I. Introduction and Context

A. Country Context

1. Pakistan is the world’s sixth most populous country with an estimated 182 million people population and per capita income of US$1,300 in 2013 placing it in the lower income country category. During recent years, macroeconomic conditions improved in the country with headline inflation declining to 4.5 percent in FY14/15 and 2.79 percent during July-April FY15/16, while the fiscal deficit contained at 3.4 percent of GDP during July-March FY 15/16\(^1\). GDP grew by 4.71 percent in FY15/16 compared to 4.2 percent last year, driven mainly by growth in industrial and services sector.

2. Pakistan’s Vision-2025 clearly underscores the importance of service delivery, especially education and health and aims at substantial expansion in levels of education as well as improvements in quality through target public expenditure on education sector to reach 4% of GDP by 2018. Similarly, the government has also planned to increase access to healthcare and ensure a minimum level of service delivery throughout the country, by enhancing spending on health sector to 3% of GDP. One of the key pillars of Vision 2025 is democratic governance, institutional reform and modernization of the public sector, underpinned by government’s resolve for simplifying procedures and thereby facilitating access to public services, ensuring accountability of public officials and enhancing transparency of government through

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\(^1\) Fiscal deficit was 3.8 percent SPLY, while it stood at 5.4 percent of GDP in FY14/15.
institutional reforms especially in areas of e-governance, open government and anti-corruption. Vision-2025 envisages a responsive, inclusive, transparent and accountable system of governance as a crosscutting foundation for all its pillars.

3. The assignment of fiscal powers and distribution of revenues between the federation and provinces is laid out in Article 160 of the Constitution, authorizing the National Finance Commission (NFC) to make recommendations to the President of Pakistan on vertical and horizontal distribution of revenues. The 18th Constitutional Amendment passed by the National Assembly on April 8, 2010, enhanced provincial autonomy and reshaped federal–provincial relations. A total of 43 departments in 18 ministries were abolished in 2011/12 and transferred to the provinces. In parallel, a new resource redistribution formula under the 7th National Finance Commission (NFC) Award of 2010 shifted greater funding to the provinces with a consensus decision for enhancing the provincial share in vertical distributions from 46.5% in 2010 to 56% in 2011 and to 57.5% for the next four years and instead of using the traditional population based revenue sharing, adopted a broader formula for revenue sharing. The provinces’ taxing powers was expanded, including a sales tax on services; and internal and external borrowing by provinces was also permitted.

4. The 7th NFC Award has three main dimensions: (i) divisible pool transfers, (ii) straight transfers, and (iii) grants/others. The 7th NFC Award assigned 82 percent weightage to population, 10.3 percent to poverty, 5 percent to revenue (2.5 percent revenue generation, 2.5 percent revenue collection); and 2.7 percent to area. After considering special needs of Balochistan and application of the multiple indicators, Punjab province got 51.74 percent, Sindh 24.55 percent, Khyber Pakhtunkhwa 14.62 percent and Balochistan 9.09 percent. Current provincial shares for the divisible pool are shown in table 1 below.

<table>
<thead>
<tr>
<th>Indicators</th>
<th>Weight</th>
<th>Punjab</th>
<th>Sindh</th>
<th>Khyber Pakhtunkhwa</th>
<th>Balochistan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population Share</td>
<td>82.00</td>
<td>57.36</td>
<td>23.71</td>
<td>13.82</td>
<td>5.11</td>
</tr>
<tr>
<td>Poverty/Backwardness</td>
<td>10.30</td>
<td>23.16</td>
<td>23.41</td>
<td>27.82</td>
<td>25.61</td>
</tr>
<tr>
<td>Revenue Generation/Collection</td>
<td>5.00</td>
<td>44.00</td>
<td>50.00</td>
<td>5.00</td>
<td>1.00</td>
</tr>
<tr>
<td>Inverse Population Density</td>
<td>2.70</td>
<td>4.34</td>
<td>7.21</td>
<td>6.54</td>
<td>81.91</td>
</tr>
<tr>
<td>Total</td>
<td>100.00</td>
<td>51.74</td>
<td>24.55</td>
<td>14.62</td>
<td>9.09</td>
</tr>
</tbody>
</table>

