

# GOOD PRACTICE NOTES FOR DEVELOPMENT POLICY LENDING

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**GOOD PRACTICE NOTE 3—  
FINANCIAL MANAGEMENT ISSUES IN DEVELOPMENT POLICY LENDING**

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# GOOD PRACTICE NOTE 3— FINANCIAL MANAGEMENT ISSUES IN DEVELOPMENT POLICY LENDING

## I. INTRODUCTION

1. Development policy support is rapidly disbursing policy-based financing, which the World Bank<sup>1</sup> provides in the form of lending or grants to help a borrower address its actual or anticipated financing requirements that have balance of payments or fiscal origins. The objective of such support is to help a borrower achieve sustainable reduction in poverty through a program of policy and institutional actions. The Bank may provide development policy support to a member country, or to a subnational division of a member country. Some key features outlined in Operational Policy (OP) 8.60, *Development Policy Lending* that are important background for the financial management of such operations, are highlighted in Box 3.1.

2. ***Purpose of this Note.*** These good practices are intended to assist financial management specialists (FMSs) and task teams on financial management issues in development policy lending. The framework for the Bank's fiduciary policies in development policy operations recognizes the need for professional judgment in each individual case; this note is intended to assist (but not replace) such judgment. In this context, staff should become familiar with the Bank's operational policies and procedures relating to development policy support.<sup>2</sup> It is expected that the good practices note will periodically be updated as operational lessons are learned.

3. ***Structure of this Note.*** Following this introduction, Section II discusses the main financial management issues in development policy operations, and how these would be addressed. Section III discusses the documentation of financial management issues in development policy operations. Section IV deals with supervision, monitoring and evaluation of financial management aspects of development policy operations.

4. ***Role of FMSs.*** FMSs, as part of the task team, work collaboratively with government counterpart teams and should be involved from an early stage of development policy operations, and should be involved throughout the operation (concept, preparation, appraisal, negotiations, supervision, and completing reporting). It is especially important that FMSs coordinate their work with the task team leader and other relevant team members (e.g., those working on public expenditure management, fiscal and governance issues) in many instances from the Poverty Reduction and Economic Management (PREM) Network.

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<sup>1</sup> "Bank" includes IBRD and IDA, "loans" includes credits and IDA grants, "borrower" includes borrower and IDA grant recipient, and "subnational divisions" refers to states or provinces.

<sup>2</sup> Refer to [OP 8.60](#) and [BP 8.60](#), *Development Policy Lending*, August 11, 2004. For additional guidance, refer to *Good Practice Note 1—Designing Development Policy Operations*. Good practice FM examples are also provided in the OPCS-FM website [<http://opcs.worldbank.org/fm/index.html>].

