



Technical Assistance Report

Project Number: 50204-001
Capacity Development Technical Assistance (CDTA)
October 2016

Papua New Guinea: Supporting Public Financial Management (Phase 3)

This document is being disclosed to the public in accordance with ADB's Public Communications Policy 2011.

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 1 September 2016)

Currency unit	–	kina (K)
K1.00	=	\$0.316
\$1.00	=	K3.170

ABBREVIATIONS

ADB	–	Asian Development Bank
DOT	–	Department of Treasury
GDP	–	gross domestic product
IMF	–	International Monetary Fund
PEFA	–	public expenditure and financial accountability
PFM	–	public financial management
PNG	–	Papua New Guinea
TA	–	technical assistance

NOTE

In this report, "\$" refers to US dollars.

Vice-President	S. Groff, Operations 2
Director General	X. Yao, Pacific Department (PARD)
Directors	M. Minc, Papua New Guinea Resident Mission, PARD E. Veve, Urban, Social Development, and Public Management Division, PARD
Team leader	Y. Basnett, Country Economist, PARD
Team member	J. Wolff, Economist (Public Finance), PARD

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CAPACITY DEVELOPMENT TECHNICAL ASSISTANCE AT A GLANCE

1. Basic Data		Project Number: 50204-001	
Project Name	Supporting Public Financial Management (Phase 3)	Department /Division	PARD/PNRM
Country	Papua New Guinea	Executing Agency	Asian Development Bank
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Public sector management	Economic affairs management		0.50
	Public expenditure and fiscal management		0.50
		Total	1.00
3. Strategic Agenda	Subcomponents	Climate Change Information	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low
4. Drivers of Change	Components	Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Institutional development Institutional systems and political economy Public financial governance	No gender elements (NGE)	✓
Knowledge solutions (KNS)	Application and use of new knowledge solutions in key operational areas Knowledge sharing activities		
Partnerships (PAR)	Bilateral institutions (not client government) Implementation International finance institutions (IFI) Private Sector		
Private sector development (PSD)	Public sector goods and services essential for private sector development		
5. Poverty and SDG Targeting		Location Impact	
Geographic Targeting	No	Nation-wide	High
Household Targeting	No		
SDG Targeting	Yes		
SDG Goals	SDG8, SDG9		
6. TA Category:	B		
7. Safeguard Categorization	Not Applicable		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		1.00	
Capacity development technical assistance: Technical Assistance Special Fund		1.00	
Cofinancing		0.00	
None		0.00	
Counterpart		0.00	
None		0.00	
Total		1.00	
9. Effective Development Cooperation			
Use of country procurement systems		No	
Use of country public financial management systems		No	

I. INTRODUCTION

1. The government of Papua New Guinea (PNG) has requested technical assistance (TA) from the Asian Development Bank (ADB) to address macroeconomic challenges and the urgent need to strengthen government capacity for policy development and execution.¹ The TA project is aligned with ADB's country partnership strategy and country operations business plan, 2017–2019 for the PNG, which in turn align with the Papua New Guinea Development Strategic Plan, 2010–2030.² The TA will support strategic budgeting within a sustainable medium-term fiscal framework, and the efficient and effective management of public funds in light of highly volatile revenues from natural resources.

2. The government has been closely involved in defining the TA's scope, focus, and approach to ensure that critical problems are addressed. Development partners—including the International Monetary Fund (IMF), the World Bank, the Australian government, and the European Union—have been consulted on the TA design to ensure that it complements other partners' assistance. A policy-based loan may be added in 2017 to address development financing needs and incentivize reform implementation and compliance.

3. The TA builds upon and advances achievements of two previous TA phases.³ The first phase strengthened the oversight of statutory authorities, improved project evaluation and prioritization, supported procurement reform efforts, enhanced subnational service delivery monitoring, and began development of the domestic debt market. The TA was rated *successful*: government institutions used policy advice and materials it produced, and development partners carried forward TA outputs in procurement and debt market development. The second phase supported financing arrangements for building and maintaining infrastructure and strengthened the accountability of statutory authorities.⁴

II. ISSUES

4. After a period of fiscal consolidation and public debt reduction from 2008 to 2012, the government expanded its fiscal policy stance in 2012, expecting windfall revenue from exporting liquefied natural gas. While annual real gross domestic product (GDP) growth increased from an average of 7.8% over 2008–2012 to 9.4% over 2013–2015, domestic resource mobilization did not keep pace. The domestic-revenue-to-GDP ratio fell from 30.4% of GDP in 2011 to 23.1% in 2015 as resource revenue dropped from 7.4% of GDP to 1.4% over the same period because of weaker global commodity prices. These factors, combined with increased spending, led to a fiscal deficit that rose from 0.2% of GDP in 2011 to an unsustainable 9.6% of GDP in 2013.

