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Public Financial Management Performance Report

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EXCHANGE RATE
(As of May 23, 2013)
1 Israeli New Sheqalim (NIS) = US $ 0.27

WEIGHTS AND MEASURES
Metric system

ABBREVIATIONS AND ACRONYMS

BISAN	Palestinian Authority Computerised Accounting System (IFMIS)
CG	Caretaker Government
CMD	Cash & Debt Management Division, MoF
COFOG	Classification of Functions of Government
DARP	Development Assistance Reform Platform
DFID	Department for International Development, United Kingdom
EU	European Union
FAD	Fiscal Affairs Department, IMF
GAD	General Accounting Department, MoF
GoI	Government of Israel
IFMIS	Integrated Financial Management Information System
INTOSAI	International Organisation of Supreme Audit Institutions
MDA	Ministry, Department and/or Agency
MENA	Middle East and North Africa region
MoF	Ministry of Finance
MoPAD	Ministry of Planning and Administrative Development
MTBF	Medium Term Budget Framework
MTFF	Medium Term Fiscal Framework
PA	Palestinian Authority
PFM	Public Financial Management
PIF	Palestinian Investment Fund
SAACB	Supreme Audit and Administrative Control Bureau
SN	Subnational
TSA	Treasury Single Account
UNDP/PAPP:	United Nations Development Program / Program of Assistance to the Palestinian People
USAID	United States Agency for International Development
WBG	West Bank and Gaza

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PREFACE

At the request of the Palestinian Authority (PA), a Public Expenditure and Financial Accountability (PEFA) assessment of the PA's public financial management (PFM) system was undertaken. The assessment process was led and coordinated by the World Bank, and included the European Union, France, and the UNDP. The discussions with the PA took place over a period from March to June 2013.

The international assessment team included Messrs: Pierre Messali (Senior Public Sector Specialist, Task Team Leader and Coordinator); Nadi Yosef Mashni (Financial Management Specialist); Basheer Ahmad Fahem Jaber (Procurement Consultant); David Hoole (PFM expert from Oxford Policy Management, Advisor to the TTL); John Short (PFM expert from REPIM contracted by Ecorys Nederland BV, financed by the EU); Patrick Mordacq (PFM expert representing France through the French ADETEF), and Gerhard Pulfer (PFM expert, representing the UNDP). Maha Muhammad Bali of the World Bank Office in West Bank & Gaza assisted in the assessment.

The assessment team met with officials from the Ministry of Finance, the Ministry of Planning and Administrative Development, the Ministry of Local Government, representatives of Ramallah and Birzeit municipalities, the Ministries of Education, Health and Public Works & Housing, the Ministry of Planning and Administrative Development, and the Supreme Audit and Administrative Control Bureau. The team also met with AMAN, the Coalition for Accountability and Integrity, as well as representatives of development partners, including the World Bank, IMF, DFID, USAID, INL, and the European Union.

The team wishes to thank Ms. Laila Sbaih-Eghreib, Acting Director General of International Relations and Projects, for ensuring excellent cooperation and dialogue, as well as officials in the Ministry of Finance and other entities/organizations for the open and frank discussions. The team is grateful to the Ministry of Finance for its work in coordinating the various meetings and its support in providing the documentation necessary to support the assessment.

SUMMARY ASSESSMENT

At the request of the Palestinian Authority (PA), the World Bank led an external assessment of the authority's public financial management (PFM) systems based on the Public Expenditure and Financial Accountability (PEFA) methodology. The assessment was undertaken with the participation of the EU, France (ADETEF), and the UNDP and in close collaboration with the Ministry of Finance (MoF), as the main counterpart of the Palestinian Authority for this assessment. DFID participated in the funding of the assessment.

The assessment mission team[1] visited Ramallah during March 10–24, 2013 and June 2–6, 2013. The report examines progress since an initial review in 2007 which was undertaken as part of a broader public expenditure review (PER) organized by the World Bank. The 2007 review did not cover all indicators in the PEFA framework (four indicators on procurement and tax administration were not covered in 2007) and was not peer reviewed under the same framework and quality assurance arrangements as the current report. The 2013 PEFA reveals some over-scoring in the previous review which makes a comparison between the two assessments difficult.[2] Nonetheless, the 2007 review provides for a certain baseline for monitoring progress in PFM reform for the 25 indicators covered by the two reports.[3] It also helps to support the PA in refining the current PFM reform strategy. The current report has been reviewed by the PEFA Secretariat, by the IMF-METAC, and by two independent peer reviewers.[4] Their comments are integrated into the report.

1. Integrated Assessment of Public Financial Management Performance

The PA has faced significant challenges in pursuing improvements to PFM. Following the 2006 election and the separation between the West Bank and Gaza, a fiscal crisis ensued and several PFM procedures and practices stopped operating**.** PFM reforms recommenced with the formation of a Caretaker Government in 2007. They involved building basic PFM systems almost from the beginning, under challenging conditions, and establishing PFM institutions in the West Bank to replace those previously operating in Gaza. Progress made in this regard within a relatively short period of time is particularly impressive. It includes: relocation of the Budget Department in Ramallah; development of the central treasury account; implementation of a new Integrated Financial Management Information System (IFMIS)[5] built around a budget classification modernized in line with the 2001 GFSM and the COFOG; establishment of a Debt Management Office; reintroduction of monthly reporting and annual financial statements;[6] and development of internal and external audits.

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[1] Pierre Messali (World Bank Senior Public Sector Specialist, Task Team Leader and Coordinator); Nadi Yosef Mashni (World Bank Financial Management Specialist); Basheer Ahmad Fahem Jaber (World Bank Procurement Consultant); David Hoole (PFM expert from Oxford Policy Management, Advisor to the TTL); John Short (PFM expert from REPIM, contracted by Ecorys Nederland BV, financed by the EU); Patrick Mordacq (PFM expert representing France through the French ADETEF), and Gerhard Pulfer (PFM expert, representing the UNDP).

[2] Where this applies is clearly indicated in both the executive summary and in the detailed assessment.

[3] Two indicators rated in 2007 are not rated in 2013 due to the absence of a functioning legislature (see below).

[4] Franck Bessette (Senior FM specialist at LAC region at the World Bank), and Andrew Bird (PFM expert).

[5] Developed by the Bisan company.

[6] Public Financial Management Reform in the Middle East and North Africa: An Overview of Regional Experience, West Bank and Gaza Case Study, M. Ahern, World Bank Report No. 55061-MNA.

The assessment of the PFM system against the PEFA indicators reveals a more positive picture overall than in 2007: On the basis of the 25 indicators assessed both in 2007 and 2013, 22 performance indicators (PI) relate to the government PFM system under the sole responsibility of the PA, and three other indicators (D) relate to donors' practices and, as such, are primarily the responsibility of the donor community supporting the PA. Overall, 21 out of the 22 indicators related to performance of the PA are either rated higher than (10) or equal to (11) indicators measured in 2007. It is important to note that this comparison takes into account reassessment of five indicators incorrectly over-scored in 2007[7] either because of a misinterpretation of some PFM procedures (notion of commitment in particular)[8], or simply because of an error in the scoring methodology. Only one indicator related to the PA actually scores below its 2007 rating. Out of the three indicators related to donor practices,[9] one indicator shows improvement and two remain the same after same reassessment of the 2007 scores.

Significant progress was achieved by the PA in indicators related to comprehensiveness and transparency, control and audit, and some indicators related to accounting and reporting. These indicators are rated around B and C, some of them A at subindicator level. This underscores the relevant efforts of the PA and achievements that have been made in a relatively short period of time in areas such as oversight of aggregate fiscal risk, public access to fiscal information, cash and debt management, annual financial statements, and external audits. This constitutes a significant improvement within the MENA region as other countries typically perform poorly in these areas.

Systemic weaknesses in budget preparation, budget execution, and accounting/reporting were also revealed. The associated indicators all score between C and D. The fiscal crisis of recent years has put considerable stress upon the PFM system, magnified the impact of these problems, and hampered appropriate budget execution reforms. Greater uncertainties over resources and cash shortages have also affected budget preparation procedures which have not sufficiently adapted to the new constraints. Accounting and reporting systems have also failed to present an accurate picture of arrears and feature them as a fiscal target for monitoring purposes. Additionally, the separation from Gaza has increased the fiscal burden on the PA which must continue to fund expenditures in Gaza but no longer receives revenues from there.

Performance against the seven PEFA broad performance areas can be summarized as follows:

- **On Budget credibility (PI-1 to PI-4), the assessment shows a rather mixed picture.** While the deviation of actual expenditures and revenues from original budgeted amounts has remained within acceptable limits, the indicator measuring arrears continues to score badly (D in 2013 versus D+ in 2007).[10] The significant increase in payment arrears from 3 percent of the operational budget in 2010 to 17.7 percent in 2012 reflects a trend of actual expenditure steadily exceeding actual resources. This is not primarily the result of actual expenditures exceeding their initial budget ceilings, but rather the consequence of the insufficient adjustment of expenditure to actual resources, in particular budget support

[7] These five indicators relate to arrears (PI-4); transparency of intergovernmental fiscal relations (PI-8), in-year budget reports (PI-24), financial information on direct budget support (D2), and proportion of aid managed using national procedures (D3).
[8] This misinterpretation of the definition of commitment according to PEFA methodology affects the 2007 scoring of the two indicators: PI-4 (ii) related to the measurement of arrears, and PI-24 (i) and (iii) related to in-year commitment reporting.
[9] Twenty-two indicators (PI) relate to the PFM system and three indicators (D) to donor's practices.
[10] This indicator was however clearly over rated at D+ in 2007.

financed by donors (see below). This is also a reflection of deficiencies in the control, monitoring, and accounting/reporting of the budget execution system, which are corroborated by convergent analysis of the related indicators.[11] The recent fiscal crisis, driven by constraints on economic activity due to local political circumstances and shortfalls in domestic revenues and budget support, largely explains the significant and sudden increase of arrears from NIS 394 million in 2010 to NIS 2,226 million in 2012. The PA has made attempts to limit the negative impact of arrears on the private sector by periodic recourse to the domestic debt market, which also affects the position of the PA vis-à-vis the banking sector. These short-term measures do not address the structural imbalance between revenues and expenditures.

- **Comprehensiveness and transparency of the budget (PI-5 to PI-10) have improved, but additional efforts are needed.** Overall, transparency of, and public accessibility to, budget information have improved. This is also the case for budget classification, which is based on adequate standards for budget formulation and execution, although further improvements are needed to ensure better consistency with the COFOG. Additional information required for further improvements in budget transparency could be publicly provided immediately (for example debt disclosure)[12] or in the near future (public disclosure of procurement contracts awards once the new procurement law is implemented).[13] The public disclosure of the proposed budget before its approval by the legislature should also be considered as part of a "quick wins" strategy.[14]

Transparency of fiscal relations between central government and local governments (municipalities and community villages) requires reduced delays in budget transfers and more transparent rules in calibrating and transferring resources to municipalities.

While extra budgetary funds are marginal, reporting of donor-funded information is comprehensive for funds channeled through the main Treasury account, but inaccurate and not comprehensive for other funds, partially due to the lack of interface between the databases for projects managed by the MoF and the MoPAD.

The central government bears major fiscal risks raised by losses of local Palestinian utilities companies.[15] The ability to address this situation is aggravated by the practice of the GoI automatically deducting unpaid bills from the clearances revenues collected on behalf of the PA; a practice that is viewed by the PA as significantly reducing the incentive of local Palestinian companies to improve collection rates. The PA also bears a fiscal risk from "letters of comfort" issued by municipalities to contractors for banking facilities purposes.

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[11] Predictability of funds for commitment (PI-16); control of nonwage expenditures (PI-20); quality of in-year budget reports (PI-24) and of annual financial statements (PI-25); and predictability of direct budget support (D1).

[12] PI-6

[13] PI-10

[14] PI-10. In the current situation, in the absence of a legislature, the proposed budget is approved by the Presidency.

[15] The unpaid invoices to the Israeli electricity/water companies are paid to them by the Israeli budget; the latter deducts correspondent amount on the clearance revenues transferred to the PA budget; the latter deducts in turn the amount from the transfer of property tax recovered by the PA tax administration to the municipalities which raises a loss for their budgets. At the end of the cycle, the losses of Palestinian electricity/water companies are netted and neutralized; the municipalities bear the final weight of the losses due to unpaid invoices by the users; the latter being left in some sense with no more incentive to effectively pay their bills and clear their arrears.

- **Policy-based (PI-11) and multiyear (PI-12) budgeting require further strengthening.** Despite improved IFMIS modalities for preparation of the budget estimates, and orderly exchanges between line ministries and the MoF, the core principles governing the budget preparation process are not in line with PEFA good practice standards and are not well adapted to the current fiscal context. The procedure is mainly organized around an informative budget circular fixing the schedule, modalities, and fiscal context of the budget. But it reveals several shortcomings, including: (i) the relatively short period given to line ministries to prepare their detailed budget requests;[16] (ii) the late stage at which budget ceilings are issued to line ministries; and (iii) the late stage at which the Cabinet becomes engaged in determination of ministerial budget ceilings.

These shortcomings typically reflect a "bottom up" procedure as opposed to the "top down" approach whereby budget ceilings are determined by the MoF and approved by the Cabinet at an earlier stage, once economic and aggregate fiscal forecasts have been completed, and then serve as a basis for budget requests of line ministries. The PA faced some difficulties introducing such a "top down" practice because: (i) the capacity of the MoF to produce a medium-term fiscal framework (MTFF) was not reached until recently with the establishment of the MFU; and (ii) the required fiscal discipline from line ministries in calibrating their budget estimates has proved difficult to secure in the current fiscal context.

- **Reform in this area is currently underway.** However, determining the recurrent budget balance and aggregate budget ceilings at an early stage of the budget preparation procedure will continue to be challenged by the uncertainty of the budget context, in particular the lack of predictability of direct budget support from some donors.

The adoption of a multiyear perspective to fiscal policy, expenditure planning, and budgeting has been hampered by the absence of an MTFF, debt sustainability analysis, the limited coverage of costed sector strategies and their likely inconsistency with fiscal forecasts, and weak integration of investment budgets with forward expenditure estimates. The horizon for 2013 and beyond seems better however, reflecting the development of the Macrofiscal Unit and ongoing reforms to expenditure planning and budgeting at MoF.

- **The set of procedures for expenditure predictability and control in budget execution (PI-13 to PI-21) requires significant improvement to address the current challenging context.** Of the four areas assessed (tax administration, procurement, budget execution, and internal control) two were not reviewed in 2007 (tax administration and procurement) and do not allow an assessment of progress.

Regarding tax administration (PI-13 to PI-15), development has begun and is very promising in terms of quick fiscal outputs. While property tax administration is the most advanced on taxpayer registration and tax assessment grounds, systems for all other taxes (income tax, VAT, and customs) are lagging. Databases for each tax are not yet interconnected to allow for better tax registration and assessment. Other relevant issues include: discretionary powers are still high for some taxes; transparency of complaint mechanisms are hampered by the absence of an intermediate appeal system; a system of

[16] Four weeks versus PEFA standard of six weeks.

penalties is not sufficiently enforced; and tax collection rates are burdened by huge arrears.[17] A USAID- and DFID-funded technical assistance program is supporting a comprehensive three-year plan for enhancing tax compliance in line with IMF recommendations. Some of the features of the plan have been implemented or are close to implementation, such as the Revenue Management IT system. In the current context of a chronic shortage of donor funds, this reform is viewed by the PA as potentially capable of generating an additional 20 percent of domestic revenue. As such, it constitutes a high priority for the PA.

Procurement reform (PI-19) is currently ongoing and should mark a huge move towards good practices. A new law was enacted in 2011 which foresees the establishment of a High Council of Procurement as an independent entity to monitor the regulatory framework of procurement. Implementing regulations have been issued in 2013 in order for this new entity to be fully operational. Once the reform is fully implemented, procurement will be brought in line with international good practices. At the time of the assessment, not all provisions of the new procurement legal and regulatory framework were implemented. This explains the current relatively low score (C+) that is nonetheless expected to improve in the near future.

The predictability of budget execution (PI-16) has not improved in recent years, despite good progress in implementing the IFMIS and pooling resources through a Treasury Single Account (TSA) system. The attempts in 2009 to develop an annual cash plan and a commitment control system to address, in particular, the increased uncertainty of external direct budget support and volatility of clearance revenues were discontinued during the period 2010–2012.[18] The main reason for this was the deterioration of the fiscal situation that deprived the PA of the necessary comfort to launch such reform, and absorbed its capacity to address the most urgent needs to ensure budget execution. As a consequence, budget execution operated under a cash rationing system in 2011 and 2012 rather than under orderly cash planning modalities. Nevertheless, this system was unable to prevent disruption in the payment of salaries and did not allow more than a one-month time horizon for spending.[19]

Recording of debt and consolidation of cash balances (PI-17) shows a mixed, but overall positive evolution. Debt recording has improved significantly since the relocation of the Debt Department Office to the West Bank. Comprehensive domestic and foreign debt records are maintained, including arrears on debt payments; this is a recent achievement in 2013. Vigilance remains necessary to ensure that all loans, including those not serviced, continue to be recorded, and the new system is maintained.[20] Consolidation of cash balances is satisfactory and consistent with the operation of a Treasury Single Account system, but this has not yet been extended to the Petroleum Authority and to donors' project funds.

The internal control (PI-18 and PI-20) and audit (PI-21) systems have been developed significantly within a short period of time, but have not been able to curb the recent disruptions in budget execution. Internal control on payroll and nonwage expenditures has improved due to efforts of capacity building and networking development among line ministries. However, there has been a continued lack of control on commitments as one of the main reasons for the increase of arrears. This explains the low score

[17] Income tax arrears represent 50% of all revenues.
[18] PA's revenues collected by the Israeli tax administration on behalf of the PA (in accordance to Oslo agreement).
[19] Salaries were paid twice a month starting from June 2012 and delayed during the last months of 2012 and early 2013.
[20] A loan from the Arab Fund for Economic and Social Development dating back to 1998–99 is no longer serviced.

(D+) of the related indicator for nonsalary expenditure.[21] This should not, however, be viewed as a weakness of the internal control system per se, as evidenced by the good score (B+) reached on payroll control which is operated by the same units, but rather as the consequence of a systemic weakness of the PFM system which does not recognize commitments. Internal audits have developed in coverage and scope, in particular with the establishment of a Central Harmonization Unit in line with good practices; the score C+[22] reflects such improvement through the ratio of systemic audit which reaches 50 percent of the total audit activity, the reporting and follow-up of recommendations.[23] An EU funded technical assistance project is currently supporting the development of internal audit.

- **Accounting and financial reporting (PI-22 to PI-25) need to improve.** Timely and reliable procedures for accounts reconciliations, in-year financial reporting, and annual financial statements are crucial for ensuring the accountability of the PFM system.[24] While bank reconciliations score at B level due to the IFMIS and Treasury Single Account system in place, two other indicators score only at C and C+ levels, despite the existence of the performing IFMIS which has allowed for more timely and accurate financial reporting.[25] Existing accounting practices comply only partially with international standards, in particular IPSAS. This relates to some general concepts (presentation of accounting statements) and some more specific concepts (arrears).[26] The assessment highlights the need for improvement in the accounting system and IFMIS (enhancements are required for issuing and managing age profile and carryover of arrears). Regarding presentation of financial accounts, consistency with IPSAS is generally ensured, however full compliance requires further improvements.

On the other hand, the coverage of the consolidated financial statements is satisfactory, though timeliness in issuing the statements could be improved (currently there is a 15-month delay). The quality of the in-year financial reports (monthly, quarterly, and annual reports) issued from the IFMIS has significantly improved, in particular through a nearly compliant presentation with the GFSM 2001. However, the quality of the reports is undermined by lack of information on commitments in line with good practices despite the apparent dual presentation in cash and commitment basis in the reports.[27]

Financial information on resources received by service delivery units is missing, as it is in many countries.[28] No routine collection of data information (through IFMIS) from primary units (primary school and primary health centers) exists, and neither surveys nor analysis on a sample basis has been carried out. Thus, it is generally not possible to assess the cost of services by delivery unit and evaluate their performance.

- **With regard to external scrutiny and audit, only indicator PI-26 on external audits was assessed; in the absence of a functioning legislature the other indicators could not be evaluated.**

[21] PI-20.
[22] Compared to a C in 2007, which was not fully evidenced and therefore scored too highly.
[23] The development of this broad set of internal control and audit procedures is all the more notable relative to the rest of the MENA region which is well known for poor achievements in internal control and audit areas.
[24] Respectively, PI-22, PI-24, and PI-25.
[25] PI-24.
[26] Regarding advances, the accounting policy adopted in WBG is not in line with the internationally recognized definition of this accounting procedure. Therefore, the PEFA methodology is not applicable to this current procedure.
[27] Guidance on scoring of commitments in the indicator PI-24 on financial reporting leads, at best, to a C score.
[28] PI-23.

External audits have considerably improved compared to 2007. The three dimensions of the indicator are rated at B or C levels, showing a certain consistency of development. The scope and coverage of external audits is comprehensive (annual audit of the consolidated 51 budget entities constituting the PA budget), and the nature of audits, including some aspects of performance audits, is in line with audit standards. Financial statements are audited within a period of 11 months, which includes time spent by the MoF amending the presentation of the statements to bring them in line with IPSAS. There is evidence of follow-up on the main recommendations of the SAACB. Such improved external audits are a real strength which should lead to increased confidence in the scrutiny of budget execution and in the financial statements of the PA. An EU-funded project is currently supporting capacity building at the SAACB.

- **In the current context of a heavily donor-supported PFM system, the absence of improvement of donor practices (D1 to D3) is a concern and makes the improvement of budget preparation and execution by the PA more challenging.** The predictability of direct budget support has improved slightly, while the quality of information for budgeting and reporting foreign aid and the proportion of aid managed under national procedures have both stagnated at an unsatisfactory level. The assessment confirms a steady decline in actual levels of budget support in absolute terms during the period 2010–2012 (-30 percent), which constitutes a challenge for the PA since an increase in domestic revenues to compensate for this reduction can only be expected to materialize in the medium and long term. Actual levels of budget support exceeded donors' forecasts provided before the beginning of the fiscal year, but fell short of the amounts budgeted by the PA. It also reveals that the amount of budget support budgeted by the PA in the annual budgets was higher than the aggregated amount of forecasts of donors. The difference between these two amounts (forecasted and budgeted) corresponds to an additional financing gap. In recent years, the PA has steadily overestimated the aggregate amount of budget support in an attempt to: (i) counterbalance the tendency of some bilateral donors to disburse their support on time and up to the pledged amount;[29] and (ii) advocate a continued need for additional financing from the donors' community.[30] The difficulties in establishing an accurate and comprehensive picture of donor-financed projects are due to uneven quality and timeliness of relevant information transmitted by development partners. One reason is the insufficient fit between the classification of the databases used by the MoF (IFMIS) and the MoPAD (DARP). Finally, most foreign aid is not managed through national procedures. From a donor perspective, a reason for the low utilization of national procedures in the implementation of programs and projects is the fact that projects are not audited by the SAACB, but by private auditors.

