

INTERNATIONAL DEVELOPMENT ASSOCIATION AND INTERNATIONAL
MONETARY FUND

**Update on the Assessments and Implementation of Action Plans to Strengthen Capacity
of HIPCs to Track Poverty-Reducing Public Spending**

Prepared by the IMF's Fiscal Affairs Department and the World Bank's Poverty-Reduction
and Economic Management Network

In collaboration with other departments of the IMF and World Bank

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EXECUTIVE SUMMARY

This paper is a follow-up to the March 2002 Board paper titled “Actions to Strengthen the Tracking of Poverty-Reducing Public Spending in Heavily Indebted Poor Countries (HIPC);” and the March 2003 Board paper titled “Update on Implementation of Action Plans to Strengthen the Capacity of HIPC to Track Poverty-Reducing Spending.” It reports on the progress of HIPC to track public spending in the context of the enhanced debt relief initiative and on the status of action plans agreed with country authorities to strengthen their public expenditure management (PEM) systems. This update is based on an assessment of PEM systems in 26 countries and is prepared by World Bank (Bank)/IMF (Fund) staff in consultation with country authorities using standardized formats.

The 2004 HIPC assessments were carried out using 16 indicators, one more indicator than the previous assessment. A new indicator was added to measure the quality of public procurement systems. The guidance material was also revised to make the assessment criteria more precise. The strengthening of the assessment criteria suggests that care should be exercised in comparing the new more comprehensive assessments with the results from the earlier rounds of assessments.

Overall, PEM performance has improved for the assessed HIPC, though the extent of progress is mixed across countries and indicators. Total benchmarks met increased by about 10 percent from 2002. Those PEM areas identified as weakest in 2002 improved significantly by 2004. Irrespective of benchmarks, assessments for one-third of indicators changed from 2002, with about 60 percent indicating improved ratings. Given the number of variables influencing a country’s PEM performance, this positive trend is encouraging. The IMF, the World Bank, and other development partners are working together to advance a strengthened approach to PEM reform that is intended to yield further improvements on the ground in many of these countries.

HIPC have also made progress in identifying and tracking public spending. The 2004 assessments indicate that while countries have made some progress in strengthening their PEM systems, substantial efforts are still needed. Of the 23 countries reassessed from 2002, two have improved and are now assessed as needing little upgrading to their PEM system. Five countries need some upgrading to their PEM systems and 16 countries still need substantial upgrading. The total number of benchmarks met improved with largest improvements in budget reporting. Reported spending on poverty-reduction has increased and a larger number of HIPC now link the budget data to spending categories as defined in their Poverty-Reduction Strategy Papers (PRSPs).

Further progress has been made in implementing the action plans since 2003. Six countries have initiated implementation of all actions defined and most countries have fully implemented or initiated implementation on a majority of their action plans. Countries with higher rates of fully implemented actions generally showed stronger improvements against benchmarks met. An analysis of 2002 actions and progress to date suggests that well-targeted

action plans, together with strong government commitment to reforms and coordinated donor assistance, have been effective in improving countries' PEM systems performance.

New actions defined in 2004 more clearly target individual indicators and focus on improving internal controls and procurement systems. As in 2002, the short-term and medium-term actions in 2004 also focus on areas such as coverage of government expenditures to include, in particular, donor-financed expenditures; budget classification systems; in-year budget reporting; Integrated Financial Management Information Systems (IFMIS); Public Expenditure Tracking Surveys (PETS); audits and parliamentary oversight committees; legal and regulatory frameworks; and budget formulation and monitoring, and capacity building. In 2004, actions have expanded to include issues related to procurement systems and decentralization.

The number of donor agencies involved in supporting PEM reforms in HIPC countries is substantial, with an average number of seven donor agencies involved per country. Donors are currently providing assistance in all PEM areas.

The World Bank and the IMF are supporting PEM reforms in HIPC countries through conditionality as well as direct assistance. A majority of Fund-supported programs include measures aimed at reforming PEM systems. The Bank provides direct support to reform through lending, grants and advisory services, in addition to incorporating HIPC action plan measures into lending.

As noted in previous Board papers, institution-building is a medium- to long-term endeavor. Sustained country and donor commitment over time is essential to overcome capacity limitations. Focused reform implementation and sequencing also point to the need for realistic expectations on the rate of improvement.

The Fund and Bank staff propose that any future assessment of HIPC countries be undertaken within the assessment framework of the strengthened approach to Public Financial Management reform, as developed by the World Bank and its Public Expenditure and Financial Accountability (PEFA) partners. The strengthened approach includes an expanded set of 28 indicators for assessing PEM systems, and a performance report modeled broadly on the HIPC Assessment and Action Plans (AAP). The performance report and indicators will be used within a framework of a country-led PEM reform strategy and a better country-level harmonization of donor work in support of the country reform strategy. In the World Bank, the monitoring and reporting of PEM performance would be integrated into the overall PEM analytic work program of a country and undertaken at the country level. The Fund will contribute to this work when related to ongoing technical assistance (TA) work.

I. INTRODUCTION

A. Background and Origins of Work

1. **This paper continues the process of reporting to the Executive Boards of the Bank and the Fund on the ability of HIPCs to manage and track public spending in the context of the enhanced debt relief initiative.** Prior papers have included the following: Tracking of Poverty-Reducing Public Spending in Heavily Indebted Poor Countries (HIPCs) (March 2001); Actions to Strengthen the Tracking of Poverty-Reducing Public Spending in Heavily Indebted Poor Countries (HIPCs) (March, 2002); and Update on Implementation of Action Plans to Strengthen Capacity of HIPCs to Track Poverty-Reducing Spending (March 2003).^{1,2,3}

2. **The March 2002 paper provided assessments of the ability of PEM systems in 24 HIPCs to track poverty-reducing spending.**^{4,5} The paper also reported on actions to strengthen PEM systems. During the discussions at the two Boards, Directors asked staff to:

- report on progress in implementing the action plans, using a standardized format, as part of the review of Fund- and Bank-supported programs;

¹ <http://www.imf.org/external/np/hipc/2001/track/index.htm>; and <http://www1.worldbank.org/publicsector/tracking.pdf>.

² <http://www.imf.org/external/np/hipc/2002/track/032202.htm>.

³ This paper was for the information of the Boards.
<http://www.imf.org/external/np/hipc/2003/track/030703.htm>.

⁴ The March 2002 Board paper was based on assessments done in 2001, and included 24 countries that had reached or were being considered for decision point status: Benin, Bolivia, Burkina Faso, Cameroon, Chad, Ethiopia, The Gambia, Ghana, Guinea, Guyana, Honduras, Madagascar, Malawi, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, São Tomé and Príncipe, Senegal, Tanzania, Uganda, and Zambia. In 2004, three new countries have been assessed—the Democratic Republic of Congo, Guinea-Bissau, and Sierra Leone. The 2004 Mauritania assessment has been put on hold due to recent macrobudgetary developments in the country. The 2004 assessment includes 26 countries, of which 23 were assessed in 2001.

⁵ “Tracking” is defined as the identification and reporting of budgeted and actual outlays. Earlier assessments emphasized the capability to track outlays specifically for poverty reduction. While continuing to report on the development of that specific capability in HIPCs, this paper provides an assessment of the budget system’s ability to manage and track overall public expenditure, including spending on all priority programs.

- continue to report on poverty-reducing spending, as defined in the PRSPs;
- provide an update in 2003 of progress in implementing action plans based on standardized reporting in Board documents;⁶ and
- conduct a new comprehensive review of the capacity of HIPCs to track public spending in 2004.