5. Government efforts to reverse this trend have had some success: the fiscal deficit fell to 8.3% of GDP in 2014 and 5.3% of GDP in 2015. However, the protracted downturn in global

¹ The TA project first appeared in the business opportunities section of ADB's website on 16 July 2016.

² ADB. 2015. *Country Partnership Strategy: Papua New Guinea, 2016–2020*. Manila; ADB. 2015. *Country Operations Business Plan: Papua New Guinea, 2016–2018*. Manila; and Government of PNG, Department of National Planning and Monitoring. 2010. *Papua New Guinea Development Strategic Plan, 2010–2030*. Port Moresby.

³ ADB. 2009. *Technical Assistance to Papua New Guinea for Supporting Public Financial Management*. Manila; and ADB. 2012. *Technical Assistance to Papua New Guinea for Supporting Public Financial Management Phase 2*. Manila.

⁴ The TA is currently being closed. Subsequently, the TA completion report will be prepared and published based on a thorough implementation review. The TA supported public finance management (PFM) reform, including monitoring of statutory authorities. The outputs of the TA were incorporated in the recently revised PFM Act approved by the Parliament.

commodity prices poses risks to the country's fiscal position. The current Medium-Term Fiscal Strategy, 2013–2017 has less fiscal anchors than the previous one. Deficits have been largely financed through domestic borrowing, but market appetite for new government securities is limited and the maturity profile is changing to shorter tenor, raising interest and rollover risks. Market changes in debt and commodities prices contributed to Moody's Investors Service downgrading PNG's rating from B1 to B2 in April 2016. The latest debt sustainability analysis—prepared as part of the 2015 Article IV consultation by the IMF and World Bank—indicates that PNG's risk of debt distress remains low based on an assessment of public and publicly guaranteed external debt. However, the overall risk of debt distress increases when factoring in public domestic and private external debt and contingent liabilities. Weak capacity means the Treasury is unable to effectively publicly communicate its fiscal intent, nor engage with stakeholders in policy development.

6. PNG needs to further cut spending in the short term and introduce new revenue and financing measures to make its fiscal position more sustainable: public debt has risen from 26.7% of GDP in 2012 to 39.5% of GDP in 2015. Budget cuts must be carefully targeted and public spending on development priorities such as health and education safeguarded so that growth, basic service delivery, and progress toward development outcomes may continue. Public finance management will need to be strengthened to effectively and efficiently manage limited resources, and internal controls need to be strengthened to ensure public spending aligns with reduced and prioritized allocations.⁵ These measures need to be applied equally to statutory authorities and subnational governments that absorb substantial shares of national revenue⁶ and pose significant fiscal risks.

7. New revenue measures, introduced with support from TA from Australia, are expected to provide some relief through improved compliance and risk management, reviewing of tax exemptions, better management of tax arrears, and taxpayer education. However, most of the population works in the informal sector, so the potential to raise revenue through taxes is limited. Lastly, new borrowing needs to be prudent and debt management strengthened to prevent interest payments from rising rapidly. The IMF and the World Bank advise the government on debt management, which needs to be complemented by macroeconomic (including monetary and structural) policy reforms. The IMF leads development partner advice in this area. If concerted reform efforts are implemented successfully, and with some easing of global commodity price pressures, the fiscal deficit is projected to narrow to 3.8% of GDP in 2016 and 2.2% in 2017.