5. Fiscal transfers from federal to provincial governments are predictable to the extent of actual revenue collection. At the provincial level the vertical and horizontal shares are determined by the Provincial Finance Commission (PFC) for the three tiered local government system (District, Tehsil and Village/Neighborhood Councils). The NFC is in the process of discussing the 8th NFC Award with the federating units. Table 2 below shows the province-wise share of Federal taxes (divisible pool taxes straight transfers, and GST on services). Deviation between actual and revised can occur due to variation in actual revenue collection.

Table 2: Province-wise share of Federal taxes (divisible pool taxes straight transfers, and

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2 NFC award is revised every five years and requires consent of the federal and four provincial governments.
B. Multi-sectoral and Institutional Context of the Program

6. Despite some improvements, Pakistan’s performance against the Millennium Development Goals (MDG) goals is lower than the South Asia Region average for most indicators in Table 3. According to Human Development Report 2016, released by United Nations Development Programme (UNDP), Pakistan ranks 147th out of 188 countries and territories. Such slow progress is inadequate to address the large burden caused by a growing population and progress needs to be accelerated.

Table 3: Social Indicators for Pakistan and Comparators

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Pakistan</th>
<th>South Asia</th>
<th>Low-income countries</th>
<th>Lower middle-income countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP per capita (constant US$ 2010) [2005-2015]</td>
<td>978.1</td>
<td>1152.1</td>
<td>967.2, 1,641.3</td>
<td>446.9, 587.6</td>
</tr>
<tr>
<td>Life expectancy (years) at birth [2005-2014]</td>
<td>63.9</td>
<td>66.2</td>
<td>64.8, 68.1</td>
<td>55.3, 61.3</td>
</tr>
<tr>
<td>Infant mortality rate [2005-2015]</td>
<td>30.6</td>
<td>32.8</td>
<td>33.4, 36.4</td>
<td>26.4, 29.6</td>
</tr>
<tr>
<td>Total fertility rate [2005-2014]</td>
<td>4.1</td>
<td>3.6</td>
<td>3.1, 2.5</td>
<td>2.6, 2.7</td>
</tr>
<tr>
<td>Net Enrolment Rate (Primary) [2005-2014]</td>
<td>87.8</td>
<td>73.3</td>
<td>85.7, 89.5</td>
<td>74.7, 82.1</td>
</tr>
<tr>
<td>DPT child immunization rates (%) [2005-2014]</td>
<td>3.4</td>
<td>3.6</td>
<td>3.1, 2.6</td>
<td>2.7, 2.7</td>
</tr>
<tr>
<td>Access to improved sanitation (%) [2005-2015]</td>
<td>45.9</td>
<td>63.5</td>
<td>34.7, 44.8</td>
<td>23.3, 28.3</td>
</tr>
<tr>
<td>Health Exp. Public (%GDP) [2005-2014]</td>
<td>0.7</td>
<td>0.9</td>
<td>1.1, 1.4</td>
<td>2.5, 2.4</td>
</tr>
</tbody>
</table>


7. Institutional fragmentation and coordination challenges between federal and provincial governments remain a challenge to improving service delivery. The Pakistan Millennium Development Goals Report 2013\(^3\) noted that Pakistan lagged behind most of the targets especially in areas of education and health. Under the goal 2 of achieving universal primary education, the country lagged on all three counts (net primary enrolment ratio; completion/survival rate; and literacy rate). Similarly results were not very different for the three education-related parameters under goal 3 of promoting gender equality and women’s empowerment. Significant inequity exists in health service access and utilization. The report (ibid) also noted that the country lagged on ten out of eleven parameters for goal 4 of reducing child mortality and goal 5 of improving maternal health. Pakistan’s performance in *maternal and child health* (MCH) has improved, but it remains a poor performer in the South Asia Region. Due to the cross-cutting function of *social protection*, tracking and real-time monitoring of expenditure on social protection is a challenge. Complex coordination issues, and inefficient