3. **This paper provides the comprehensive reassessment requested by Directors.**

The other requests made by Directors at the 2002 discussion have been met. The rest of the paper is organized as follows: Section II describes the process and methodology used in conducting the comprehensive reassessment; Section III reports on the status of PEM systems as captured by the comprehensive reassessment and compares this with the status as reported to the boards in 2002; Section IV examines the extent to which the action plans are being incorporated in country-owned strategies and in programs supported by the Fund and the Bank; Section V discusses trends in poverty-reducing public spending; and Section VI lays out the next steps.

II. PROCESS AND METHODOLOGY FOR CONDUCTING THE COMPREHENSIVE REASSESSMENT

A. Process

4. **The results presented here are the outcome of extensive collaboration among the IMF and the World Bank, country authorities, and relevant donors.** The work was coordinated by the Poverty-Reduction and Economic Management Vice-Presidency (PREM) and the Africa (AFR) and Latin America and the Caribbean (LAC) Regions in the World Bank and by the Fiscal Affairs Department (FAD) in the IMF. It involved 27 Bank and Fund teams in Africa and Latin America. In-country work was conducted over the period from mid-2003 to December 2004.

5. **The Bank (14 countries) and the Fund (13 countries) divided the leadership for preparing each of the comprehensive reassessments.** In most cases, missions were fielded with representation from both institutions. Guidance material for the reassessments was shared with country authorities, who were encouraged to prepare self-assessments. Where prepared, staff reviewed the self-assessments in the field, and provided draft reassessments, which were then subsequently reviewed in Washington, D.C.. Countries were asked to agree to publication. So far, eight countries have agreed to this and their reassessments have been posted on a website,⁷ and a further 15 countries have allowed lapse-of-time (LOT) approval

⁶ This was done in the 2003 paper.

⁷ <http://www1.worldbank.org/publicsector/pe/hipcpapers.htm>.

periods for publication to expire.⁸ It is proposed that these LOT-agreed reassessments be published 15 days after the issuance of this paper.

B. Methodological Changes in Carrying out the Assessments

6. **Country PEM systems were comprehensively reassessed in this round using 16 indicators, one more indicator than in the previous assessment.** The new 16th indicator assessed the effectiveness of the public procurement system. Furthermore, following review of the assessment instrument used in 2002, the guidance material was revised to make the assessment criteria more precise. Table 1 lists the 16 indicators.

Table 1. Description of Expenditure Tracking Indicators and Benchmarks

Public Expenditure Management Issue		Benchmark Description
Formulation	1. Composition of the budget entity	Very close fit to government finance statistics (GFS) definition of general government
	2. Limitations to use of offbudget transactions	Extra (or off) budget expenditure is not significant
	3. Reliability of budget as guide to outturn	Level and composition of outturn is "quite close" to budget
	4. Data on donor financing	Donor-funded expenditures included in budget or reports
	5. Classification of budget transactions	Functional and/or program information provided
	6. Identification of poverty-reducing expenditure	Identified through use of classification system
	7. Quality of multiyear expenditure projections	Projections are integrated into budget formulation
Execution	8. Level of payment arrears	Very few or no arrears accumulated
	9. Quality of internal audit	Effective internal audit function
	10. Use of expenditure tracking surveys	Tracking used on regular basis
	11. Quality of fiscal/banking data reconciliation	Satisfactory and timely reconciliation of fiscal and monetary data
Reporting	12. Timeliness of internal budget reports	Monthly expenditure reports provided within four weeks of end of month
	13. Classification used for tracking poverty-reducing expenditures	Good quality, timely functional reporting derived from classification system
	14. Timeliness of accounts closure	Accounts closed within two months of year-end
	15. Timeliness of final audited accounts	Audited accounts presented to legislature within one year
Procurement	16. Effective procurement	Procurement processes promote competition, transparency and value-for-money

⁸ <http://www1.worldbank.org/publicsector/pe/hipcpapers.htm>.

7. **The strengthening of the assessment criteria has resulted in more consistent application of the guidance across countries in the 2004 assessment.** In particular, the most significant changes occurred to Indicators 1, 2, 3, 4, 11, and 13,⁹ of which, Indicators 1, 2, 4, and 13 were made slightly easier to meet, and guidance for Indicators 3 and 11 was slightly tightened. The more precise guidance material, coupled with stronger efforts at quality review, resulted in a generally higher standard of assessments this round, which should facilitate comparability across countries, and reduce any perceived lack of clarity in applying the guidance. Notwithstanding the improvements to the criteria, institutional differences between countries suggest that cross-country comparisons should continue to be made cautiously. There has been no change in the way that the action plans have been drafted, or implementation progress recorded.

8. **Results of the 2004 assessment suggest that the strengthening of the guidance did not significantly affect assessed country performance.** In a large majority of cases, improvements and deteriorations in country ratings were reflections of changes in country performance.¹⁰ Tighter application of the guidance, a better understanding of the country systems in 2004 or availability of additional information have also contributed to changes in ratings and benchmarks met in 2004 in some of the countries.

9. **Procurement systems in HIPCs were found to be weak, with no country meeting the benchmark for Indicator 16.** The procurement indicator is new to the 2004 assessment. Assessments of country procurement systems or cross-country comparisons using this indicator should also be made with caution, as the indicator proved to be difficult to administer uniformly across countries by different assessment teams.^{11,12} As a new indicator,

⁹ For example, Indicator 1 was revised to acknowledge that countries might still have comprehensive fiscal information through reporting arrangements even if the GFS definition of general government is not met by the budget itself. For federal systems of government, subnational government spending would not normally be included in the central government budget, but likely would be in regular reporting arrangements. By expanding the scope to include fiscal reporting as well as budgets, the benchmark could be considered easier to achieve, and some improvements in the 2004 assessment for Indicator 1 can be attributed to this revision.

¹⁰ Approximately 4 percent of the improvements in ratings in 2004, irrespective of benchmarks met, can be attributed to changes to indicator guidance that might themselves improve country rating and approximately 3 percent of the deteriorations in ratings, irrespective of the benchmark met, can be attributed only to changes to indicator guidance that may have themselves resulted in lower country ratings.

¹¹ Reflecting the Bank's expertise in this area, all procurement assessments were led by Bank staff or drawn from Bank Country Procurement Assessment Reviews.

there are no prior year ratings to compare with the current results, and the remainder of the paper focuses on comparative 2002–04 results for the 15 original indicators.

III. RESULTS OF 2004 REASSESSMENTS OF PEM SYSTEMS AND COMPARISON WITH 2002

A. Summary of the 2004 Results and Comparison with 2002 Benchmarks Met

10. **There has been some improvement in the performance of PEM systems in assessed HIPCs since 2002. However a majority of HIPCs still require substantial upgrading to have effective PEM systems capable of reliably tracking public spending.** For the 23 countries assessed in 2002 and reassessed in 2004, the average number of benchmarks met increased from 6 to 6.5. Two countries are now assessed as requiring little upgrading to their PEM systems, an improvement from zero in 2002. Five countries can be characterized as requiring some upgrading and 19 of the 26 countries were assessed as requiring substantial upgrading.¹³ Figure 1 shows the distribution of all countries based on the 2004 assessment (see Box 1 for further details on interpreting the assessment instrument), and Appendix I indicates a country’s performance according to a scale from A to C.