III. THE CAPACITY DEVELOPMENT TECHNICAL ASSISTANCE

A. Impacts and Outcome

8. The TA impacts will be (i) prudent management of PNG's fiscal policy and budget, and (ii) the attainment of high standards of public sector management in all levels and institutions of

⁵ Many of the immediately necessary reforms aiming at more effective and efficient spending—including stronger internal controls for accountable and transparent budget execution—will stretch into the medium term. These include ongoing reforms to the integrated financial management information system, public procurement, debt management, payroll management, oversight and management of statutory authorities, and the intergovernmental fiscal transfer system. Building up a sovereign wealth fund is a medium- to long-term avenue for building fiscal buffers against future commodity price shocks. These reforms are supported by all major development partners, including ADB. While much of the reforms stretch beyond this TA project's focus, gaps in assistance that are identified as priorities may potentially be filled by the flexible support available under this TA.

⁶ Provinces receive about one-third of the resources from the national budget.

government.⁷ The outcome will be strengthened government capacity for prudent fiscal management. The TA will equip the government to take prudent decisions in a strained fiscal environment that requires gradual adjustments. This will allow the government to reduce the fiscal deficit and stabilize debt levels while safeguarding social spending for basic services, especially to poor and vulnerable groups.

9. The TA outcome will be measured through (i) ADB's annual country performance assessment, which reviews institutional performance across a range of relevant indicators, including fiscal policy and quality of budgetary and financial management; and (ii) public expenditure and financial accountability (PEFA) assessments, or equivalent reviews in between PEFA assessments. The PEFA performance indicators that are most relevant to this TA project cover public access to key fiscal information and fiscal risk management. Improvements in capacity are expected to gradually lift PNG's PEFA performance scores.

B. Methodology and Key Activities

10. The TA has two outputs:

- (i) **Prioritized spending within a sustainable fiscal envelope supported.** The main focus of this output is policy advice on and technical support for economic and fiscal analysis and upstream public financial management (PFM). Activities would include developing a credible, regularly updated medium-term fiscal strategy; annual budgets; and in-year budget reporting. The output also aims to strengthen budget processes and formats to increase the sustainability of ADB's support. The output will explore the possibility of increasing public engagement in the budget process, in coordination with the communication activities in output 2. The output also provides flexible support for reforms in economic management, upstream PFM, and downstream PFM to respond to evolving reform needs and political windows of opportunity. Potential reform areas in downstream PFM, which aim to improve spending in line with a credible budget, include support for internal controls, compliance with budget execution rules and procedures, and management of government trust accounts. Flexible support under this output will be prioritized in close consultation with government stakeholders and development partners.
- (ii) **Fiscal and public financial management reform program communicated effectively to all stakeholders.** This output aims to support output 1 by facilitating a constructive reform dialogue among key stakeholders (national and subnational public sector, the private sector, and the general public), and by supporting coordination, cooperation, and buy-in among all affected groups. This also aims to help the government signal commitment to prudent fiscal management and support for the private sector. A brief, focused communication strategy will assess existing limitations in government communication, define reform priorities, and identify effective and efficient communication channels for targeted audiences. It will then focus on facilitating better internal and external communication, including informal coordination forums, regular press briefings, policy briefs, and economic updates. The TA will build the government's communication capacity through training and mentoring.

⁷ Government of PNG, Department of National Planning and Monitoring. 2010. *Papua New Guinea Development Strategic Plan, 2010-2030*. Port Moresby.

11. The Department of Treasury (DOT) said during discussions on the TA design that it preferred to work directly with ADB. Deepening the trusted relationship, maintaining continuous dialogue on fiscal management, and providing access to high-quality knowledge solutions are critical to develop joint solutions to the country's pressing fiscal issues. For this, ADB's PNG resident mission requires expertise and resources to engage meaningfully and regularly with the authorities, as well as to coordinate with development partners.

12. The PNG Resident Mission's country director and country economist will continue to lead dialogue with the DOT and other relevant departments on fiscal policy. The TA will provide the resident mission with high-quality expertise and support to develop and implement specific measures in a flexible and responsive manner. This approach is consistent with ADB's country partnership strategy, fosters space for a joint reform agenda to emerge, and provides flexibility to support reforms that the government prioritizes. The TA aims to strengthen government capacity through day-to-day staff mentoring rather than to replace it with external advisors.