\(^3\) http://www.pk.undp.org/content/dam/pakistan/docs/MDGs/MDG2013Report/final%20report.pdf
public financial management (PFM) and accountability adversely affect the attainment of these goals

8. **Pakistan’s high rate of stunting, which affects 44 percent of children under five is an ‘emergency like situation’**. Key challenges include: identifying and categorizing nutrition sensitive programs; weighting nutrition sensitive programs; tracking personnel costs; policy formulation and communication; harmonizing government budget data with external sources; and tracking nutrition budget allocation and expenditures at a sub-national level. Regarding other services, while Pakistan demonstrated on-track performance on proportion of population with access to improved water sources at 89% against the target of 93%, the proportion of population with access to sanitation at 72% lagged behind the target of 90 percent. Also, sub-sector MDG target for sanitary coverage is not likely to be met and water supply will fall short of the target as access is not expected to increase beyond the current level.

9. **Pakistan needs to improve significantly its performance in the human development outcomes. The low social service outcomes are exacerbated by PFM bottlenecks that are affecting efficient management and decision making to deliver social services.** Addressing the social sector challenges requires strong leadership, good governance, and effective coordination with provinces by the federal government, to support implementation of fundamental reforms, restructure institutions, and strengthen systems including public financial management and procurement systems across all three levels of government. Pakistan has implemented the SAP-based Financial Accounting and Budgeting System (FABS) at all levels of government (federal, provincial, and district) for managing budgets and making payments (including salaries and pensions). However, some outstanding key PFM/procurement bottlenecks include:

(i) Budgeting, accounting, reporting and audit rules and procedures require revisions to align financial management system with improvements like medium term budgets, electronic fund transfers and requirements due to shift in responsibilities post 18th Amendment. This is exacerbated by highly centralized payment authorization system without commitment controls causing delays of up to three weeks for Drawing and Disbursing Officers (DDOs to pay suppliers. Also, there is weak internal audit arrangements centralized at Office of Accountant General Pakistan Revenues (AGPR) with limited focus on pre-audit of payment vouchers instead of risk-based internal audit at line ministries/departments;

(ii) Non-linkage of approved budget and procurement plans with inefficiencies in procurement systems and processes result in project implementation delays thus impacting service delivery;

(iii) Need for consolidated data collection and reconciled reporting with a particular focus on sub-sector allocations and expenditure tracking against service delivery indicators (outputs/outcomes) affect program/sub-program monitoring and evaluation;

(iv) Need for system improvements to support integrated budgeting and reporting of recurrent and development budgets and critical ex-ante transaction processing and budget control of development budget and self-accounting entities.

(v) **External audit** - in the backdrop of current and future challenges, a comprehensive review exercise undertaken by the Department of Auditor General of Pakistan (DAGP) revealed challenges from the ever changing complex governance environment including; the growing reliance on information and communication technologies (ICTs) employed in
the public sector, gender issues, and enhanced accountability demands for service delivery that need to be considered for meaningful audit to citizens;

(vi) Need for social accountability for service delivery due to awareness and access to public finance information;

(vii) Payroll and pension – need for improved and timely service delivery in pension payments, improved internal controls to support timely prevention and detection of unlawful pension payments and shift from manual to IT based recording and payment of pension; and

(viii) Public Sector Enterprises (PSEs) are prevalent in utilities and infrastructure industries, such as energy, transport, telecommunications and banking. The PSEs lack high standards of quality accounting, procurement, disclosure, compliance and auditing standards to meet their specific public policy objectives or economic activity.