2. Assessment of Impact of PFM Weaknesses

Most issues identified by the current PEFA assessment have already been recognized in previous PFM evaluations, including: the need to improve the upstream budget preparation procedure, focusing in particular on multiyear fiscal frameworks; the absence of cash planning and commitment control tools as one of the key obstacles to smoothed budget execution and controlling arrears; the absence of sound

[29] In particular, some Arab donors.

[30] According to the IMF, these discrepancies have been addressed more carefully for the preparation of the 2013 budget, i.e. the budget support budgeted by the PA should now correspond to the forecasts of the donors.

accounting policies regardless of the capability of the IFMIS to address them; and finally, the need to enhance internal controls.

The 2013 PEFA has, however, refined the analysis and identified the meaningful interconnection between these weaknesses, as follows:

- The budget preparation process is not sufficiently driven by early and hard budget ceilings approved by the Cabinet to serve as guidance for annual budget preparation, and coordination between MoF and MoPAD in budget preparation is weak. The result of this prevailing "bottom up" mechanism is that budget ceilings are not sufficiently owned and regarded as binding by many line ministries, which leads to problems during budget execution.[31]

- The budget execution process is not proactively adjusted to take account of revenue availability, and instead continues to a certain extent to be driven by the original approved budget, rather than by the actual revenue situation and a realistic cash plan. The result is a budget execution process which fails to adjust to actual revenues and follows a short-term cash rationing pattern rather than orderly cash planning, contributing to an accumulation of arrears exacerbated by a lack of control on commitments and undermined by the current low tax collection rate.

- An accounting and reporting process that is not sufficiently focused on arrears presentation is a key indication of the weak link of budget preparation and execution. The result is that the fight against accumulation of arrears is not addressed as a fiscal discipline target, but instead as one option among many, such as increased domestic debt, to address the shortage of resources. This dual management of the fiscal policy—increasing arrears and/or increasing domestic debt—is still operating in 2013 and is likely to continue in the short to medium term, given the significant amount of accumulated arrears. A medium-term plan is required to address the buildup of arrears.

- Direct budget support is budgeted by the PA at levels which are higher than donors' forecasts and lack a realistic timetable for disbursements. The result is that the proportion of budget support which is budgeted in excess of the forecast corresponds to an additional financing requirement needed to meet the budget deficit. This situation further compounds the fragmentation in the budget execution process and also contributes to arrears' generation.

3. Prospects for Reform Planning and Implementation

Despite a challenging political and institutional context in recent years, PFM reform has been high on the agenda of the PA. Significant work has been done towards implementing international good practices, and there is broad agreement between the PA and the international development community to continue to pursue these efforts. Actual achievements include:

[31] These problems are being addressed by the support of the current DFID governance project.

- Institutional reform at the MoF, since the 2007 separation with Gaza, to bring its main functions together, alongside improved organization, management of responsibilities, and coherent staffing both in quality and quantity.

- The recent establishment of the macro fiscal unit, which should enable the MoF to develop and maintain an MTFF as a prelude as part of a "top down" budget preparation process, and support linking budgeting with planning.

- Successful development of an IFMIS based on a near-compliant budget classification with the GFSM 2001, and disseminated among all line ministries and agencies to ensure on a routine basis better integrity and accountability of the PFM system. This is also an additional guarantee for the use of donor-funded budget support, acknowledged as an achievement in the region.

- Development of a broad repertoire of control and audit functions (both internal and external); the recent development of internal financial control in all line ministries (in addition to their own system of control) is a potentially promising development for further strengthening the accountability of the system. Developments of internal audit in line ministries, as well as the efforts to increase the capacity and role of external audits[32] in a short period of time are impressive. Such achievement is all the more noticeable in a region traditionally poor in success in this area.

- Development of appropriate banking arrangements such as the Treasury Single Account (TSA) system for better pooling of fiscal resources and minimizing the risks raised by the recent devolution of payments procedures to line ministries through the IFMIS and their own bank subaccounts.

Achievements in the area of budget integration have been less successful, such as program budgeting, linking strategic planning to budgeting, and fiscal forecasting and the medium-term fiscal framework. This should not be viewed too negatively. Such reforms usually take time and have been hampered by the challenging fiscal environment during the recent period. They have also not been a top priority given the need to consolidate the PFM system, and re-establish PFM institutions and systems in the West Bank following 2007. Nonetheless, a new promising impetus of these reforms is expected in the near future.[33]

The prospect of continued fiscal stress affecting the PFM reform agenda is still high. There is not, on the foreseeable horizon, a continued level of substantial budget support, and the rise of PA's owned revenues based on the tax administration reform is expected to materialize only in the medium term. In addition, the political environment remains uncertain. In this context, the PFM system and its reform agenda will continue to be put under significant stress, with possible ups and downs in the path of the reforms. This will require a continued effort of the PA over time to maintain the impetus of reforms and address the systemic weaknesses noted above.

The PFM reforms achieved so far have the potential to generate further noticeable progress if addressed in a less fragmented way. The current PEFA assessment indicates for each of the positive achievements associated weaknesses that need to be adequately addressed. Some of these weaknesses are

[32] Both of them supported by an EU-financed TA project for capacity building.
[33] These ongoing reforms are supported by a program of technical assistance financed by DFID.

serious and are impacting negatively the quality of the whole PFM system. For example, the uncontrolled accumulation of arrears raises significant systemic risks that may worsen if no reform is undertaken. One key finding of the PEFA assessment is the linkages revealed between some core weaknesses, for example the link between budget preparation, budget execution, absence of cash planning, and commitment control, arrears, and weak accounting, and the need to address them as part of a more integrated PFM reform strategy.

A strategic renovated PFM reform approach could leverage the strengths of the current PFM system by using and improving IFMIS functionalities, existing control/audit capacities, potential reforms; and learning for the experience accumulated with the ongoing budget integration reforms, could include:

- Shifting towards a more "top down" budget preparation process to ensure line ministries build their budget estimates in a more realistic way. Increased MoF/MoPAD coordination is required to build a credible MTFF, from which annual budget ceilings would be derived.

- Developing cash planning and commitment control to streamline budget execution by building on: (i) the good understanding of these concepts among budget operators, (ii) the existence of some related functionalities in the IFMIS, and (iii) the network coverage of the internal and financial controllers over line ministries.

- Improving accounting policy, in particular for the presentation of arrears as a new fiscal target for budget monitoring purposes.

Figure 1: Summary of the PEFA 2013 Assessment

Indicator	Indicator Description	Score 2007	Score 2013	Variation
PFM OUTTURNS: CREDIBILITY OF THE BUDGET				
PI 1	Aggregate expenditure outturn compared to original approved budget	B	A	↑
PI 2	Composition of expenditure outturn compared to original approved budget	C	C+	↑
PI 3	Aggregate revenue outturn compared to original approved budget	B	B	-
PI 4	Stock and monitoring of expenditure payment arrears	D+	D	- *
KEY CROSS-CUTTING ISSUES: COMPREHENSIVENESS AND TRANSPARENCY				
PI 5	Classification of the budget	D	B	↑
PI 6	Comprehensiveness of information included in budget documentation	B	B	-
PI 7	Extent of unreported government operations	C+	C+	-
PI 8	Transparency of intergovernmental fiscal relations	C+	D+	- *
PI 9	Oversight of aggregate fiscal risk from other public sector entities	D+	D+	-
PI 10	Public access to key fiscal information	C	B	↑
BUDGET CYCLE				
Policy-based budgeting				
PI 11	Orderliness and participation in the annual budget cycle	C	C	-
PI 12	Multiyear perspective in fiscal planning, expenditure policy, and budgeting	D	D	-
Predictability and control in budget execution				
PI 13	Transparency of taxpayer obligations and liabilities	NR	C+	N/A
PI 14	Effectiveness of measures for taxpayer registration and tax assessment	NR	D+	N/A
PI 15	Effectiveness in collection of tax arrears	NR	D+	N/A
PI 16	Predictability in the availability of funds for commitment of expenditures	D+	D	↓
PI 17	Recording and management of cash balances, debt, and guarantees	C	B	↑
PI 18	Effectiveness of payroll controls	C+	B+	↑
PI 19	Competition, value for money, and controls in procurement	NR	C+	N/A
PI 20	Effectiveness of internal controls for nonsalary expenditure	D+	D+	-
PI 21	Effectiveness of internal audit	C	C+	↑
Accounting, recording, and reporting				
PI 22	Timeliness and regularity of accounts reconciliation	C	B	↑
PI 23	Availability of information on resources received by service delivery units	D	D	-
PI 24	Quality and timeliness of in-year budget reports	B	C+	- *
PI 25	Quality and timeliness of annual financial statements	D+	C	↑
External scrutiny and audit				
PI 26	Scope, nature, and follow-up of external audit	D	C+	↑
PI 27	Legislative scrutiny of annual budget law	D	NU	NU
PI 28	Legislative scrutiny of external budget reports	D	NU	NU
DONOR PRACTICES				
D1	Predictability of Direct Budget Support	D	D+	↑
D2	Financial information provided by donors for budgeting and reporting on project and program aid	C	D	- *
D3	Proportion of aid that is managed using national procedures	C	D	- *

NR: Not rated, N/A: Not applicable, NU: Not used

*2007 indicator incorrectly scored

Section 1 – INTRODUCTION

1. The purpose of the PEFA assessment is to review the performance of the Palestinian Authority's PFM framework. The assessment examines progress since an informal PEFA assessment in 2007 and provides a baseline for supporting the PA in refining, where necessary, the current PFM reform strategy.

2. The assessment has been undertaken following the PEFA Performance Measurement Framework methodology as revised in January 2011. The full set of methodological guidance provided by the PEFA Secretariat has been utilized, including both the guidelines themselves and the various clarifications on the use of the guidelines issued since 2005.[34]

3. The assessment has been undertaken at the request of the PA by a multidonor team with representation from the EU, UNDP, and France, under the leadership of the World Bank and with the financial support of DFID. The work has been peer reviewed by the IMF/METAC and by the PEFA Secretariat for quality control. Their comments upon the first draft, as well as those of the PA, have been incorporated where appropriate as corrections or amendments in the current text.

4. The assessment builds on previous reports by the World Bank and the IMF on various aspects of the PA's PFM system. In 2007, the World Bank conducted a PER which included a summarized ranking of 27 out of the 31 PEFA indicators.[35] Although this was not a full-fledged and comprehensive PEFA report, it is nonetheless reflected in this report for purposes of comparison. A full list of previous World Bank and IMF technical assistance reports consulted is attached in Annex 5.

5. PA inputs for the assessment have been coordinated by Ms. Laila Sbaih-Eghreib, Acting Director General of International Relations and Projects, and by the General Directors in the Ministry of Finance. In addition to providing background data and documentation, they have coordinated a full program of meetings requested by the assessment team and supported interim and final feedback to the Ministry of Finance on the results of the assessment.

6. The assessment is based on publicly available documents and supplementary information provided by the PA and other stakeholders. These include annual budget documents, annual fiscal outturn reports, and specific reports produced by various stakeholders. The information gathered has been cross-checked against different sources and in a series of in-depth interviews with PA officials.

7. A wide range of interviews has been undertaken to obtain and validate evidence, including members of the executive branch, the SAACB, and development partners. Within the executive branch, interviews have been held with all relevant departments of the Ministry of Finance, MoPAD, and the

[34] These are available at www.pefa.org.
[35] The four indicators not rated in the 2007 PER for West Bank and Gaza were indicators in tax administration (3) and procurement (1).

ministries of Local Government, Education, and Health and Public Works. Meetings were also held with two municipalities and several nongovernmental bodies. A full list of stakeholders consulted is attached in Annex 2.

8. The scope of the assessment includes the Public Financial Management of the central government, the subnational government (municipalities and community villages), and the autonomous public entities which are all under the umbrella of the Palestinian Investment Fund. Share of expenditures between these institutions are shown in the table below. The central government expenditures represent the largest part of the total.

Institutions	**Number of entities**	**Percent of total public expenditure**[36]
Central government	51	93.5
Autonomous government agencies	12 (including holding PIF)	4.5
Local government units	377 (including 243 villages)	2

[36] All data are based on 2012 (actual) except for local governments (estimates 2012 on the basis of 2011 actual).
These data do not include the expenditures of the Petroleum Authority, which cover the purchases of oil from Israeli companies (re-sold at a lower price to gas stations in West Bank and Gaza), since they are accounted for through a complex mechanism of tax refunds on the resources side.

Section 2 – COUNTRY BACKGROUND INFORMATION

A. General Overview[37]

The Palestinian Authority (PA) was established in 1994 following the 1993 Oslo Agreement, with responsibility for the West Bank and Gaza (WBG) under Palestinian control. The PA has adopted a PFM model which broadly follows the Anglophone model, but in the years following its establishment, authority has increasingly become concentrated in the executive branch and the role of parliament has been reduced. Within the executive branch, the president has the most power and collective decision-making appears to be limited.

With the start of the second *intifada* in 2000, the PA's finances deteriorated and the authority was persuaded to initiate a series of reforms, including reforms of the PFM system. The PFM reforms started in 2002 under the leadership of Salam Fayyad, the Minister of Finance. The broad aim of these reforms was to improve expenditure control and oversight of PA resources. They ended up being among the most far-reaching PFM reforms implemented in the MENA region during the last decade.

The imposition of budgetary restrictions by Israel[38] and development partners (following the election of the Hamas government in 2006) triggered a fiscal crisis; as a consequence, PFM reforms were by-and-large discontinued. In the middle of the year 2007, a second stage of reforms, initially aimed at re-establishing the systems in place in 2005, commenced with the formation of a Caretaker Government (CG) led by Salam Fayyad. The CG was recognized by both the government of Israel (GoI) and the international community. The GoI resumed full transfer of PA revenues with accrued interest. Because the CG did not have effective control over Gaza, this second stage of reforms involved establishing institutions in the West Bank to replace those previously operating in Gaza. Since 2007, the year of separation between the West Bank and Gaza, there has been no functioning legislature.

Important agencies in the reform process are the Ministry of Finance (MoF), the Ministry of Planning and Administrative Development (MoPAD), and the Palestinian Investment Fund (PIF), which is responsible for the oversight of state enterprises. In 2005, the Supreme Audit and Administrative Control Bureau (SAACB) was established with an external audit function. A large number of development partners are active in WBG, delivering budget support, conducting projects, or providing technical assistance. In 2007, the World Bank produced a Public Expenditure Review which included an informal PEFA assessment. Since 2007, the IMF has provided strategic advice on both budget execution and budget preparation reforms. The EU has taken a specific interest in the areas of internal control and external audit. Several bilateral donors support other aspects of the PFM reform agenda.

[37] This section summarizes an overview of the West Bank and Gaza provided in '"PFM Reform in the MENA Region," World Bank, June 2010.

[38] The government of Israel has ceased transfer of clearance revenues to the PA. Clearance revenues are taxes that the GoI collects for the PA and remits to them monthly.

B. Country Economic Situation[39]

The Palestinian territories comprise the West Bank (including East Jerusalem, 5,640 square kilometers) and Gaza (360 square kilometers). The West Bank is divided, per the Oslo Accords, into three areas: two areas are under Palestinian control and correspond to all major population centers (Area A) and most rural communities (Area B). The third area, Area C, covers about 60 percent of the West Bank and access to Gaza, and is under GoI control for both security and civilian affairs. The West Bank is governed by the Palestinian Authority led by Fatah. Since 2007, the area of Gaza has been governed independently led by Hamas.

The total population of 4.3 million (2012) is largely urbanized (72 percent), with 2.6 million people living in the West Bank and 1.6 million in Gaza. Income per capita is $2,489 (2011), which is at the lower-middle-income level. It is higher than some other countries in this category, but lower than the average for the MENA region. The poverty headcount ratio using the national poverty line rose from 22 percent in 2009 to 26 percent in 2011.[40]

After growing at an annual rate of 11 percent during 2010–2011, the Palestinian economy has recently slowed down significantly. According to the Palestinian Central Bureau of Statistics, the real GDP growth rate in the West Bank and Gaza declined to 5.9 percent in 2012, as growth dropped both in Gaza and the West Bank. Between 2010 and 2011, Gaza was growing at an average annual rate of 15 percent. In 2012, however, Gaza's growth rate dropped to 6.6 percent. This is attributed to the waning of the rebound effect and to a strong decline in the agriculture and fishing sector due to frequent electricity blackouts and unfavorable weather conditions. Growth in the West Bank has mainly been driven by an expansion of the services sector, particularly real estate activities, health, and education, in addition to wholesale and retail trade. Average real GDP growth in the West Bank exceeded 9 percent between 2010 and 2011, but declined to 5.6 percent during 2012, reflecting lower donor aid and the absence of further progress in easing of restrictions on internal movement and exports.

Table 1 – Selected Economic Indicators

				Estimate	Projections	
	2009	2010	2011	2012	2013	2014
Output and prices			(Annual percentage change)			
Real GDP (2004 market prices)	7.4	9.3	12.2	5.9	5.0	4.4
West Bank	7.1	8.4	10.4	5.6	4.7	4.2
Gaza	8.4	11.9	17.6	6.6	6.0	4.9
CPI inflation (period average)	2.8	3.7	2.9	2.8	2.8	2.8
CPI inflation (end of period)	4.3	2.8	2.7	1.7	2.8	2.8
Memorandum items:						
Nominal GDP (in millions of US$)	6720	8344	9775	10255	11117	11904
Per Capita nominal GDP (US$)	1708	2061	2489	2534	2515	2616
Unemployment rate (average in percent of labor force)	25	24	21	23	22	21

Sources: Palestinian Central Bureau of Statistics www.pcbs.gov.ps , IMF and WB staff estimates.

[39] This section summarizes "Fiscal Challenges and Long-Term Economic Costs," Economic Monitoring Report to the Ad Hoc Liaison Committee, World Bank, March 2013, and fiscal data provided by the Ministry of Finance.

[40] Palestinian Central Bureau of Statistics, www.pcbs.gov.ps.

The decomposition of recent growth trends in the West Bank and Gaza underscores the importance of aid in driving the economy. Most of the growth witnessed over the last years was in the public and nontradables sectors and was driven by donor supported PA expenditures. To illustrate, public administration and defense and other public services, including health, education, water, and electricity, grew from 20 percent of GDP in 1994 to 25 percent in 2012. Meanwhile, the manufacturing and agriculture sectors, constrained by the Israeli restrictions on movement and access, declined from 19 to 10 percent and 13 to 5 percent, respectively. The pattern was similar in both the West Bank and Gaza.

The share of exports of goods in the Palestinian economy, at around 7 percent in 2011 (from around 10 per cent in 1996), is among the lowest in the world. Palestinian exports are concentrated in low-value-added goods and services, and both imports and exports are concentrated on a small number of trading partners, with Israel dominating external trade: more than 85 percent of exports and 73 percent of imports were with Israel in 2011. There is strong empirical evidence on the correlation between export diversification and economic growth. The Palestinian economy is ill-positioned to benefit sufficiently from export opportunities in global markets even when export restrictions have been removed.

Private investment in the Palestinian territories, which is essential for maintaining competitiveness, has been low and much of it has been channeled into the nontradable sector. Private investment, at around 15 percent of GDP for the last seven years, is very low compared to other fast-growing economies. Much of this is channeled into internal trade activities and real estate development—investment decisions that would be suboptimal if GoI restrictions on economic activity were not in place. Foreign direct investment has averaged only 1 percent of GDP over the last ten years.

Unemployment in the Palestinian territories is high, with low labor force participation rates in both the West Bank and Gaza. The overall unemployment rate has increased by 2 percentage points in the last year to reach 22.9 percent by the end of 2012. Gaza's unemployment rate continues to be among the highest in the world at 32.2 percent. Youth unemployment is a particular concern, with the data indicating that Palestinian youths are discouraged from joining the labor force due to lack of employment opportunities. Prior to the year 2000, when the second *intifada* broke out, a large portion of Palestinian youth were employed in Israel. The public sector has, in effect, become the employer of last resort for many Palestinians. It employed around 23 percent of those in the labor force in 2012; 38 percent in Gaza and 16.3 percent in the West Bank.

Table 2 – Labor Force Statistics (at end of 2012)

	Palestinian Territories	West Bank	Gaza
Unemployment rate	22.9	18.3	32.2
Underemployment	5.7	5.0	7.1
Labor force participation rate	43.9	46.1	40.0
Youth unemployment (ages 15–29)	35.1	27.9	48.9
Youth labor force participation	38.0	40.3	34.2

Source: PCBS Labor Force Survey

Economic growth in WBG is projected to further slow down in 2013. The overall growth rate is expected to decline to 5 percent; 4.7 percent in the West Bank and 6 percent in Gaza. This projection assumes no significant easing in movement and access restrictions within the Palestinian territories. Controls on imports as well as exports are expected to only be modestly eased, and it is expected that no significant easing of restrictions on economic activity in Area C will be made during 2013. These restrictions pose a binding constraint to tradable sector growth and consequently to private sector led growth. As foreign aid to the public sector is not expected to increase enough to offset the impact of restrictions on private sector growth, and space for new domestic borrowing is highly constrained, fiscal contraction is expected to cause growth to further slow down.

C. Budgetary Outcomes[41]

The PA's fiscal stress increased significantly during 2012. This was mainly due to higher than expected expenditures and domestic revenues and levels of external budget support which have fallen short of budgetary targets. Total domestic revenues were 8 percent below the budgeted target in 2011 and 6 percent below the target in 2012. In addition, external budget support has fallen since 2010 and budgets have not reflected this reduction adequately. The PA has not been able to contain the growth of expenditures to levels which match the level of resources available. The recurrent balance after external budget support has grown from -1.1 percent of GDP in 2010 to -6.9 percent of GDP in 2012. In 2012, the original approved budget had a recurrent budget deficit target of NIS 3.62 billion, whereas the actual recurrent budget deficit amounted to NIS 5.6 billion—an increase of 55 percent. The overall financing gap, taking into account development financing, was -7.8 percent of GDP at the end of 2012, compared to -3.2 percent of GDP at the end of 2010.