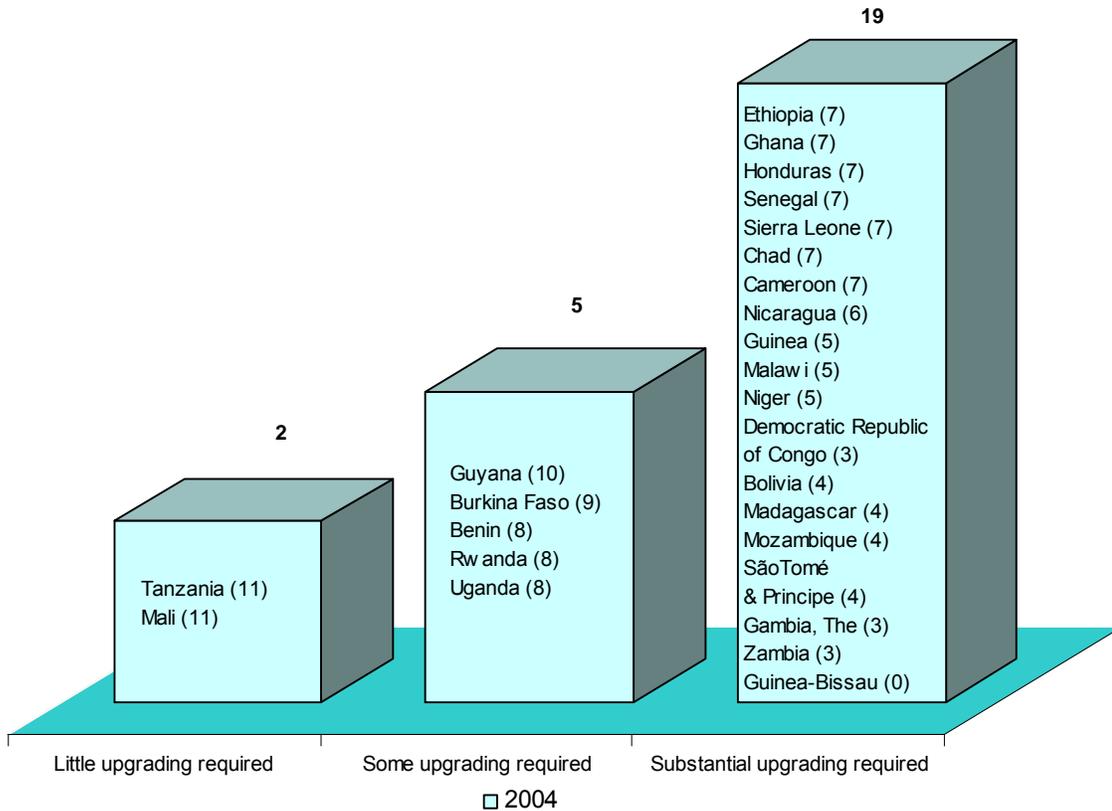
11. **The total number of benchmarks met improved for the entire sample of 23 reassessed HIPCs.** The total number of benchmarks met increased from 137 in 2002 to 150 in 2004. The distribution of country performance has changed, with four countries now meeting nine or more benchmarks compared to only one country in 2002. In both years, the worst performing quartile averaged less than three benchmarks, indicative of sizable PEM system problems. Although the aggregate change in benchmarks met looks quite modest, the disaggregated data show significant changes within PEM areas, and movements between scores for many indicators.

12. **The three new HIPCs assessed in 2004 (the Democratic Republic of Congo, Guinea-Bissau, and Sierra Leone), all of them post-conflict cases, require substantial improvement in their PEM system.** The Democratic Republic of Congo met three benchmarks. Guinea-Bissau did not meet the benchmark for any indicator, and was assessed

¹² Application of the procurement indicator tested in the 2004 reassessment proved challenging. Country teams were less able to directly assess country performance directly against the indicator. Nonetheless, testing the procurement indicator has provided valuable lessons that are being incorporated into a stronger set of procurement indicators currently under development, as well as an expanded set of public financial management indicators.

¹³ A country is deemed to require “little or no upgrading” if at least 11 of the benchmarks were met; “some upgrading” is required if between eight to ten benchmarks were met; and “substantial upgrading” is required if less than half (seven or fewer) of the benchmarks were met.

Figure 1. Relative Need for Upgrading PEM Systems
(Number in parentheses indicate the total number of benchmarks met)



Source: Fund-Bank AAP database.

at (C) for 14 indicators and at (B) for two indicators (inclusion of donor funds and effectiveness of internal control systems). Sierra Leone met seven benchmarks of the indicators assessed.

B. Benchmarks Met by Area (Budget Formulation, Execution, and Reporting)

13. **Performance across the major PEM categories was uneven.** Countries improved in some categories, and fell back in others. In terms of the benchmarks met, for the 23 countries assessed in both 2001 and 2004, budget formulation improved in nine countries, and declined in eight. Six countries showed improvements in budget execution, while eight countries showed deteriorations.

Box 1. Understanding Changes in Assessed PEM Performance: Malawi

The Malawi 2004 HIPC AAP reports Malawi meeting the benchmarks for five indicators, two less than the 2001 HIPC AAP report. In terms of raw assessment ratings irrespective of the benchmarks, Malawi was assessed lower in four indicators (5, 8, 10, and 13), compared to the 2001 assessment.

The results suggest a deterioration in PEM system performance in Malawi between 2001 and 2004. In fact, the results reflect a combination of an improved information basis, declining PEM system performance, and adjustments or improvements in the evaluation criteria. For example:

- **Indicator 5: Budget classification.** Malawi met the benchmark (B) for Indicator 5 in both 2001 and 2004. Malawi's budget expenditures are classified on an administrative, economic, and detailed programmatic basis, and this has not changed since 2001. However, in 2004, this indicator was downgraded from an (A) to a (B), based on a better understanding of how expenditure classification is applied in Malawi and application of the new guidance standard. The 2004 assessment revealed that while the detailed program classification allowed mapping into functions for broader assessment of poverty-reducing spending, the classification of spending is not carried out directly by spending units and therefore was deemed by the assessors to be of lower standard than required for an "A." The rating change should be viewed as reflecting an improved understanding of current country performance rather than a deterioration in country performance since 2001.
- **Indicator 8: Arrears.** The 2001 assessment was based on official reports from the Auditor-General, which drew data from the Commitment Control System, the best available information at that time. A subsequent external audit in 2004 revealed a significantly larger stock of arrears. Based on the new information, Malawi was reassessed as no longer meeting the benchmark for Indicator 8. Had this information been available in 2001, Malawi would also have been assessed as not meeting the benchmark at that time. Thus, in this area as well, the current assessment reflects better information on the country's performance. As all assessments reflect best available information at the time of assessment, no historical readjustments are made to reflect new information on prior conditions.
- **Indicator 10: Use of expenditure tracking surveys.** The 2001 assessment was based on self-reporting by authorities. In 2004, a further review of the authorities' expenditure tracking exercises showed that, as executed, they should not be classified as a PETS. New information led to a reassessment of overall performance in this area, resulting in a different assessment.

Source: Malawi HIPC AAP 2001 and 2004.

14. **Of the three main PEM areas assessed, budget reporting showed the largest improvement, with 14 countries improving and four deteriorating.** A total of 42 percent of budget reporting benchmarks were met in 2004, up from 33 percent in 2002. In contrast, both in the areas of formulation and execution, countries generally reported no overall increase in the percent of benchmarks met since 2002; 44 percent of formulation benchmarks are met in 2004 (down from 45 percent in 2002) and 35 percent of execution benchmarks are met (down from 39 percent in 2002). Figure 2 shows the percent of benchmarks met by the major categories of formulation, execution, and reporting.

Figure 2. Percent of Benchmarks Met
(by PEM category)



Source: Bank-Fund AAP database.

15. **Altogether, five of the 23 reassessed countries showed improvements in the PEM systems by meeting at least three more benchmarks than in 2002;** only one country saw a reduction of similar magnitude. However, the total number of benchmarks met masks changes among the individual indicators. Zambia is a typical example of the variability of movement in benchmarks. Overall, Zambia reported no improvement in the total number of benchmarks met since 2002. However, a more disaggregated evaluation shows that Zambia met one less benchmark in budget formulation, had no change in budget execution, but met one additional benchmark in budget reporting.

