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Project Information Document/ Integrated Safeguards Data Sheet (PID/ISDS)

Concept Stage | Date Prepared/Updated: 16-Feb-2017 | Report No: PIDISDSC21176

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Parent Project ID (if any)	Project Name
West Bank and Gaza	P162850		Improve Public Financial Managment of the Palestinian Authority (P162850)
Region	**Estimated Appraisal Date**	**Estimated Board Date**	**Practice Area (Lead)**
MIDDLE EAST AND NORTH AFRICA	Mar 29, 2017	Jul 27, 2017	Governance
Lending Instrument	**Borrower(s)**	**Implementing Agency**	
Investment Project Financing	Ministry of Finance and Planning	Ministry of Finance and Planning	

Proposed Development Objective(s)

The Project Development Objective (PDO) is to enhance the Palestinian Authority's budget execution monitoring and control, financial accountability, and procurement.

Financing (in USD Million)

Financing Source	Amount
Special Financing	3.00
Total Project Cost	**3.00**

Environmental Assessment Category	Concept Review Decision
C-Not Required	

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Other Decision (as needed)

B. Introduction and Context

The proposed project would provide $3 million to the Palestinian Authority (PA) to support public financial management reform efforts executed by the Ministry of Finance and Planning (MoFP). These would focus on the *downstream* budget cycle (execution, reporting/accounting and procurement) and would mostly build on the recent technical assistance provided in these areas by the World Bank and UK DFID.

Country Context

West Bank and Gaza (WB&G) has particular characteristics given its very unusual political context. The 1993 Oslo Agreements and subsequent arrangements have (i) given Israel control of the flow of goods and people into and out of the West Bank and Gaza (ii) divided the West Bank into three different zones A, B and C with different modalities of Israeli control, and particularly constrained the movements of persons and goods in zone C which is under military control; (iii) in line with its control of the "borders" given Israel responsibility for collecting customs and VAT taxes on goods entering the Palestinian territory; and (iv) given Israel responsibility for power distribution according to modalities for each area. The territories are also divided politically with the PA controlling the West Bank and Hamas which are controlling Gaza. The latter has also been under various modalities of blockade with Israel and Egypt since 2006.

With these obstacles economic growth has been sluggish (3.5 per cent in 2015, which is stagnant in per capita terms) and many economic indicators are weak (while some social indicators are stronger). Although extreme poverty is not observed in WB&G, a situation quite unique in the region, poverty (less than $5.5 per day) remains high (8 per cent) especially in Gaza where it would be much higher without international aid. The unemployment rate is also high at 27 per cent but with huge differences between the West Bank (18 per cent) and Gaza (42 per cent).

Because it has limited borrowing capacity, WB&G is dependent on foreign aid mostly provided as budget support. It represented some 20 per cent of the projected budget for 2016. There has been a steady decline in budget support from about US$2 billion in 2008 to about US$600 million in 2016. While the main factors relate to broader political issues, the lack of tangible progress in the accountability of the Public Financial Management System during recent years has not encouraged confidence in donors.

In addressing this challenging situation it is urgent for the PA to improve its Public Financial Management (PFM) system. The rationale behind this strategic objective is to (i) make better use of national resources and ensure more effective and transparent implementation of policy decisions through the budget; (ii) better support service delivery to the public; and (iii) restore some confidence of the development partners in order to mitigate the risk of continued aid decline, in particular through budget support.

Sectoral and Institutional Context

During recent years the PA has made an effort to improve the Palestinian PFM system. The Ministry of Finance and Planning (MoFP) achievements cover the *downstream* cycle of the budget: (i) developing an IFMIS to devolve some of the implementation of the accounting and the budget functions to line ministries; (ii) managing on a cost-effective basis a treasury single account (TSA); and (iii) enhancing transparency with detailed monthly fiscal reports in line with GFS. In addition, the MoFP developed the *upstream* budget cycle by (i) operationalizing a macro-fiscal unit for better fiscal forecasting as part of a modernized budget preparation procedure; and (ii) preparing move towards program budgeting. In addition, the PA enacted in 2014 a new Public Procurement law that is consistent with international good practices.