The gap between expenditures and revenues has led to a significant accumulation in the level of wage and nonwage arrears and unplanned borrowing from the domestic banking sector. According to the Ministry of Finance, at the end of 2012, the balance of the PA's arrears was NIS 2,226 million, or 18 percent of total primary expenditure, excluding debt servicing. Arrears were owed mainly to civil servants, private suppliers, and to the pension system. This compares with a stock of arrears in December 2010 of NIS 394 million, or three percent of total expenditure. The PA's fiscal difficulties have caused delays in the disbursement of civil servants' monthly wages, which have been paid in tranches since June 2012. The PA's stock of local debt increased to NIS 5.1 billion (US$ 1.4 billion) or 14 percent of GDP at the end of 2012, up from NIS 4.2 billion (US$ 1.1 billion) in 2011.

[41] World Bank, March 2013, op cit.

Table 3 – Palestinian Authority: Fiscal Operations, 2010–13

	2010	2011	2012 (est)	2013 (proj)
		(percent of GDP)		
Revenues	22.0	20.9	21.0	21.9
Recurrent expenditures and net lending	36.9	34.0	35.8	33.5
Wage expenditures	19.4	18.2	17.9	17.5
Nonwage expenditures	14.7	14.3	15.0	14.9
Net lending	2.8	1.4	2.8	1.2
Recurrent balance (before external support)	-14.9	-13.1	-14.8	-11.6
Development expenditures	3.6	3.8	2.5	2.4
Overall balance (before external support)	-18.5	-16.9	-17.2	-14.0
External recurrent budgetary support (US$ m)	1,147	814	775	1,000
Recurrent balance (after external support)	-1.1	-4.7	-6.9	-2.6
Development financing (US$ m)	487	605	156	300
Overall balance (after external support)	-3.2	-6.8	-7.8	-2.3
Financing gap (overall)	..	..	7.8	2.3
Memorandum items				
Nominal GDP (US$ m)	8,331	9,775	9,858	11,072
Nominal GDP (NIS m)	31,073	34,996	37,954	40,968
Arrears (NIS m)	*394*	*1,938*	*2,226*	*n.a.*
Exchange Rate (NIS/US$)	3.73	3.58	3.85	3.70

Source: MoF

In terms of the economic composition of spending, during 2012 actual levels of nonwage and operational expenditures were significantly higher than budgeted expenditures while actual capital expenditures were significantly lower than budgeted amounts. Nonwage expenditures exceeded their budget by 16.5 percent due mostly to unbudgeted pension payments to retirees in the security sector. Operational expenditures were 15 percent above their year-end budget target mainly due to higher than forecasted health spending, of which the fastest growing component is outside treatment referrals. In order to control wage expenditures the PA introduced a hiring and promotions freeze in mid-2012 which has limited the net growth of the public sector labor force. However, the PA has not been able to regain control over net lending, which was 168 percent above its budget target at the end of 2012.[42]

[42] The jump in this budget item in 2012 arose because the Palestinian electricity distribution companies and municipalities have been accumulating large arrears to the Israeli Electric Corporation. The GoI therefore made higher than anticipated deductions from clearance revenues in 2012 to clear some of these arrears. These deductions are recorded as "net lending" in the PA's budget.

Table 4 – Palestinian Authority Expenditures 2012, Budget versus Actual

Expenditure Item (NIS million)	2010 actual	2010 budget	percent difference	2011 actual	2011 budget	percent difference	2012 actual	2012 budget	percent difference
	USD million	USD million		NIS million	NIS million		NIS million	NIS million	
Total expenditure & net lending	**3,076**	**3,170**	**97%**	**11,897**	**11,960**	**99%**	**13,593**	**12,624**	**108%**
Wage expenditures	1,613	1,550	104%	6,381	6,325	101%	6,812	6,831	100%
Nonwage expenditures	1,227	1,370	90%	5,015	5,043	99%	5,709	5,393	106%
Operation expenditures	493	514	96%	1,792	1,864	96%	2,257	2349	96%
Transfers	705	813	87%	3,165	3,089	102%	3,426	2966	115%
Minor capital	29	43	67%	58	90	64%	26	78	33%
Net lending	236	250	94%	500	592	85%	1,072	400	268%

Source: MoF

Excluding arrears, which are reported as a single figure in the PA's fiscal reports, the allocation of recurrent expenditure (excluding debt service) by the PA in 2012 was predominantly towards the security and social sectors. The five largest expenditure allocations (Ministry of Interior and Security, Ministry of Education, Ministry of Social Affairs, and Ministry of Health and Pensions) accounted for around 75 percent of total annual recurrent expenditure in 2012, and similar shares in 2010 and 2011.

Table 5 – Palestinian Authority, Recurrent Expenditures (Excluding Public Debt Service) by Entity

Administrative head (NIS million)	2010 actual	2010 budget	percent share of total budget	2011 actual	2011 budget	percent share of total budget	2012 actual	2012 budget	percent share of total budget
	USD million	USD million		NIS million	NIS million		NIS million	NIS million.	
Ministry Interior and Security	813	757	26.5	3,124	3,009	27.0	3,912	3,352	29.2
Ministry Education	526	544	19.0	2,130	2,352	21.1	2,206	2,354	20.5
Ministry Social Affairs	236	317	11.1	1,015	1,081	9.7	1,296	1,132	9.9
Ministry Health	344	323	11.3	1,197	1,228	11.0	1,177	1,294	11.3
Retiree Pensions	184	197	6.9	944	676	6.1	447	470	4.1
Other	608	720	25.2	2,429	2,793	25.1	2,824	2,877	25.0
Total expenditure (ex. debt service)	2,711	2,858	100.0	10,839	11,139	100.0	11,862	11,479	100.0

Source: MoF

D. Legal and Institutional Framework for PFM[43]

According to the Palestinian Basic Law the current structure of the PA is based on three separate branches of power: executive, legislative, and judiciary. The president of the PA is directly elected by the people. In an amendment to the Basic Law approved in 2003, the president appoints a prime minister who is also the chief of the national security services. The prime minister chooses a cabinet of ministers and runs the government, reporting directly to the president.

The Palestinian Legislative Council (PLC) is an elected body of 132 representatives and acts as a parliament. The PLC must approve all government cabinet positions proposed by the prime minister, and must also confirm the prime minister himself upon nomination by the president. The first PLC was elected in 1996. The authority of this body is restricted to the Palestinian population in the West Bank and the Gaza Strip and is concerned with domestic rather than foreign policy issues or those concerning relations with Israel.

In the 2006 elections, the Hamas party gained control over the parliament, while the Fatah party leader was elected president, leading to conflict between the two main political parties in the Occupied Palestinian Territories and a situation where Hamas had control in Gaza and Fatah had control in the West Bank. This situation remains. In practice, there are two governments with different strategies and programs at all levels. The Palestinian legislative council has not been convened since 2007.

Two sources of legal authority govern the government budget and public financial management: the annual budget law and the Organic Budget Law No. 7 of 1998, both administered by MoF. The former gives annual authority and the latter permanent authority. The Organic Budget Law defines roles for the revenue collection agencies, spending agencies, MoF, the Legislative Council and the Council of Ministers, and defines terms such as public funds, special funds, current expenditure and capital expenditure. In addition, fiscal directives are issued under the Organic Budget Law. As in other countries, the annual budget law can be used to introduce new financial management principles.

The Organic Law covers ministries and agencies and other public institutions such as autonomous institutions. It does not cover companies or corporations owned in full or in part by the PA, nor does it cover public enterprises, which operate under the Companies Law. It also provides the institutional basis for a number of important processes, requirements, and principles, for instance:

- preparation, submission, and authorization of budgets (together with an established budget calendar providing the dates at which various actions are to be taken);
- financial procedure in the event the budget law is not enacted in time for the start of the financial year;
- use of the Central Treasury Account (CTA) for pooling government revenues;
- expenditures to be drawn from the CTA only in accordance with the budget law;

[43] This section is drawn from "West Bank and Gaza Country Financial Accountability Assessment," World Bank, June 2004, the most recently available review PFM Progress Review (see section IV), and interviews with the Ministry of Finance.

- the required contents of the budget circular and annual budget law and the requirement for the latter to be a public document;
- execution of the budget including the MOF's leading role in this area;
- lapse of unused funds at year end;
- the annual budget to establish the upper limit for government borrowing; and
- procedures for the preparation and submission of financial reports and annual financial statements.

The additional laws and regulations underpinning PFM include in particular:

- Financial regulations issued under the Organic Budget Law (2009);
- Palestinian Financial By-Laws (1998 Law on Finance);
- Debt Law (2005);
- Income Tax Law (No. 8 of 2011);
- Public Procurement Law (new Law 2012); and
- Government Tenders and Works Law (previous system)

In 2010, the Ministry of Finance prepared amendments to the financial regulations affecting a number of regulations and practices, including commitment control, the role of financial controllers, and support to the introduction of a new budget classification structure for preparation, execution, accounting, and reporting. These amendments were submitted to the cabinet in 2011 but have not yet been formally adopted nor fully reviewed by the donor community. However, some of the improved methods and procedures have been adopted in practice by officials. The IMF has recommended that this work on upgrading the regulatory framework should culminate in the preparation and adoption of a new organic budget law.

The Annual Budget Law covers recurrent expenditures plus the relatively small amount of capital expenditures funded from PA revenues. Most capital expenditure is funded by donors, for which MoPAD is the coordinating agency. While MoPAD is responsible for aid coordination and capital expenditure planning, under the Organic Budget Law the Minister of Finance has the sole authority to conclude loan agreements with donors.

The budget includes all PA ministries and agencies in addition to public institutions such as the Land Authority, Palestinian Water Authority, Industrial Zones Board, Environmental Quality Authority, and the Palestinian News Agency. In 2012, there were 51 budget entities comprising a mix of ministries and relatively small agencies, grouped into ten broad functional categories (central administration, security and public order, financial affairs, foreign affairs, economic development, education, health, social services, culture and information services, transport, and communications).

The main departments of the MoF with responsibility for PFM are the Budget Department and the General Accounting Department which includes the Cash Management, Payroll, and Control departments. In 2012, the MoF formally adopted the Macrofiscal Unit into its program and approved its staffing structure. The role and capacity of the MFU has continued to develop: there are currently two economists on staff in the unit and interviews are planned for a full-time director appointment. Further progress has

also been made in clarifying the institutional roles and responsibility of MoF and MoPAD with regard to the overall strategic framework for planning and budgeting. Two ongoing reforms are to be highlighted. The development by the MFU at MoF of a medium-term fiscal framework (MTFF) is expected to serve as a basis for defining annual fiscal policy and budget ceilings. There are, in addition, ongoing reforms to improve the planning and budgeting capabilities in line ministries with a view to better integrating recurrent and capital expenditure (which are currently negotiated separately with the MoF and the MoPAD). These reforms need to be further deepened.

The budget preparation and execution process has been supported by a devolved IFMIS (Bisan Enterprise Edition) since 2009. Most payments, in particular operational and some transfer expenditures, are executed by line ministries in a devolved Treasury model. Salary payments and some other payments are conducted centrally. Budget funds are released quarterly on a pro rata basis (one fourth) through the issuance of Financial Orders (also called budget allotments). The IFMIS ensures controls of payments against cash ceilings but is not used to prevent arrears being accumulated. A module which controls and records commitments has been developed but has not yet been activated in a systematic manner.

The fiscal year of the PA runs from 1 January to 31 December. The 2013 PEFA assessment is based on data from the most recently completed fiscal year prior to the assessment (2012) and the two preceding fiscal years (2011 and 2010).

E. Country-Specific Issues

There are a number of country-specific issues which affect the PEFA assessment.

- **Implementation of expenditures in Gaza**. Since the separation between Fatah and Hamas in 2007, the budget of the Palestinian Authority continues to be implemented in Gaza as in other parts of the West Bank and Gaza. However, the PA receives no domestic revenue from Gaza. The wage bill for all civil servants in WB&G is paid centrally by the PA. Goods and services are procured centrally by line ministries (e.g., books, drugs, stationery, and furniture) and are sent to service delivery units in Gaza (e.g., schools). Development projects are financed by donors and implemented and controlled in Gaza according mostly to their own requirements. Therefore, the PA's expenditures executed in Gaza are not reviewed differently from those executed in other parts of WBG.

- **Clearance Revenue**. The monthly transfer of revenues collected by the GoI on goods and services destined for WBG constitute a major part of the PA's budgetary revenue. The major components of these "clearance revenues" are customs, VAT, and petroleum excise duty. In 2012, clearance revenues constituted NIS 5,617 million out of total domestic revenues of NIS 7,989 million, equivalent to 70 percent of net domestic revenues. Clearance revenues followed a fairly stable monthly pattern for 2009 and 2010. However, for 2011 and 2012 the monthly pattern was distorted by disruptions in transfers. This presents significant difficulties in forecasting the cash clearance revenue on a monthly basis. It is noted that repayments and/or continuation in payments are generally made the following month and that gross clearance revenue is more predictable on an annual basis.

- **Legislature**. There has not been a meeting of the Palestinian Legislative Council since 2007. Approval of the annual budget is currently by the president following recommendations of the Minister of Finance. In this situation, it is not possible to assess PEFA indicators relating to the scrutiny of the annual budget by the legislature and scrutiny of external budget reports. For this reason PI-27 and PI-28 are "Not Used (NU)" in the 2013 assessment.[44]

[44] The PEFA methodology stipulates that "Not Used" is the correct terminology to be used when there is no intention to assess a dimension or an indicator for a specific reason.

Section 3 – ASSESSMENT OF PFM SYSTEMS, PROCESSES, AND INSTITUTIONS

The methodology adopted for the PA 2013 PFM assessment is available online at www.pefa.org. In addition to a comprehensive description of the methodology, the site also provides additional clarification on the interpretation and application of the guidelines.[45]

The PEFA methodology identifies six core dimensions which are crucial for an orderly and transparent PFM system:

A. **Credibility of the budget** – the budget is realistic and is implemented as intended.

B. **Comprehensiveness and transparency** – the budget and oversight of fiscal risk are comprehensive, and fiscal and budget information is available to the public.

C. **Policy based budgeting** – the budget is prepared with due regard to government policy and its implications over a medium term perspective.

D. **Predictability and control in budget execution** – the budget is implemented in an orderly and predictable manner and there are arrangements for the exercise of control and stewardship in the use of public funds.

E. **Accounting, recording, and financial reporting** – adequate records and information are produced, maintained, and disseminated to meet decision making, control, management, and reporting purposes.

F. **External scrutiny and audit** – legal and institutional arrangements for external scrutiny of public finances and follow-up by the executive branch are operating effectively.

Donors' practices are also measured:

G. **Donors' practices** – donors' grants and external loans are budgeted and disbursed with due consideration to the predictability of funds, the allocation and use of those funds, and the promotion of use of national systems and procedures.

For each of the 29 indicators which it is possible to score, this chapter explains the scores achieved in the 2013 assessment. As mentioned in the previous section, two indicators, PI-27 (which relates to legislative scrutiny of the annual budget law) and PI-28 (which relates to legislative scrutiny of external audit reports) are not rated.

[45] PEFA – "Field guide."

PFM Outturns: Credibility of the Budget

PI-1 Aggregate Expenditure Outturn Compared to Original Approved Budget

This indicator measures the extent of the difference between actual total expenditure and the originally budgeted total expenditure as defined in government budget documentation and fiscal reports. It aims to assess the extent to which the PFM system can develop and execute a realistic overall budget. The indicator excludes two expenditure categories over which the government has little control. These are (i) debt service payments, and (ii) donor-funded project expenditure.[46]

	Minimum Requirements (Scoring Method M1)	
PI-1 Aggregate Expenditure Outturn Compared to Original Approved Budget	2007	2013
	Score B	**Score: A** In no more than one out of the last three years has the actual primary expenditure deviated from budgeted expenditure by more than five percent of budgeted expenditure

The data for this indicator are drawn from the approved General Budget Laws and the annual financial reports for 2010, 2011, and 2012 issued by the Ministry of Finance. The data collected and compiled are shown in the table below. Annex 4 provides detailed calculations in accordance to the required methodology.

Table PI-1: Budget Appropriations and Actual Expenditure Outturn, 2010–2012.

Allocated Expenditure	**2010** USD(m)	**2011** NIS(m)	**2012** NIS(m)
Approved Budget Expenditure	2,858	11,139	11,4 79
Actual	2,711	10,839	11,862
Difference	-147	-299	383
Percent Difference	**5.1%**	**2.7%**	**3.3%**

NB: Allocated Expenditure excludes debt and externally financed project expenditure. 2010 data are only available in USD (this does not impact the result in percentage).

Total primary expenditure deviated from the original budget appropriations by more than five percent only in 2010 (5.1 percent); deviation was less than five percent in 2011 (2.7 percent) and 2012 (3.3 percent).

Viewed in isolation, this indicator suggests a strong ability to implement expenditure plans in accordance with the approved budget. However, this view is misleading because the expenditure data do not show the accumulation of arrears (which are separately reported as a consolidated figure in the PA's financial

[46] The indicator measures primary expenditure. Primary expenditure is defined as total expenditure excluding: (i) payments of principal and interest on debt, as these can often be sources of volatility due to interest and exchange rate fluctuations which are outside the control of the authorities; and (ii) externally financed project expenditures, which are excluded for a similar reason.

reports). As shown in Table 3 in Section II, there has been a sharp deterioration in the recurrent fiscal balance after external budget support, which has increased from -1.1 percent of GDP in 2010 to -6.9 percent of GDP in 2012. The excess of actual expenditure over revenues has only been made possible through a significant increase in arrears (see PI-4) and in unplanned borrowing from the domestic banking system. In 2012, net domestic lending was NIS 1.1 billion compared to a budgeted figure of NIS 0.4 billion, a difference of 268 percent.[47]

In the 2007 PEFA, PI-1 scored B. Actual expenditure deviated from budgeted expenditure by 6.3% in 2003, by 4.2% in 2004, and by 13.9% in 2005.

PI-2 Composition of Expenditure Outturn Compared to Original Approved Budget

This indicator measures the extent to which variance in expenditure composition exceeded overall deviation in primary expenditure (as defined in PI-1) during the last three years. The scoring methodology has been refined since the 2007 assessment by the inclusion of a second dimension on contingencies (since expenditure charged to the contingency vote represents a departure from policy intent) and by a refinement in the method of calculation of the variance in expenditure composition.

	Minimum Requirements (Scoring Method M1)	
PI-2 Composition of Expenditure Outturn Compared to Original Approved Budget	2007	2013
	Score C	**Score: C+** (i) Variance in expenditure composition exceeded 15 percent in one of the last three fiscal years (Score C) (ii) Actual expenditure charged to contingency vote was on average less than three percent of the original budget (Score A)

The data for this indicator are drawn from the approved General Budget Laws and the annual financial reports for 2010, 2011, and 2012 issued by the Ministry of Finance. The data collected and compiled are shown in the table below. Annex 4 provides detailed calculations in accordance with the required methodology.

Table PI-2: Expenditure composition, variance between budget allocation and outturn

Expenditure Variance and Contingency	**2010** USD(m)	**2011** NIS(m)	**2012** NIS(m)
Original approved budget	2,858	11,139	11,479
Total expenditure outturn	2,711	10,839	11,862
Absolute difference	-147	-300	383
Percent difference between approved and actual	5.1%	2.7%	3.3%
Contingency	218	65	6
Contingency as percent approved budget	**7.6%**	**0.6%**	**0.1%**

[47] Net change in government balances from changes in government deposits with the banking system and government borrowing from the banking system.

Expenditure outturn less contingency	2,493	10,774	11,856
Sum of deviations (in absolute terms)	591	1,193	1,328
Variance as a percent of approved expenditure	**23.7%**	**11.1%**	**11.2%**

Source: Ministry of Finance

NB: This indicator takes into account expenditure deviation across all ministries. It takes the sum of expenditure deviations in absolute terms and expresses this as a percentage of the expenditure outturn less contingency.

Dimension (i): the extent of the variance in expenditure composition in the last three years excluding contingencies

The variance in expenditure composition as a percentage of approved expenditure has exceeded 15 percent in only one of the last three fiscal years (23.7 percent in 2010); variance was 11.1 percent in 2011 and 11.2 percent in 2012. Variance in expenditure composition during the period for the Ministries of Interior and Security, Education, Health, Social Affairs, and the budget for pensions, which together account for around 75 percent of total expenditure of the PA, have been the most significant in absolute and percentage terms for the Ministry of Interior and Security (+11 percent) and for pensions (+45 percent). By comparison, variance for the Ministries of Health and Education were -8 percent and -6 percent, respectively.

Dimension (ii): the average amount of expenditure charged to the contingency vote over the last three years

Actual expenditure charged to the contingency vote over the last three years was on average 2.8 percent of the original budget. This is not significant.

In the 2007 PEFA, PI-2 scored C. The variance in expenditure composition exceeded the overall deviation in primary expenditure by 25.7 percent in 2003, by over 6 percent in 2004, and by 5.8 percent in 2005. Measurement of the use of contingencies was not part of the rating in 2007.

PI-3 Aggregate Revenue Outturn Compared to Original Approved Budget

This indicator measures actual domestic revenue collection compared to domestic revenue estimates in the original approved budget. It excludes budget support (i.e., external revenue) but includes all components of domestic tax and nontax revenue.

	Minimum Requirements (Scoring Method M1)	
PI-3 Aggregate Revenue Outturn Compared to Original Approved Budget	2007	2013
	Score B	**Score B** Domestic revenues were between 94 percent and 112 percent of budgeted domestic revenue in two of the last three fiscal years

In common with indicators PI-1 and PI-2, the data for this indicator are drawn from the approved General Budget Laws and the annual financial reports for 2010, 2011, and 2012 issued by the Ministry of Finance.

The scoring methodology has changed since the 2007 assessment, with the main difference being that over-collection is now also considered as part of the assessment.

Table PI-3: Revenue Variance

Revenue Variance	**2010** (USD m)			**2011** (NIS m)			**2012** **(NIS m)**		
	Budget	Actual	Percent variation	Budget	Actual	Percent variation	Budget	Actual	Percent variation
Net Revenues	1,927	1,927	**100%**	7,951	7,321	**92%**	8,492	7,989	**94%**
Domestic	707	745	5.3%	3,004	2,642	-12.1%	3,087	2,806	-9.1%
Clearance	1,320	1,258	-4.6%	5,335	5,095	-4.5%	5,859	5,617	-4.1%
Tax Refund	-100	-76	-23.7%	-388	-416	7.2%	-454	-434	-4.4%

Source: Ministry of Finance

Domestic revenues for the PA comprise: (i) tax revenues, which include income tax, VAT, and property tax; and (ii) nontax revenues, which include property income, interest, sale of goods and services, fines and penalties.