C. Benchmark Results by Indicator

16. **The number of countries that met the benchmarks improved for eight indicators since 2002.**¹⁴ As shown in Figure 3, improvements in budget formulation are seen in the comprehensiveness of the budget (Indicator 1), availability of a functional or programmatic budget classification (Indicator 5), identification of poverty-reducing spending (Indicator 6), and integration of medium-term expenditure projections in the budget cycle (Indicator 7). Improvements in budget execution occurred in more routine reconciliation of fiscal and banking records (Indicator 11). Budget reporting also improved, primarily in the quality of fiscal reports tracking public spending (Indicator 13), routine booking of transactions after the end of the fiscal year (Indicator 14) and the timeliness of audited financial information (Indicator 15).

¹⁴ All indicators are considered to be of equal significance in analyzing overall performance of the assessed countries.

Table 2. Country Change in Benchmarks Met

Change from 2002 to 2004	FORMULATION X	EXECUTION Y	REPORTING Z	TOTAL X+Y+Z
>=3	-	-	-	Ghana (6); Cameroon (3); Mali (3); Senegal (3), Tanzania (3)
2	Bolivia, Cameroon, Ghana, Mali, Tanzania	Ghana, Senegal, Uganda	Ghana, Mali	Guyana, Niger
1	Ethiopia, Guyana, Niger, São Tomé and Príncipe	Burkina Faso, Ethiopia, Chad	Benin, Burkina Faso, Cameroon, Guinea, Guyana, Honduras, Niger, Rwanda, Senegal, Tanzania, Zambia	Burkina Faso, Ethiopia
0	Benin, The Gambia, Mozambique, Malawi, Senegal	Cameroon, Guinea, Guyana, Honduras, Niger, Rwanda, Tanzania, Zambia	The Gambia, Madagascar, Mozambique, São Tomé and Príncipe, Chad	Benin, Guinea, Rwanda, São Tomé and Príncipe, Zambia
-1	Burkina Faso, Guinea, Rwanda, Zambia	Benin, Bolivia, Madagascar, Mali, Mozambique, Malawi, São Tomé and Príncipe	Ethiopia, Malawi, Uganda	Bolivia, Honduras, Mozambique, Chad, Uganda
-2	Honduras, Madagascar, Chad, Uganda	The Gambia	Bolivia	The Gambia, Malawi
-3	-	-	-	Madagascar

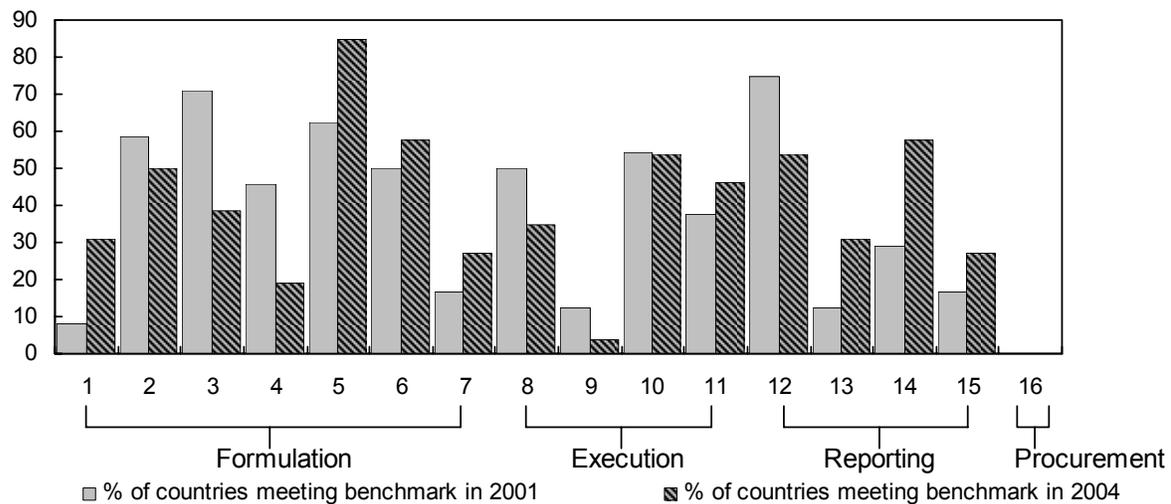
Source: Fund-Bank AAP database.

17. **However, the number of countries that met the benchmark for six other indicators deteriorated since 2002.** Performance of HIPC's in budget formulation deteriorated, with fewer countries meeting the benchmark for extrabudgetary spending (Indicator 2), reliability of the budget (Indicator 3), and reporting of donor financing (Indicator 4). More countries reported problems with budget execution in the areas of accumulation of arrears (Indicator 8) and internal controls (Indicator 9). Fewer countries met the benchmark for the timeliness of internal fiscal reporting (Indicator 12).

18. **PEM areas that were weakest in 2002 improved significantly by 2004 in most cases, relative to the benchmark.**¹⁵

- 31 percent of countries now provide budget data consistent with the GFS definition of general government (Indicator 1), compared with only 9 percent in 2002.
- 27 percent of countries now have a medium-term perspective integrated into their budget formulation process (Indicator 7), up from 18 percent in 2002.
- 31 percent of countries now produce timely, functionally based expenditure reports from core accounting data (Indicator 13), up from 14 percent in 2002.
- 58 percent of countries now close their accounts within two months of the end of the year (Indicator 14), up substantially from 32 percent in 2002.
- 27 percent of countries have final audited accounts presented within 12 months of the end of the year (Indicator 15), up from 18 percent in 2002.

Figure 3. Progress in Meeting Benchmarks



Source: Bank-Fund AAP database.

¹⁵ Data for 2004 do not include Côte d'Ivoire, the Democratic Republic of Congo, Guinea-Bissau, and Sierra Leone (since they were not assessed in 2001).

19. **About one-third of all ratings (irrespective of benchmarks) changed from the 2002 assessment, and of these roughly 60 percent were improvements.** In some cases countries improved their ratings but did not meet benchmarks. This section analyses changes in ratings of indicators regardless of whether the benchmark is met. Reflecting its relative weight in the assessment methodology, budget formulation accounted for more upward and downward indicator movement than either budget execution or reporting.

20. **Many staff teams reported that HIPCs experienced problems obtaining appropriate fiscal data from donors.** This was the case even where standard reporting formats had been agreed (e.g., Ghana, Uganda, and Tanzania). In many of these countries, donors prefer to have their grants directly executed through the agency they support, in order to have a responsible assurance of project implementation. This problem persists despite general improvements in donor coordination seen in many countries. A lack of such donor data contributed to the poor performance on Indicators 3 and 4.

D. Other Country Assessments

21. **The HIPC assessment tool has also been used by the World Bank and IMF staff to evaluate the PEM systems of several countries not in the original sample of 24 HIPCs that were assessed in 2001.** The HIPC assessment tool was applied in Cambodia, Comoros, Kenya, Laos, Lesotho, Peru, and Timor-Leste.

22. **These other countries showed a wide variation in the quality of their PEM systems when evaluated using the HIPC assessment criteria.** The percentage of benchmarks met for these countries ranged from zero (Laos) to 11 (Timor-Leste), with Peru (10 benchmarks met), Comoros (1), Cambodia (3), Lesotho (4), and Kenya (4) in between.

