

**PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE**

Report No.: PIDA714

Project Name	Financial Reporting and Oversight Improvement Project (P130878)
Region	AFRICA
Country	Malawi
Sector(s)	Central government administration (70%), Sub-national government administration (30%)
Lending Instrument	Technical Assistance Loan
Project ID	P130878
Borrower(s)	Republic of Malawi
Implementing Agency	Ministry of Finance
Environmental Category	C-Not Required
Date PID Prepared	06-Dec-2012
Estimated Date of Appraisal Completion	26-Nov-2012
Estimated Date of Board Approval	22-Jan-2013
Decision	Authorized appraisal

I. Project Context

Country Context

Malawi is a landlocked low income country with an estimated Gross National Income per capita of US\$330 (in 2009), registering an average real GDP growth rate of about 7% per annum for the last five years. It is also one of Southern Africa's most densely populated countries, with an estimated population of 14.9 million as of 2010 and a significant percentage (52.4%) of them currently live under the 1.25 dollar-a-day income poverty line. Income inequality also remain high reflecting profound inequities in the access to assets, services and opportunities across the population.

Until 2010, Malawi experienced solid growth through prudent macroeconomic policies and a supportive donor environment. This performance was built on strong stabilization policies since 2004, and the debt relief from the Heavily Indebted Poor Countries (HIPC) initiative which helped to improve public expenditure management and created the fiscal space needed to generate the momentum for growth. Growth was largely driven by high agricultural exports, rising Foreign Direct Investment (FDI) inflows related to mining and Government spending.

In early 2012 it was estimated that 2011 real GDP had slowed to about 4.3 percent. The new government has taken decisive policy measures to arrest the slowdown in the economy and is already implementing a comprehensive package of economic reforms. These reforms aim to address the current external imbalances with plans to cushion the vulnerable poor against the impact through social protection programs, and facilitate a growth rebound in the short term. In this regard, some decisive and credible measures have been taken by the authorities to strengthen economic governance, while at the same time signaling to development partners and the private sector of government's commitment to create a favorable environment for a return to positive growth. The measures are so far having their intended effect. The authorities are also committed to a program of fiscal consolidation in their 2012/13 budget, while ensuring there is some room to promote a private sector rebound.

The swift movement of President Banda's government to approve changes and to repair relations with donors and international financial institutions has put Malawi on a firm position to regain macro-economic balance and return to a positive growth path. The policy reform measures undertaken recently would now allow for a relatively quick return to a growth path that is in line with Malawi's recent historical trend. The government's efforts to restrain fiscal and monetary policy, in support of the recent devaluation of the Kwacha and adoption of a flexible exchange rate regime, will support the quick recovery if sustained.

The Second Malawi Growth and Development (MGDS II) 2011-2016, which is the country's second medium term plan, was approved by the Cabinet in April 2012. The MGDS II is a medium term strategy designed to attain Malawi's long term aspirations as spelt out in its Vision 2020 and strives to foster a more inclusive job creating growth to address the unemployment problem as well as reduce poverty. The strategy reflects a general consensus on the country's broad goals for growth, social equity, and governance. The MGDS II was developed in an all inclusive process. All levels of society, including women, the youth, private sector, civil society and development partners were all involved in the MGDS II consultation process. To respond to the negative impact of policies undertaken by the previous administration, the Government has come up with a short term economic recovery plan, which was approved by Cabinet in April 2012. This Recovery Plan is well aligned with MGDS II and its focus is on short term measures to restore macroeconomic stability while mitigating the impact on the poor.

II. Sectoral and Institutional Context

The Government of Malawi (GoM) has been reforming its public financial management systems over the last ten years. While this has yielded significant improvements in the legal framework, IT systems and budget procedures, the full benefits of these reforms have not yet been felt in terms of aggregate fiscal discipline, strategic allocation of resources and effective service delivery. The authorities and development partners recognize the need to move to a new phase of the reforms focused in greater implementation of the new rules and regulations, tighter internal controls and greater attention to the benefits of PFM reforms for MDAs and sectors. The management of the PFM system is mainly concentrated within the Ministry of Finance and Development Planning (MFDP). Within the Ministry, the Secretary to the Treasury has a key responsibility for budget planning and execution, while the Accountant General has responsibility for producing timely and appropriate management and financial accounts. Within MDAs it is the Controlling Officers who have overall responsibility for effective PFM.

Overall, four Public Expenditure and Financial Accountability (PEFA) assessments have been conducted in Malawi in 2005, 2006, 2008 and 2011. The 2011 PEFA assessment was based on an analysis of performance for the years from 2007-08 to 2009-11. The main findings relating to budget execution, accounting and financial reporting and internal and external oversight are summarized in the box given below.