Clearance revenue includes VAT, petroleum excises, and other duties collected by the Israeli authorities and transferred to the PA on a regular basis.

Actual domestic revenues (including clearance) as a percentage of the approved budget were 92 percent in 2011; in 2010 and 2012 the percentage difference was less: 100 percent and 94 percent, respectively.

The forecasting of revenues is undertaken during the budget preparation process by the Macro Fiscal Unit (MFU) in the Ministry of Finance. The Revenue Department provides revenue projections on domestic revenues and clearance revenues to the MFU. Projections are made on the basis of data collected from the various directorates managing the various taxes to produce the forecasts. Domestic revenue forecasting is currently guided, though in a rudimentary way, by overall macroeconomic assumptions (e.g., GDP, inflation, consumption rate) and by inputs from the various revenue departments on previous collection rates and their own estimates of the growth of collection rates of the taxes. The accuracy of forecasting domestic revenues is mixed.

- Domestic taxes (33 percent of domestic revenue in 2012) have been overestimated in the last two years. Actual domestic revenues were 12 percent lower than the original approved estimate in 2011 and 9 percent lower than the original approved estimate in 2012.
- Clearance revenues (66 percent of domestic revenue in 2012) are unpredictable on a monthly basis because of political circumstances (for example, disruption in the transfer of revenue) and other financial issues (higher than anticipated deductions by GoI in certain months to clear arrears to the Israeli Electric Corporation accumulated by Palestinian municipalities).[48] However, over a longer time frame (quarterly and annually), the average flow of clearance revenue has followed a stable trend over the last three years.

[48] See indicator PI-9.

In the 2007 PEFA, PI-3 also scored B. Actual domestic revenue collection exceeded revenue forecasts by 30.4 percent in 2003, by 6.1 percent in 2004, and by 23.8 percent in 2005.

PI-4 Stock and Monitoring of Expenditure Payment Arrears

This indicator measures the level of arrears and the availability and accurateness of data for monitoring the stock of arrears. It is concerned not only with measuring the stock of arrears, but also the extent to which there are systemic problems which generate arrears and whether these have been brought under control.

	Minimum Requirements (Scoring Method M1)	
PI-4 Stock and Monitoring of Expenditure Payment Arrears	2007	2013
	Score D+ (i) D (ii) C *NB: Dimension (ii) should have scored D in 2007; the indicator score should have therefore been D.*	**Score D** (i) The stock of arrears exceeds 10 percent of total expenditure (Score D) (ii) There are no reliable data on the stock of arrears from the last two years(Score D)

Dimension (i) the stock and monitoring of expenditure arrears as a percentage of actual total expenditure and any recent change in the stock

The system for controlling arrears has not improved since the previous assessment. Shortfalls in budgeted revenues and difficulties in containing nonwage expenditures have led to a significant increase in the accumulation of arrears by the PA in the last three years. Measuring the comprehensive stock of arrears for nonwage expenditure is currently difficult due to the absence of a proper commitment control.[49] Data provided in the annual financial reports of the Ministry of Finance for nonwage expenditure arrears can be considered accurate though not comprehensive. Therefore, reported arrears data should be viewed likely as a minimum. On this basis, total net accumulation of arrears at the end of 2012, according to the Ministry of Finance, was NIS 2,226 million ($570 million) or 17.7 percent of total expenditure as defined in PI-1. This includes wage arrears of NIS 816 million, nonwage arrears of NIS 1,046 million, development expenditures arrears of NIS 124 million, and tax refund arrears of NIS 239 million.[50] These data appear to exclude debt arrears[51] as well as uncleared advances carried over from previous years (marginal amounts).[52] This compares with a stock of arrears of NIS 394 million, or three percent of total expenditure, in December 2010.

[49] See indicator PI-20 and PI-22.
[50] MFU, Ministry of Finance, March 2013, op cit.
[51] MoF has only recently started to record debt arrears. In June 2013 the Ministry confirmed arrears on domestic debt (principle and interest) of $149 million and arrears on external debt of $86 million. See PI-17.
[52] See indicator PI-22 (ii).

Table PI-4: Net accumulation of arrears, January–December 2012

Budget Classifications	**NIS** million	**Components**	**NIS** million
Wage	816.4	Employee contribution	544.4
Nonwage	1,046.3	Social security, government share	607.7
Development projects	124.3	Private sector	740.5
Tax refund	239.4	Other transfers	333.8
Total	2,226.4		2,226.4
Memorandum items:			
Total expenditure in 2012 (from Table PI-1)			11,862
Arrears (excluding development projects) as a percent of total expenditure			**17.7%**

Source: MoF

Dimension (ii) availability of data for monitoring the stock of expenditure payment arrears

The latest available report on the 2010 financial statements of the PA from the State Audit and Administrative Control Bureau (SAACB) states that "MoF does not have a clear policy to deal with arrears, so the SAACB could not make an inventory of arrears . . . and could not test or verify the nature or classification of those arrears by responsibility center."[53] The PA does not have an accurate estimate of the global sum of arrears. It currently reports only the net accumulation of arrears, which for several reasons is likely to be significantly underestimated. There are two main obstacles to allowing the PA to provide comprehensive data for monitoring the stock of arrears.

- An arrear is a liability or obligation that is not met by the due date. The PA's IFMIS is capable of providing accurate reports on arrears but several elements of the system are bypassed. The most significant problem is that commitments are not entered into the system when they are incurred by line ministries. Although the IFMIS has a commitment module, this is generally not used. The result is that it is possible for a line ministry to enter into a commitment with a supplier without having to first inform the IFMIS and the Ministry of Finance,[54] and without having to ensure that cash will be available when the payment falls due. This has led to a situation where a significant volume of commitments have built up outside the IFMIS. The MoF has not undertaken a full inventory of all arrears nor has it initiated management action to prevent further accumulation of such commitments outside the system. This suggests that the full stock of arrears is not known.

- It is not possible to generate an age profile of arrears that are in the system. Financial obligations are entered into the IFMIS according to the date the invoice is received, rather than the date on which payment falls due. In addition, the accumulation of arrears is not automatically rolled over in the system at the end of the year. Instead, arrears are manually reentered which leaves scope for incomplete or inaccurate reentry of data into the system. If the correct date is not entered

[53] Audit Report on PA 2010 Final Accounts, December 2012.

[54] The control of this "commitment" against the budget allocation, as an essential fiscal discipline step in the budget execution process is usually performed internally in the line ministry. Apparently, this control is effectively performed.

when data are reentered into the system, the accumulated days in arrears from the previous year are lost and the number of arrear days begins again from the date the invoice is reentered into the system. This suggests that the arrears data in the IFMIS may not be accurate.

Good practices in such case would recommend controlling generation of arrears as follows:

- First, all proposed nonwage expenditures should be entered into the IFMIS at the commitment stage. If this were the case, where funds were not available (either because the proposed expenditure was not in the approved budget or because of lack of cash) the proposed expenditure could be rejected at an earlier stage and the related arrear would not be generated.

- Second, all proposed nonwage expenditures should be effectively recorded in the system by their due date, so that an aged profile of arrears can be generated.

- Third, all arrears should, at the year-end, be automatically rolled over with their due date, so that arrears are not lost.

In the 2007 PEFA, PI-4 scored D+. The stock of arrears to commercial banks stood at $600 million at the end of 2005 (dimension score D). The second dimension, which measures the availability of data to monitor the stock of arrears, scored C in 2007. However, the 2007 report did not provide any evidence of accurate arrears data being generated by at least one comprehensive ad hoc exercise, which is the criterion required to reach a score of C for this dimension. Moreover, the 2007 report states that "the exact magnitude of arrears is not known." This suggests that the second dimension should have been scored D in 2007 and that the overall score for PI-4 should have been D, and not D+.

Key Cross-Cutting Issues: Comprehensiveness and Transparency

PI-5 Classification of the Budget

This indicator assesses the quality of the classification system used in practice for formulating, executing, and reporting the central government budget.

	Minimum Requirements (Scoring Method M1)	
PI-5 Classification of the Budget	2007	2013
	Score D	**Score B** Budget formulation and execution is based on administrative, economic, and functional classification using the 10 main COFOG functions and can produce consistent documentation to GFS/COFOG standards

A new budget classification and Chart of Accounts (CoA) were introduced with the 2011 budget that includes economic, administrative, program/activity, funding, and geographic segments. Manuals on principles and modalities of the new system have been issued. The new system has been developed in compliance with international standards, in particular the GFSM 2001 and COFOG. Ad hoc codifications have also been developed to map classification of budget data with the National Development Plan's data

(i.e., the 23 sector strategies). The new budget classification (including program/activity code) has been loaded in the IFMIS and was fully operational with the 2011 budget.
The Chart of Accounts (CoA) comprises a 16-digit coding system which includes five segments: (i) economic classification based on the GFSM 2001; (ii) administrative segment; (iii) program/activity classification; (iv) funding (source of fund) segment; and (v) geographic dimension. It also includes a COFOG compliant functional classification for reporting purposes only. In line with good international practices, the CoA is based on two levels: one aggregated level for control purpose, and one more detailed level for recording/reporting the budget expenditures.

The new CoA facilitates expenditure reporting by sectoral classification. This classification groups expenditure into ten high-level functions consistent with the COFOG classification.[55] At this level the classification is used for monitoring of budget implementation. However, reporting by the subfunctional classification has not yet been effectively introduced. The program structure is not yet sufficiently defined and backed by robust management arrangements to be used effectively for expenditure monitoring and control. The MoF is currently revising its subfunctional classification (programs) with technical assistance from DFID.

The PA has recently received technical assistance from the World Bank to ensure compliance with the GFS methodology.[56] A number of misclassifications have been identified, some of which have been addressed. Issues identified related to: government contribution to civil servants' pensions and social security benefits, which according to GFS should be treated as wages and salaries, not transfers; civil servant pension payments, which should also probably be shown as wages and salaries; and "reserves," which should be recorded as "contingency" and when used should be recorded to the ministry and expense category to which they relate.

In the 2007 PEFA, PI-5 scored D. The classification provided only a limited breakdown of expenditures and the object classification was not consistent with GFS. There was no provision for the breakdown of expenditures by spending unit, program, or activity.

PI-6 Comprehensiveness of Information Included in Budget Documentation

This indicator assesses whether the coverage of the annual budget documentation as submitted to the legislature for scrutiny and approval allows a complete picture of central government fiscal forecasts, budget proposals, and outturn of previous years.

	Minimum Requirements (Scoring Method M1)	
PI-6 Comprehensiveness of Information Included in Budget Documentation	2007	2013
	Score B	With six out of nine benchmarks met: **Score B**

[55] The ten functions are: central administration, security and public order, financial affairs, foreign affairs, economic development, education, health, social services, culture and information services, transport, and communications. The ten functions are consistent with COFOG; the function "social services" used by the PA regroups three separate categories according to COFOG (health, education, and social protection).
[56] World Bank TA report "West Bank and Gaza – Using the Government Accounting System for Reporting & Management" (M. Ahern and G. Grosenick) – November 2010.

The annual General Budget Law provides considerable detail on the forthcoming budget year and previous years in the Arabic language with an English language translation available. The latter excludes the detailed budget for line ministries and agencies, but includes a summary of recurrent expenditure by economic classification for each of them.

Six elements for the assessment criteria are included in the General Budget Law for Fiscal Year 2012. Three elements are not included although the information on one of them (debt stock) is available in various in-year reporting documents.

Table PI-6: Budget Documentation

Criteria	**Met/Not Met**	**Comment**
1. Macro-economic assumptions, including at least estimates of aggregate growth, inflation, and exchange rate.	Met	GDP, growth, inflation, exchange rate are disclosed.
2. Fiscal deficit defined according to GFS or other internationally recognized standard.	Met	Fiscal deficit on cash and commitment basis.
3. Deficit financing, describing anticipated composition.	Met	Figures for budget support and development financing given as financing of deficit.
4. Debt stock, including details at least for the beginning of the current year.	**Not met**	Debt stock not provided, but only debt repayment (interest and principle) in budget year by domestic and foreign loans. The information is, however, available to meet this element.
5. Financial assets, including details at least for the beginning of the current year.	**Not met**	Chapter 9 of the Financial Regulations deals with the management and reporting of financial assets, but is not implemented (not required by IPSAS cash basis).
6. Prior year's budget outturn, presented in the same format as the budget proposal.	Met	2012 budget gives actual for 2008–2010 and budget and projection for 2011.
7. Current year's budget (either the revised budget or the estimated outturn), presented in the same format as the budget proposal.	Met	2012 budget gives actual for 2008–2010 and budget and projection for 2011.
8. Summarized budget data for both revenue and expenditure according to the main heads of the classifications used, including data for the current and previous year.	Met	Revenue by main tax groups, expenditure by main economic categories, and net lending as above.
9. Explanation of budget implications of new policy initiatives, with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs.	**Not met**	Revenue enhancing measures are given in the Budget Speech, but no estimates of yield are given by individual measures or in aggregate. Expenditure restraint measures are given but without any estimate of savings.

PI-7 Extent of Unreported Government Operations

This indicator measures whether financial reports produced by the government reflect the full picture of central government operations for the last completed fiscal year (2012). The indicator considers extra budgetary expenditure not reported against the budget, as well as income and expenditure information on donor-funded projects in support of government operations.[57]

There is no evidence of unreported extra budgetary expenditure for central government operations. However, there are serious deficiencies in recording income/expenditure information on donor funded projects, both as a result of deficient donor reporting, as well as of disconnected recording systems at MoF and MoPAD.

	Minimum Requirements (Scoring Method M1).	
	2007	2013
PI-7 Extent of Unreported Government Operations	Score C+ (i) Score A (ii) Score C	**Score C+** (i) The level of unreported extra budgetary expenditure (other than donor-funded projects) is insignificant (below 1 percent of total expenditure). Score A (ii) Complete income/expenditure information for all loan-financed projects is included in fiscal reports. Score C

Dimension (i) level of extra budgetary expenditure (other than donor-funded projects) which is unreported, i.e., not included in fiscal reports

The 2012 General Budget Law for the fiscal year 2012 contains 51 budget entities,[58] including pension and social payments, as well as autonomous government agencies. On the basis of information obtained from the MoF, the SAACB, AMAN, (the Coalition for Accountability and Integrity—the Palestinian chapter of Transparency International) and line ministries, there is no evidence of unreported extra-budgetary expenditure for central government operations.

Dimension (ii) income/expenditure information on donor-funded projects which is included in fiscal reports

Donor-funded projects in support of central government operations are executed through a broad range of modalities, ranging from implementation through the PA's financial management system to donor-based

[57] To facilitate the import of gasoline under the special conditions of the West Bank and Gaza, the Ministry of Finance has set up a Petroleum Authority under its auspices (the Petroleum Authority has been established as a Directorate General of the MoF) and has assumed the role of a petroleum importer and distributor to the private sector. This government function has the character of a public business enterprise. Petroleum purchases and sales are not budgeted, since they are driven by market demand. The losses accumulated from these transactions, as well as administrative costs associated with the task (operations of the Directorate General) are, however, reflected in the budget.

[58] The budget is presented by 51 entities, which encompass all line ministries, all autonomous agencies, all governorates, the pension fund, and others. Local Government Units are represented under the budget of the Ministry of Local Government.

execution that may deprive the PA of basic information. Donor's projects are executed through the Treasury Account at Arab Bank[59] or through other bank accounts. Data about income/expenditure on donor-funded projects passing through the Treasury account are available in fiscal reports for 2012. Data about projects executed outside the Treasury accounts are not fully available, despite the existence of an aid information management system (DARP) launched in mid-2010 by the Ministry of Planning and Administrative Development, through its Aid Management and Coordination Department.

DARP is fully functional and largely based on the standards identified by the International Aid Transparency Initiative (IATI), but data entry by donors is not sufficiently timely, detailed, or accurate. Furthermore, DARP's functional classification system at MoPAD, and IFMIS functional classification at MoF, have not been brought in line. As a result, DARP data are not captured in the IFMIS. Since the IFMIS is the only source of information for financial reporting, it is not possible to establish the accurate and, above all, complete picture of donor financed projects based on in-country systems. Such a situation partially deprives the PA of basic information required for implementation of its national plans, as well as for budgeting the recurrent cost implications of investment projects.

According to an excerpt from the IFMIS at MoF, some $167 million[60] was recorded as income from donor-funded projects in fiscal 2012. According to another report obtained from MoF,[61] and as reported by the IMF,[62] some $156 million was recorded for fiscal 2012. The DARP system, despite deficient donor reporting, already captured $314 million[63] of development funding for the national plan in fiscal 2012. On the basis of the OECD's aid statistics[64] for development programs and projects disbursed in fiscal 2011,[65] disbursements for projects and programs in support of government operations are assessed to be well above $350 million in 2012. This suggests that fiscal reports for external development which are based on the IFMIS (whether $167 million or $156 million) reflect in all cases less than 50 percent[66] of externally financed projects. Loan-financed projects are marginal[67] and income/expenditure information for these loans is fully included in fiscal reports.[68]

Compared to the 2007 PEFA (score C+) there was no change related to the extent of unreported government operations.

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[59] See indicators PI-17, PI-22, and D1.

[60] IFMIS N excerpt from March 14, 2013.

[61] Table provided by MoF on March 11, 2013.

[62] "Recent Experience and Prospects of the Economy of the West Bank and Gaza – Staff Report Prepared for the Meeting of the Ad Hoc Liaison Committee", IMF, March 19, 2013; p. 12.

[63] "Palestine: A State under Occupation – The Government of Palestine's Report to the Ad Hoc Liaison Committee", March 19, 2013; p. 21.

[64] Source: OECD-DAC data for 2011 based on Query Wizard for International Development Statistics (http://stats.oecd.org/qwids/).

[65] US$ 961 million disbursed in the West Bank and Gaza in 2011 for development programs and projects. It is reasonable to assume that at least half of this amount, $480 million, was disbursed to central government operations in fiscal 2011, and that the disbursements in 2012 for central government, in taking into account the reduction of donor funding, should amount to some $350 to $400 million.

[66] Criteria for score B.

[67] According to the MoF, loan disbursements amounted to some $3 million in fiscal 2010, $0.5 million in fiscal 2011, and $7 million in fiscal 2012.

[68] As outlined under PI-17, the Cash and General Debt Department (CGDD), under the Accountant General, has built up a record of historical debt data after being relocated from Gaza in 2007, when records were lost or destroyed. Once external loans are reconfirmed by the lending agency, the external loan is entered into BISAN. GCDD indicates that the only loans not verified and outside BISAN are from China, but are included in a spreadsheet and the monthly reports.

PI-8 Transparency of Intergovernmental Fiscal Relations

This indicator assesses the transparency and timeliness of grants from the center to municipalities and the consolidation of the expenditures by municipalities into general government accounts. While this performance indicator set is focused on PFM by central government, Subnational (SN) Governments in many countries have wide-ranging expenditure responsibilities.

	Minimum Requirements (Scoring Method M2).	
PI-8 Transparency of Intergovernmental Fiscal Relations	2007	2013
	Score C+ *NB: This corresponds to a score D+ on M2 method.* (i) Score C (ii) Score D (iii) Score D	**Score D+** (i) The horizontal allocation of most transfers from central government (at least 50 percent of transfers) is determined by transparent and rules-based systems. Score B (ii) Reliable estimates on transfers are issued after SN government budgets have been finalized, or earlier issued estimates are not reliable. Score D (iii) Fiscal information that is consistent with central government fiscal reporting is collected and consolidated for less than 60 percent (by value) of SN government expenditure OR if a higher proportion is covered, consolidation into annual reports takes place with more than 24 months delay, if at all. Score D

Dimension (i) transparent and rules-based systems in the horizontal allocation among SN governments of unconditional and conditional transfers from central government (both budgeted and actual allocations)

The Local Government Act (Law No. 1 of 1997) governs the transfer of funds from central government to local government units (LGUs). Transfers, which are assessed in this indicator, consist of 50 percent of all automobile licensing fees and fines, 65 percent of which are allocated in proportion to the population size of the LGUs, with the rest based on a variety of criteria such as notion of need, assistance to merging municipalities, and location such as Jerusalem. In addition, the Central Government Tax Department collects property tax on behalf of LGUs, withholding ten percent as a collection charge, but these are not transfers for the purpose of this indicator. Other sources of local revenue are from user charges (water, electricity, and solid waste collection), market and building fees, and shop licenses.[69] LGUs benefit from the donor-financed support Municipal Development Loan Fund (MDLF) which aims to improve financial performance. The underlying principles of the Municipal Development Program underpinning the MDLF are better managed and accountable local governments for provision of improved local government services. The MDLF has a grants allocation mechanism formula that distributes infrastructure grants to LGUs based on need and population. A good management practices criterion is to be added to the mechanism in the future. The scoring of this dimension is based on the use of population as a major (65

[69] Transfers represent about 2 percent of Ramallah's revenue while property tax constitutes some 45 percent. Transfers are not an important source of local government funding.

percent) basis for at least 50 percent of transfer as indicated by the Ministry of Local Government and confirmed by LGUs visited (Ramallah and Birzeit).

Dimension (ii) timeliness of reliable information to subnational (SN) governments on their allocations from central government for the coming year

There is a budget calendar that governs the preparation of LGUs' budgets and the involvement of the Ministry of Local Government (MLG), whose minister must approve and sign off on each LGU budget. The ministry plays an active part in assisting LGUs in preparing their budgets. However, because information on budget transfers from the central government is not provided in due time to the LGUs, budgetary projections for the coming year are made by them based on the previous year's allocation. Similarly, there is no predictability or certainty on when transfers are made for budget execution purposes, which is also a key element of this dimension. This has been confirmed by visits to two LGUs (Ramallah and Birzeit).

Dimension (iii) extent to which consolidated fiscal data (at least on revenue and expenditure) are collected and reported for general government according to sectoral categories

Each LGU submits a budget execution report to the MLG every six months and a financial report is submitted by end of March. The financial returns from individual LGUs are not consolidated. There is no consolidated general government information. Score D.

Compared to the 2007 PEFA, this indicator's score appears to have deteriorated. However, this is not the case as it actually remains the same. The reasons are an incorrect aggregation (M1 instead of M2 in 2007) and a lower score in dimension (i) of the similar basis for the transfers using population as the determinant of the transfer of cash from vehicle licenses and fines.