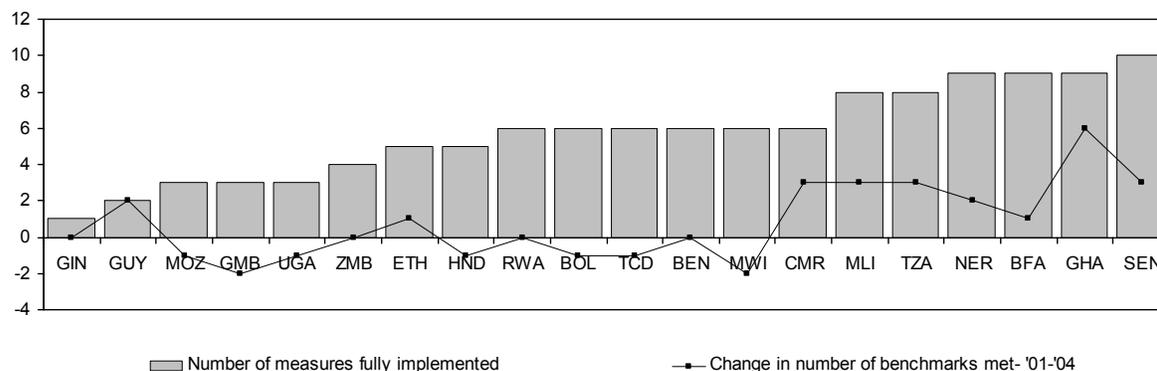
IV. ACTION PLANS

A. Progress in Implementing Action Plans (2003)¹⁶

23. **Further progress was made in the implementation of 2002 action plans since the last update presented to the Board in 2003.** As Figure 4 indicates, six countries (Burkina Faso, Chad, Ghana, Mali, Niger, and Tanzania) fully implemented 50 percent or more of the measures identified in their 2002 action plans. More than half the countries implemented at least 40 percent of their action plans. Seven countries (Benin, Chad, Ghana, Mali, Rwanda, Senegal, and Tanzania) have initiated action on all measures from their original actions plans.

¹⁶ This section relates to 20 countries, and excludes the Democratic Republic of Congo, Guinea-Bissau, Nicaragua, Madagascar, Mauritania, São Tomé and Príncipe, and Sierra Leone.

Figure 4. Number of Measures Fully Implemented (FI) and Change in the Number of Benchmarks Met



Source: Fund-Bank AAP database.

24. **Countries with high implementation rates (percentage of actions fully implemented) generally show improvements against benchmarks.** This is especially true in the cases of Ghana, Mali, Senegal, and Tanzania—where strong implementation rates correlate with a higher number of benchmarks met.¹⁷

25. **Sustained government commitment to reforms, together with coordinated donor assistance, explain some of these success stories.** Low rates of action implementation, which might be a proxy for low degree of commitment, appear to be related to low rates of improvement against the benchmarks. Other factors, such as political instability in the region and a lack of coordination between donors may also have contributed to poor performances. Some countries saw very limited impact on the performance of PEM systems, despite high level of donor assistance. This could be explained by several factors, including inadequate government commitment to the entire reform agenda, limited institutional capacity to implement reforms, poorly sequenced or coordinated reforms, too broad a reform agenda, and too many donors engaged in PEM reforms.

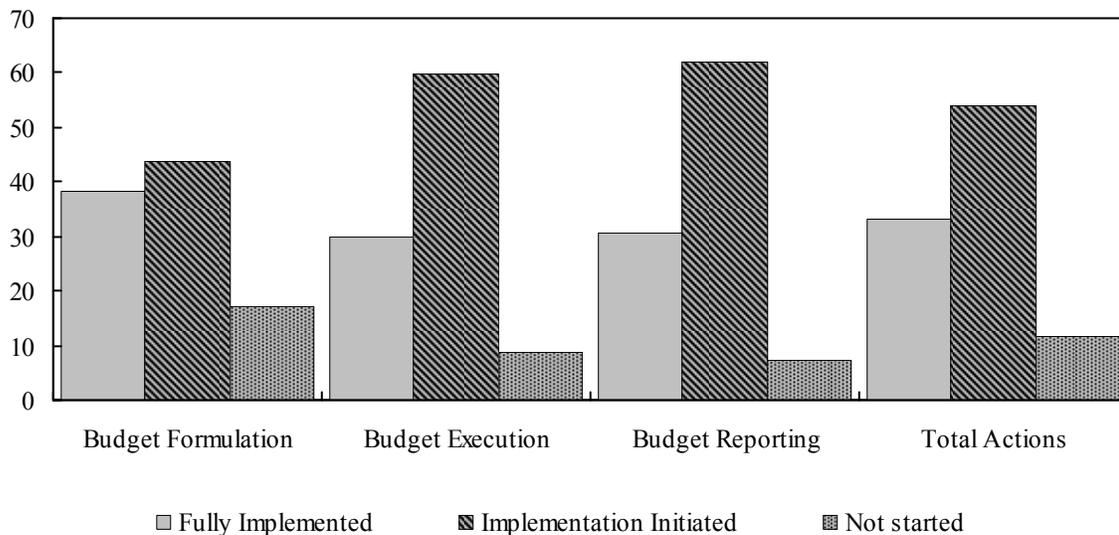
26. **Narrowly focused action plans, reflecting clear reform priority setting, might also improve performance.** Countries generally formulated action plans and pursued action implementation to improve performance across all indicators. An average of 23 actions were planned for each indicator, and countries on average initiated nine actions and fully

¹⁷ Caution is warranted in interpreting the results. The concept of “action” is not uniform, with some actions being a broader reform and others a narrow, well-defined measure. In some cases, actions bear an indirect relationship to an indicator, or apply to multiple indicators. For example, implementing a new IFMIS might be deemed an action to improve budget execution rates as well as reduce arrears. Several actions may in fact be necessary over several years to actually improve performance on the indicator.

implemented six actions per indicator. Where capacity is limited, choosing one or two indicators where government effort will focus might lead to better results. Priorities can also be set during implementation, where a few measures are emphasized.

27. **Although more than 90 percent of all planned measures in budget execution were either initiated or completed, the gains in terms of benchmarks met have been limited so far.** The impact of measures in budget execution appears lower relative to those in reporting and formulation. Progress was made in the area of budget formulation where over 30 percent of measures were fully implemented (compared to 20 percent in 2003). In addition to the breadth of some actions in budget execution (e.g., IFMIS), there are time lags before the implemented actions are reflected in country performance. Figure 5 shows the rate of implementation according to major PEM category.

Figure 5. Status of Measures by Type of PEM Reform (2003 Update)
(in percent)



Source: Bank-Fund AAP database.

B. Actions Included in 2004 Assessments

28. **In the 26 countries for which comprehensive assessments and action plans have been completed in the current round, there were in total 801 PEM reform measures identified.**¹⁸ About 39 percent of these actions relate to budget formulation, 29 percent to budget execution, 22 percent to budget reporting and audit, and 11 percent to procurement

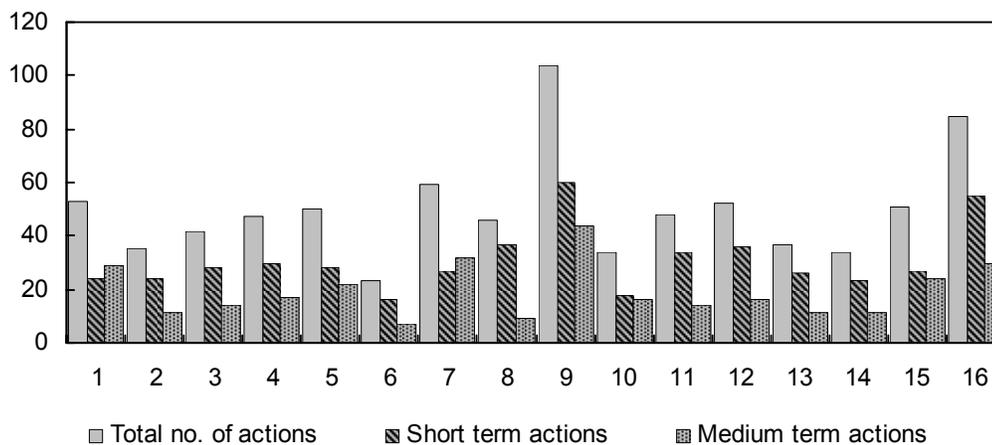
¹⁸ This compares with 367 actions that were identified in the 2001 exercise.

reforms. Sixty two percent of these measures are deemed to be short term in nature; the rest are medium- to long-term measures.