However some significant weaknesses in the PFM system were identified by the 2013 PEFA. These systemic failures persist and affect the whole PFM cycle including: (i) budget preparation and formulation (*upstream* budget) is failing to achieve a sustainable annual budget; (ii) weak budget execution resulting in the continued accumulation of arrears; and (iii) insufficient financial accountability with the late disclosure of the audited Financial statements (FSs) of the PA for 2010 and 2011 and with significantly unexplained discrepancies (5% of total expenditures) in these FSs.

An effort has been made to address these weaknesses through technical support and capacity building provided to the MoFP by the Bank and other TA providers. The Bank has been supporting the *downstream* budget process since 2013 with new tools and procedures put in place to: (i) monitor arrears' accumulation[1]; (ii) improve preparation of financial statements (FSs) consistent with International Public Sector Accounting Standards (IPSAS)[2]; and (iii) expedite the backlog of FSs for 2012-2015 for audit by the State Audit and Administrative Control Bureau (SAACB)[3]. On the other hand DfID, has provided support to *upstream* budget preparation processes.

There has been little progress with the implementation of the recommended procedures due to weak management within the MoFP. This is evidenced by the fact that many reforms have stalled irrespective of their complexity or political sensitivity. In particular the procurement reform and other accounting reforms could have been launched since 2014 (e.g. bank reconciliation or commitment recording procedures) if strong management had been in place.

Furthermore, PFM deficiencies in some sectors keep impacting budget implementation and the associated service delivery. This relates in particular to the three key drivers of the national civil budget in three main sectors that need to be tackled from a PFM perspective:

- **Education sector** - The excessive size of the wage bill analyzed in the 2015 PER remains insufficiently addressed by the authorities. This is due in part to the lack of an adequate link to the budget to allow timely and well-informed implementing decisions on vacancies' management and wage bill components' control (salaries, allowances) ;

- **Health sector** - Medical referrals for Palestinians to hospitals or medical centers (mainly East-Jerusalem, Israel and Jordan) constitute one of the main sources of budget execution overrun and payment arrears in recent years (some $100 million in 2016). The accounting treatment of these arrears has been improved since 2015, but they are not reported on a timely basis, and the introduction of budget discipline and adequate procedures in the referrals process is still in its infancy; and

- **Municipal sector** - A huge fiscal problem has emerged in recent years with municipalities and distribution companies not paying electricity and water obligations to Israeli companies. This has resulted in significant claims on the PA budget by Israel (which is reported as "net lending" by the PA to the municipalities and distribution companies). The problem is due in part to the lack of transparency and accountability of the fiscal relations between the PA and the local governments (insufficient predictability of the amounts and timeliness of the flows of funds).

[1] annual cash plan, commitment recording, new accounting module of arrears in the IFMIS
[2] General Instruction for the preparation of the statements in 2014, Accounting Handbook tailored to the Palestinian system in 2015, training in 2016
[3] MoU between the MoFP and SAACB for the FSs in July 2014 updated in July 2016.

Additional weaknesses are affecting the accountability of the PFM system. This is evidenced by: (i) persistent problems in the reporting on payment arrears despite recent progress on their recording under Bank TA; (ii) a lack of clarity upon the accounting treatment of the commercial activities of the Petroleum Authority that are incorrectly mixed with the general budget transactions in the FSs; (iii) a backlog of outstanding FSs since 2013[4] giving no picture on recent financial accountability, (iv) the lack of a clear PFM strategy, and (v) more generally a lack of capacity and significant turnover among MoFP staff.

The implementation of Procurement reform has also been delayed. The reform and modernization of the public procurement system, which has been supported by the World Bank, including through the DPG series, aims at improving accountability, integrity, and transparency of the system, in addition to preventing corruption and increasing opportunities for the private sector. A new Public Procurement Law (PPL) and its implementing regulations were enacted in 2014. It lays down an acceptable institutional and organizational set-up for public procurement (procedural matters, transparency and accountability, complaint/dispute review mechanism) and provides for routine dissemination of information on public procurement through a single portal procurement website. The Higher Council for Public Procurement Policies (HCPPP) was established in September 2012 to oversight all public procurement activity, in addition to the development of the procurement system, but it entered in effect only on July 2016 and is not yet fully operational. With the Bank's support a single procurement portal is under development and scheduled to launch in March 2017.