10. Systems support and sustainability - the SAP-based Financial Accounting and Budgeting System (FABS) is managed by the Controller General Accounts (CGA) but the Directorate of Management Information Systems (DG-MIS) is understaffed with only 44 out of 64 critical positions filled. This is grossly affecting support to end-users and systems upgrade to meet emerging requirements.

11. The proposed project will support the government in reducing the bottlenecks which constrain service delivery by improving the PFM/procurement systems that will allow for better management at the service delivery level. A unified PFM systems exists at all three levels of government in Pakistan. Despite the 18th constitutional amendment, responsibility for financial management systems remain within the federal jurisdiction, with direct bearing on provincial governments’ capacity for service delivery. However, the same 18th amendment devolves procurement to the provincial levels. The planned intervention of introducing e-Government Procurement (eGP) at Federal and provincial levels, and dove-tailing it with existing PFM mechanisms, has the potential of creating a truly unified PFM system that the provincial governments would benefit from and will also contribute to improving service delivery results expected from the devolved provincial functions.

C. Relationship to CPS

12. The proposed project is in line with the Pakistan Country Partnership Strategy (CPS) for FY15-19 approved by the Bank Board in May 2014 (Report No. 84645-PK). The CPS recognizes service delivery in health/education as key areas of the World Bank Group engagement. The CPS also envisages seeking opportunities to address malnutrition in a multi-sectoral way by adding nutrition components to programs in various sectors. The strategy states that, “lack of administrative capacity and transparency are also contributing to poor outcomes. A citizen-centered approach to service delivery, focusing on results and fully exploiting the potential of emerging technologies will provide opportunities for achieving CPS Result Area 4: “Service Delivery” in a transparent and accountable manner. The project will also contribute to the sustainable development goal target 16.6: develop effective, accountable and transparent institutions at all levels.

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4 Pakistan has about 200+ commercial and semi-commercial PSEs suffering from approximately $15 billion loss per annum with total outstanding domestic debt and liabilities amounting to PKR 689.6 billion (i.e. 2.2% of GDP).
II. Program Development Objective(s)

A. Program Development Objective

13. The proposed project development objective (PDO) is “to improve public financial management and procurement systems for better management and accountability in service delivery”.

B. Key Program Results

14. In order to enable and potentially unlock constraints to public service delivery, strengthening and mainstreaming of Pakistan’s PFM system is critical. The proposed project is divided into two main pillars with five key results areas (KRA) that are strategically chosen to support the government Program and will also contribute to achieving the PDO. The Technical Assistance (TA) component will be complementary by funding some investments and hand-holding (coaching and mentoring) to support implementation of the key reforms.

15. The ultimate benefit of the project to citizens is that the PFM/procurement system will support the government in providing critical social services in a transparent and accountable manner. For example, basic health units and schools will be able to procure drugs, books and other essential health and school materials on time and pay health workers and teachers when due. Confidence in government payment systems will allow fair competition amongst suppliers for items to be procured economically. Civil servants and pensioners through facilitation centers and direct credit scheme will be able to receive their benefits on time and in a secured and dignified manner. Making key public finance and social sector indicators readily available in a user-friendly format at service delivery centers will provide opportunities for beneficiary feedback and social accountability. Public sector enterprises will be in a better position to contribute to pro-poor growth.

III. Program Description

A. PforR Program Boundary

16. The project will be anchored on the PFM Reform Strategy (2016-2025) which is being developed to consolidate PFM progress and making incremental improvements, ensuring that systems deliver to their full potential in an accountable and transparent manner and the National Procurement Strategy (2013-2016 – to be updated). The PFM reform strategy is further supported by the approved Department of the Auditor General of Pakistan strategic plan (2015-2019) and the CGA action plan – see annex 3.