Public Financial Management Assessment, 2011 – Major Findings (extract from PEFA report)

Predictability and control in budget execution: Reforms are on-going in the Malawi Revenue Authority. The Ministry of Finance has improved the cash management process. Debt management and payroll system are being operated efficiently. The Procurement system continues to be unable to provide statistics with regard to the implementation and comprehensiveness of competitiveness in public procurement. The IFMIS rollout process has been concluded to the central government and 22 Local Authorities. Although awareness seems to be rising with regards to internal control, the evidence does not yet support the finding of improved control and internal audit procedures and processes being implementing and taking effect.

Accounting, recording and reporting: Progress in the period under review has featured the improved timeliness of the closure of the accounts and the production of the financial statement for audit. Also, in-year budget execution reports are produced on a timely basis and with some improvements in quality. However, management information at service delivery units still needs to improve. A serious control concern identified is the backlog in bank reconciliations since July 2010. Timely bank reconciliation is an essential discipline in the ongoing checking and verification of accounting practices across Government and it also provides assurance as to the integrity of data used for reporting.

External scrutiny and audit: The period covered by this assessment has seen a backlog of external audits and Public Accounts Committee (PAC) scrutiny cleared. However, there are still weaknesses in the actions and follow up based on the recommendations of the National Audit Office (NAO) and PAC. In summary, NAO and PAC scrutiny has been characterized by periods when there has been no public scrutiny followed by intense activity to clear backlog s. In respect the Parliamentary Finance Committee, there is more opportunity for scrutiny of the draft budget than for budget execution.

The Group on Finance and Economic Management (GFEM), originally a donor grouping, was transformed in 2006 to a joint donor GOM forum. This provides a management steer of PFM reform through participation of both GoM and donors. It is now co-chaired by the Secretary to the Treasury and a head of a development agency on a rotating basis. The Ministry of Finance recognized the importance of developing a facilitating unit for PFEM reforms and acting as a secretariat, and thus set up a PFEM Unit in 2008. This was formally established through the Ministry of Finance functional review in 2010. With this establishment of a unit to deal with PFEM, it became possible to consider developing a more structured approach to PFEM reform.

The PFM reforms are being supported by donors through the Common Approach to Budget Support (CABS) Group who have been providing assistance to the Government of Malawi (GoM) since 1997. The reform efforts are coordinated between the Government of Malawi and donors through GFEM meetings that are jointly chaired by the Secretary of the Treasury and a representative from the donors. Through the Financial Management Transparency and Accountability Project (FIMTAP) financed by the World Bank and the European Union, capacity development assistance was provided to Internal Audit, External Audit and the Office of the Director of Public Procurement. The project also supported the acquisition, installation and operationalization of the IFMIS, the Government Wide Area Network and general governance improvement among others. Through the Malawi Social Action Fund (MASAF), the Bank helped in building capacity including FM capacity at the District Level. There were also significant contributions to PFEM reform from DfID, Norway and the EU. The EU Capacity Building Project for Economic Management and Policy Coordination was instrumental in developing the PFEM programme and strengthening capacity in both the MOF and the Ministry of Economic Development and Planning.

Though progress has been registered in several areas, there is much more to achieve. Progress has indeed been made on many of the activities in the PFEM AP but for many, they are well behind initial target dates and insufficient attention and resources have been given to identifying and resolving bottlenecks. Several reforms and improvements have been introduced but implementation lags behind. It is evident that there needs to be a consolidation of what has been introduced and for a more thorough attention to implementation with an assured stream of resources. A more comprehensive approach is required through a sector wide approach to PFEM reforms. The government therefore decided to introduce a PFEM Reform Program (RP) and the proposed support is being designed on the basis of the new reform program using a common basket funding mechanism by establishing a Multi Donor Trust Fund for PFEM to be administered by the World Bank and executed by GoM.

III. Project Development Objectives

The project development objective (PDO) is to improve the internal controls, accounting, reporting and oversight of government finances at the central and decentralized levels in Ministries, Departments and Agencies (MDAs) and districts in Malawi.

IV. Project Description

Component Name

Internal Audit

External Audit

PFEMRP Management

Accounting and Financial Management

Contingencies

V. Financing (in USD Million)

For Loans/Credits/Others

Amount

Borrower

0.00

Malawi Public Finance and Economic Management Reform Program

19.00

VI. Implementation

The individual components will be managed by senior officers responsible to the heads of the relevant agencies – Accountant General, Auditor General, Internal Audit Director and Head of PFEM Unit. The project is being implemented within the framework of the Public Finance and Economic Management Reform Program (PFEMRP) and will be overseen by the PFEM unit in the MoF which will also be responsible for centralized procurement, financial management and monitoring of the overall trust fund program. Capacity building will be given to this unit both in terms of staff training and also additional appointments to support its main functions. Project implementation arrangements have been derived from the governance arrangements set up for the PFEMRP as a whole and will consist of: (i) PFEM Steering Committee; (ii) PFEM Technical Committee (PFEMTC); (iii) Technical Working Groups (TWGs) and (iv) PFEM Unit (PFEMU). In addition to this, there is also a Joint Government Donor Committee.

VII. Safeguard Policies (including public consultation)

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

VIII. Contact point**World Bank**

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