**Box 3.1. Key Features of Development Policy Lending Outlined in OP 8.60**

- *Country Assistance Strategy (CAS).* The appropriateness of development policy lending is determined in the context of the CAS and the country's policy and institutional framework. The CAS assesses the country's ability to effectively implement the program to be supported and describes the country's capacity-building efforts.
- *Macroeconomic framework.* The Bank undertakes development policy lending in a country only when it has determined that the country's macroeconomic policy framework is appropriate. For development policy operations to a subnational entity, the state or region must have an appropriate expenditure program, as well as appropriate fiscal arrangements with the central government.
- *Coordination with development partners.* In preparing development policy operations, the Bank collaborates with the IMF and other international financing institutions and donors, as appropriate, while retaining responsibility for its financing decisions.
- *Analytic underpinnings.* A development policy operation draws upon analytic work on the country, including relevant analyses of the country's public expenditure management, procurement, and financial accountability systems. Such analytic work may be carried out by the country, the Bank, or third parties. Drawing on a consultative process, the CAS assesses the adequacy of analytic work on the country and indicates how gaps will be addressed.
- *Development objectives.* The program documentation sets out the specific outcomes expected from the resource transfer and the country program being supported. The program design includes measurable indicators for monitoring progress during implementation and evaluating outcomes upon completion.
- *Program funding and size of operation.* The size of each development policy operation is based on country circumstances, including the following factors: (a) projected financing requirements at the time of the operation (including the costs of reform, if applicable), the availability of alternative financing, debt sustainability, and creditworthiness (IBRD) or relative claim on available concessional resources (IDA); (b) the envisaged lending envelope and share of development policy lending in total lending in the CAS; and (c) compliance with country performance triggers set out in the CAS.
- *Conditions.* The program conditions set out the agreed policy and institutional actions by the country that are necessary to implement the development policy operation. The Bank makes development policy lending available to the borrower when the program conditions are met. The Bank seeks to harmonize conditions with other development partners.
- *Tranching.* Development policy lending can be provided in one or more tranches, depending on the country's policy environment and capacity, the country's financing requirements and other available financing, and the content and phasing of the reform program. Development policy operations can also follow a programmatic approach (i.e., consist of a series of operations within a medium-term framework of policy and institutional actions). Such operations involve (a) clear monitorable indicators and progress benchmarks, (b) triggers for moving from one operation in the series to the next, and (c) notional timing and amounts of subsequent operations. In a country with a Poverty Reduction Strategy Paper (PRSP), development policy operations following a programmatic approach may be called poverty reduction support credit (PRSC). Single-tranche and programmatic development policy operations are embedded in an explicit medium-term framework of policy and institutional actions.
- *Risk management.* The Bank independently identifies the risks (financial and nonfinancial risks such as operational, developmental, macroeconomic, political economy, governance, reputational, and capacity/implementation risks, as appropriate) associated with the program and ensures that the operation contains appropriate mitigation measures and monitorable indicators to track high-probability risks.
- *Disbursements.* Development policy operational funds are disbursed against satisfactory implementation of the program, including compliance with tranche release conditions and maintenance of a satisfactory macroeconomic policy framework.

## II. FINANCIAL MANAGEMENT IN DEVELOPMENT POLICY OPERATIONS

5. Development policy lending provides both balance of payments and budget support to the country. Financial management in development policy operations focus on two major issues: (a) funds flow arrangements giving reasonable assurance that the foreign exchange from loan proceeds are deposited into an account of the central bank that forms part of the country's foreign exchange reserves, and that an equivalent amount is credited to an account of the government available to finance budgetary expenditures; and (b) the appropriate management of the country's budget resources through the country's public financial management (PFM) system. Bank reviews of the above inform decisions on development policy loan amounts, tranching, program content, conditionality, and risk mitigation measures.

6. ***Tracking Use of Bank Funds and the "Negative List."*** Given the fungibility of foreign exchange reserves and budget resources, it is not required (and normally not possible) to track the ultimate use of the Bank funds in development policy operations. The borrower provides an undertaking, documented in the legal agreements, that it would not use the proceeds of development policy lending to finance ineligible items (called "the negative list").<sup>3</sup> This is in effect a self-implementing "code of conduct" for borrowers, which, if breached, would trigger the enforcement by the Bank of its legal remedies.

### A. Funds Flow Arrangements and Management of Foreign Exchange

7. The Bank disburses the loan proceeds into an account that forms part of the country's official foreign exchange reserves (normally held by the central bank). An amount equivalent to the loan proceeds is credited to an account of the government available to finance budgeted expenditures (e.g., Consolidated Fund or Single Treasury Account). The Bank requires assurance that the full amount of the loan proceeds reaches the country's budget resources, as outlined below.

8. ***Foreign Exchange.*** It is not possible to track the ultimate use of the foreign exchange provided by the Bank loan proceeds, given the fungibility of the country's foreign exchange reserves. However, it is relevant to review the control environment within which foreign exchange is managed by the borrower. The IMF reviews this control environment through its safeguards assessments of central banks.<sup>4</sup> Therefore, Bank staff review, and discuss with IMF

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<sup>3</sup> The "negative list" for development policy lending covers items such as alcoholic beverages, tobacco, radioactive and associated materials, nuclear reactors and parts thereof, jewelry of gold silver or platinum, expenditure for goods intended for a military or paramilitary purpose or for luxury consumption or expenditures for environmentally hazardous goods. It is contained in Schedule 1 of the Model Form of Loan Agreement following issue of OP 8.60 which is currently in the process of being finalized.