13. The TA will closely coordinate with other partners to save resources. In addition to support from ADB, PNG receives PFM support from Australia, the European Union, the IMF, the Pacific Financial Technical Assistance Centre, and the World Bank. The Public Finance Working Group consisting of partners and the government will be the main forum for coordinating TA activities. Short-term consultancy inputs from ADB will seek to align with and respond to the recommendations of the PEFA assessment and IMF Article IV staff reports.

14. Risks—such as waning government commitment to macroeconomic and fiscal management and insufficient policy coordination among key government agencies—are mitigated or minimized through the TA design. Ongoing oversight from ADB's resident mission will further allow appropriate responses to evolving risks. Oversight from ADB's resident mission will include the regular assessment of progress toward the (i) adoption of a credible medium-term fiscal strategy; (ii) safeguarding of allocation toward medium-term national development priorities; (iii) fiscal consolidation through cuts to nonproductive and wasteful expenditure; and (iv) frequent public government communication on the macroeconomic and fiscal position. Regular macroeconomic and PFM reviews, such as IMF Article IV staff reports, will serve as independent sources to verify progress against these milestones.

C. Cost and Financing

15. The TA is estimated to cost \$1,150,000, of which \$1,000,000 will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF-other sources). The government will provide counterpart support, including staff time, office space, office supplies, secretarial assistance, and domestic transportation, and other in-kind contributions.

16. The TA will be implemented over 36 months from November 2016 to October 2019. The initial funding will be \$1,000,000, despite likely larger financing needs, to (i) gauge the government's willingness to take on TA recommendations, (ii) avoid ring-fencing of scarce departmental TA resources until needed, and (iii) provide an opportunity to pursue cofinancing. If additional financing or cofinancing is needed and can be secured, the design and monitoring framework will be expanded to reflect any additional contributions to TA outcome, outputs, and activities.

D. Implementation Arrangements

17. ADB will be the executing and implementing agency. ADB will administer the TA in close collaboration with the DOT. The Department of National Planning and Monitoring and the Department of Finance will also be key counterparts given their critical roles in planning, preparing, and executing the budget. The DOT has asked ADB to help set up a macroeconomic policy analysis committee, chaired by the Treasury Secretary and with representatives from the Treasury Fiscal Policy and Budget Division, the Bank of Papua New Guinea, country economists from ADB and the World Bank, and a representative from the National Research Institute.⁸ The macroeconomic policy analysis committee will provide strategic guidance on the fiscal consolidation process and act as the TA's steering committee. The TA will also closely coordinate with the Public Finance Working Group.

18. The TA is expected to mobilize 27 person-months of individual consultants from the initial grant of \$1,000,000. An international public finance economist will work on both outputs. The country economist will supervise the consultant, who will be based at the resident mission. She or he will be responsible for providing DOT and other relevant departments with technical support on budget operations, for building capacity, and for providing advice on fiscal policy communication. A pool of short-term public finance specialists will also be recruited to provide flexible, highly specialized expertise as required. All experts will be recruited following ADB's Guidelines on the Use of Consultants (2013, as amended from time to time). The outline terms of reference is in Appendix 3. TA proceeds will be disbursed in accordance with ADB's *Technical Assistance Disbursement Handbook* (2010, as amended from time to time).

19. Resident mission staff and technical and administrative support from the sector division will be allocated to support TA management and administration, and to oversee technical outputs. ADB will determine whether the resident mission country economist needs support to manage the TA and its technical outputs, and explore avenues for funding such support.

20. The resident mission country economist (also acting as the TA team leader) will monitor the TA on an ongoing basis during implementation. Consultants will be required to submit regular progress and final reports. Specific technical outputs such as reports or policy briefs will be specified in the consultants' terms of reference. Evaluation of the TA will draw on (i) these technical TA outputs; (ii) TA performance against output and outcome indicators in the design and monitoring framework; and (iii) the findings of assessments by ADB and development partners, including ADB's country performance assessment for PNG and the next PEFA assessment. The consultants and the ADB TA team leader will identify good practices and lessons and outline these in TA outputs. Practices and lessons applicable to other countries will be shared, with support from ADB's responsible sector division, through policy briefs and presentations at regional conferences, such as the annual Pacific Update conference.

IV. THE PRESIDENT'S DECISION

21. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$1,000,000 on a grant basis to Papua New Guinea for Supporting Public Financial Management (Phase 3), and hereby reports this action to the Board.