17. The PFM reform strategy and the pipeline project builds on the foundation of reforms undertaken through earlier projects. In particular, the strategy closely draws from lessons learned from Project to Improve Financial Reporting and Auditing (PIFRA5), supported by the Bank. Although the Implementation Completion Report for PIFRA was rated as exemplary by the Independent Evaluation Group of the World Bank, the ICR identifies some important lessons

for future PFM projects. These include encouraging government to further strengthen post PIFRA arrangements to ensure sustainability of reforms; shifting implementation from accounting entities to executing agencies responsible for service delivery; empowering Principle Accounting Officers through decentralizing accounting and reporting functions; and enhancing independence of the Supreme Audit Institution. These needs have also been recognized by government stakeholders, who believe that the next phase of PFM reforms should be about informed fundamental policy decision-making by the government, backed by firm political commitment, then leading to behavioral changes in the ranks and file of the government.

18. **Three pillars of the PFM Reform Strategy are specifically supported by the PforR.** The project is selective to ensure that whilst alignment is sought with the PFM reform strategy, the breadth of this operation takes cognizant of the absorptive capacity and financial resources of GoP. This allows the operation to strategically focus on core ongoing reforms where there is political commitment and traction by the key PFM actors to create a platform for more advanced PFM reforms that focus on results. While the project specifically supports the third (Service Delivery and Results Based Management) and fifth (Oversight, Transparency, and Accountability) pillars of the strategy, it also transcends to other areas.

**B. Description**

19. The first pillar of the PforR focuses on interventions to address the core PFM process and system bottlenecks and behavioral change management; the second pillar addresses the downstream accountability issues to improve service delivery in the targeted social services; and the third pillar will establish a PFM Innovation and Service Delivery Fund.

**Pillar 1: Unlocking system constraints to service delivery**

**KRA 1: Internal management systems in line ministries and service delivery units**

20. **This area will support budget holders at all levels with systems and processes to be held accountable for providing public services, through appropriate use of funds under their control.** Processes will be improved for public managers at all levels for timely availability and predictability of funds to meet the objectives of the public services reflected in the government’s policies and priorities. This requires convenient and reliable access to the integrated financial management information system to provide real-time and reliable information on the implementation of budget and remaining available funds. Under the program, the system will be improved to better align and track budget and expenditure with service delivery needs. Most importantly, public funds could be better managed by suitably qualified PFM professionals who will need continuous professional development.

**Behavioral change**

21. The success of the reform program depends on how well it addresses the complex nature of reforms that involve political leadership and multiple stakeholders with varying degrees of disposition towards embracing change. This requires multilayered behavioral change approach that can help optimize and leverage the PFM systems and processes to improve service delivery. Cross-support will be provided by the Leadership, Learning, and Innovation (GGELI) Unit to
embed Collaborative Leadership for Development (CL4D) activities to strengthen leadership capacities for change as individual leaders and through effective management of teams and participatory engagement with stakeholders (citizen/beneficiaries).

**Public Sector Enterprises (PSE)**

22. A set of analytic work for emerging issues will be undertaken starting with preparation of good practice financial management/governance model\(^6\) including update of the Audit Code that prescribes the procedures for accounting and controls for PSEs starting with Pakistan Post, Central Depository of National Savings (CDNS), Water & Power Development Authority (WAPDA) and National Highway Authority (NHA). As a priority because of their payment roles, suitable application interfaces with FABS will be implemented for Pakistan Post and CDNS and this will also provide synergy with the Financial Inclusion and Infrastructure Project.

**KRA 2: Improved procurement outcomes**

23. The federal and provincial Public Procurement Regulatory authorities (PPRA) have developed a National Procurement Strategy (2013-2016) that lays down a roadmap for procurement regulators in Pakistan to realize procurement performance effectiveness, and mentions \(e\)-procurement as an important step forward. A Procurement Advisory Group (PAG) comprising heads of PPRAs is working towards a harmonized procurement reforms and align the functions of the provincial PPRAs with that of the federal PPRA. The E-procurement strategy recommends a common electronic government procurement (\(e\)-GP) infrastructure. This preferably common \(e\)-procurement system will be a key intervention (\textit{starting with the key foundation features}) under the proposed program. This will address leakages resulting in savings of billions of rupees and reduce the time taken for procurement making the process more efficient. The preference for a common \(e\)-GP system will enable a comprehensive set of procurement data for public disclosure or for auditors, making the process more transparent.