<sup>4</sup> The purpose of safeguards assessments is to identify vulnerabilities in a central bank's control, accounting, reporting, auditing systems, and legal structure to identify any weaknesses that may impair the integrity of central bank operations, and to determine if resources, including those provided by the Fund, are adequately monitored and controlled. A safeguards assessment does not seek to validate the actual use of foreign exchange reserves; it is limited in its scope to a review of control systems. For more details on the safeguards assessment, see <http://opcs/FM/ESW/esw-IMFsafeguardsassessment.html>. Copies of the IMF's safeguard assessment reports are held by the FM Anchor; and are available to staff on request. The staff member's manager should be copied on the request. The staff member will be asked to confirm in writing that the report will be treated confidentially, and that it will only be used for official business.

staff as appropriate, the IMF's most recent safeguards assessment of the borrower's central bank; and review the available published annual audit reports and financial statements of the central bank to determine the possible:

- (a) Where the IMF's safeguards assessment shows that the control environment of the central bank is satisfactory, or reveals issues for which the borrower has agreed to take remedial actions that are monitored by the IMF, the World Bank takes no further action. Bank staff do not address matters concerning the management of foreign exchange reserves beyond the scope of the safeguards assessment, such as foreign exchange management policy. These are addressed by the IMF.
- (b) Where the World Bank has inadequate knowledge of the borrower's central bank control environment (e.g., where the IMF has not carried out a safeguards assessment), and audit reports of the central bank indicate weaknesses (e.g., no independent audit of the central bank, major issues regarding foreign exchange management indicated in audit reports), or no acceptable IMF-monitored plan to deal with identified control weaknesses is in place, the Bank may apply additional fiduciary arrangements (outlined in Section II-C below).

9. ***Credit of Loan Proceeds to the Government's Budget Resources.*** The foreign exchange should be promptly converted into local currency and equivalent amounts credited into an account of the government that is available to finance budgeted expenditures (normally within 30 days of disbursement).<sup>5</sup> The country's regular or established procedures should be used for this purpose. The government should provide a confirmation to the Bank that the amount of the loan has been credited to an account that is available to finance budgeted expenditures (including the date and name/number of the government's bank account in which the amount has been deposited, and that it has been credited to an account of the government available to finance budgeted expenditures, e.g., Consolidated Fund or Single Treasury Account).

10. ***Subnational Operations.*** When Bank loan proceeds are passed on from the borrowing government to other entities (e.g., to subnational governments/entities), on-lending terms and funds flow arrangements (into an account of the subnational government/entity that is used to finance its budgetary expenditures) should also be developed and agreed, again using the country's regular procedures.

## **B. Public Financial Management System**

11. A development policy operation draws upon analytic work on the country that includes relevant analyses of the country's PFM systems. Such analytic work normally focuses on aspects such as the comprehensiveness and transparency of the budget, systems that facilitate implementation and monitoring of the budget, fiscal transparency (reliable information on fiscal results and position), and financial accountability for use of public resources. The country, the Bank, or third parties may carry out such analytic work. The Bank's own principal instruments for such analytic work on the country's system are Country Financial Accountability

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<sup>5</sup> In some countries, the local currency is the same as the currency in which disbursements are made. In such cases, the conversion into local currency is not relevant; the only relevant aspect is credit of the amount to the government's account available to finance budgeted expenditures.