The comparison between the scoring of this indicator in 2007 and 2013 reveals two issues: (i) the whole indicator should have been rated D+ in 2007 (and not C+) according to the M2 methodology; and (ii) the score of the first subindicator reveals an improvement from C to B in 2013 that is not evidenced because the legal framework under which transfers are operated has remained unchanged since 2007 and the 2007 scoring was not supported by a narrative. This may reveal a cumulative error in 2007.

PI-9 Oversight of Aggregate Fiscal Risk from Other Public Sector Entities

This indicator assesses the oversight role of central government in relation to other public sector entities in terms of monitoring and managing fiscal risks with national implications arising from activities of subnational (SN) levels of government, autonomous government agencies (AGA), and public enterprises (PE).

	Minimum Requirements (Scoring Method M1).	
PI-9 Oversight of Aggregate Fiscal Risk from Other Public Sector Entities	2007	2013
	Score D+ (i) Score C	**Score D+** (i) All major AGAs/PEs submit fiscal reports to

	(ii) Score D	central government at least biannually, as well as annual audited accounts, and central government consolidates fiscal risk issues into a report at least annually. Score A (ii) No annual monitoring of SN governments' fiscal position takes place or it is significantly incomplete. Score D

Dimension (i) the extent of central government monitoring of AGAs and PEs

There are a number of SOEs that make up the portfolio of the Palestine Investment Fund (PIF) which is a public company. PIF returns dividends to the Ministry of Finance and manages a strategic investment program in a number of vital sectors directly or through a number of fully owned subsidiaries. It is financially and administratively independent and is governed by an independent general assembly and board of directors. PIF's consolidated financial statements are composed of the financial statements of PIF and its subsidiaries, which are companies over which PIF exercises financial and operational policy control. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies. PIF is audited, both internally and externally, in line with best standards. In 2011, PIF's activities and operations were subject to a thorough audit on a co-sourcing agreement (working closely with PIF's internal audit unit). The annual financial statements are audited and published both in the annual report and on PIF's website.

The PIF's Annual Report includes a section on risk management. The 2012 report lists PIF's principal financial liabilities (loans, accounts payable, etc.) whose main purpose is to raise finance for its operations. The report also outlines its financial assets (loans granted, available-for-sale investments, accounts receivables, cash and deposits at banks, etc.). The report highlights the main risks arising from PIF's financial instruments (interest rate risk, foreign currency risk, equity price risk, credit risk, and liquidity risk). PIF's Board of Directors reviews and approves policies for managing these risks. On the basis of the information in this annual report and the evidence gathered from its internal audit team, there is a reporting mechanism from all subsidiaries on a monthly basis. There is an annual consolidated risk assessment report for PIF and its subsidiaries.[70]

Given that the PIF: (i) encompasses all SOEs in Palestine under its umbrella, (ii) receives a monthly management statement, and (iii) prepares an annual consolidated financial report including a fiscal risk report, this dimension merits an A Score.

Dimension (ii) extent of central government monitoring of SN governments' fiscal position

The Minister of Finance has not granted borrowing powers to LGUs under the jurisdiction of the Financial Regulations or the Debt Act.[71] However, under the Local Government Act, the Minister of Local Government can authorize LGUs to borrow, provided he carries out due diligence.

[70] This assessment is based on documentation. The mission was unable to meet with the PIF's officials due to logistic reasons, but had an audio conference with the internal auditor of the PIF.
[71] See PI-17, (iii).

However, there are two potential fiscal risks.

(a) The Minister of Local Government provided a few LGUs with “letters of comfort” to obtain overdraft facilities from commercial banks to meet due payments while transfers or revenues are not available. The guarantor status of such “letter of comfort” is not clear: it is not issued by the Minister of Finance who is the only legal guarantor, notwithstanding the Local Government Act, but it is a potential and unquantified fiscal liability.

(b) There have been deductions from clearance revenue (transferred by the Israeli tax administration) in lieu of nonpayment to Israeli utility companies from LGU distribution companies who themselves have not been paid by their clients. While the authorities (both central and local) are taking steps to reduce nonpayments, such as the installation of prepaid meters for electricity and provision of evidence of payment of utility bills to access public services, the deduction from clearance revenue in lieu of payment to Israeli utilities companies is an unquantified and unsupervised fiscal risk. Before transferring property taxes to LGUs, the MoF subtracts any deductions from clearance revenue that have been identified for an LGU. This mitigates the fiscal risk for the central government, but only incompletely and with no annual monitoring.

Overall the second of two main fiscal risks is not annually monitored in a comprehensive manner.

Since the 2007 PEFA, there has been an improvement on dimension (i). PIF now undertakes fiscal risk analysis and consolidates it in its annual report. Moreover the 2007 PEFA incorrectly designated the Petroleum Authority as an SOE rather than a General Directorate of the Ministry of Finance that has off-and-on budget expenditures and revenues.

PI-10 Public Access to Key Fiscal Information

This indicator measures the transparency of the PFM system by assessing timely public access to six categories of key fiscal information documents during the past fiscal year (2012).

	Minimum Requirements (Scoring Method M1).	
	2007	2013
PI-10 Public Access to Key Fiscal Information	Score C (i) Score C	**Score B** (i) The government makes available to the public three to four of the six listed types of information. Score B

The government makes available to the public three of the six listed types of information.

Table PI-10: Public Access to Key Fiscal Information

Framework Requirement	Met/Not Met	Comment
(i) Annual budget documentation: A complete set of documents can be obtained by the public through appropriate means when it is submitted to the legislature.	**Not met**	A complete set of documents cannot be obtained by the public upon submission of annual budget documentation to the legislator (in the current Palestinian environment to the president). The MoF, however, provides a citizen budget to civil society, along with supporting budget documentation. The citizen budget does not include the budget statement and the policies upon which the budget is based. Once approved, the budget is published on the MoF website www.pmof.ps.
(ii) In-year budget execution reports: The reports are routinely made available to the public through appropriate means within one month of their completion.	Met	In-year budget execution reports are published on the MoF's website on a monthly basis within four weeks following the end of the month.
(iii) Year-end financial statements: The statements are made available to the public through appropriate means within six months of completed audit.	Met	Preliminary year-end financial statements are published on the MoF's website within six months following year's end. Final year-end financial statements are published within six months of complete audit (published three months after audit on the SAACB website in 2013).
(iv) External audit reports: All reports on central government consolidated operations are made available to public through appropriate means within 6 months of completed audit.	Met	A certain amount of information, in particular the audit of central government financial statements, is posted on the website of the SAACB (www.saacb.ps) within six months of completed audit. For civil society (and researchers according to the SAACB) it is possible to obtain through free access all other more technical reports on central government consolidated operations by formally approaching the SAACB and requesting access in writing.
(v) Contract awards: Award of all contracts with value above approximately $100,000 equivalent are published at least quarterly through appropriate means.	**Not met**	All supply contracts above the threshold of $15,000 and reaching back to 2009 are published on the website of MoF's General Supplies Department: www.gs.pmof.ps. However, contract awards for public works are not published, regardless of their amount.
(vi) Resources available to primary service units: Information	**Not met**	Information on resources available to primary service units (e.g., primary schools and primary

is publicized through appropriate means at least annually, or available upon request, for primary service units with national coverage in at least two sectors (such as elementary schools or primary health clinics).		health clinics) has not been produced and is not readily available. Only limited categories of expenditures are available at a disaggregated level (by primary service unit). According to MoE and MoH, the provision of such detailed information would require further resources in the entry of data into the government's financial management system (IFMIS).

Compared to the 2007 PEFA (Score C), more key fiscal information is available and can be accessed by the public, especially external audit reports which are now made available to the public by the SAACB. The 2007 PEFA does not clearly indicate which criteria were met or not met and therefore a detailed comparison with the 2007 PEFA is not possible. Under the current PEFA, three out of six criteria are met, which justifies the score B.

Budget Cycle – Policy Based Budgeting

PI-11 Orderliness and Participation in the Annual Budget Process

This indicator has three dimensions to assess: (i) the existence and adherence to a fixed budget calendar; (ii) the existence of quality guidance on preparation of the budget submissions; and (iii) timely budget approval by the legislature (or similarly mandated body). The assessment covers the preparation of the 2013 budget for (i) and (ii), and the last three fiscal years for (iii).

	Minimum Requirements (Scoring Method M2)	
PI-11 Orderliness and Participation in the Annual Budget Process	2007	2013
	Score C (i) B (ii) C (iii) D	**Score C** (i). A clear annual budget calendar exists, but some delays are often experienced in its implementation. The calendar allows MDAs four weeks to meaningfully complete their detailed estimates. Score B. (ii). A budget circular is issued to MDAs, including individual ceilings; the budget estimates are reviewed and approved by the cabinet only after they have been completed by MDAS, thus seriously constraining the cabinet's ability to make adjustments. Score C. (iii). The budget has been approved with more than two months' delay in two of the last three years. Score D

Dimension (i) existence of and adherence to a fixed budget calendar

A clear budget calendar is set out in the Financial Regulations issued under the Organic Budget Law as follows: the budget circular is to be issued by July 1, with the proposed budget to be submitted by the

Ministry of Finance to the cabinet by October 15, presented to the legislative council by November 1 and passed by it on or before December 31.

Table PI-11: Budget Calendar

Budget Calendar as Per Regulations Issued under Law No.7	Budget Calendar Actual Process Followed in 2012
By May 1: Report submitted to cabinet on economic and fiscal developments and proposed fiscal measures	March 15: MoF instructs ministries to nominate budget team and issues passwords for the IFMIS budget preparation module
By July 1: Budget circular to be issued, setting out main fiscal policies and budget preparation instructions, forms, and timetable	August 14: MoF instructs ministries to identify priorities, strategies, programs, and subprograms and enter details directly into the IFMIS system by September 1 (called 'S1' Form). No ceilings are notified at this stage; preparation time: two weeks
By October 15: Submission of the draft budget law by the minister to cabinet for approval	August 30: MoF issues instructions for preparation of detailed annual budget
By November 1: Submission of the draft budget law by cabinet to the Legislative Council	September and October: Budget discussions between MoF and individual ministries
By December 31: Approval of the budget by the Legislative Council	November 15: MoF issues ministerial ceilings for the recurrent budget. Development budgets negotiated directly with MoPAD. Detailed estimates to be entered into the IFMIS by November 29; preparation time: two weeks

The comparative table above shows that the budget calendar defined under Law No.7 suffers some delays. In 2012, the budget circular was sent to line ministries after July 1 and line ministries had less than six weeks to prepare their budget requests as recommended by best practice.

The delays in the implementation of the budget calendar in 2012 were due, in part, to the need to modify some of the budget preparation forms as part of the ongoing work on improving program structures (subfunctional classification). A budget preparation module was also set out on the IFMIS to smooth the preparation procedure from a technical perspective. The budget circular was issued on August 14, 2012, with instructions for its completion by September 1. On November 15, expenditure ceilings were issued to line ministries for completion of their detailed annual budget with instructions to complete their detailed estimates by November 29, 2012. The ceilings issued were only for operational expenditure estimates. Development expenditure estimates are normally agreed between line ministries and the Ministry of Planning and Administrative Affairs (MoPAD) on the basis of available external financing projections and project plans.

Dimension (ii) clarity and comprehensiveness of political involvement in the guidance on preparation of budget submissions

The budget circular is issued to line ministries in two parts. The first part of the budget circular should be issued by July 1, according to the budget calendar, and does not include budget ceilings for individual administrative units or functional areas.[72] At this stage, the circular provides an overview of the economic and fiscal context within which the recurrent and development budget for the forthcoming year shall be prepared, based on the fiscal framework approved by the cabinet. For preparation of the 2013 budget, the fiscal framework was approved by the cabinet in May 2012. The first part of the budget circular requires each ministry and agency to provide information about their policy priorities, strategic plans, objectives, and targets in a consistent format (Form S1). The information entered by ministries is used by the Ministry of Finance as the basis to determine sector, ministry, and agency expenditures for the coming year. This process involves further discussions with the relevant ministries and may involve the Minister of Finance, but it does not involve the cabinet. The Ministry of Finance then distributes the second part of the budget circular which contains ceilings for operational expenditure at the ministry or agency level, and within these ceilings at more detailed levels for each entity (salary, capital, goods and services, and pensions).

In summary, the budget circular is issued to ministries in two stages and includes in its second stage ceilings for individual ministries and administrative units for the coming year. The role of the cabinet in the budget preparation process is to focus on approval of the aggregate economic and fiscal framework for the budget year to come. The detailed budget estimates for each MDA are reviewed and approved by the cabinet only after they have been completed in all their details by ministries and agencies and submitted to the cabinet for approval.

The whole procedure is very much guided by a “bottom up” approach as opposed to a “top down” best practice whereby budget ceilings are fixed by the cabinet at an early stage, once the full economic and fiscal picture is cleared. The cabinet then notifies line ministries to launch discussion on their budget requests formed on the basis of ceilings already decided. According to the MoF, difficulties in establishing the fiscal framework for the coming year at the start of the budget preparation process have been an underlying reason for this “bottom up” approach. With the establishment of the MFU in MoF, the PA now has greater capacity to assess alternative fiscal scenarios and set realistic budget preparation ceilings for MDAs earlier in the budget preparation cycle. The MoF intends to implement this change starting with preparation of the 2014 budget; see PI-12(i).

Dimension (iii) timely approval of the budget by the legislature or similarly mandated body within the last three years

The annual budgets for 2011, 2012, and 2013 were not approved by the formal deadline of December 31. The 2013 budget was approved by the cabinet on March 28, 2013, and approved by the president on March 31, 2013. The 2012 budget was approved by the president on April 10, 2012. The 2011 budget was also only approved in April 2011.

[72] A Budget Preparation Manual and Budget Preparation Module Users’ Manual have been developed by the Ministry of Finance. The manuals have not yet been formally approved; however, the budget preparation process in place largely corresponds to the process described in the manuals.

In 2007 PI-11 scored C. There were only minor slippages in the calendar. Given the special circumstances of the 2006 election, the 2006 budget had not been presented to the PLC as of June 2006 (dimension score B). The timetable for preparation of budget submissions in 2007 was the same as the one which exists currently, with little time for cabinet consideration (dimension score C). The PLC had, in two of the three years 2003–2006, approved the budget with one month delay (dimension score C).[73]

PI-12 Multiyear Perspective in Fiscal Planning, Expenditure Policy, and Budgeting

This indicator has four dimensions. It assesses: (i) the preparation of multiyear fiscal forecasts; (ii) the scope and frequency of debt sustainability analysis; (iii) the existence of sector strategies; and (iv) linkages between capital and recurrent estimates. The assessment covers the last two completed fiscal years (2011, 2012) for dimension (i), the last three years for dimension (ii), and the last completed budget (2012) for dimensions (iii) and (iv).

	Minimum Requirements (Scoring Method M2)	
PI-12 Multiyear Perspective in Fiscal Planning, Expenditure Policy, and Budgeting	2007	2013
	Score D	**Score D**
	(i) C	(i) No forward estimates of fiscal aggregates are undertaken. Score D
	(ii) D	(ii) No debt sustainability analysis has been undertaken in the last three years. Score D
	(iii) D	(iii) Sectors strategies do not include consistent costing consistent with aggregate fiscal forecasts. Score C
	(iv) D	(iv) Budgeting for investment and recurrent expenditure are separate processes with no recurrent cost estimates being shared. Score D

Dimension (i) preparation of multiyear fiscal forecasts and functional allocations

Medium-term fiscal forecasts on the basis of the main economic classifications have not been prepared by the Ministry of Finance in recent years.[74] The ministry is now rebuilding this capability with the establishment of a Macro Fiscal Unit (MFU) in August 2011. Initially the role of the MFU focused on collecting macroeconomic and fiscal data and producing informative quarterly reports on economic and fiscal outturns. In June 2012, the MFU was formally approved and incorporated into the organization chart of the Ministry of Finance. During 2012, the MFU developed a financial programming framework which was used to produce for the first time a Medium Term Fiscal Framework (MTFF) towards the end of the year. The MTFF has been used to support finalization of the budget for 2013 and has been shared with an IMF technical assistance team. The unit plans to maintain the MTFF and expects to be able to

[73] A score D in 2007 would have better reflected the practice, since in no year of the assessment had the budget been approved before the start of the fiscal year.

[74] Arguably this has not been the priority until relatively recently. The early years of PFM reform by the PA (2002–06) were focused on expenditure control and oversight of PA resources, and then by reestablishment of systems following the relocation from Gaza to Ramallah (2007-09).

provide multiyear estimates to guide the setting of annual budget ceilings for preparation of the 2014 budget.

Dimension (ii) scope and frequency of debt sustainability analysis

Debt sustainability analysis is not routinely undertaken by the Ministry of Finance. The focus of the work of the Cash and Debt Management Unit has been on reestablishing an accurate and comprehensive debt database following destruction of the unit's debt records when the MoF relocated from Gaza to Ramallah.

Dimension (iii) existence of sector strategies with multiyear costing of recurrent and investment expenditure

The PA has a well-developed system of sector strategies. The National Development Plan 2011–13 (NDP) is built on four major sectors (governance, social, economy, and infrastructure) which are in turn based on 23 sector and cross-sector strategies. Progress has been made since the previous plan on developing clear objectives, policy interventions, and results frameworks, but the costing of sector strategies is mixed. There is no systematic consideration of the future recurrent costs of capital projects in sector plans. Sector programs are linked conceptually with the NDP, but it is acknowledged that they have not been developed in a way that facilitated accurate or affordable costing.[75] Sector strategies have been developed in the absence of medium-term allocations to each MDA for recurrent and development expenditure to guide the development of the strategies. Some sectors have extensive and well-developed costing of development expenditures (e.g., education) whereas others have only "indicative" cost estimates with more accurate costing to be developed as part of the annual budget process (e.g., agriculture). In some sectors, the costing of sector strategies is acknowledged as incomplete (e.g., water and waste water) or appears to be absent (e.g., higher education). Costed sector strategies exist for 25 percent or more of primary expenditure, but individually and in aggregate these are likely to be inconsistent with fiscal forecasts.

Dimension (iv) linkages between investment budgets and forward expenditure estimates

In recent years, attempts have been made to clarify the institutional roles and responsibilities of MoF and MoPAD with regard to the overall strategic framework for planning and budgeting. The MoPAD is responsible for the broad directions for economic development, including individual sector strategies, and these are contained in the NDP. The MoF is responsible for management of the annual budget process and is moving towards a more strategic allocation of resources through the improvement of program budgeting and the development of a three-year budget framework. However, the planning and budgeting processes are in many respects still two separate processes, and links between investment budgets and forward expenditure estimates are weak.

The PA does not operate a system of medium-term budgeting that would provide the basis for linking the medium-term expenditure implications of capital projects with the annual budget. Linkages between investment budgets and forward expenditure estimates are weak. Sector strategies are mostly oriented towards the externally financed development budget, rather than the recurrent budget. The responsibility for ensuring that sector strategies are adequately reflected in the annual budget and that forward recurrent

[75] This was confirmed to the mission in interviews with MoPAD.

expenditure is covered in the annual budget is primarily the responsibility of the relevant line ministries. However it is not clear they have the tools or guidelines to do this effectively.

MoPAD has produced guidelines for the proposed review of the sector strategies that it plans to undertake prior to the preparation of the next NDP. Recent IMF technical assistance[76] has identified the following priorities for the next two years: (i) adopting a common macro fiscal framework for planning and budgeting with realistic revenue, expenditure, and borrowing policies over the medium-term period; (ii) adopting a multiyear budget planning approach in which expenditure plans can be related to specific and achievable development objectives; (iii) ensuring that individual sector strategies and needs are better reflected in annual budget programs of the responsible ministries and agencies; and (iv) progressively improving the classification and management of current and capital expenditures within both the recurrent and development budgets. These issues are being addressed by technical support from DFID and the IMF.

In the 2007 PEFA, PI-12 scored D. Forecasts of fiscal and macroeconomic aggregates were prepared on an annual basis with IMF and World Bank support and work was underway on developing a medium-term fiscal framework (dimension score C). No debt sustainability analysis had been undertaken (dimension score D). Sector planning was underdeveloped. Some sectors had prepared several competing plans, reflecting the work of different donors (dimension score D). Budgeting for recurrent and development expenditures was not linked (dimension score D).

Budget Cycle – C (ii) Predictability and Control in Budget Execution

PI-13 Transparency of Taxpayer Obligations and Liabilities

This indicator assesses whether the overall control environment that exists in the revenue administration system, and the direct involvement and cooperation of the taxpayers from the individual and corporate private sector, allow for effective assessment of tax liability. The quality of such control is very much linked to the degree of transparency of tax liabilities, including clarity of legislation and administrative procedures, access to information in this regard, and ability to contest administrative rulings on tax liability.

	Minimum Requirements (Scoring Method M2).	
PI-13 Transparency of Taxpayer Obligations and Liabilities	2007	2013
	Not assessed	**Score C+** (i) Legislation and procedures for some major taxes are comprehensive and clear, but the fairness of the system is questioned due to substantial discretionary powers of the government entities involved. Score C (ii) Taxpayers have easy access to comprehensive, user friendly, and up-to-date information on tax liabilities and administrative procedures for some of the major taxes, while for other taxes the information is limited. Score B (iii) A tax appeals system of administrative procedures has been established, but needs substantial redesign to be fair, transparent, and effective. Score C

[76] IMF/FAD report "Progress Financial Management Progress Review" (D. Radev) – January 2012.

There is no unified system of Tax Administration in the PA. There are a number of departments that deal with the administration of different taxes: property tax, income tax, VAT, and customs and excise. There is a Large Taxpayers Unit (LTU) that deals with the 5 percent of taxpayers[77] that generate 70 to 80 percent of domestic revenues (25 percent of total revenues, including imports). Revenue administration has been the subject of many IMF TA missions and reports. There are currently DFID and USAID TA programs in place supporting a Three Year Plan for Enhanced Compliance which are linked to the IMF report recommendations. The implementation of the Three Year Plan, which is guided by a recently created Revenue Council, will improve indicator scoring from the current scores. This plan is comprehensive, leading to the effective unification of tax administration under an overall director with a new organization chart. There will be new IT systems, laws, and procedures designed for the Palestine Authority rather than the existing amendments to Israeli and Jordanian laws, taxpayer client services and taxpayer education, and the use of electronic filing and registration, that all reflect the programs contained in modern tax administrations. Some of these features have been implemented or are close to implementation, such as the Revenue Management IT system which became fully active in mid-June 2013. This system will be fully compatible with other IT systems such as ASYCUDA (for customs) and other relevant government departments.