24. The 18\(^{th}\) amendment devolves procurement to the provinces, with each of them having their own PPRAs. The various PPRAs will have separate secured accesses to the preferred common unitary \(e\)-GP system. Separate developments of e-procurement systems within individual provinces or within individual ministries or departments risk fragmentation of opportunities and would not be an optimal solution, duplicating costs and raising risks of security, lack of interoperability, common data capture, performance assessments and financial integration, as well as differences in implementation timelines, putting at risk the broader project objectives.

25. Bottlenecks to service delivery due to weak procurement process will be addressed through aligning procurement plans with the approved budget and downstream processes to strengthen the value chain through seamless integration with the \textit{Supplier Relationship}

\(^6\) \textit{OECD Guidelines on Corporate Governance of SOEs — Best Practices: Disclosure and transparency} - State-owned enterprises should observe high standards of transparency and be subject to the same high quality accounting, disclosure, compliance and auditing standards as listed companies. [http://www.oecd-ilibrary.org/docserver/download/2615061e.pdf?expires=1456645220&id=id&accname=guest&checksum=9FA809DB9367E7EFCDB5FE395585740]
Management (SRM) module of FABS as shown in Figure 1: (i) check for budget availability at point of requisitioning; (ii) commitment control at point of raising purchase order; (ii) obligations at point of receiving goods/services and supporting invoice/claim; and (iv) cash management at point of making payment with automatic general ledger postings.

Figure 1: Features for linkage between procurement plans and budget with basic e-procurement portal

26. Support will be provided for examining the role of small and medium enterprises (SMEs) in public procurement, with a view to expanding their access to public contracts thereby increasing job-creation and using downstream interventions to support marginalized groups by providing preference to SMEs that are either owned by or employ such groups. In this phase, the project will support analytical work to map out the SME in terms of locations and types of businesses, their access to government contracts and barriers to their participation in government tenders, and to financial markets to fund such participation.

KRA 3: Payroll and pension payment systems

27. Payroll and pension payment is one the largest expenditures of the government and is one of the key internal service delivery mandate of MoF and CGA. Through improvement in governance, internal controls and automation, the program is expected to improve transparency and improve service delivery to civil servants and pensioners. Transparent and efficient management of various major expenditures would address leakages and provide fiscal space for more allocation to service delivery. The payroll/pension reform measures will support CGA and Pension Reforms and Facilitation Committee nominated by the Finance Minister to implement Human Resource Management Information System by linking payroll and sanctioned positions; establish facilitation centers for pensioners; ensure mandatory payment into pensioner’s bank accounts, establish facilitation centers for pensioners and reduce leakages through improved pension audit system.
Pillar 2: Enhancing transparency, citizen participation and accountability

KRA 4: External audit and legislative scrutiny

28. As the Supreme Audit Institution (SAI), external audit of public funds is conducted by the Department of Auditor General Pakistan (DAGP) which has adopted a five years strategic plan and established a Policy Board to monitor its implementation. The Public Accounts Committee (PAC) is one of the statutory organs of the National Assembly of Pakistan. The PAC existence and its success require three basic conditions: proper staffing and information, non-partisan functioning of the committee, and media coverage (electronic, print and broadcast). A major challenge facing the DAGP is that quite often their recommendations are ignored or not implemented by government departments. The activity to support this result area will include enhancing capacity of DAGP to prevent or detect instances of fraud, waste and abuse; collaboration with private sector firms in audit of PSEs; effective audit of service delivery units through citizen participatory audits, establishment of audit management information system and strengthening legislative (PAC) demand for accountability.