Assessments (CFAAs) and Public Expenditure Reviews (PERs). In addition to these, the Bank reviews the available published annual audit reports and financial statements of the government, and other relevant reports to inform itself on the working of the country's PFM system.<sup>6</sup>

12. ***Design of Program Content, Conditionality, Tranching, and Risk Mitigation Measures.***<sup>7</sup> No minimum standard of public financial management has been established which may be used as a precondition for development policy lending. Development policy operations could be provided in a country that has a weak public financial management environment but has committed itself to an adequate program of public financial management improvement/reform, and there is reasonable evidence that improvements are occurring in a timely manner. Improved PFM performance may indeed be an outcome, rather than a precondition, of development policy lending. In some countries, PFM improvements may be supported by other donors, rather than by the Bank through the development policy operation.

13. Development policy operations may include measures to develop country PFM capacity and address key weaknesses and risks identified in the diagnostic reviews. Such measures draw on key elements of the government's PFM improvement program or plan. While there cannot be rigid rules, some general principles for designing conditions, triggers, and benchmarks, based on review and experience of past operations, are outlined below (see Box 3.2).

- ***Link PFM conditions, triggers, and benchmarks to diagnostic work.*** Results of diagnostic work, particularly major weaknesses and risks, should have adequate follow-up.
- ***Appropriately sequence PFM benchmarks, conditions and triggers.*** Ensure continuity of actions (actions should not disappear after one year, particularly in programmatic operations and multitranche operations). Determine conditions and triggers for each operation in a programmatic series building incrementally on progress and results achieved, and push boundaries as far as possible. In some cases, it may be appropriate to initially agree on a package of short-term measures (covering to the extent possible the various elements of the PFM cycle) that could serve as a platform or step for deeper improvements.

<sup>6</sup> For more details on CFAA, see <http://opcs/FM/documents/CFAA/CFAA%20Guidelines%20May%2027.%202003.pdf>. The parts of PERs that deal with public expenditure management and institutional issues are most relevant for this analysis (as contrasted with parts that deal with aspects such as public expenditure policy, and size and composition of public expenditures). Examples of other reports are HIPC expenditure tracking assessments, IMF Fiscal Transparency Reports on Observance of Standards and Codes, diagnostic reports prepared by other donors, and relevant parts of Institutional and Governance Reviews and Country Procurement Assessment Reports. [A new approach to PFM work, which includes public expenditure management, procurement, and financial accountability, is being developed to help countries develop and implement a sequenced program of PFM improvements.

<sup>7</sup> *Conditions* are the agreed policy and institutional actions of the government which are deemed critical to the long-success of the reform program *and* which are included in the development policy operation documents as legal conditions for disbursements. In the context of programmatic development policy operations, *triggers* are the progress benchmarks in the second or subsequent year of a reform program, which are expected to become prior actions for subsequent operations. The details of prior actions for a subsequent operation may differ somewhat from the triggers in the preceding operation due to changes in circumstances or information. *Benchmarks* refer to outputs, intermediate outcomes, or final outcomes that are monitored as part of the reform program but are not legal conditions for disbursements.

- ***To the extent practicable, focus PFM conditions and triggers on results***, rather than inputs/processes; and spell out the expected results of the PFM improvement program. Results should be specific, significant, observable, time bound and measurable as far as practicable. Focus on fewer and better conditions and triggers — not all the actions included in the country’s PFM improvement program need to be included as conditions or triggers. In some cases, input or process-oriented conditions/triggers may be appropriate in the early operations (e.g., first and second) in a programmatic series, with a gradual move to more results-oriented conditions/triggers e.g., year 1 pass a law, year 2 show capacity and implement it, year 3 show results. Intermediate outcomes can be used as needed to progressively lead to final outcomes e.g., regular and timely reconciliations could be an intermediate outcome that would facilitate the final outcome of timely and reliable annual financial statements.
- ***Ensure that appropriate implementation arrangements for the PFM improvement program are in place***, for example, training and technical assistance to assist the government in implementing the PFM improvement program.