29. **Indicators for which most 2004 action plan measures are identified are internal control (104 measures) and procurement systems (85 measures).** Figure 6 shows the distribution of new measures to indicators, with Indicators 9 (internal control) and 16 (procurement) showing the greatest number of measures, reflecting the weak state of these aspects of PEM and the intention of countries to take remedial steps.

30. **Overall, the current action plans are more clearly defined than previous plans, with more tightly described individual measures.**¹⁹ This bodes well for better implementation and results if reform efforts are sustained. Areas of greater relative weaknesses, such as budget execution (e.g., Indicator 9 dealing with internal control), have been given more sustained attention as action plans for these have been extended.²⁰

Figure 6. Total Measures per PEM Indicator in 2004 Action Plans



Source: Fund-Bank AAP database.

31. **Short-term actions identified in 2004 cover a wide array of PEM areas and are consistent with the medium-term improvements pursued in PEM systems.** Measures deemed to be of a medium-term nature in some countries are being implemented as short-

¹⁹ The concept of “action” is not uniform, and varies between countries and within countries among PEM areas or indicators. Actions might be narrow and relatively easy to implement, or broad and less specific, and therefore more challenging to implement. Caution is warranted in interpreting the results, or placing too much weight on conclusions.

²⁰ See p.17 of the March 2002 Board paper.

term actions in others, as countries are at different stages in the reform of their PEM systems. Key short-term actions include:

- Broadening the coverage of government expenditures to include, in particular, donor-financed expenditures (e.g., Benin, Bolivia, Ghana, Uganda, and Rwanda).
- Upgrading of the budget classification systems (to GFSM 2001 standards) (e.g., Bolivia, Cameroon, Honduras, and Zambia).
- Introducing functionally-based, in-year budget reporting (to aid in the tracking of poverty-related expenditures) (e.g., Cameroon, Burkina Faso, and Honduras).
- Piloting IFMIS (e.g., Zambia).
- Improvements in audits and parliamentary oversight committees (e.g., Burkina Faso, Ghana, Tanzania, Bolivia, and Zambia).
- Undertaking regular PETS (e.g., Malawi and Ghana).

32. Substantive medium- to long-term actions to PEM systems are also planned.

These actions focus on several key areas:

- Legal and regulatory frameworks (e.g., Rwanda, Niger, and Guinea-Bissau).
- Budget formulation and monitoring processes (e.g., Senegal and Chad).
- Information systems for improved control and reporting (e.g., Bolivia, Ghana, Niger, and Zambia).
- Human resource capacity building (e.g., Rwanda, São Tomé and Príncipe, and Sierra Leone).
- Budget coverage, reporting, and auditing at the local level (e.g., Ghana and Tanzania).

33. Action plans included in 2004 assessments have expanded, relative to 2002, to include:

- Issues related to decentralization. For example, in some countries, budget coverage includes ensuring regional and local compatibility with the central budget (e.g., Malawi and Tanzania).
- Improvements to the procurement systems (e.g., Bolivia, Ghana, Malawi, and Chad).

C. Inclusion of Actions in PRSPs

34. **In general, there is a wide variation in the extent of treatment of PEM across PRSPs.** The number of PEM measures included in PRSPs ranges from zero (first PRSP for Burkina Faso, and one of the first full PRSPs²¹) to 82 (Niger).²² PEM measures include reforming budget classification and accounting (Niger), implementing a medium-term expenditure framework (MTEF) (The Gambia, Guinea, Mauritania, Tanzania, and Uganda), strengthening expenditure control (Mauritania, The Gambia, and Niger), automating the budget system (Ethiopia, Ghana, Malawi, Uganda, and Zambia), strengthening audit institutions (The Gambia, Ghana, Mauritania, Rwanda, and Uganda), and instituting procurement regulations (Ghana, Malawi, and Uganda). In some PRSPs, PEM measures go beyond those included in the action plans. These include Malawi, Uganda (fiscal decentralization and introduction of results-oriented management to improve service delivery), Tanzania (decentralization), and Guyana, Honduras, and Zambia (governance and anti-corruption measures).

35. HIPCs are increasingly incorporating PEM measures from their AAPs into PRSPs.²³ The average number of PEM measures rose from eight in 2002 to over 16 in PRSPs produced during 2003.²⁴ Overall budget formulation has received most attention. However, since 2002, new PRSPs have included more PEM measures, with a focus on budget execution and reporting. More recent PRSPs also include procurement reforms. In addition, over one-third of PRSPs incorporate measures to strengthen the PEM capacity of local governments.

D. Action Plans in Bank- and Fund-Supported Programs

36. **There has been significant use of the action plan measures in Fund-supported programs.** Following the assessment exercises in both 2002 and 2003/04, the measures set out in the action plans were used to help design conditionality in Fund-supported programs in

²¹ A substantial number of PEM measures have since been included in the second PRSP for Burkina Faso in 2004.

²² Source: "Update on Implementation of Action Plans to Strengthen Capacity of HIPCs to Track Poverty-Reducing Spending," March 11, 2003, SM/03/90; World Bank, March 13, 2003, IDA/R2003-0043.

²³ "Update on Implementation of Action Plans to Strengthen Capacity of HIPCs to Track Poverty-Reducing Spending," March 11, 2003, SM/03/90; World Bank, March 13, 2003, IDA/R2003-0043.

²⁴ No new PRSPs were published during FY 2004 for HIPCs.

slightly less than 50 percent of countries assessed.²⁵ The vast majority of Fund-supported programs include measures aimed at reforming PEM systems, but some of these are based on inputs other than the AAP, including from the TA delivered directly by FAD.²⁶

37. The implementation of those action plan measures that are incorporated into Fund-supported programs is slightly above the average for all action plan measures. Half of the measures from the assessment in 2002 that became program conditions were fully implemented by the time of the 2004 exercise, compared to the median of 40 percent for general action plans.

38. Bank adjustment operations have supported a substantial number of HIPC action plan measures. Nineteen of the 24 HIPCs assessed have received Bank adjustment lending since January 2002, of which 12 were new adjustment operations initiated since the 2003 Board paper.²⁷ The World Bank provided about US\$1.8 billion in adjustment loans to assessed HIPCs since January 2002. In 17 countries, HIPC action plans are substantially reflected in Bank conditionality.²⁸ About 36 percent of measures defined in the 2002 HIPC assessments action plans have been incorporated in Bank adjustment lending operations. About 40 percent of medium-term measures and 35 percent short-term measures in HIPC action plans have been included as PEM conditions in adjustment operations. Generally, more conditions were included on areas where countries did not meet the assessed benchmark.

E. Donor Assistance

39. The number of donor agencies (54 in total) involved in supporting PEM reforms in HIPCs is significant, with an average number of seven donor agencies involved per country. The multilaterals (the IMF, the World Bank, and the European Commission (EC))

²⁵ The analysis includes prior actions, structural performance criteria and structural benchmarks contained in IMF-supported programs. Staff reports reviewed for this exercise were those issued during June 2003 to September 2004.