The Bank and MoFP have agreed on the necessity to change the TA approach to strengthen the motivation of the authorities to implement the PFM reforms. So far, the financial instruments used by the Bank[5] for financing and incentivizing TA activities (DPG and NLTA) have contributed to developing new tools and procedures but have been less effective in incentivizing their effective implementation. To address this weakness, the Team has: (i) identified critical PFM problems that the authorities are motivated to address on a priority basis (both MoF and line ministries will be engaged on this); and (ii) agreed to use a recipient-executed investment project financing (IPF) to provide the MOFP with the resources to implement the technical assistance and capacity building.

The PA has firmed out its engagement in PFM reforms with the 2017-2022 Palestinian National Policy Agenda (NPA). The NPA includes as Pillar 2 – "Government Reform" a national priority called "Effective Government" and linked to a "National Policy" called "Effective and Efficient PFM", which is also in line with the proposed project. A "PFM Strategy Paper" is also planned to be integrated into the NPA. The first draft of this document and earlier discussions with MoFP indicate tight convergence with the proposed project.

Relationship to CPF

The draft **Bank Assistance Strategy** for 2018-19 (under finalization) includes as Pillar 1 – "Strengthening Peace and Stability through Inclusive Institutions," which includes an outcome 1.1 – "Improved fiscal and public financial management" with a sub-component called "Public Financial Management" fully in line with the proposed project. This covers budget execution management and control including in line ministries which are service providers.

[4] the audited financial statements for FY 2012 and subsequent FYs are yet to be issued
[5] Also DfID is using such instruments

C. Proposed Development Objective(s)

Note to Task Teams: The PDO has been pre-populated from the datasheet for the first time for your convenience. Please keep it up to date whenever it is changed in the datasheet.

The Project Development Objective (PDO) is to enhance the Palestinian Authority's budget execution monitoring and control, financial accountability, and procurement.

Key Results (From PCN)

In order to achieve the PDO, the Project will support the implementation of priority tools and procedures to address systemic weaknesses of the PFM system. This includes:

1) Developing a Commitment Control System (CCS) across all budget entities and activating a Cash Planning Committee at the MoFP in parallel in order to serve as a “guide” for budget execution;
2) Setting up an Establishment Control System in order to better control the evolution of the wage bill and the recruitments in line with the budget. This will be particularly focused at the Education sector which wage bill is the most important of civil services (see above);
3) Operationalizing budget mechanisms in the Ministry of Health in order to link the annual referrals Master Plan with CCS for budget affordability;
4) Upgrading the accounting and reporting of the (i) *Net lending*, (ii) Petroleum Authority’s commercial activities, and (iii) payment arrears; and expediting the backlog of outstanding financial statements of the PA in coherence with the MoU agreed in July 2016 between the MoFP and SAACB (audited FS for year N issued no later than year N+2); and,
5) Operationalize the functionalities to support national bidding documents by sectors and Complaint Handling Mechanism in the Procurement Portal.

Progress on achieving the PDO will be measured and monitored through a specific Results-Monitoring Framework.

D. Concept Description

The project is designed in order to address the main systemic budget *downstream* weaknesses identified in the 2013 PEFA building on earlier Bank direct support and TA (especially in accounting and procurement). Therefore the project is not aimed at a comprehensive PFM Reform because (i) it does not include the *upstream* budget cycle or taxation (already supported by DfID and the IMF) although it could seek to provide better information for some items which are suffering from insufficient budgeting *upstream* (wage bill, and medical referrals) and (ii) it would be premature to have broader objective before the basic PFM infrastructure is fixed, and (iii) it is doubtful that the MoFP is in a position to digest more innovative knowledge and to develop more capacity toward new PFM procedures and concepts.