**Box 3.2. Summary List of Good Practices for Designing Conditions, Triggers, and Benchmarks in Development Policy Operations**

- Select a small number of conditions and triggers.
- Give particular attention to policy and institutional changes that contribute to desired outcomes.
- Be as specific as possible about what, by whom, and when.
- Include conditions and triggers that the government considers useful for signaling its commitment and for keeping implementation on schedule.
- Define many benchmarks and use them flexibly.
- Include intermediate outcomes.
- Build on national strategies.
- Show the linkages among outputs, intermediate outcomes and final outcomes.
- Ensure monitorability.
- Avoid conditions and triggers that create perverse incentives.
- Allow adequate time for the completion of the various steps in the reform program.
- When appropriate, allow for the gradual implementation of a reform program in different part of the country.
- Remember that year 1 is not really year 1. The policy matrix might include follow-up actions to policy changes that were made prior to the operation itself and sustained implementation of previous reforms.

*Source: Good Practice Note 1—Designing Development Policy Operations.*

14. Where the Bank has inadequate knowledge of the country’s PFM system, or where an acceptable action plan to deal with identified weaknesses in the country’s PFM is not in place, the Bank may apply additional fiduciary arrangements (outlined in Section II-C below). In exceptional cases, it may be appropriate to recommend (to the task team and in management reviews) one of the following actions: (a) delay the operation until adequate diagnostic information is available or certain conditions are met; (b) reduce the size of the operation; (c) tranche the operation, with appropriately sequenced actions as conditions for each tranche release; or (d) not proceed with the operation.

15. ***Subnational or Sector Operations.*** In development policy operations to a subnational entity, the PFM diagnostics as outlined above would be carried out at the relevant subnational level, and corresponding actions would also focus at the subnational level.<sup>8</sup> Similarly, in sector-specific development policy operations, the PFM diagnostics would be carried out at the sector level, and corresponding actions would focus on PFM improvements in the sector. Relevant links between the PFM system at the subnational/sector level and the country's overall PFM system should be recognized.

### C. Additional Fiduciary Arrangements in Some Circumstances

16. The need for additional fiduciary arrangements should be judged in the context of particular country circumstances. Circumstances in which additional fiduciary arrangements may be required include the following examples:

- (a) The World Bank has inadequate knowledge of the borrower's central bank control environment (e.g., where the Fund has not carried out a safeguards assessment) and audit reports of the central bank indicate weaknesses (e.g., no independent audit of the central bank, major issues regarding foreign exchange management indicated in audit reports), or no acceptable IMF-monitored plan to deal with identified control weaknesses is in place.
- (b) The World Bank has inadequate knowledge of the country's PFM system, or an acceptable plan to deal with identified weaknesses is not in place. These include cases where there may not be sufficient time or country capacity to draw on adequate analytic underpinnings or to determine how weaknesses in fiduciary arrangements might be addressed.<sup>9</sup>
- (c) Additional fiduciary arrangements may also be appropriate where Bank management considers that there is a significant possibility of "reputational risk" that Bank loan proceeds could be identified with being used for ineligible expenditures (the "negative list").

In judging the need for and potential effectiveness of such additional arrangements, aspects such as the size of the Bank's loan relative to the country's overall public expenditures and foreign exchange reserves held by the central bank should also be considered.

17. ***Mechanisms.*** These additional fiduciary arrangements could comprise any of the following:

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<sup>8</sup> Annex A of the CFAA Guidelines also provide guidance on diagnostic work at sub-national level.

<sup>9</sup> For example, in development policy support to countries affected by crisis or conflict, and similar exceptional situations that call for an unusually quick response from the borrower and the Bank.