⁸ Either the Department of National Planning and Monitoring and the Department of Finance will be part of the macroeconomic policy analysis committee or another coordination mechanism will be used to strengthen interdepartmental communication, coordination, and collaboration in planning and budget formulation.

DESIGN AND MONITORING FRAMEWORK

Impacts the TA is Aligned with			
Fiscal policy and budget prudently managed; and high standards of public sector management in all levels and institutions of government attained (Papua New Guinea Development Strategic Plan, 2010–2030) ^a			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
Outcome Government capacity for prudent fiscal management strengthened	By the end of 2019: a. Country performance assessment scores for fiscal policy and quality of budgetary and financial management increased by 0.5 points Baseline: 3.0 for fiscal policy and 3.5 for quality of budgetary and financial management (2015) b. PEFA performance indicator ^b scores for PI-9 and PI-10 improved to C Baseline: D (2015)	a. ADB annual report on the country performance assessment exercise b. PEFA report or equivalent assessment in between PEFA reports	Political instability, with elections scheduled for 2017, or external shocks undermine fiscal consolidation efforts and shift government attention away from the reform program. Political and/or administrative commitment to prudent macroeconomic and fiscal management and good governance decreases.
Outputs^c 1. Prioritized spending within a sustainable fiscal envelope supported	By the end of 2017: 1a. Medium-term fiscal strategy, 2017–2021 approved and published 1b. Annual budget strategy paper and budget, in compliance with medium-term fiscal strategy, approved and published	1a. Copy of strategy 1b. Copy of budget documentation	Administrative commitment to reform or capacity, e.g., through high staff turnover, weakens and undermines reform implementation and compliance. Lack of coordination in policy formulation among key government agencies and/or limited stakeholder consultations put the fiscal and PFM reform program at risk.
2. Fiscal and PFM reform program communicated effectively to all stakeholders	2a. Communication strategy approved 2b. Semiannual press conferences held and fiscal updates published	2a. Copy of document 2b. Press coverage and government website	Lack of or delay in TA to support reform design and implementation undermines reform pace.
Key Activities with Milestones			
1. Prioritized spending within a sustainable fiscal envelope supported (2016–2019)			
1.1 Conduct economic analysis to support the development of prudent macroeconomic and fiscal policies (November 2016–October 2019).			
1.2 Update medium-term revenue and expenditure plans to feed into a regularly updated medium-term fiscal strategy that safeguards social spending in education and health and other development priorities (November 2016–October 2019).			
1.3 Support preparation of annual budget strategies and documentation based on medium-term fiscal			

strategies (November 2016–October 2019).

- 1.4 Provide PFM policy and technical advice and capacity development to ensure prioritized allocation and spending of public funds based on priorities identified in consultation with government stakeholders and coordination with other development partners (November 2016–October 2019).

2. Fiscal and PFM reform program communicated effectively to all stakeholders (2016–2019)

- 2.1 Develop a brief communication strategy for the government's comprehensive fiscal and PFM reform program, identifying key internal and external audiences, and tailored, effective communication channels (November 2016–March 2017).
- 2.2 Organize regular internal discussion forums and press conferences, and prepare and publish frequent economic and fiscal reform program updates (November 2016–October 2019).
- 2.3 Release policy briefs on economic, fiscal, and PFM policy concerns to the public (November 2016–October 2019).
- 2.4 Develop fiscal and PFM communication capacity within key government institutions (November 2016–October 2019).

Inputs

ADB: \$1,000,000

Note: The government will provide counterpart support, including staff time, office space, office supplies, secretarial assistance, domestic transportation, and other in-kind contributions.

Assumptions for Partner Financing

Not applicable

ADB = Asian Development Bank, PEFA = public expenditure and financial accountability, PFM = public financial management, TA = technical assistance

^a Government of Papua New Guinea, Department of National Planning and Monitoring. 2010. *Papua New Guinea Development Strategic Plan, 2010–2030*. Port Moresby.

^b performance indicators refer to public access to key fiscal information (PI-9) and fiscal risk management (PI-10).

^c Baselines for output indicators are not applicable.

Source: Asian Development Bank.