The Project will draw on the lessons learned from previous Bank TA activities in the PFM area, in particular poor capacity and a weak management environment at the MoFP and in some line ministries (Education, Health and Local Governments). As a result, the project will be particularly focused on implementation and change management with a dedicated Project Management Unit established at the MoFP to support the development of managerial decision-making procedures to implement the reforms and address bottlenecks that may arise over the course of the project. Ensuring that the PMU has an effective link to the Minister and senior management in MoFP will be critical, in addition to the more traditional objective of a PMU to manage the implementation of the Project.

Furthermore the Bank intends to establish an associated Bank-Executed TA engagement on PFM that will complement the project. This would allow the Bank to bring in experts to address particular challenges faced by the project, and to support oversight and guidance on the reforms. Discussions are advanced with both the European Union and the French AFD to finance the proposed Bank engagement. The scope of the engagement and how it supports the specific components of the project will be decided as the negotiations with the donor partners proceed.

The main proposed components of the Project that will be implemented and monitored against results indicators are the following:

- **Component 1**: Improving Budget Execution and Control at central and selective sector levels;
- **Component 2**: Improving Financial Accountability of the PFM system with the support of the SAACB, and improving capacity of private auditors of local governments;
- **Component 3**: Developing modern Procurement instruments in order to implement the new 2014 Public Procurement Law; and
- **Component 4**: Project Management arrangements.

More detailed breakdown for each component will be made during the Project Appraisal Document under preparation. However the main objectives by component can be drawn at this stage as follows:

The **Component 1** will address the two core weaknesses in the budget execution and control:

1) budget execution procedures to serve as a “guide” for better coherence with the initial budget and its cash projection, knowing that the initial budget is already passed with a financial gap. The project will help achieve this objective by complementing and upgrading the existing commitment system (CS) and annual cash planning. It will include: (i) rolling-out the CS from 6 to all ministries and upgrading the control modalities in order to identify, report, and control commitments on a timelier basis to allow effective and well-informed decision making; and (ii) institutionalizing and activating the cash Plan through a Cash Planning Committee in order to validate the commitments trend (new and outstanding) against budget and cash affordability. Substantial capacity building and training will be provided at the MoFP and line ministries by a dedicated team of peripatetic experts at the PMU in order to (i) implement the reform with issuing manuals accordingly; (ii) organize workshops and exchanges; and (iii) monitor and evaluate its implementation. The reform across-the-board will also be adapted to the specificities in (i) the Health sector by integrating the commitment/cash procedures with the existing annual referrals Master Plan for better financing affordability and control; and (ii) Local Govs sectors *net lending*-related expenditures by reducing the gaps in accuracy, timeliness and predictability of fiscal

inter-governments relations at the origin of these expenditures. Capacity will be built in sectors and MoF with additional manuals of implementation, including works on adequate calendar for the forecasting of financial transfers. In that regard, the project may be led to touch upon the budgeting procedures *upstream* for referrals and net lending insofar as this may help better execution and control.

2) insufficient budgetary oversight of the wage bill to monitor implementation of related policy decisions (salaries, allowances, staffing adjustment through vacancies' replacement, functional reviews, etc.) made *upstream* by a high-level HR committee (Cabinet, General Personal Council and MoFP). The primary objective of the Project is not to help the authorities define wage bill policy (this will be done elsewhere through other appropriate means, in particular the DPG) but to help instead their implementation and control through better budget procedures, including establishment control. The project could define after analysis further orientations for improving the interconnection between the IT systems of the GPC and MoFP if it helps to have better information and control on the wage bill. This activity could also have some implication in the *upstream* process whereby the HR decisions are to be incorporated in the annual budget preparation process. The Project will handle such activity, in particular at the Education sector, insofar as it may contribute to better execution and control (same rationale than bullet above for referrals).

This component will also include general training and workshops to complement staff's knowledge and skills about budget execution procedures in liaison with the Palestinian Financial Institute. A study tour at the MoF in Jordan could also be useful in order to reflect on the Commitment Control System reform recently launched in this country.