KRA 5: Social accountability and open government data (OGD)

29. Voice, accountability and participation are an “inescapable” part of governance today. CSOs contribute to the PFM reform process through advocacy, training and capacity development. “Closed” governance cannot deliver quality services reliably to citizens. Thus an important requirement for transforming governments for the future to ensure transparency and accountability through citizen feedback is by the adoption of open government and open data. This involves making available to the public, through the World Wide Web, data relating to public service delivery and socio-economic development so that citizen feedback is informed and government processes are made transparent to keep a check on corruption. The project will seize the opportunity of the improvements in voice and accountability according to the WGI indicator to widen the space to mobilize citizen/beneficiary engagement to demand for good governance with regards to the quality of policy formulation and implementation. The project will support; strengthening demand for accountability from CSOs; institutionalizing citizen engagement and social accountability and Open Government Data. Deliberate efforts will be made to utilize inclusive approaches to capacity building and institutional strengthening to ensure good gender balance. Collaboration with UN Women will support development and implementation of tracking systems to assess budgetary allocations and spending from a gender perspective and women’s empowerment.

Pillar 3: PFM Innovation and Service Delivery Fund

30. The PforR will set aside a PFM Innovation and Service Delivery Fund to introduce innovations by piloting in Islamabad before considering rollout to the provinces. The proposed Fund would provide resources for rewarding innovative service delivery and accountability ideas within the PFM domain that have the potential to or have a direct bearing on improving service quality.

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7 Pakistan Vision 2025 pg 57
delivery. The objective of this intervention would be to identify innovations that can be scaled up or replicated across government and create wider ownership for such innovations by targeting existing or potential innovations supporting any part of the PFM cycle, ranging from allocation of public resources through inclusive strategic planning, budget formulation, budget implementation, revenue collection, cash and expenditure management to accounting, financial reporting, external audit and public oversight with citizen participation and grievance redress mechanism. An important thematic consideration of the proposed Fund would be seizing opportunities availed by technology-backed applications such as smart mobile devices for service delivery monitoring and CSO based interventions at different entry points of PFM cycle; GIS solutions (including geo-tagging of project schemes); social media; and open government data to improve service delivery.

31. **Coordination and strengthening of federal-provincial fiscal relationship will be incentivize through performance based grants (PBG) against mutually agreed Fiscal Responsibility and Accountability Index and Service Delivery Barometer that would be anchored around the principles of the Pakistan Fiscal Responsibility and Debt Limitation, Act, 2005.** The performance grant could be two-dimensional: (i) tied-grant to targeted service delivery interventions; and (ii) earmarked grant for improving PFM systems that will contribute to service delivery and accountability for the use of public funds. The Fund will complement existing funding mechanism of block grants to provinces outside the National Finance Commission (NFC) Awards to serve as catalytic fund for a whole-of-government approach to socio-economic development.

32. The PFM Service Delivery Barometer will gauge citizens’ satisfaction on economic governance factors and selected service delivery indicators to bring a human face to PFM. The performance grants will be piloted in selected priority sectors which will be selected in agreement with Ministry of Capital Administration and Development (MoCAD). Grant execution will be monitored by MoF (financial and non-financial) and DAGP financial and performance audits corroborated by social audits.

**B. Proposed Disbursement Linked Indicators (DLIs)**

33. To ensure direct alignment with the government Program, the proposed Disbursement Linked Indicators (DLIs) in Table 2 that will contribute to achieving the PDO are derived from the performance indicators and targets in the *Medium Term Budget Estimates for Service Delivery (BESD)* commonly referred to as the “Green Book” and will be discussed with the Government counterparts in parallel with our support to finalization of the PFM reform strategy. The results chain in annex 4 logically shows how attainment of the DLIs will address the PFM/procurement bottlenecks.

34. Since the program is focused on strengthening the PFM and procurement systems that are pre-requisites for achieving positive social sector outcomes, the DLIs exclude specific social sector outputs/results as these are directly supported through ongoing/pipeline social sector projects. Gender disaggregation and baselines will be established for the proposed DLIs. Also,

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8 The DFID Sub-National Governance program in Punjab will be studied for adaptation.