COST ESTIMATES AND FINANCING PLAN

(\$'000)

Item	Amount
Asian Development Bank^a	
1. Consultants	
a. Remuneration and per diem	
i. International consultants	700.0
ii. National consultants	100.0
b. International and local travel	50.0
c. Reports and communications	5.0
2. Training, seminars, and conferences ^b	50.0
3. Miscellaneous administration and support costs ^c	5.0
4. Contingencies	90.0
Total	1,000.0

Note: The technical assistance (TA) is estimated to cost \$1,150,000, of which contributions from the Asian Development Bank are presented in the table above. The government will provide counterpart support in the form of counterpart staff, office accommodation, office supplies, secretarial assistance, domestic transportation, and other in-kind contributions. The value of the government's contribution is estimated to account for 13% of the total TA cost.

^a Financed by the Asian Development Bank's Technical Assistance Special Fund (TASF-other sources).

^b The indicative number of training sessions, seminars, and conferences is 10, targeting a total number of 150 participants. Training sessions and seminars will be held in the Department of Treasury, Department of Finance, and Department of National Planning and Monitoring conference halls and meeting rooms in Port Moresby.

^c Includes editing and translation of reports and other logistical and administrative costs.

Source: Asian Development Bank estimates.

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

A. Public Finance Economist (international, 18 person-months, full-time)

1. The public finance economist will have at least 8 years of work experience. She or he will have a master's or higher graduate degree in public finance, economics, or a related field. Prior experience in public finance reform in Papua New Guinea and/or the Pacific will be an advantage. She or he will have experience with fiscal policy, budgetary and public financial management processes, advising government officials, and facilitating multi-stakeholder coalitions and communication for reform. She or he will work closely with and mentor government officials on a day-to-day basis. Flexibility and responsiveness to evolving needs is important.

2. Outputs will include

- (i) providing technical support on overall budget planning and execution, including for financial analysis and forecasting, budget strategy and budget framework paper preparation, and monitoring budget outcomes;
- (ii) facilitating cooperation between government institutions and officials, as well as coordinating with development partners active in the macroeconomic and public finance arena;
- (iii) supporting effective communication of fiscal policy with government stakeholders, development partners, the private sector, and the general public;
- (iv) assisting in identifying fiscal policy and public financial management reform needs and required assistance, in coordination with the Department of Treasury and other relevant departments; and
- (v) providing secretarial support to the macroeconomic policy analysis committee, including organizing meetings, drafting minutes, and circulating policy papers.

B. Senior Public Finance Specialists (3 international or national specialists, 3 person-months each, intermittent)

3. The senior public finance specialists will have 10 years or more of international experience in fiscal policy and public financial management. They will have a master's or higher graduate degree in public finance, economics, or a related field. Experience in the Pacific region and/or in fragile states is preferred. The specialists will be recruited based on specific policy advisory and technical assistance needs that evolve during the design and implementation of the government's fiscal and public financial management reform program.

4. The specialists will provide day-to-day support to decision makers, senior government officials, and technical staff as per the scope of their specific terms of reference. The specialists will produce regular briefs for decision makers; support data analysis and the production of fiscal updates; and support the development of systems, processes, and capacity for transparent and accountable allocation and management of public resources. Specific areas of expertise required for the positions may include:

- (i) economic analysis to support the development of macroeconomic and fiscal policies;
- (ii) reviews of public expenditure allocations and sources of government revenue, and development of proposals for stabilizing the fiscal position and building government capacity to undertake economic and fiscal policy reforms;
- (iii) analysis of the impact of changes in public expenditures on fiscal targets and the performance of line ministries in delivering public services;

- (iv) review and design of budgeting processes and formats, and in-year budgetary reporting;
- (v) internal controls on spending, including for payroll, and compliance with budget execution rules and procedures;
- (vi) support for public accounting and financial reporting, including reliable accounting records, timely reconciliations, and clearance of suspense accounts and advances;
- (vii) management of public trust accounts;
- (viii) assessment of (off- and on-budget) public liabilities and fiscal risks, including from government loans, guarantees, and public–private partnerships; and
- (ix) supplementary reform efforts supported by other development partners to improve public financial management, including through reform of the integrated financial management information system, public procurement, debt management, payroll management, and the intergovernmental fiscal transfers system.