The **Component 2** will aim at:

1. Completing the alignment of the accounting and reporting on international standards (GFS and IPSAS) in order to improve the accountability of the PFM system and restore the international community's trust on the PA's financial data. This activity will follow up on Bank TA works that were carried out since 2014 (Accounting Handbook, Instruction for issuing the FSs) and will provide an additional impetus in order to energize their implementation. This activity will also include implementation of the actions that have stemmed from a recent Bank-funded external review on the accounting system in relation with re-engineering bank reconciliations' process and upgrading the IT software supporting system;

2. Improving the capacity of private sector auditors insofar as their audit of local governments is affecting the accountability of the broader PFM system and the associated fiduciary risk. This activity will address the challenge of having municipalities and village councils' financial affairs audited by private auditors who may not be sufficiently knowledgeable, prepared, trained and aware about the nuances and particularities of these institutions from a fiduciary perspective. A program of targeted training and education will be designed and implemented for that purpose; and

3. Establishing a normal cycle of issuance (production by MoFP and audit by SAACB) of the annual financial statements (FSs) of the PA in line with international standards in terms of accuracy and timeliness. This will stem from the improvement of accounting and reporting procedures outlined above, but will also require that the backlog of outstanding FSs since 2013 is expedited both by the MoFP and the SAACB, by additional temporary accounting (MoFP) and auditing (SAACB) task forces.

This component will also include associated training and capacity building, in particular with workshops and training sessions with the Palestinian Financial Institute to follow up on previous training based on the Accounting handbook as mentioned above.

The **Component 3** will aim at supporting: (i) the effective implementation of the Single Procurement Portal with the functions already developed (procurement data collection, monitoring, performance benchmarking, information about national procurement policies, and complaint handling mechanism/dispute); and (ii) the development of sector specific bidding documents already identified (pharmaceuticals in the health sector, textbooks, non-consulting services and ICT) in order to address the procurement requirements on these sectors for better standardization, harmonization, transparency, and predictability. These activities to be operationalized through the Portal will be developed with associated training and capacity building as needed in all areas of procurement as a continuation of training activities supported by the Bank since the issuance of the new Public Procurement Law.

The **Component 4** is aimed at establishing a Project Management Unit (PMU) in order to ensure the administration and implementation of the Project. This will include coordinating with the MoFP General Director in charge of international cooperation, contracting with consultants to address some specific topics of the project (e.g. CCS as said above), communicating internally with the MoFP and externally with the Bank, ensuring the financial management and procurement arrangements, monitoring and evaluating the project execution according to the agreed results-framework, ensuring the audit of the project, and disseminating the project's activities toward other development partners, in particular to provide inputs to the quarterly PFM donors meeting group co-chaired by the Bank and the IMF. The modalities and functioning of this PMU will be further defined during the preparation of the Project Appraisal Document (PAD), especially in light of the plan of the MoFP to establish a Strategic Committee and a Technical Committee in charge of the broad PFM reform as defined in the MoFP "PFM Strategy Paper" mentioned above.

The PMU will aim at energizing project's implementation and promoting within the MoFP a Change Management Approach in line with the PFM Strategy. This will be informed by the lessons learned during the previous Bank and DFID TA activities since 2014. In particular, the PMU will seek to identify implementation bottlenecks and facilitate coalition-building and streamlined decision making mechanisms.

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SAFEGUARDS

A. Project location and salient physical characteristics relevant to the safeguard analysis (if known)

not applicable

B. Borrower's Institutional Capacity for Safeguard Policies

not applicable

C. Environmental and Social Safeguards Specialists on the Team

D. Policies that might apply

Safeguard Policies	Triggered?	Explanation (Optional)
Environmental Assessment OP/BP 4.01	No	
Natural Habitats OP/BP 4.04	No	
Forests OP/BP 4.36	No	
Pest Management OP 4.09	No	
Physical Cultural Resources OP/BP 4.11	No	
Indigenous Peoples OP/BP 4.10	No	
Involuntary Resettlement OP/BP 4.12	No	
Safety of Dams OP/BP 4.37	No	
Projects on International Waterways OP/BP 7.50	No	
Projects in Disputed Areas OP/BP 7.60	No	

E. Safeguard Preparation Plan

Tentative target date for preparing the Appraisal Stage PID/ISDS

Apr 28, 2017

Time frame for launching and completing the safeguard-related studies that may be needed. The specific studies and their timing should be specified in the Appraisal Stage PID/ISDS

No timeframe required

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APPROVAL

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