of Treasury System or FMIS solutions. Twenty-three out of 55 completed projects were in IDA countries (12 completed in Africa). Similarly, 23 out of 32 projects are being implemented in IDA countries (12 active in Africa).

**Implementation and Strengthening of Medium Term Expenditure Frameworks (MTEFs):** A MTEF translates macro-fiscal objectives and constraints into broad budget aggregates and detailed expenditure plans, which should result in a more strategic approach to expenditure prioritization and increased spending efficiency. Currently, 93 IDA countries have adopted some variant of a MTEF and the Bank has actively supported many of these reforms (for example, in Albania, Armenia, Bangladesh, Ghana, Malawi,

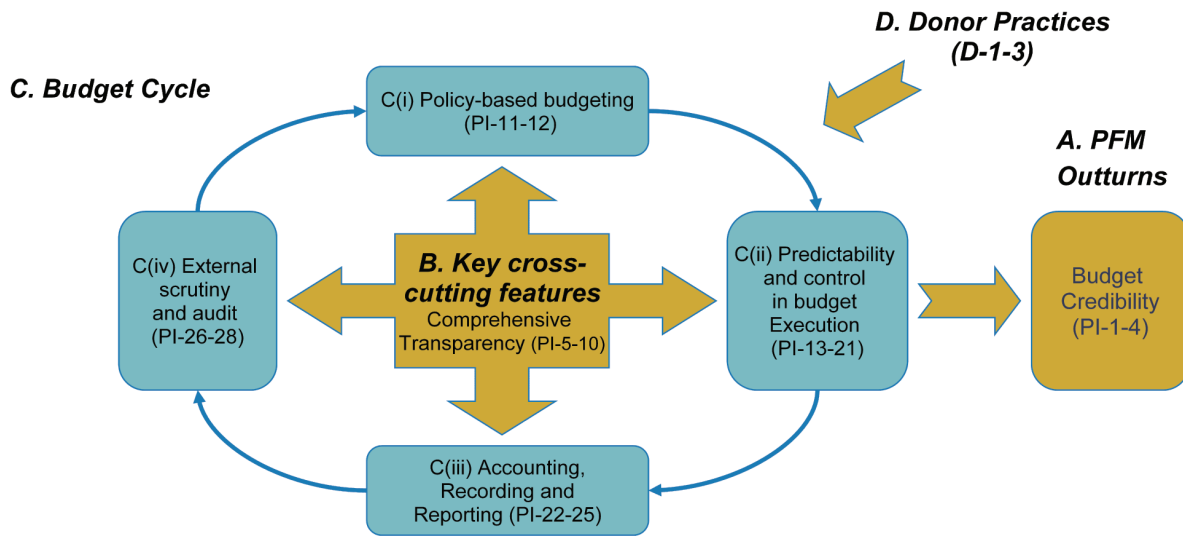
### Box 1. Results from PFM Projects

In **Guatemala**, the Third Integrated Financial Management Technical Assistance Project is extending and deepening reforms to increase the effectiveness, efficiency, and transparency of public sector financial management and control, and strengthening financial management at the municipal level.

In **Bangladesh**, to improve aid effectiveness, a World Bank-managed Multi-Donor Trust Fund for capacity building in PFM is strengthening Public Expenditure Management, the Office of the Auditor General, and Parliamentary Oversight Committees.

In **Timor-Leste**, the PFM Capacity Building Project has improved harmonization and alignment by integrating all similar bilateral agency projects under its umbrella. The project's innovative governance arrangements include (a) strategic management through the Ministry of Finance's senior management committee, chaired by the Minister of Finance; (b) regular World Bank oversight and supervision; and (c) overview by the joint donor supervising committee chaired by the Minister of Finance.

**Figure 3. CPIA Indicators on Public Sector Management and Institution**



Source: CPIA Indicators, World Bank.

Rwanda, and Uganda). In Armenia, a MTEF has contributed to greater fiscal discipline and ownership in line ministries by “enforcing” the culture of implementing sectoral policies within given limits, increasing allocative efficiency, strengthening strategic planning and budgeting and better policy formulation.