Dimension (i) clarity and comprehensiveness of tax liabilities

The main taxes represent approximately 70 percent of total taxes.

For property tax, there is a legal basis for property tax based on rental values for all classes of commercial and domestic properties, but the law goes back to 1954 with amendments. There is an ongoing Japan International Cooperation Agency (JICA) supported project to change the current valuation standards (based on the Jordanian property tax law) to one that is based on international standards. There is no power of discretion available to the administration in the law; indeed a visit to a property tax office indicated a queuing system based on an electronic ticket system so that queue jumping (usually viewed as an indication of possible discretionary power) was eliminated.

For income tax, there is a *"*pay as you earn*"* (PAYE) system for collecting taxes on employees and companies, sole traders, and partnerships, governed by Law No. (8) of 2011 (and secondary regulations). This law lays out procedures on the key elements of tax computation (such as rates, allowances, penalties), and lists deductions from income which are not discretionary and are part of the Income Tax Code. Procedure manuals for income tax are presently under development. At the same time, another law on the Encouragement of Investment in Palestine (Law No. 1 of 1998, as amended) allows significant discretion on the granting of income tax incentives under article 24 over and above predetermined qualifying investments.[78] There are thus for income tax significant discretionary powers over the granting of investment incentives, which is contrary to good tax practice.

[77] There are 200 companies reporting to the LTU, compared to the 20 to 30 recommended as a starting number by the IMF and other TAs, as noted in "Biannual Report on PA Revenues Trade Facilitation Project," December 2012, Chemonics International for USAID.

[78] Investment exemptions and incentives under Articles 22 and 23 are specific to investments that meet predetermined criteria and are not considered discretionary.

For VAT and customs, there are laws based on the Israeli and Jordanian laws, respectively. Both are considered by the authorities to be in need of updating and modernization. For instance while the Jordanian customs law has been modernized, the old (1962) law is still used in Palestine. The current customs law is comprehensive but not compliant with international agreements.[79] Procedure manuals for customs and VAT have been promulgated. There are no discretionary powers to bypass the laws and procedures.

Dimension (ii) taxpayer access to information on tax liabilities and administrative procedures.

The Property Tax Department has an active public awareness culture. It uses brochures, printed and voice media, as well as billboards to broadcast information, which has resulted in increased compliance. However, taxpayer awareness and education on income tax is ad hoc and considered to be ineffective. The Income Tax Department recognizes that information to taxpayers needs to be addressed through heightened taxpayer education programs. A similar situation is present for customs and VAT. The Customs Tariff (Israeli) is now translated into Arabic and available on line from Customs Departments for interested clients. It is too big to publish in a paper format (the last paper one was 30 centimeters thick). Taxpayer education is a key element in the Three Year Plan for Enhanced Compliance. This will include the creation of a Taxpayer Services Department, which is welcomed by the private sector.

Dimension (iii) existence and functioning of a tax appeals mechanism

There is a formal tax appeals mechanism through the court system for all taxes.

For income tax, there is an Income Tax Appeal Court. The norm, however, is for a taxpayer to challenge an assessment (property tax or income tax) which must be done within 30 days of the assessment (although there are circumstances for this time period to be extended) and both parties to come to an agreement. There is no intermediate independent appeal mechanism between the two mechanisms (negotiation and court) for appeals. The private sector is highly critical of the existing mechanism. Addressing the appeals mechanism is a key feature of the Three Year Plan.

For VAT and customs, the appeals mechanism is not WTO/GATT compliant.[80] The Customs Court for appeals has been operational for about 13 months and is broadly based on the Jordanian model, but is not as sophisticated. In general, all appeals for all tax assessments are based on discussion between the taxpayers and the relevant tax authority, and if there is no agreement/resolution, the only recourse is to the court system.

PI-14 Effectiveness of Measures for Taxpayer Registration and Tax Assessment

Effectiveness in tax assessment is ascertained by an interaction between registration of liable taxpayers and correct assessment of tax liability for those taxpayers. This indicator assesses these elements of tax administration.

[79] World Trade Organization, World Customs Organization, or General Agreement on Tariffs and Trade.

[80] As set out in ANNEX H.2, "Concerning Customs Offences" of the WCO's Revised Kyoto Convention and by the WTO under GATT Article X 3 (b).

	Minimum Requirements (Scoring Method M2).	
PI-14 Effectiveness of Measures for Taxpayer Registration and Tax Assessment	2007	2013
	Not assessed	**Score D+** (i) Taxpayers are registered in database systems for individual taxes, which may not be fully and consistently linked. Linkages to other registration/licensing functions may be weak but are then supplemented by occasional surveys of potential taxpayers. Score C (ii) Penalties for noncompliance are generally nonexistent or ineffective (i.e., set far too low to have an impact or rarely imposed). Score D (iii) Tax audits and fraud investigations are undertaken on an ad hoc basis, if at all. Score D

Dimension (i) controls in the taxpayer registration system

There is no unique Tax Identification Number (TIN). To establish a legal entity, the ID cards of the principals are required before a unique business ID is generated which then, in theory, should be used for taxation. In practice, each tax department has its own database with little or no linkages. There are a number of unlinked software systems. The Customs Department operates ASYCUDA while the VAT Department operates SHAAM, as does the Income Tax Department, and these are being linked in the LTU for its clients. The Property Tax Department has its own computerized property tax database, which is linked neither to the others nor to LTU.

The Property Tax Department has a system of linking evidence of registration (through evidence of payment) to other activities: public bodies cannot pay a contract without the contractor furnishing proof of payment of property tax; rental payment cannot be made without proof of payment of property tax. This system is being extended to electricity payments. The department also carries out physical inspections of localities for new buildings at the end of each quarter. As part of its overall assessment of rental values, it evaluates additional municipalities (eight, in 2012) and revalues existing municipalities on a five-year cycle (13 in 2012, and 60 in total reevaluated thus far). Some 500,000 properties are now in the database.

There is no effective link with income tax and the business license system (administered by the Property Tax Department). For example, to illustrate this lack of linkage, the Income Tax Act states that “a person who practices business or investment activity shall be obliged to register with the Income Tax Department from the date of conducting the activity or operating the business.” However, there are 80,000 business licenses according to the Property Tax Department, though not all of these businesses may be active. In 2011, the number of active taxpayers registered in the income tax system was 14,414 and the number of inactive taxpayers was 932. There were 1,694 closed files. In the same period, some 86,338 taxpayers registered for VAT, but 24,932 were noncompliant in terms of submitting monthly returns. A joint tax registration system would not show such discrepancies between numbers of companies registered. Tax clearance certificates are used for importers, but are not linked to opening of bank accounts. The private sector is critical of the use of tax clearance certificates to enforce payments on account which are challenged by the taxpayer.

Dimension (ii) effectiveness of penalties for noncompliance with registration and declaration obligations

Both property and income tax departments offer a discount scheme for quick payment once an assessment of tax liability of the tax payer has been made. There are penalties for late payment. For property tax, this is 5 percent of the assessment after 12 months. There is also a sanction of imprisonment (which has been used) and confiscation of property for violation of the law. Article 36 of the Income Tax provides for fines for late payment up to 2 percent of the assessment per month, and 3 percent of the assessment once made for late filing, up to 20 percent. Article 37 provides for a penalty of imprisonments and fines for fraud in relation to income tax matters. Notwithstanding this, there is no penalty or sanction for not registering in the first instance in relation to Article 2 (on Taxpayer Registration). For customs, there is no effective penalties regime as face-to-face negotiation is the norm. A key feature of the penalty mechanism is its general nonuse in application which means that it is ineffective even though the penalties may be significant on paper.

Dimension (iii) planning and monitoring of tax audit and fraud investigation programs.

At present, neither the Property Tax Department nor the Income Tax Department operate a self-assessment system and do not have a risk-assessed system of tax audits. Assessment of tax liabilities is made by tax assessors in both departments based on information supplied by the tax payer that is required to assess liabilities. The Customs Department has started to use the ASYCUDA functionality for pre- and post-clearance with green (no inspection of imports), yellow (document inspection), and red (document and physical inspection of imports) channels. Information sharing with Israeli customs is awaiting final approval, but it has been tested. Training for customs staff in Post-Clearance Audit and Customs and VAT in Risk Management is currently being undertaken. There is a plan to develop a central audit/risk database and presently a paper-based reporting of audit examination is being implemented. Score D

PI-15 Effectiveness in Collection of Tax Payments

This indicator assesses the accumulation of tax arrears and the collection of tax debt as they lend credibility to the tax assessment process and reflects equal treatment of all taxpayers. Prompt transfer of the collections to the Treasury is essential for ensuring that the collected revenue is available to the Treasury for spending.

	Minimum Requirements (Scoring Method M1)	
PI-15 Effectiveness in Collection of Tax Payments	2007	2013
	Not assessed	**Score D+** (i) The debt collection ratio in the most recent year was below 60 percent and the total amount of tax arrears is significant (i.e., more than 2 percent of total annual collections). Score D (ii) All tax revenue is paid directly into accounts controlled by the Treasury or transfers to the Treasury are made daily. Score A (iii) Complete reconciliation of tax assessments, collections, arrears, and transfers to Treasury takes place at least annually within three months of end of the year. Score C

Dimension (i) collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal years).

There is an estimated NIS 4 billion in income tax arrears alone, but these arrears are neither aged nor assessed as to the possibility of collection. There is no system of write-offs of uncollectable tax which means that the stock of arrears is growing annually if additional arrears are added during the year (which appears to happen). This is being addressed through the Tax Administration Reform project. An importer is unable to receive goods without payment (which is made though the clearance system), which does not give the Palestine Customs the ability to assess liabilities and therefore assess whether the correct payment has been made.

Accurate data related to all categories of domestic revenues are incomplete for the standard assessment of arrears. Nevertheless, this assessment can easily be made in terms of allocating a score based on available data relating to the income tax alone, which represents more than 40 percent of all domestic revenue in 2012 (see table below). At the time of the assessment, the stock of arrears for this tax stood at some NIS 4 billion, and represented six times the actual collection of income tax and almost three times the actual collection of all domestic revenues. Sixty percent of estimated arrears of NIS 4 billion represented an amount of approximately NIS 2.4 billion. This is far more than the total amount collected each year for all domestic revenues (NIS 1.4 billion and NIS 1.5 billion, respectively, in 2011 and 2012). Therefore, without considering any other tax arrears even, it is possible to deduce that the debt collection ratio is below 60 percent (due to the fact that revenue collection has not significantly increased). The amount of arrears is also more than two percent of all domestic revenues. That indicates that a score D is merited on the sole basis of this calculation despite the lack of comprehensive information to assess the dimension. Addressing tax arrears in their totality (amount, timeliness, and ability to collect) is one of the components of the current work program in improving tax administration, particularly using the new IT system, but also represents a conscious policy effort to address arrears, including write-off of uncollectable debt and the maintenance of meaningful, timely, and accurate data.

Table PI-15: Ratio for Gross Tax Arrears on Domestic Revenues (NIS million)

Taxes	**2011**	**2012**	**Arrears**
Income Tax	475	661*	4,000**
VAT	677	675	N/A
Customs	250	158	N/A
Property Tax	10	10	N/A
Totals	**1,412**	**1,504**	**4,000**

*Income tax represents 44 percent of total domestic revenues (1,504)

**Amount estimated for 2011 and 2012

Dimension (ii) effectiveness of transfer of tax collections to the Treasury by the revenue administration

Tax payments are made directly into the MoF account at the Bank of Palestine. For property tax payment, an invoice/assessment for payment purpose is issued in triplicate and payment is made daily into the department's subaccount with the Ministry of Finance at the Bank of Palestine. A similar system operates for the Income Tax Department.

Dimension (iii) frequency of complete accounts reconciliation between tax assessments, collections, arrears records, and receipts by the Treasury

Reconciliation between the Treasury subaccount and payment is made daily. Reconciliation between tax paid and tax assessment on the taxpayer can be done daily for property tax as the system is fully interactive. Reconciliation between payment and assessment for customs is expedited through the IT systems when payments are made. Reconciliations between tax paid and tax assessment on the taxpayer is done weekly on the SHAAM spreadsheet system for income tax payments. For income tax paid by companies (profits tax), there is a system of payment on account during the year, and at the end of a company's financial year, the assessment is made based on the accounts and appropriate tax allowances and deductions and reconciled with payments made on accounts.

This allows the Income Tax Department to track payment against assessment, whether appeals have been lodged and whether payment has not been made. While historically there are significant arrears (some of which are likely to be uncollectable), the current system of recording and reconciliation merits a score C. The new IT system due to be implemented in mid-2013 will improve the existing information system.

Indicators on taxation were not assessed in the 2007 PEFA so a comparison cannot be made with the current situation.

PI-16 Predictability in the Availability of Funds for Commitment of Expenditures

This indicator assesses whether the spending ministries, departments and agencies (MDAs) receive reliable information from the Ministry of Finance on availability of funds within which they can commit expenditure for recurrent and capital inputs.

	Minimum Requirements (Scoring Method M1).	
PI-16 Predictability in the Availability of Funds for Commitment of Expenditures	2007	2013
	Score D+ (i) Score D (ii) Score D (iii) Score B	**Score D** (i) Cash flow planning and monitoring are not undertaken or are of very poor quality. Score D (ii) MDAs are provided commitment ceilings for less than a month or no reliable indication at all of actual resource availability for commitment. Score D (iii) Significant in-year budget adjustments are frequent and not done in a transparent manner. Score D

Dimension (i) extent to which cash flows are forecast and monitored

The budget is executed based both on the original approved budget and the cash availabilities through the IFMIS. Budget ceilings are allocated by the budget department to each line ministry on a quarterly basis. However, the payment of the expenditures is performed according to cash availability only. Cash availability is determined separately by the Cash and Debt Management Department (CDMD), which requests cash flow forecasts from the Revenue Department and a forecast on budget support from the International Relations Department. Methods for forecasting cash flows (inflows/outflows) are under developed. The CDMD does not utilize any formalized annual cash plan to allow a smooth budget execution. In the recent period of fiscal crisis due to the uncertainty of revenue realization (particularly from clearance revenues and budget support), this lack of cash forecasting framework has resulted in several disruptions in the payment of expenditures, such as salaries or debt service, as well as arrears for nonwage expenditures. The CDMD is addressing the situation by monitoring the cash position to decide, on a daily basis, payments of invoices and other liabilities. Overall, no cash flows are forecasted and monitored.

Dimension (ii) reliability and horizon of periodic in-year information to LMs on ceilings for expenditure commitment

Execution in terms of payment is based on cash availability and payments are made on a needs basis. Transactions entered into the IFMIS by line ministries as "payment requests" are checked daily with available cash funds in the system. If the CDMD cannot allocate the necessary cash due to shortage, an arrear report is automatically generated. Payment of salaries is made on the basis of available cash and other payments on an as-need basis without specific and transparent criteria. Payments of utilities and medicines appear to get higher priority. Ministries provide a monthly list of invoices to be paid and they are informed on what should be paid based on the availability of cash and the priorities within competing claims. The horizon of line ministries for expenditure execution is often less than the month, featuring a cash-rationing execution process.

Dimension (iii) frequency and transparency of adjustments to budget allocations, which are decided above the level of management of LMs

There are no supplementary budgets as commonly understood, which reflect duly authorized changes to the original budget.[81] Changes do in fact take place as some ministries exceed their allocated budget (see PI-2).[82] The 2012 original budget had a recurrent budget deficit target of NIS 3.6 billion, but the actual 2012 recurrent budget deficit amounted to NIS 5.6 billion. The cabinet approved a supplementary budget of NIS 950 million, financed through domestic bank borrowing to cover additional expenditures, of which around NIS 510 million were actually allocated. The allocation of the supplementary budget by economic classification was as follows: NIS 18 million for wages and salaries, NIS 389 million for operational expenditures, mainly to cover arrears to the health sector, and NIS 103 million for transfer expenditures.[83] This has not followed the same process that governs the original budget. The supplementary budget made

[81] Article (54) of the Financial Regulations states "In case of necessity to amend or add any clauses to the general budget law, which may entail the allocation of new appropriations, such amendment or addition shall be prepared in the form of appendix and submitted by the cabinet to the legislative council for ratification and issuance of a law to this effect."

[82] Some of these are for pension payments which would constitute first call on expenditure, but also include spending by ministries.

[83] Fiscal Developments & Macroeconomic Performance: Fourth Quarter and Fiscal Year 2012, MOF MFU.

in October 2012 was for regularizing expenditures already made, not allocating or adjusting funds for expenditure as an initial or a true supplementary budget would do. Some ministries also had their budgets adjusted to account for moneys withheld from clearance revenue to account for relevant payments for cross-border services (usually for the Ministry of Health for medical referrals). While this procedure reflects spending rather than a change in the budget, it is also possible that this may result in additions to the original budget generating arrears as noted above. Changes within a budget total are also possible, but are not covered in this dimension.[84]

There appears to be deterioration in this indicator since the 2007 PEFA on dimension (iii), but the 2007 PEFA appeared to score this dimension on the strength of Article 54 (footnote 58) rather than its application. The other dimensions remain the same.

PI-17 Recording and Management of Cash Balances, Debt, and Guarantees

This indicator assesses (i) the quality of debt recording and reporting; (ii) the extent of consolidation of the government's cash balances; and (iii) the systems for contracting loans and issuance of guarantees.

	Minimum Requirements (Scoring Method M2).	
PI-17 Recording and Management of Cash Balances, Debt, and Guarantees	2007	2013
	Score C	**Score B**
	(i) Score D	(i) Domestic and foreign debt records are complete, updated and reconciled on a monthly basis with data considered of high integrity. Comprehensive management and statistical reports (cover debt service, stock, and operations) are produced at least quarterly. Score A
	(ii) Score B	(ii) Most cash balances calculated and consolidated at least weekly, but some extra budgetary funds remain outside the arrangement. Score B
	(iii) Score C	(iii) Central government's contracting of loans and issuance of guarantees are always approved by a single responsible government entity, but are not decided on the basis of clear guidelines, criteria, or overall ceilings. Score C

Dimension (i) quality of debt data recording and reporting

The Cash and General Debt Department (CGDD) under the Accountant General is responsible for managing domestic and external debt. At the time of the assessment, 93 external loans and 45 domestic loans were under management by CGDD. The department was formed in 2009 after the Ministry of Finance's relocation from Gaza. Since then, the CGDD has built up a record of historical debt by taking the information from past budgets and then contacting lending agencies to obtain loan agreements, records of which had been lost or destroyed. The department maintains a debt database on Excel software which details term, principle, and interest, as well as source of loans, based on these two sources of

[84] Indicator PI-27 (iv) (not rated here) deals with virement which is covered by Article 54 of the Financial Regulations.

information. Once the CGDD receives confirmation of an agreement from a lending agency, it revises the figures in the spreadsheet and only then inputs the information into the IFMIS. The IFMIS contains only debt from verified agreements.[85] The CGDD manages all new loans. The department produces monthly reports detailing the stock of debt (see PI-6, element 4) and repayments of principle and interest, both in NIS and USD. Foreign loans are broken down by lender. Domestic loans are classified by short- and long-term bank loans and overdrafts. The CGDD also operates accrual accounts for its loan and repayments and can track nonpayments when they occur, thus recoding arrears on principle and interest.

Dimension (ii) extent of consolidation of the government's cash balances

There are three main Treasury Accounts (TA): (i) Clearance Revenue Account with the Arab Bank; (ii) a Donor Fund Account with the Arab Bank; and (iii) an account with the Bank of Palestine catering to domestic revenues and expenditures. Salaries are typically paid from the Clearance Revenue Account (subject to availability of funds). There are two other revenue receiving accounts: (i) Jordanian Bank for transportation fees and (ii) Cairo Jordan Bank for taxes paid by telecommunications companies. Revenues received into these two accounts are transferred daily to the TA in the Bank of Palestine. In addition the Petroleum Authority (a General Directorate of the Ministry of Finance) also holds accounts in banks to facilitate its operations.

Each TA has subaccounts which are consolidated each day to ensure zero balances in the subaccounts (of each TA). All accounts are managed online and a daily cash report is produced. Transfers are made between accounts in the Bank of Palestine and the Clearance Account in the Arab Bank to minimize overdraft on a daily basis. However, the Donor Fund Account in the Arab Bank remains outside the consolidation arrangement with the two other main TAs as do the accounts managed and maintained by the Petroleum Authority. These follow the same regime as the other TAs with respect to consolidation and reporting for the Petroleum Authority.

Dimension (iii) systems for contracting loans and issuance of guarantees

Both the regulations governing the 1998 Law on Finance and the 2005 Debt Law assign the power to contract loans and issue guarantees to the Minister of Finance only, by attribution from the cabinet to the Minister of Finance. The 2005 Debt Law stipulates that total stock of debt (domestic and foreign) cannot be greater than 40 percent of GDP. The General Debt Department negotiates loans taking account of competing lenders' conditions including term, grace period, interest, and currency of the loan, as well as the respect of the 40 percent ceiling (not reached yet). The most favorable loan is recommended to the minister in a report. In practice, some irregularities with these arrangements have been highlighted by the SAACB audit report for the 2010 financial statements relating to the regulation in the annual budget law which disallows any short-term borrowing in excess of the previous year's level. This has still been the case in 2011 and 2012 where short-term borrowing has exceeded the previous year's level.

Compared to the 2007 PEFA, there has been significant improvement in this indicator both in the score [dimension (i)] and quality. While the score has not improved for dimension (ii), there has been reduction

[85] The Audit Report on the 2010 Financial Statement commented that not all debt was accounted for (loans from Spain, Sweden, and Greece). Since then loans from Spain have been verified and loans from Sweden and Greece have been verified and written off. GCDD indicates that the only loans not verified and outside IFMIS are from China, but are included in the spreadsheet and the monthly reports.

in the number of bank accounts, and for dimension (iii), fiscal rules have been adopted albeit not always followed.

PI-18 Effectiveness of Payroll Controls

	Minimum Requirements (Scoring Method M2).	
PI-18 Effectiveness of Payroll Controls	2007	2013
	Score C+ (i) Score C (ii) Score B (iii) Score C (iv) Score C	**B+** (i) Personnel data and payroll data are not directly linked, but the payroll is supported by full documentation for all changes made to personnel records each month and checked against the previous month's payroll data. Score B. (ii) Up to three months' delay occurs in updating of changes to the personnel records and payroll, but affects only a minority of changes. Retroactive adjustments are made occasionally. Score B (iii) Authority and basis for changes to personnel records and the payroll are clear. Score A. (iv) A payroll audit covering all central government entities has been conducted at least once in the last three years (whether in stages or as a single exercise). Score B.