²⁶ The link between FAD TA and IMF-supported programs in Sub-Saharan Africa is discussed further in “Technical Assistance Evaluation Program—Findings of Evaluations and Updated Program,” IMF Board Paper, March 2, 2004, SM/04/67.

²⁷ Nineteen HIPCs with adjustment lending since January 2002 include Benin, Bolivia, Burkina Faso, Cameroon, Chad, Ethiopia, Ghana, Guyana, Honduras, Malawi, Mali, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda, and Zambia.

²⁸ HIPC action plans reflected in Bank lending operations for Benin, Bolivia, Burkina Faso, Chad, Ethiopia, Ghana, Guyana, Honduras, Malawi, Mali, Mozambique, Nicaragua, Niger, Rwanda, Tanzania, Uganda, and Zambia.

are involved in most countries, with some bilateral donors such as the DFID, the U.S. Agency for International Development (USAID), France, and Norway involved in at least three or more countries. Four donors (the European Union (EU), the IMF, the United Nations Development Programme (UNDP) and the World Bank) are involved in more than ten countries.

40. **The presence of active donor agencies does not appear to correlate strongly with improved PEM performance.**²⁹ Other factors, such as government commitment, may contribute more strongly to improved country performance. On average, donor agencies support about 20 different reform actions per country, with an average of ten actions per donor.

41. **Existing donor assistance programs are substantial and cover most areas identified in the action plans in need of upgrading.** According to the 2004 assessment, donor assistance covers all PEM areas. Multilateral and bilateral assistance typically focuses on strengthening expenditure commitment control systems (e.g., in Malawi, Rwanda, Sierra Leone, and Tanzania by the IMF and the DFID), development of IFMIS (e.g., in Ghana, Malawi, Mauritania, and Tanzania by the World Bank), external and internal audit in most countries, decentralization (e.g., Ethiopia and Tanzania by the Inter-American Development Bank (IDB), the USAID, Norway, and the EC), legal framework for budgeting (e.g., Tanzania, The Gambia, Bolivia, Mozambique, Zambia, and Honduras by the IMF, the World Bank, the IDB, and the EC), budget formulation and MTEF (e.g., Malawi, Uganda, and others by the IMF and the DFID), and budget classification and reporting (e.g., in Benin and Cameroon by the IMF and France).

V. REPORTING ON POVERTY-REDUCING SPENDING

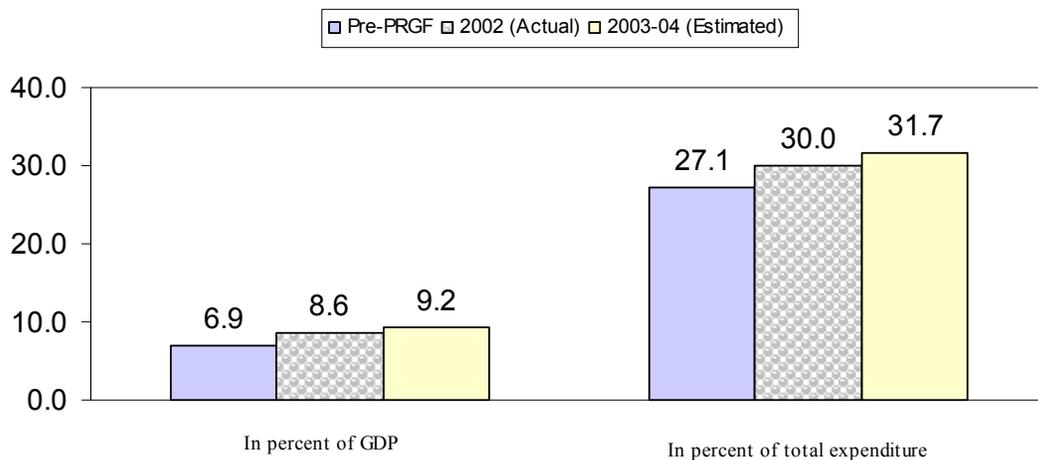
42. **Twenty of the 27 HIPCs have defined poverty-reducing spending in their PRSPs.**³⁰ The definitions are country-specific and have generally included spending on basic health care, primary education, agriculture, infrastructure, housing, basic sanitation, and HIV/AIDS. However, not all the countries can identify these areas of expenditures in their budgets or report on such spending, due to weaknesses in their budget classification and reporting systems.

²⁹ Caution is warranted in interpreting the results. Donor activity in an area of PEM may or may not directly support the country action plan, or provide assistance that will directly lead to improved performance against the indicator.

³⁰ These countries are: Benin, Bolivia, Burkina Faso, Ethiopia, The Gambia, Ghana, Guinea, Guyana, Honduras, Malawi, Mali, Mauritania, Mozambique, Niger, Rwanda, Senegal, Sierra Leone, Tanzania, Uganda, and Zambia.

43. **Reported poverty-reducing spending is increasing in the 27 HIPCs covered in this assessment.**³¹ Spending on poverty-reducing programs in these countries has increased as a share of GDP by 1.6 percentage points between 1999 and 2002 (Figure 7). As a share of total government expenditure, such spending has increased by 2.3 percentage points during the same period. This has translated into substantial annual increases in real per capita spending on poverty-reducing programs over this period. HIPCs are planning to further increase poverty-reducing spending, both as a share of GDP as well as total government spending during 2003–04.

Figure 7. Poverty-Reducing Spending in HIPCs



Sources: National authorities; and Fund/Bank staff estimates.

VI. NEXT STEPS

44. **The World Bank and its PEFA partners have developed a strengthened approach to Public Financial Management (PFM) reform.**³² Building on the present 16 HIPC PEM indicator set, the strengthened approach includes an expanded set of

³¹ For the purposes of this exercise, in countries where spending data according to PRSP definition of poverty-reducing spending was not available, country teams estimated such spending by broad mapping of budget data to poverty-reducing categories defined in the PRSP. For countries where definition of such spending has not yet been established in the PRSPs, country teams provided data on spending that most closely matched poverty-reducing categories for these countries. In most cases this included education and health spending.

³² PEFA is a partnership program of the World Bank, the EC, the DFID, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Norwegian Ministry of Foreign Affairs, and the IMF.

28 indicators for assessing PEM systems, and a performance report modeled broadly on the HIPC AAPs.³³ The expanded indicator set provides a more comprehensive assessment of PFM performance in a concise form. The performance report and the underlying indicators are intended for use within the framework of country-led PEM reform strategies, and aim at a better country-level harmonization of donor work in support of the country reform strategy. The strengthened approach is not new, but was developed by drawing lessons from the reform experience of the World Bank, the IMF, and other development partners.

45. **The World Bank is encouraging country teams to use the strengthened approach where appropriate, including the expanded indicator set and PFM performance report.** World Bank country PFM assessments are increasingly using indicator-based tools, providing the Bank and client with a more objective performance framework for measuring progress over time, and providing a sound basis for annual Country Policy and Institutional Assessment (CPIA) PFM ratings. The expanded indicator set represents a common information pool that different networks inside the World Bank and other donors can draw upon, thereby reducing transactions costs for clients. The PFM performance report is an integrated and concise diagnostic of a country's PFM system, and can reduce overlapping assessment tools.

46. **Based on these considerations, the Bank and IMF staff propose that the formalized, periodic assessments of HIPCs be replaced by the diagnostic framework of the strengthened approach, which is fully integrated with other country work.** PEFA partners also plan to carry out assessments of PFM systems in countries where they are engaged. The results of these assessments would be available on a country-by-country basis as they are completed. The operational needs of the Bank and bilateral donors can be expected to ensure that the assessments are updated on a timely basis.