- (a) **Deposit of Bank loan proceeds into a dedicated account.**<sup>10</sup> Satisfactory mechanisms need to be in place to ensure that the amount disbursed by the Bank reach a specific deposit account in the central bank, used exclusively for this operation.<sup>11</sup>
- (b) **An audit of the dedicated account.** When agreed upon, the scope of the audit in such cases would normally cover the following: (i) the accuracy of the *summary of transactions* of the dedicated account, including accuracy of exchange rate conversions; (ii) that the dedicated account was used only for the purposes of the operation (i.e., no other amounts are deposited into this account); and (iii) that all payments out of the dedicated account were or were not used for specified purposes. The format of the summary of transactions of this dedicated account and the periodicity of the audit and time period for submission of the audit report to the Bank should also be agreed. While the audit should be carried out at least annually, in some cases, it may be necessary to agree on a shorter time period (e.g., within six months after the funds in the dedicated account have been fully utilized). The time period for submission of the audit report to the Bank should normally not exceed six months. The approach should be normally used regarding the need for and contents of the terms of reference of the audit, the selection of the auditor (including use of Supreme Audit Institutions), auditing standards, timing of auditor appointment, and audit reports.<sup>12</sup>
- (c) **Agreeing on specified purposes for which loan proceeds may or may not be used.**<sup>13</sup> In most instances, purposes for which payments from the dedicated account may not be used (the “negative list”) would be agreed upon (rather than purposes for which these may be used).<sup>14</sup>

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<sup>10</sup> Where the concerns underlying these additional arrangements relate to foreign exchange management control weaknesses, it may be appropriate for the dedicated account to be maintained in the currency of Bank loan disbursements. In other circumstances, the amounts of the loan could be converted into local currency, and the dedicated account maintained in local currency.

<sup>11</sup> While such additional arrangements require loan funds to be deposited in a dedicated (separate) bank account, and for tracking payments from this account, such funds should be included in the country’s budget and be subjected to the country’s normal PFM processes.

<sup>12</sup> The approach is outlined in *Guidelines: Annual Financial Reporting and Auditing for World Bank-Financed Activities*, <http://opcs.worldbank.org/fm/documents/Audit%20Policy/AuditGUIDELINES.pdf>. Specifically, Terms of Reference (para 16), the auditor (paras 17-20), the auditing standards (paras 21-22), timing of auditor appointment (para 27), and audit reports (paras 28-31).

<sup>13</sup> Where specific purposes for which funds will be used are agreed, also refer to [OP 6.00](#), *Bank Financing*, regarding policies on retroactive financing (para 7). The Bank may finance payments made by a borrower out of its own resources before the date of the loan agreement provided that such payments do not exceed 20 percent of the loan amount; and the payments were made by the borrower not more than 12 months before the expected date of Loan Agreement signing.

<sup>14</sup> Only the payments made directly out of the dedicated account itself would be tracked, to confirm that they are (or are not used) for specified purposes. The end-use of such funds will not be tracked since this will not be feasible in many instances (given fungibility and mingling of these funds with other funds after they are paid out of the dedicated account).

### III. DOCUMENTATION OF FINANCIAL MANAGEMENT ISSUES

18. Documentation required for development policy operations is described in Box 3.3.

19. ***Financial Management Issues in the Concept Document.*** The objectives, expected outcomes, and provisions of financial management aspects of the proposed operation should be outlined. If sufficient information is not available, the proposed approach to develop these should be indicated. The current status of and proposed plans on diagnostic work (IMF safeguards assessment and on the PFM system) should also be indicated.

#### Box 3.3. Documentation for a Development Policy Operation

A *Concept Document* is prepared during the preparation stage of the operation.

A *Program Document*, that includes a policy matrix, describes the program in details, and sets out the objectives of the operation in terms of the specific outcomes expected from the resource transfer and the government program being supported. It includes measurable indicators for monitoring progress during implementation and evaluating outcomes upon completion; and the considerations, design provisions, and fiduciary arrangements. The policy matrix summarizes all of the conditions, triggers, and benchmarks that constitute the reform program supported by the development policy operation.

In a multitranche operation, for each tranche after the first a *Tranche Release Document (TRD)* is prepared that reports on the status of the program being supported under the operation.

In addition, the borrower's *Letter of Development Policy* that sets out the program of objectives, policies, and measures to be supported by the development policy operation is attached to the Program Document.

An *Implementation Completion Report* is prepared upon completion of an operation, and, for programmatic development policy lending, a simplified implementation completion report is prepared for each operation in the series and a full report is prepared upon completion of the program.