Dimension (i) degree of integration and reconciliation between personnel records and payroll data

The payroll is centralized and unified at the Ministry of Finance and covers the whole set of staff employed in civil services and security forces. The staff registered amounts approximately to 150,000, of which 65,000 are in the security forces.[86] The payroll system is fully computerized and allows for editing of paystubs. It is managed by the Payroll Directorate which comprises some 40 staff, of which a dozen are assigned with audit and control tasks. The payroll software has been developed by a local IT company on an Oracle-based platform. All salaries are paid by bank account and it is forbidden to pay salaries over the counter to any employees. The general personnel database which provides a list of civil staff (in all budget entities listed in the annual budget law) and which underpins the monthly payroll calculation by the Payroll Department above is held by the General Personnel Council (GPC), an independent entity from the Ministry of Finance linked to the cabinet. The database for security forces is held separately at the Ministry of Interior. The GPC database is also fully computerized as part of a human resources IT system developed in recent years; however, it is not integrated with the payroll IT system held at the Ministry of Finance. The same situation prevails for the database at the Ministry of Interior (MoI). As a result, there is no direct link or IT interface between both systems at MoF and GPC and MoI, but rather an indirect link through exchange of files in a proper format (Excel-like spreadsheet and PDF). The maintenance of the personnel database is made on a monthly basis. Any change in the situation of the staff impacting the payroll (death, illness, promotion, etc.) is supported by paper-based documentation

[86] Feb. 2013: 153,643.

sent to the Ministry of Finance by the GPC (or the line ministry based on a delegation of authority given by the GPC) and the MoI. These data are controlled and preaudited by the Payroll Directorate at the Ministry of Finance before being entered into the payroll system for payment. Data are also postaudited later on. These changes made on a monthly basis and checked against the previous month's payroll data ensure good data consistency. An important improvement took place in 2011 and 2012 to ensure this consistency.

Dimension (ii) timeliness of changes to personnel records and the payroll

The Ministry of Finance (Payroll Directorate) receives requests for changing the situation of staff and register them into the payroll system up to the closure date (twenty-eighth day of the month). Change requests are primarily made by line ministries and first sent to the GPC (or MoI); this latter forward them to MoF after registration in its own personnel database. As a result, changes made in the payroll system by MoF are deemed to be routinely cleared and preaudited by the GPC, avoiding errors that could result from a direct link between line ministries and MoF. All exchanges of documents are made manually through PDF scanned documents[87] since there is no interface between both IT systems at MoF and GPC (or MoI) as outlined in (i). While changes are made on a monthly basis, some of these changes reflect changes made during previous months. The delay between a legal change (e.g., a death, a promotion, etc.) and its reflection in the payroll occurs usually the next month after it is registered in the database, but cumulative delays occurring in the transmission between line ministry, GPC or MoI, and MoF, may reach three months. Nonetheless, retroactive adjustments are made occasionally (less than 2 percent).[88]

Dimension (iii) internal controls of changes to personnel records and the payroll

The Ministry of Finance (Payroll Directorate) accepts changes in the payroll only after these changes have been preaudited and controlled through the network of the administrative controllers and financial controllers (MoF affiliated) and then cleared by the GPC or MoI. The Payroll Directorate at MoF also controls the legal compliance of these changes on a desk review basis by its control and audit teams before registering them in the payroll. The traceability of all the related documentation is ensured for further audit.

Dimension (iv) existence of payroll audits to identify control weaknesses and/or ghost workers

In 2010, it does not appear that a general internal audit of the payroll was operated by the Internal Audit Unit. In 2011, the Internal Audit Unit launched a general audit of the payroll (civil and security forces), with a main objective of identifying ghost workers and control procedures' weaknesses related to data entry and calculations.[89] In 2012, the GPC also launched a general review of the staff payroll in order to identify ghost workers. The Auditor General (SAACB) has launched in 2013 a general audit on payroll with a view to release a report in the second half of 2013.

There is improvement between 2007 and 2013 on most subindicators except the second which is rated B in both years (a good score). Improvements for subindicators are due to: (i) shorter period for reconciliation of data (three months instead of six months in 2007); (iii) additional control in 2013 by financial controllers newly established and the GPC; and (iv) first internal audit on payroll performed in 2011.

[87] In order to avoid any change on its content.
[88] Data provided by the Payroll Directorate at MoF on the basis of 2012 payroll statistics.
[89] The 2011 audit report did not evidence ghost workers.

PI-19 Transparency, Competition and Complaints Mechanisms in Procurement

This indicator measures the transparency, competition, and compliant mechanisms in procurement.

Dimensions to be assessed are:
(i) Transparency, comprehensiveness, and competition in the legal and regulatory framework
(ii) Use of competitive procurement methods
(iii) Public access to complete, reliable, and timely procurement information
(iv) Existence of an independent administrative procurement complaints system

	Minimum Requirements (Scoring Method: M2)	
	2007	2013
PI-19 Transparency, Competition and Complaints Mechanisms in Procurement	Not assessed	**Score C+** (i) The legal and regulatory framework for procurement meets all six of the listed requirements. Score A (ii) For at least 80 percent of the value of contracts awarded by methods other than open competition, they are justified in accordance with the legal requirements. Score B (iii) At least two of the key procurement information elements are complete and reliable for government units representing 50 percent of procurement operations (by value) and made available to the public through appropriate means. Score C (iv) There is no independent procurement complaints review body. Score D

Dimension (i) transparency, comprehensiveness, and competition in the legal and regulatory framework

The first dimension of the indicator refers to the legal and regulatory framework under the new 2011 law. The current procurement environment in West Bank and Gaza is undergoing comprehensive reform. A new procurement law was enacted in December 2011 and derived regulations were finalized in 2013. The law creates an independent High Council for Public Procurement to oversee this legal and regulatory framework, as well as the awarding process of contracts. It important to note that: (i) the implementation of this new legal and regulatory framework was underway at the time of the assessment; and (ii) statistics on procurement have not been developed until recently and no historical data exist, making the PEFA assessment more difficult.

This dimension is measured according to the following requirements:

Framework Requirement	Met/ Not Met	Comment
(i) The legal and regulatory framework for procurement is organized hierarchically and precedence is clearly established.	Met	The new law is viewed so as to reflect a balance between the current means of the country and internationally accepted principles and practices. It lays down an acceptable institutional and organizational setup for public procurement, provides comprehensive provisions on procedural matters, and sets out provisions on transparency and accountability.
(ii) The legal and regulatory framework for procurement is freely and easily accessible to the public through appropriate means.	Met	The new law was published in the National Gazette of December 25, 2011.
(iii) The legal and regulatory framework for procurement applies to all procurement undertaken using government funds.	Met	The new law is applicable to all procuring activities (works, supplies, services) and all procuring entities using public expenditures.
(iv) The legal and regulatory framework for procurement make open competitive procurement the default method of procurement and define clearly the situations in which other methods can be used and how this is to be justified.	Met	Under the new law, there is an explicit requirement that open competitive bidding is the default method; there is also a clear definition of the permissible procurement methods which specifies the monetary thresholds and conditions for the use of each method.
(v) The legal and regulatory framework for procurement provide for public access to all of the following procurement information: government procurement plans, bidding opportunities, contract awards, and data on resolution of procurement complaints.	Met	Under the new enacted law, it is a requirement to prepare annual public procurement plans of the different procuring entities in accordance with the Annual General Budget and update these plans periodically. Bidding opportunities and contract awards will be published. The new law establishes a complaint mechanism and a dispute review body and will be elaborated in the regulation.
(vi) The legal and regulatory framework for procurement provide for an independent administrative procurement review process for handling procurement complaints by participants prior to contract signature.	Met	The regulatory framework under development provides for an independent review mechanism of all formally compliant complaints coming from the bidders and also for a standstill period after the announcement of the winning bidder. The new regulations clearly state the complaints mechanism, settlement of contract implementation disputes, data collection and publication of information and reports on public procurement.

Dimension (ii) use of competitive procurement methods

Regarding competitive procurement methods, according to the Palestinian Authority, noncompetitive awarding procedures are in practice exceptional and justified in most cases, either for supplies or public works. No supporting statistics are available to ascertain the ratio of such practices compared with the value of total contracts awarded. However, all convergent analysis and evidence were gathered during the assessment with the various operators in the procurement field, including at line ministry level, to assess the amount of such contracts as a marginal part of the total value of the awarded contracts. For public works, the authorities acknowledged that during the period 2010–2012, only two contracts were awarded on a single source basis (one at the Ministry of Public Works and another at the Public Water Authority) and justified on the basis of exceptions under the previous regime.[90] In addition, noncompetitive awarding decisions were always sent for prior approval to the High Tender Committee at the Ministry of Public Works and approved by the Council of Ministers. On supplies, competitive procedures seem to be always applied in practice. On this basis, the subindicator is scored B.

Dimension (iii) public access to complete, reliable, and timely procurement information. Key procurement information (government procurement plans, bidding opportunities, contract awards, and data on resolution of procurement complaints) is made available to the public through appropriate means.

Public access to procurement information is measured against four main criteria: procurement plan, bidding opportunities, contract awards, and complaints.

While the new legal and regulatory framework is implemented, not all of its provisions were effective at the time of the assessment. The two main procurement entities within the government previously operating on procurement area, which are the Central Tenders Department (CTD) in Ministry of Public Works and Housing (MOPWH) and the General Supplies Department in Ministry of Finance were still operating. The fit with the four criteria above for each entity was as follows:

- For the general supplies department, there is a website www.gs.pmof.ps (e-platform) that provides information on bidding opportunities, simple database related to past procurement, contract awards; bidding documents can be downloaded (three criteria met since complaints mechanism criterion is not met);

- For the public works contracts, only bidding opportunities are publicly disclosed (only one criterion met).

Since there are no available statistics on value of procurement contracts awarded, the scoring of this subindicator is difficult. However, an estimation on the basis of two criteria (three for supply and one for

[90] Four conditions justify noncompetitive awarding procedure: only one bidder based on specific technicalities, requirements for further spare parts, extension of existing contracts, and emergency.

works) representing 50 percent of procurement operations (by value) is highly reliable and justifies a score C.[91]

Dimension (iv) existence of an independent administrative procurement complaint system

At the time of the assessment, the administrative procurement complaint system stated by the new procurement law was not effectively established. Therefore, current complaints continue temporarily to be addressed and handled by the Tender Committee. However, the latter has no competence to reform its own decision. As a consequence, the complaint is handled by a Judicial Court. The regulations to implement the new law will state the administrative procurement complaint mechanism.

PI-20 Effectiveness of Internal Controls for Nonsalary Expenditure

This indicator measures whether an effective internal control system is in place that is able to manage risks, incorporates an adequate set of controls, is widely understood and applied, and is only circumvented for genuine emergency reasons. It covers only nonsalary expenditure. It gives special attention to the effectiveness of expenditure commitment controls due to the importance of such controls for mastering the expenditure process and in particular avoiding the creation of arrears.

	Minimum Requirements (Scoring Method: M1)	
	Score 2007	Score 2013
PI-20 Effectiveness of Internal Controls for Nonsalary Expenditure	Score D+ (i) Score D (ii) Score B (iii) Score B	**Score D+** (i) Commitment control systems are generally lacking. Score D (ii) Other internal control rules and procedures consist of a basic set of rules for processing and recording transactions, which are understood by those directly involved in their application. Some rules and procedures may be excessive, while controls may be deficient in areas of minor importance. Score C (iii) Rules are complied with in a significant majority of transactions but use of simplified/emergency procedures in unjustified situations is an important concern. Score C

Dimension (i) effectiveness of expenditure commitment controls

The IFMIS is used on a routine basis to process budget expenditures. However, it does not include a clear step for entering and recording budget commitments.[92] It includes instead a step called "budget credit

[91] A score D would certainly not fit with the practice since it would mean that the government does not provide any procurement information to the public or that the system does not generate substantial and reliable coverage of information.

[92] Budget commitment is the stage corresponding usually to a budget authorization connected to entering a legal obligation (e.g., a contract) with a supplier/contractor or more generally a third party. A certification of budget commitment is usually required to

reservation" for reserving, prior to the incurrence of any legal obligation (e.g., a purchase order), a budget allocation, the amount of which corresponds to the estimated cost of the good or service or equipment.[93] This procedure does not fully equate to a commitment as it is less binding over the rest of the expenditure process: its recording is not mandatory, and it is not controlled by the financial controller. In practice, the procedure varies considerably according to the ministry and entity. Most line ministries do not apply this "budget credit reservation" because of some inherent constraints it implies over the rest of the expenditure process, such as the necessity to align these expenditures with the cash available further at payment stage. The mission understood that only the Ministry of Education uses this procedure of "budget credit reservation" on a routine basis. As a consequence, the vast amount of the expenditures are entered into the IFMIS at a later stage of the expenditure process,[94] i.e, after the issuance of the purchase order, the delivery of goods and services, and after receipt of invoice. Such procedures only ensure control over the payment when it falls due rather than when it is incurred or committed. The result is that the system can generate arrears: once the payment request is entered into the IFMIS and approved by the financial controller (called "Level Sign 2"), an arrear report is automatically generated if there is no cash available to process the disbursement. It is to be noted that some key line ministries control, to a certain extent, incurred expenditures by means of spreadsheets separately from the IFMIS for their own internal planning purposes. Hence, this information is not homogeneous nor is it consolidated by the MoF.

A new module for commitment control has been developed in the IFMIS at MoF's request. Implementing this module would represent an important step towards the strengthening of the expenditure process outlined above and would contribute to reducing the generation of arrears, or at least better monitor their accumulation. The new module has been developed in line with good practices, i.e., the stage of commitment becomes mandatory and binding over the rest of the expenditure management procedure. It is also important that the management rules underpinning the system are updated accordingly. As a consequence, this stage should be controlled by the financial controller as a main step of the budget control. It is unclear whether these amended rules have been effectively prepared and submitted to the cabinet.

Dimension (ii) comprehensiveness, relevance, and understanding of other internal controls

Other internal financial control procedures than the commitment controls are defined in the regulation issued under Article 67 of law No. 7 of 1998, regulating general budget and financial affairs. These other internal financial controls include two main operators as follows:

(a) Internal financial control units affiliated to the General Directorate for Administrative and Financial affairs in most line ministries. These units review the supporting documents of the expenditure before submission to the financial controller. According to the SAACB annual report for the year 2011, the quality of this control is unequal and in some entities lacking adequate guidelines. In some key ministries the procurement process is carefully checked. However, internal control procedures, beyond their objectives primarily aimed at compliance and accuracy, are not driven by a risk-based approach, or to

send a purchase order or formalize a contract in order to ensure that the delivery of the good or service will effectively be financed on a budget allocation available for that purpose.

[93] Called in the IFMIS "level budget request" or "budget credit reservation."

[94] Called in the IFMIS "Level Sign 1."

efficiency or performance. A Central Harmonization Unit was created in 2010 within the Ministry of Finance to help develop such an approach.[95] To date this task remains in its infancy.

(b) Internal financial control performed in line ministries by the Financial Controller affiliated to the Ministry of Finance. The network of the 82 financial controllers covers the activities of all line ministries under the authority of the General Financial Controller at the Ministry of Finance who monitors their work (permanent exchange of information, ad hoc meetings if needed, quarterly meetings). The Financial controllers perform control prior to the payment (before "Level Sign 2") by checking budget availability and completeness of all required supporting documents in conformity with the financial regulations. Financial controllers do not control commitments nor reservation of credits at an earlier stage (see assessment of dimension (i) above).

Hence, the internal control rules and procedures are limited to those for basic processing and recording transactions and do not constitute a comprehensive set of controls. The General Financial Controller has recently issued a circular summarizing the main roles, procedures, and responsibilities of financial controllers at line ministries, so that the control procedures for processing payments are well understood by the operators. Its implementation is underway and should improve the quality of control in 2013 and further.

Dimension (iii) degree of compliance with rules for processing and recording transactions

The review performed by the internal controller and the financial controller gives reasonable assurance on the regularity of the formal process of payment and compliance with the rules underpinning the expenditure (including procurement rules) although risks posed by the lack of commitment control cannot be mitigated. The practice of financial controllers referring cases of irregularity to the Financial Controller General at the MoF is an additional element for this assurance. In those cases where the Financial Controller General rejects a payment, decision is submitted to the cabinet by the Ministry of Finance. Statistically the rules appear to be complied with in a significant majority of cases. The rate of rejection by the Financial Controller network slightly decreased from 16.7 percent in 2011 to 14.8 percent in 2012. No figure could be given to the mission on the number of cases submitted to the cabinet.

Financial controllers in line ministries send to the Financial Controller General quarterly reports, prioritizing the main issues (significant issues; important challenges; and statistics such as number of payments approved, number of payments rejected, and reasons). The Financial Controller General sends to the prime minister periodic reports on work performed and major issues raised.

Emergency or simplified procedures are usually examined by the internal and financial controllers, but sensible matters are referred to the cabinet through the General Financial Control. Quantitative information on these categories of control is not available and no specific approach has been defined to address them. This suggests that no policy has been defined yet for such cases and that the control is in practice mostly driven by the cabinet's instructions rather than by a systemic approach of the risks defined by the financial controller.

There is no evidence for improvement of the overall score since the PEFA 2007. As for subindicators (ii) and (iii) the score has been lowered from B to C, although there is no evidence of deterioration. This is

[95] And also to monitor internal audit network as described in PI 21.

clearly the result of an over rating in 2007 mostly due to a misinterpretation of the notion of commitment as defined by the PEFA methodology and international standards. The score also reflects the unequal quality of internal control performed in line-ministries and the risks posed by the absence of commitment control.

PI-21 Effectiveness of Internal Audit

This indicator measures the performance of the internal control system through an internal audit function. This function should meet international standards such as the standards issued by the Institute of Internal Auditors, in terms of (i) appropriate structure in particular with regard to professional independence, (ii) sufficient breadth of mandate, and (iii) use of professional audit methods including risk assessment techniques. The function should focus on systemic issues in relation to reliability and integrity of financial operations, effectiveness and efficiency of operations and compliance with laws and regulations.

	Minimum Requirements (Scoring Method: M1)	
	2007	2013
PI-21 Coverage and Quality of the Internal Audit Function	Score C[96]	**Score C+** (i) Internal audit is operational for the majority of central government entities and substantially meets professional standards; it is focused on systemic issues (at least 50 percent of staff time). Score B (ii) Reports are issued regularly for most government entities, but may not be submitted to the Ministry of Finance and the SAI. Score C (iii) A fair degree of action taken by many managers on major issues but often with delay. Score C

Dimension (i) coverage and quality of the internal audit function

The Internal Audit Department was created in 2004 within the MoF with the dual mandate to perform the internal audit function centrally at MoF and to initiate the decentralization of the internal audit function from the MoF to line ministries. In 2012, a Central Harmonization Unit (CHU) was established under the direct authority of the Ministry of Finance. The CHU is responsible for: (i) setting and updating the internal audit methodology; (ii) providing advice to the internal audit units in all ministries; and (iii) developing a quality control framework for the network. Currently headed by an acting director, the CHU is a unit of six staff assisted by four advisers seconded under the European Commission assistance program by an international advisory firm. Its charter conforms to the Institute of Internal Auditors (IIA) standards. It has produced a three-year strategic plan and an annual program for the audit network. The CHU's staff regularly visits the audit units in the line ministries and supervises the decentralization process to ensure that each line ministry has an effective internal audit function.

At present, 15 line ministries already have their own internal audit unit under the authority of the minister. This is currently being extended to nine ministries. The eight remaining ministries are audited by the audit

[96] No breakdown of the scoring available.

unit of the Ministry of Finance. The IIA standards have been customized to meet West Bank and Gaza needs, and a charter regulation (No. 11/2011) has been issued accordingly. The internal audit network has been governed by this charter since August 2011. The charter defines the scope of the internal audit, and clarifies its roles and responsibilities, independence, and its reporting requirements. The internal audit network has a total headcount of 180 staff. Around half of them have an accounting background, the other half being composed of specialists in each ministry, bringing their expertise to compliance audit tasks. On-the-job training has been carried out for the internal auditors.[97]

According to the CHU, the internal audit network covers approximately 80 percent of the total budget activities each year: 50 percent represented by the audit of the payroll expenditures, and 25 to 30 percent by the audit of the remaining expenditures (approximately half of these expenditures). In the Ministry of Finance, the internal audit unit covers every year the main five activities including revenues and expenditures (including salaries).

On the other hand, the CHU considers that more than 50 percent of the staff work focuses on systemic issues. The mission was provided with evidence of this ratio: the mission examined a sample of three main annual audit reports respectively on information system, payroll and hospitals, which effectively included systemic review for at least half of their findings and recommendations. These reports can be considered as representative of the whole program of internal auditing. The training program also focuses very much on systemic audits. However, as noted above (PI-20), since the internal control framework is not fully developed yet, there is room for increasing the systemic approach for identifying the risks. As a consequence, the internal audit will continue in the next few years to focus on some compliance and operational issues alongside the development of systemic audits.

Dimension (ii) frequency and distribution of reports

At present, internal audit reports issued at line ministry level are not sent directly to the CHU at the Ministry of Finance, but only upon its request. The Internal Audit regulations stipulate systematic transmission of these reports to the CHU. So far, no clear reporting mechanism is implemented.

In December 2012, the MoF and the Audit Bureau signed a Memorandum of Understanding. Following this agreement a joint committee composed of the Audit Bureau, the internal audit function, and the Department of Legal Affairs at the MoF was established in February 2013. The agreement grants to the Audit Bureau full access to the reports of the Internal Audit network. Practicalities of this agreement are to be finalized in mid-2013, and there is reasonable assurance of their implementation. However, at the time of the current PEFA assessment, the Audit Bureau was not provided automatically with the internal audit reports. These reports were sent only on request. Overall cooperation is improving, in particular with the participation of the SAACB to the Audit Committee [see (iii) below].

Dimension (iii) extent of management response to internal audit findings

According to the CHU, there is increased attention paid to the internal audit reports by most government entities: in 2011 and 2012 around 75 percent of the recommendations were accepted and 30 percent

[97] There are 16 full-time and six occasional trainers supported and guided by four international experts who perform training. Training represents 20 to 30 percent of the staff time and even up to 50 percent in the audit units in the process of being decentralized.

implemented. However, there were delays in implementing a number of recommendations at some line ministries due to weak decision-making processes and insufficient readiness and resources to make the changes. Recently, an independent internal Audit Committee, reporting to the Ministry of Finance, has been formed in order to monitor the implementation of the recommendations of the internal audit network.[98] This committee has not issued an activity report so far.