### IDA Contribution

**PFM plays an important role in governance reform and policy-based lending:** In IDA countries, the relative importance of PFM-related reforms is pronounced, accounting for over half of public sector governance actions and benchmarks. Loan commitments for projects with public expenditure, financial management or procurement components increased from US\$1,280 million in the period 1991-2000 to US\$6,410 million in the period 2001-10. There was an increase

in every region, including an increase from US\$840 million to US\$3,694 million in Africa and from US\$123 million to US\$1,813 million in South Asia. The number of projects with a public expenditure, financial management or procurement component rose from 26 to 34. Furthermore, loan commitments for projects with PFM components averaged US\$777.3 million annually between 2005 and 2010 with projects in 58 IDA countries. For countries with access to IDA or blend resources, over 75 percent requested public sector reform related lending and almost all had analytical and advisory work (AAA) activities, usually numerous. The majority of this lending and technical advice is in the area of PFM. Low-income countries generally have weaker public institutions and a higher share of financing in the form of budget support. PFM reform is therefore a necessary underpinning for effective government institutional strengthening.

**Substantial analytical and advisory work in PFM is helping build capacity and increase ownership of the reform agenda.** The World Bank Independent Evaluation Group Review of 2008 credited good diagnostic work in PFM as having contributed to successful outcomes in Bank operations. In particular, it cites Public Expenditure Reviews and public expenditure and financial accountability indicators as useful in this regard. Between 2000 and 2010, 272 analytical products supporting PFM were provided to IDA countries.

## Partners

The Bank has been a leader in promoting donor harmonization around a common results framework. It has led harmonization efforts through the Multilateral Development Bank (MDB) Financial Management (FM) Harmonization Working Group, the Public Expenditure and Financial Accountability (PEFA) Program, Organisation for Economic Co-operation and Development–Development Assistance Committee (OECD-DAC) Joint Venture on Public Financial Management, and the DAC itself.

The PEFA Program has been jointly financed by the World Bank, the European Commission, the U.K. Department for International Development, the Swiss Secretariat for Economic Affairs, the Royal Norwegian Ministry of Foreign Affairs and the French Ministry of Foreign Affairs. The International Monetary Fund (IMF) is also a partner.

The Bank also has partnerships with the international accounting and auditing organizations (International Federation of Accountants (IFAC), International Accounting Standards Board (IASB), and International Organization of Supreme Audit Institutions (INTOSAI)) which reflect the shared goals of promoting

global accounting and auditing standards building capacity, creating financial reporting infrastructure, developing financial systems, and combating corruption for effective growth, development, and poverty reduction. The Bank has joined with the IMF and other multilateral and bilateral donor agencies to sign a Memorandum of Understanding with INTOSAI to work together in a coordinated way to support developing the capacities of supreme audit institutions—an initiative to enhance collective support for INTOSAI and its members at the global, regional, and country levels. Preparatory work has been launched for a similar arrangement with IFAC to address building the capacity of the accountancy profession in member countries

## Moving Forward

Looking ahead, IDA will remain a key player in PFM reform because of its technical expertise, global experience and its acknowledged leadership role. Countries will continue to request IDA financing and advisory support to achieve progress in PFM reform—an essential input into improving the spending of public resources and the effective use of aid to support national poverty reduction strategies.

**Country-led reform strategy:** IDA will focus on deepening implementation of reforms and building sustainable country financial management capacity through the use of the Bank’s range of instruments: more continuous dialogue on reforms with member countries, targeted diagnostic work to inform the dialogue and help member countries develop appropriately sequenced and sustainable reform programs, advisory services, technical assistance, investment and development policy operations, and capacity-building support.

**Governance and Anti-Corruption:** PFM will be used to implement the Bank's Governance and Anticorruption (GAC) agenda, with extensive analytical and advisory work on fiduciary issues; joint analytical work to provide a more holistic view of GAC issues; and support in such areas as computerization of government financial systems; strengthening of public sector internal controls and internal audit, and enhanced legislative scrutiny of public finances. IDA will continue supporting governments in strengthening their own institutional arrangements for preventing and detecting corruption, supplementing these arrangements as necessary with additional fiduciary safeguards in Bank-financed operations; and it will specifically support key government agencies responsible for the management and control of corruption

risks—the Ministry of Finance, the supreme audit institution, anticorruption agencies, and legislative oversight body.

**Monitoring Progress:** Tracking of performance over time is being completed through repeat assessments of the PEFA framework and enhanced joint work among donor agencies in line with the Paris Declaration and the Accra Agenda for Action. Likewise, guidance is being prepared in response to the many partners who are asking for advice on how to use the PEFA assessment reports for identifying reform priorities and establishing comprehensive and well-sequenced reform action plans.

Last updated September 2010.  
<http://www.worldbank.org/ida>