20. ***Financial Management Issues in the Program Document.*** The following issues should be covered (financial management should also be appropriately reflected in the legal documents):

- (a) ***Funds flow arrangements.*** (i) Describe briefly the funds flow arrangements, including the account into which Bank loan proceeds would be deposited (and which forms part of the official foreign exchange reserves), and the mechanisms by which equivalent amounts would be credited to an account of the government available to finance budgeted expenditures; if applicable, highlight any deviation from the country's regular or established procedures and reasons for these; and in this section also describe (ii) whether the IMF has completed a safeguards assessment of the central bank, and if the latest assessment has been reviewed; and summarize its major findings (e.g., whether the control environment is satisfactory) and the status of major agreed follow-up actions. (Note that Bank reports should only record information contained in the summaries of safeguards assessments that are submitted to the IMF's Board.)

- (b) ***PFM system.*** Include (i) the status of PFM diagnostic work and its results in summary form; (ii) a summary of the country's PFM improvement program/plan to address weaknesses and risks (this includes actions taken and committed by the borrower, and an assessment of adequacy of commitment toward and progress in PFM improvement); (iii) PFM conditions, triggers and benchmarks (these would be normally covered in the policy matrix and should be consistent with the discussion of PFM issues in the Program Document); and (iv) indicators for monitoring progress during program implementation and evaluating outcomes upon completion.<sup>15</sup> Implementation arrangements should also be outlined. For multiple-tranche operations, the Program Document should indicate conditions for tranche releases; and the Tranche Release Document should indicate the borrower's progress toward meeting the conditions for release of the tranche. In programmatic operations, the Program Document should indicate the progress in implementing the agreed triggers for the particular operation; and the proposed trigger for the subsequent operation.
- (c) ***Additional fiduciary arrangements.*** Description of such arrangements, in cases where such arrangements are used (Section II-C above).

#### IV. SUPERVISION, MONITORING, AND EVALUATION

21. ***Supervision and monitoring.*** The borrower implements the development policy operation, monitors progress during implementation, and evaluates results upon completion. Bank staff review implementation progress to verify fulfillment of program conditions and compliance with legal covenants, and to validate monitoring and evaluation findings. The task team consults and coordinates with the IMF and any cofinanciers in carrying out its supervision work. In this context, major FM supervision issues involve the following:

- (a) Monitoring that the agreed funds flow arrangements were complied with, following the disbursement of Bank loan proceeds; and that the required confirmation is received from the government.
- (b) Reviewing implementation progress of the agreed PFM actions. A periodic (e.g., annual) assessment of PFM performance indicating the extent of improvements should be carried out. For multiple-tranche operations, the borrower's progress toward meeting the conditions for release of the next tranche should be assessed. For programmatic operations, the borrower's progress in implementing the agreed triggers for the operation should be assessed. The borrower's monitoring and evaluation findings on the progress and results of program implementation should also be validated.
- (c) Monitoring that any agreed additional fiduciary arrangements (as outlined in Section II-C) were complied with. Where an audit of the dedicated account is required, timely submission of the audit report should be monitored, and the audit report should

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<sup>15</sup> These should be covered in the Program Document and in the policy matrix as appropriate and generally follow the presentation format used for all the policy and institutional issues covered by the operation. Whenever needed, the main text could be supplemented with an Annex on PFM aspects.

be reviewed. Where such arrangements were not complied with (e.g., the audit report is not submitted or indicates problems such as noncompliance with agreed arrangements), appropriate actions indicated in the legal agreements should be taken (e.g., enforcing the Bank's right to request the borrower to return that amount to the dedicated account or to refund the amount directly to the Bank; and, in extreme cases, to also cancel an equivalent undisbursed amount of the loan).

22. **Evaluation.** As appropriate, financial management issues should also be covered in the ICR. The ICR assesses (a) the degree to which the program achieved its development objectives and outputs as set out in the Program Documents; (b) other significant outcomes and impacts; (c) prospects for the program's sustainability; and (d) Bank and borrower performance, including compliance with relevant Bank policies. It draws upon the data and analysis to substantiate these assessments, and it identifies the lessons learned from implementation.