47. **In particular, in the World Bank such monitoring and reporting of PFM performance would be integrated into the overall PFM analytic work program of a country and undertaken at the country level in line with priorities and budget constraints.** The HIPC performance assessment exercise has entailed substantial costs for Bank country teams in the regions, but in view of the importance of the exercise, teams have been making adjustments to carry out the exercise. Because of the self-evident value of indicator-based assessments, country teams are increasingly using performance measurement in their work. It is felt that this can support capacity building by reducing some overlapping diagnostics and by allowing measures to track progress over time. In line with the Bank's overall approach to analytic work, country teams will undertake PFM analytic work within the constraints of their budget and priorities of their country programs. Such analytic work would be programmed taking into account the type and level of Bank engagement, client priorities and circumstances, and the availability of relevant knowledge from partners and the

³³ The draft indicator set is available at <http://www.pefa.org>.

country.³⁴ The Bank's network anchors will continue to provide support and guidance to country teams in implementing and mainstreaming this approach to PFM reform within their budget realities.

48. **From the IMF's perspective, the periodic PEM assessment exercise has entailed substantial resource costs.** The current round involved FAD leading missions to 13 countries and participating in another 14 Bank-led missions, costing more than two years of direct staff time in field work. Preparation and follow-up costs have also proven to be high. As a result, the AAP work has crowded out some of FAD's core TA in the PFM area. Continuing this work in the future would entail a further scaling down of FAD's core TA work, which would be an undesirable long-term redirection of FAD's activities.

49. **IMF staff proposes that the Fund support the strengthened approach, but continue to give priority to the capacity-building objective of its TA work.** FAD TA is generally focused on specific issues and does not include comprehensive assessments of all aspects of a country's PFM systems. FAD TA will continue to be driven by country demands and the needs of Fund operations. At the same time, FAD will ensure coordination of its activities with all other stakeholders, and will share information arising from its TA activities or the Report on the Observance of Standards and Codes (ROSC) assessments with the World Bank and bilateral donors that carry out PFM assessments. Thus, the parts of a PEFA assessment that are closely related to FAD's TA or ROSC work could draw on corresponding sections in FAD's reports (within existing policies on confidentiality), thereby helping ensure consistency of policy advice. At the same time, FAD reports could draw on PEFA assessment results, as appropriate, to help avoid duplication of efforts.

³⁴ See "Improving the Bank's Analytic and Advisory Services: Progress Report" (OM2004-0047/1), August 12, 2004. The proposed diagnostic Economic and Sector Work (ESW) program is expected to ensure the availability of sufficient country knowledge on macroeconomic, structural, and public sector management and institutions. The PFM analytic work program would be determined at the country level, summarized in the Country Assistance Strategy (CAS), and regularly updated during the annual country business planning exercises.

PEM System Performance in 2001 and 2004

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
Benin	B(B)	A(A)	B(B)	B(B)	B(B)	B(A)	A(B)	B(A)	B(B)	B(B)	A(A)	A(B)	A(C)	B(B)	C(C)	C
Bolivia	A(B)	A(B)	C(C)	A(A)	B(B)	B(B)	B(B)	C(B)	B(B)	C(B)	B(B)	C(B)	C(C)	C(B)	C(B)	B
Burkina Faso	B(B)	A(A)	B(B)	C(C)	B(B)	B(A)	A(A)	A(B)	B(B)	A(A)	A(A)	A(A)	B(C)	A(B)	C(C)	B
Cameroon	B(B)	B(A)	B(C)	B(B)	A(C)	A(B)	C(C)	C(B)	B(B)	B(B)	A(A)	C(B)	A(C)	B(C)	B(C)	B
Chad	B(B)	A(A)	C(B)	A(A)	B(B)	C(A)	B(C)	C(C)	B(C)	B(B)	A(C)	C(B)	C(C)	A(B)	B(B)	B
Congo, Dem. Rep.	B	A	C	B	B	A	C	C	B	C	C	C	B	C	C	C
Ethiopia	A(B)	A(A)	C(B)	B(B)	B(C)	A(A)	B(B)	A(A)	B(B)	B(C)	B(B)	C(B)	B(A)	A(B)	C(C)	B
Gambia, The	A(A)	C(B)	C(B)	B(B)	A(C)	A(A)	B(B)	C(A)	B(A)	C(C)	C(C)	C(C)	B(C)	C(C)	C(C)	B
Ghana	B(C)	B(B)	C(C)	B(B)	B(C)	A(C)	B(B)	A(C)	B(C)	B(B)	A(C)	C(C)	A(C)	A(C)	C(C)	B
Guinea	A(C)	B(B)	C(B)	B(A)	B(B)	B(B)	B(C)	C(B)	B(C)	C(C)	A(A)	B(B)	B(B)	C(C)	B(C)	B
Guinea Bissau	C	C	C	B	C	C	C	C	B	C	C	C	C	C	C	C
Guyana	B(A)	A(B)	B(B)	A(A)	B(C)	A(A)	B(B)	A(A)	B(B)	C(C)	C(C)	A(A)	A(B)	A(A)	B(B)	C
Honduras	B(B)	A(A)	C(B)	B(A)	B(A)	A(A)	B(B)	A(A)	B(B)	C(C)	C(C)	B(B)	A(B)	A(A)	C(C)	B
Madagascar	B(B)	A(A)	C(B)	B(A)	A(B)	B(A)	A(C)	B(C)	B(B)	B(B)	B(A)	C(C)	B(C)	B(B)	C(C)	B
Malawi	C(C)	A(A)	C(C)	B(B)	B(A)	A(A)	B(B)	B(A)	B(B)	B(A)	B(B)	B(B)	B(A)	B(B)	C(C)	B
Mali	A(B)	B(A)	B(B)	B(B)	A(B)	A(B)	A(B)	A(A)	B(A)	B(B)	A(A)	B(B)	A(C)	A(B)	C(C)	B
Mozambique	A(B)	C(C)	B(B)	B(B)	C(B)	C(C)	B(B)	A(A)	B(A)	C(C)	C(B)	C(B)	B(B)	A(B)	C(C)	C
Niger	A(B)	B(A)	C(C)	B(A)	B(C)	A(B)	B(C)	B(C)	B(B)	C(B)	A(B)	A(C)	B(C)	C(C)	C(C)	B
Rwanda	B(B)	B(A)	B(B)	B(B)	A(A)	A(A)	A(A)	C(B)	B(B)	B(B)	C(C)	B(B)	B(B)	A(A)	B(C)	B
Sao Tome & Principe	B(B)	A(B)	C(C)	A(A)	C(C)	C(C)	C(C)	B(A)	C(C)	C(C)	B(B)	B(A)	C(C)	A(A)	C(C)	C
Senegal	A(B)	B(A)	B(B)	B(B)	B(B)	B(B)	B(B)	A(A)	B(B)	B(C)	A(B)	B(C)	B(C)	B(B)	C(C)	B
Sierra Leone	B	A	B	B	B	A	C	C	B	B	C	B	C	A	C	C
Tanzania	B(B)	A(A)	B(B)	B(B)	B(C)	A(B)	A(A)	A(A)	B(B)	B(B)	A(A)	B(B)	A(B)	A(A)	C(C)	B
Uganda	B(B)	B(B)	C(B)	B(A)	B(A)	A(A)	A(A)	C(B)	A(B)	B(B)	A(B)	C(B)	B(A)	A(B)	B(B)	B
Zambia	C(C)	B(B)	C(C)	B(A)	C(C)	C(C)	B(C)	C(C)	B(B)	C(C)	A(A)	C(C)	C(C)	A(A)	B(C)	B

Source: Bank-Fund AAP database.

Bold type indicates benchmark met.

Note: Grade in parenthesis is assessment for 2001; not applicable for Guinea-Bissau, Sierra Leone, and Indicator 16.