9 NFC award is revised every five years and requires consent of the federal and four provincial governments.
the yearly targets for the proposed DLIs will be properly sequenced to achieve the ultimate results. In order to be selective, some issues will be included in the Program Action Plan (PAP).

Table 2: Proposed Disbursement Linked Indicators (DLIs)

<table>
<thead>
<tr>
<th>Pillar 1. Unlocking system constraints to service delivery</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>KRA 1:</strong> Strengthened the internal management systems in line ministries and service delivery units (SDU)</td>
</tr>
<tr>
<td>DLI 1: Percent of payment to suppliers within 5 days by Controller General of Accounts (CGA) through electronic fund transfer (EFT) (output).</td>
</tr>
<tr>
<td>DLI 2: Percent of development budget transactions processed through (output).</td>
</tr>
<tr>
<td><strong>KRA 2:</strong> Procurement practices</td>
</tr>
<tr>
<td>DLI 3: Percent of contract awards processed through e-procurement system (outcome).</td>
</tr>
<tr>
<td>DLI 4: Percent of budget derived from procurement plans in selected federal ministries and provincial departments (outcome).</td>
</tr>
<tr>
<td><strong>KRA 3:</strong> Payroll and pension payment systems</td>
</tr>
<tr>
<td>DLI 5: Percent of gratuity and first pension payments made within 15 days of retirement of civil servants in X line ministries through Direct Credit Scheme (DCS) (output).</td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th>Pillar 2: Enhancing transparency, citizen participation and accountability</th>
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<tbody>
<tr>
<td><strong>KRA 4:</strong> Improved external audit and legislative scrutiny</td>
</tr>
<tr>
<td>DLI 6: X Rupees of cost efficiency as result of DAGP audit observations/queries and implementation of PAC recommendations (outcome).</td>
</tr>
<tr>
<td>DLI 7: Number of Public Sector Enterprises (PSE) audit reports published (output).</td>
</tr>
<tr>
<td><strong>KRA 5:</strong> Social accountability and open government data (OGD)</td>
</tr>
<tr>
<td>DLI 8: Percent of performance audits conducted through Citizen Participatory Audits and reports published (output).</td>
</tr>
<tr>
<td>DLI 9: Upload of Budget Performance Observatory (BPO) reports for targeted social service sectors within 30 days of each month-end on Ministry of Finance's website and display of dashboards on notice board of departments and service delivery units (output).</td>
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<tr>
<th>Pillar 3: PFM Innovation and Service Delivery Fund</th>
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<tbody>
<tr>
<td>DLI 10: Fiscal Responsibility and Accountability Index and Service Delivery Barometer (outcome).</td>
</tr>
</tbody>
</table>

C. Initial Environmental and Social Screening

Social

35. The project is expected to have positive social impacts through improved public confidence in government in the management of public funds in a transparent and accountable manner. However expectations should be well managed because legal structures and technology, though necessary, are not sufficient; “supportive social and political context” with strong leadership that provides space for citizen participation to demand accountability are critical. Complementary reforms in the judicial sector, rule of law and wider public sector reforms will be required. Shifting behavior to achieve the PFM reform objectives requires not only technical actions (e.g. laws, standards, ICT, training) but considerations of the dynamics in the policy arena (e.g. incentives, power relationships, stakeholders) and appropriate tools (cooperation, commitment, coordinate). A Behavioral Change and Communications Framework has been prepared to address the attitudinal barriers to change.

Environmental
36. The program covers minor civil works which are expected to have no or negligible environmental or social impacts. The task team will conduct an Environmental and Social Systems Assessment (ESSA) of the national systems by January 2017 for clearance by the Regional Safeguards Adviser (RSA) before project appraisal. The Bank will assist the counterpart to prepare an Environmental and Social Management Plan (ESMP).

D. Tentative financing
Source: ($m.)
Borrower/Recipient
IBRD
IDA 200
Others (specify)
Total 200

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