There is an improvement in the score between the PEFA 2007 and 2013. This improvement could have been reflected more clearly in the rating 2013 if the 2007 score, based on projections at the time, had not been clearly overestimated. Progress has been achieved in the organization and work of the internal audit function. However a clear reporting mechanism for reporting and follow-up of the recommendations is still lacking.

Budget Cycle – C (iii) Accounting, Recording, and Reporting

PI-22 Timeliness and Regularity of Accounts Reconciliation

This indicator measures timeliness and frequency of reconciliation of data from different sources, as it is a fundamental component of data reliability. Two critical types of reconciliation are (i) reconciliation of accounting data with bank accounts, and (ii) clearing and reconciliation of suspense accounts and advances.

	Minimum Requirements (Scoring Method M2)	
	2007	2013
PI -22 Timeliness and Regularity of Accounts Reconciliation	Score C (i) C (ii) C	**Score B** (i) Bank reconciliations for all bank accounts take place at least monthly, usually within four weeks from end of month. Score B (ii) Not applicable; no score.

Dimension (i) regularity of bank reconciliations

Reconciliations on expenditures are performed at the level of the 51 budgetary entities. Each of the 51 budgetary entities has a zero-balance account open at the Bank of Palestine; they are managed by the treasury through the IFMIS. The budgetary entities' payments are transacted electronically. These entities perform reconciliations and send a detailed report to the Ministry of Finance (General Directorate for General Accounting) who monitors the reconciliation process of each entity and ensures that all differences are cleared or explained. Donors' funds held at the Bank of Palestine are reconciled following the same procedures. Previous delays of bank reconciliations for accounts of the Palestinian Water Authority and the Petroleum Authority held in commercial banks have been solved in 2013. However, some donors' funds also held in commercial banks are not centralized at the Bank of Palestine and reconciliations may not be performed in a timely manner and not at aggregate and detailed levels.

[98] The Committee comprises of three independent experts and the Director of the CHU; a representative of the Audit Bureau is invited to attend its sessions.

Reconciliations on revenues are performed at the Ministry of Finance, Directorate General for General Accounting. Accounts are open at the Arab Bank for clearance revenues and Bank of Palestine for general revenues and donors' contributions. This unit performs also the reconciliations for the account open by the Ministry of Finance with the Bank of Jordan.

Dimension (ii) regularity of reconciliations and clearance of suspense accounts and advances[99]

Four suspense accounts were opened in 2010 to receive funds from donors, out of which three accounts are still maintained in US dollars amounting to $1.1 million, and one account is maintained in New Israeli Shekels amounting to NIS 66,442. They remained uncleared because they are donor restricted, and there is no guidance from the respective donors on how to utilize these funds. These suspense account balances were carried forward to 2011 and 2012. No further uncleared suspense account has been registered in 2011 and 2012. These suspense accounts involve very small amounts of funds and no further uncleared suspense accounts were registered in 2011 and 2012.

Regarding advances, the rationale for not rating the subindicator is as follows.

The terminology and mechanism of "advance" in the Palestinian PFM system are misleading with respect to the internationally recognized definition.[100] Historically, such confusion derives from the particular development of the PFM system since early 2000. Initially, all expenditures were initiated by line ministries but operated and paid by the MoF. The concern at the time was that any expense was expected to be reversible until the transaction was completed and fully cleared by the MoF. This is the reason why the expenditure cycle was operated on an advance pattern (though the concept was not really compliant with the true definition of an advance). In the wake of the development of the IFMIS (2007) and the TSA (2009), the expenditure process was gradually devolved to line ministries. However, the MoF largely replicated this ad hoc mechanism of advance in the IFMIS in spite of the assurance granted to the MoF by this new IT system and also by the TSA with regard to the use of the funds for their intended purposes.

This procedure initially applied to all kinds of expenditures and not only to those that are usually treated as advances: staff travel expenses and medical referral expenses. Since then, the MoF has deeply reformed the procedures underpinning the management of these two main categories of expenditures: (i) the procedure for staff travel initially based on a temporary advance for further regularization on a real basis was recently replaced by a definitive payment procedure (similar to an allowance and much less cumbersome) on a per diem basis; (ii) the advances for medical referrals for health care abroad were replaced by direct payment to the hospitals instead of payment to the beneficiaries. Additionally, grants to NGOs mistakenly classified as advances are in fact to be considered as conditional transfers.

However, the current IFMIS keeps operating these three categories under an ad hoc advance-based routine and coding while in reality it consists of real budget expenditures. The terminology "advances" mistakenly applied to these expenditures brings more confusion.

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[99] Regarding advances, the mission considers that the related subindicator (ii) is not applicable to the current system. As a result, this subindicator is not rated and the whole indicator is rated only on the basis of its first subindicator (i).

[100] An advance is a temporary expense to a beneficiary which has to be repaid at a due date agreed between the ministry and the payee. The advance is not financed on a budgetary allocation "above the line," but rather on a cash resource "below the line." At the beginning and the end of the fiscal year, the related advance account is balanced with no impact on the budget result, as opposed to a definitive budget expenditure which is financed on a budget allocation and impacts the budget result.

At present, they are no more advances, as defined by international accounting practices, in WBG. As a consequence, the PEFA methodology for assessing the practices of advances (second dimension) is not relevant.

It is important to note that there is still a stock of uncleared advances carried over the last years under the previous procedures (estimated at around half a million shekels), most of them corresponding by and large to the true concept of advance. These must be now considered as arrears and as such are reviewed by the indicator PI-4. No uncleared advances have been inventoried since the reforms above have been implemented.[101]

The variation in the overall score between the PEFA 2007 and 2013 is not relevant since procedures have completely changed since 2007. However dimension (i) related to bank reconciliation has improved (from C to B) due to the improvements in the regularity of the process and the support of the IFMIS and the TSA.

PI-23 Availability of Information on Resources Received by Service Delivery Units

This indicator measures whether the government's financial system is capable of tracking the allocation of resources to front line service delivery units (primary schools, primary health clinics, etc.) to provide for basic services. Collecting and processing of such information can inform decision makers about how the PFM system is capable of supporting basic services in relation to the overall resources made available to the sector(s).

In the Palestinian context, no comprehensive data collection on resources to service delivery units in the observed sectors has been conducted within the last three years.

	Minimum Requirements (Scoring Method M1)	
PI-23 Availability of Information on Resources Received by Service Delivery Units	2007	2013
	Score D	**Score D** No comprehensive data collection on resources to service delivery units in any major sector has been collected and processed within the last three years.

Recording of resource flows to front line service delivery units is not consolidated within and between different institutions and different operational levels within the institutions. Hence, the current system does not allow for comprehensive data collection at the level of front line service delivery units.

A breakdown of resource flows to schools illustrates the difficulty of compiling comprehensive data:

- Governmental schools and the Ministry of Education's District Directorates have the full record on school revenues (e.g., school fees, cafeteria revenues, etc.), expenses related to general supplies, and bank/cash balance for each individual school. The information is then processed into the IFMIS by item and program only. Thus, upon entry into the IFMIS, the system no longer allows disaggregation of data by school.

[101] Under the new regime, conditional expenditures not achieved or implemented for non-intended purposes are systematically cleared through reimbursements to the budget by the beneficiaries. In some cases, when per diem for staff missions are not used, a deduction in salary is operated.

- Utility bills (water, electricity, and telephone) are paid centrally by the Ministry of Education. Schools do not have a record of utility bills.
- Teacher and support staff salaries are paid centrally by the government. The schools do not have a record.
- Infrastructure works (construction, repairs, etc.) could be conducted by the municipality, by a donor-funded project, or by cash and in-kind contributions from the local community. Each mechanism would entail different contracting modalities, but none would directly involve the school.

The provision of information on resource flows to primary health centers is very similar, except that supplies provided by the Ministry of Health's District Directorate are not captured on a monetized basis, but rather on an itemized basis.

A broad range of countries struggle with tracking the allocation of government funding to primary service delivery units. Some countries, like Serbia, have resolved this issue by modifying their financial information systems and policies to capture such data on a routine basis, while others have conducted special surveys. In late 2010, supported by a donor agency, a study on the health and education efficiency in the West Bank was conducted. This study assesses the costs of health and education services by patient and pupil, respectively, and thus does not meet the PEFA criteria of assessing overall resources received by health center or school.

Compared to the 2007 PEFA (score D), there was no evolution related to the availability of information on resources received by service delivery units.

PI-24 Quality and Timeliness of In-Year Budget Reports

This indicator measures the ability to issue timely and regular information on actual budget performance to monitor performance and, if needed, to identify actions to get back on track. Coverage at both commitment and payment levels is important for monitoring budget implementation and utilization of funds.

	Minimum Requirements (Scoring Method: M1)	
PI-24 Quality and Timeliness of In-Year Budget Reports	2007	2013
	Score B (i) B (ii) B (iii) B	**Score C+** (i) Comparison to budget is possible only for main administrative headings. Expenditure is captured only at payment stage. Score C (ii) Reports are prepared quarterly or more frequently and issued within four weeks of end of the period. Score A (iii) There are some concerns about the accuracy of the information which may not always be highlighted in the reports, but this does not fundamentally undermine their basic usefulness. Score C

Dimension (i) scope of reports in terms of coverage and compatibility with budget estimates

The monthly reports issued by the Ministry of Finance (Directorate for Financial Reporting) are presented according to GFS1986. They are published on the MoF public website. Data are directly compiled from the IFMIS. The reports allow direct and detailed comparison to the original approved budget. They include quarterly and yearly recapitulations.

The monthly reports are deemed to present the expenditure on commitment and cash basis. However, the data produced in the monthly reports on commitment are extracted from the IFMIS ("Level Sign 2") and do not correspond to the proper concept of commitment as outlined above (see indicators PI-4 and PI-20). The result is that the information produced on a commitment basis by the monthly reports is not comprehensive. It will be comprehensive only once an adequate commitment module in the IFMIS is made operational and mandatory for all budget entities and all categories of expenditures.[102]

The presentation of revenues on commitment basis is however much more in line with international practices.

The tables of the monthly reports are related to:

- Comparison of the actual and budgeted expenditures
- Expenditure of the 51 budget entities of the PA presented by economic classification
- Revenue at the level of commitment and payment. At commitment level, revenue includes the clearance revenue as due and the tax refunds as expected.
- External financing received from donors
- Stock of debt to banks

The Ministry of Finance (Macro Fiscal Unit) also issues quarterly and annual reports under the GFMS 2001 format.

Dimension (ii) timeliness of the issue of reports

Reports are prepared monthly and issued 15 days after the end of the month. This timetable is fully respected, except a delay of a few days that may happen at year end.

Dimension (iii) quality of information

The payment stage information produced in the reports is considered to be largely accurate, since it is directly extracted from the IFMIS. It shows a significant improvement to previous practice. However, as noted above (i), the data on commitments lack accuracy and comprehensiveness. Changes in the budget classification are explained. Mention is also made of the supplementary budgets or adjustments to the initial budget.

Information included in MFU reports is coherent with the in-year reporting issued by the Directorate of Financial Reporting; MFU reports include comments on the evolution of the major items. However they exclusively present the expenditure at commitment level, which as outlined above, covers only the

[102] Except possibly on wages and salaries for which many countries do not apply commitment.

expenditure entered in the IFMIS ("Level Sign 2") and does not cover those already incurred (committed) but not yet entered in the IFMIS.

The variation of score between the 2007 PEFA (B) and the current report (C+) is mostly due to the fact that an inadequate definition of commitment was taken into account in 2007 to assess dimensions (i) and (iii). If a more accurate definition of commitment had been applied in 2007, these two dimensions would have scored C, at most. However, due to the improvement in the time allotted for issuing the reports, the score for dimension (ii) has improved.

PI-25 Quality and Timeliness of Annual Financial Statements

This indicator measures the capacity to produce consolidated year-end financial statements dealing with all transactions, assets, and liabilities in a transparent and consistent manner, which is critical for transparency in the PFM system. The financial statements shall be produced in a timely fashion and abide by financial reporting standards aligned with international standards such as the IFAC's International Public Sector Accounting Standards (IPSAS).

	Minimum Requirements (Scoring Method: M1)	
PI-25 Quality and Timeliness of Annual Financial Statements	2007	2013
	Score D+ (i) Score D (ii) Score C (iii) Score C	**Score C** (i) A consolidated government statement is prepared annually. Information on revenue, expenditure, and bank accounts balances may not always be complete, but the omissions are not significant. Score C (ii) The statements are submitted for external audit within 15 months of the end of fiscal year. Score C (iii) Statements are presented in consistent format over time with some disclosure of accounting standards. Score C

Dimension (i) completeness of financial statements

The Consolidated Financial Statements for 2010 provide information on cash basis of the revenue, expenditure, and cash availability of the central government. The consolidation of the financial statements is processed by the IFMIS and controlled by the Accountant General. The financial statements do not include information on financial assets (nor on nonfinancial assets), since they are presented according to the cash basis IPSAS [see (iii) below]. They provide only partial information on financial liabilities, including the stock of loans and overdrafts from banks, at the beginning and at the end of the year. Also, the financial statements do not provide explanations on the variance between the original budget and the final budget and the variance between the budget and actual spending. No information on arrears is provided.

Dimension (ii) timeliness of submission of the financial statements

The Ministry of Finance is required by law to produce Consolidated Financial Statements within a year of close of the fiscal year, whereas according to the cash IPSAS, an entity should be in a position to issue financial statements within six months. The last financial statements issued at the time of the mission were for fiscal 2010. These financial statements were submitted for external audit on January 23, 2012 after the SAACB had issued its opinion on the financial statements for 2009 (issued in September 2011) in order to adjust the 2010 opening balance.[103] At the request of the SAACB, the MoF issued three successive versions of the financial statements during the examination period because some adjustments requested by the SAACB were not made. Overall, the financial statements were submitted to the SAACB for external audit 13 months after the end of the fiscal year 2010.

Dimension (iii) accounting standard used

The financial statements for 2010 present the consolidated cash receipts, cash payments, and cash balances under an appropriate subclassification, and have been produced based on the information collected in the Bisan financial reporting system. They have been prepared according to the cash basis IPSAS. However, IPSAS have not been completely applied, as noted by the SAACB in its 2010 qualified opinion. The financial statements do not adhere to several standards detailed in the cash basis IPSAS and lack certain useful information and/or explanations. Nevertheless, there is consistency over time in the implementation of standards and improvements have been introduced in the preparation of the financial statements for 2011.

For some of the misstatements, the MoF indicated that, since the SAACB has issued its opinion, it has already completed the accounts or improved the accounting methodology regarding:

- Disclosure of undrawn foreign loans and undrawn foreign external assistance as required by cash basis IPSAS standards 1.4.9. and 1.10.18.
- Treatment of unrealized exchange gains or losses complying with standard 1.7.8.

Some other deficiencies should be easily mitigated in the future if the MoF develops explanations and comments in the notes, in particular:

- The comparison between the budget and the actual expenditure has not been accompanied by comments as required by standard 1.9.17.
- The comparison between initial budget and final budget was only presented at an aggregate level, without any explanation or comment, contrary to the requirement of standard 1.9.23.
- Changes of classification have not been accompanied by appropriate mapping tables in order to ensure comparability, or at least by explanations of the reasons for not reclassifying and the nature of the changes that would have been made if amounts were reclassified, as required by standard 1.4.19.

Other deficiencies or omissions reflect weaknesses already mentioned under other indicators that the MoF should address by improving accounting policies and procedures:

[103] The MoF follows a policy of only issuing the financial statements once the Audit Bureau has issued its opinion on the previous year accounts, which is not usual practice elsewhere.

- Payables, such as payables to contractors and vendors that are not recognized in the financial statements under cash basis standard, are not separately disclosed as required by standard 1.3.10 accounting of advances and arrears.
- Thus significant progress can be expected in the production of the financial statements for the year 2011, the cash basis IPSAS being applied in a consistent manner with improvements already stated in those for 2010.

Score improvement between PEFA 2007 and 2013 (from D+ to C) is explained by the progress in the completeness of the consolidated financial statements dimension (i). However dimensions (ii) and (iii) do not justify an increase in the 2007 score despite some progress in the delay of issuance and the improvements already achieved and expected in the implementation of IPSAS cash based standards.

Budget Cycle – C (iv) External Scrutiny and Audit

PI-26 Scope, Nature, and Follow-Up of the External Audit

This indicator measures the quality of external audits, which is an essential requirement for creating transparency in the use of public funds and furthermore contributes to the improvement of governance and sound financial management of the government bodies.

Key elements of the quality of the actual external audit comprise: (i) the scope of the audit, including the adherence to appropriate standards, the focus of the audits on significant and systemic issues in the PFM (including reliability of financial statements), functioning of the internal control systems, and some aspects of performance audit; (ii) the timeliness of production of audit work; and (iii) the effective follow-up of audit findings.

	Minimum Requirements (Scoring Method: M1)	
PI-26 Scope, Nature, and Follow-Up of External Audit	2007	2013
	Score D (i) Score D (ii) Score D (iii) Score D	**Score C+** (i) Central government entities representing at least 75 percent of total expenditures are audited annually, at least covering revenue and expenditures. A wide range of financial audits are performed and generally adhere to auditing standards, focusing on significant and systemic issues. Score B (ii) Audit reports are submitted to the legislature within twelve months of the end of the period covered and, in the case of the financial statements, from their receipt by the audit office. Score C (iii) A formal response is made, though delayed or not very thorough, but there is little evidence of any follow-up. Score C

Dimension (i) scope and nature of audit performed (including adherence to auditing standards)

The SAACB audits all of the 51 central and local government entities on a regular basis, at least annually for the audit of the financial statements at the consolidated level.[104] The SAACB audit plan is developed on a risk-based approach according to the priorities defined in its medium-term strategic plan. It takes into account the necessary flexibility needed by the circumstances and the specific audits the government may by law request from it. According to this audit plan, the SAACB audits individually each of the 51 budget entities once every three or four years at least. More frequent review of the most risky entities is conducted. The reports are basically compliance reports; however, some of them address thematic or significant systemic issues (like the status of water sewage in the country or the amalgamation of municipalities). Some elements of performance audit are introduced in a limited number of audit reports. The SAACB plans to further develop proper performance audit methodology.

In 2010, the SAACB issued 151 reports; in 2011, 156; and in 2012, 123. The major findings of these reports are summarized in the quarterly and annual SAACB reports.

The SAACB also issues an opinion on the financial statements of the Palestinian Authority, which in its structure and content conforms to the relevant INTOSAI standards. On the financial statements for 2010 it has issued a qualified opinion (see PI-25) dated December 31, 2012. This opinion relied on the financial and regularity audit of all responsibility centers that are directly included in the budget of the Palestinian Authority for the year 2010 as presented in the cash basis financial statements.[105]

Dimension (ii) timeliness of submission of audit reports to the legislature

This assessment of this dimension relates to two categories of audit reports: (i) activity reports (quarterly and annual), and (ii) annual audit report of financial statements.

Quarterly and annual activity reports are issued within the first quarter following the end of the period. These reports gather the main conclusions and recommendations of the SAACB's audit work separately from the opinion on the consolidated financial statements. The report for 2010 was issued on February 14, 2011, and the report for 2011 on April 2, 2012. These periodic activity reports are made public on the SAACB website.[106]

The final version of the Palestinian Authority's consolidated financial statements for the year ending December 31, 2010, were submitted to the SAACB 13 months following the year end, on January 23, 2012. Seven months later, in August 2012, the SAACB submitted its draft management letter to the Ministry of Finance, which sent its official response to the letter on December 2, 2012. Finally, the SAACB produced its qualified audit opinion on the financial statements on December 31, 2012, i.e, 11 months from January 23, 2012 to December 31, 2012, after reception (delay taken into account for scoring this dimension).

[104] In 2012, there were 51 budget entities.

[105] It also partially included Petroleum Authority accounts. The Petroleum Authority is an independent entity and should not be included in the PA financial statements. However, MoF incorrectly included Petroleum Authority's cash balances (only) in the opening and ending balances presented in the financial statements.

[106] A total of 17,011 visitors in 2012; 5,496 of them having consulted reports.

Dimension (iii) evidence of follow-up of audit recommendations

The follow-up to the audit reports is explicitly defined by the Audit Law Art. 36b: "audited ministries and entities shall answer within a month to observations issued by the Bureau." Out of the 123 audit reports issued by the SAACB in 2012, 83 have been answered within the legal period of one month. The remaining 40 have been or will be the subject of an agreement after discussions between the SAACB and the auditees. At present, according to the SAACB around 70 percent of the recommendations are accepted by the auditees and 30 percent implemented. Auditees acknowledge in writing the accepted recommendations and these correspondences are registered by SAACB's Archive Service. The relevant numbers are shown in the statistical part of SAACB's annual reports.

The bureau has recently issued a follow-up methodology for its recommendations. According to the introduction of this guide, "due to the absence of a Palestine Legislative Council role to follow up recommendations because of political conditions, the SAACB attempts to create a specific methodology to make sure that audited bodies apply and follow up recommendations." A major impediment to a smooth follow-up has been the difficult relations with the internal audit function. They have recently improved and further progress is thus expected.

In addition, as mentioned in indicator PI-21, the Memorandum of Understanding signed on December 12, 2012, between the SAACB and the MoF created a joint committee that should also improve the follow-up of the implementation of the SAACB's recommendations.

The improvement of the score between PEFA 2007 and 2013 from D to C+ covers all three components of the indicator since progress is noted in the nature and scope of the external audit and in the timeliness of issuance of the reports; the follow-up of recommendations is developing.

PI-27 Legislative Scrutiny of the Annual Budget Law

As indicated in Section 2, subsection 2.3, this indicator is not rated.

PI-28 Legislative Scrutiny of External Audit Report

As indicated in Section 2, subsection 2.3, this indicator is not rated.

Donor Practices

D-1 Predictability of Direct Budget Support

This indicator measures the correlation between forecasted direct budget support provided by external donors and actually disbursed budget support during the last three years. The indicator considers annual deviations of actual budget support from the forecast provided by donors; it also assesses the extent to which the disbursements of the budget support are predictable during the year on a quarterly basis.

	Minimum Requirements (Scoring Method M1).	
	2007	2013
D-1 Predictability of Direct Budget Support	Score D	**Score D+**
	(i) Score D	(i) In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than 5 percent. Score A
	(ii) Score D	(ii) The requirements for score C (or higher) are not met. (Score C: Quarterly disbursement estimates have been agreed upon with donors at or before the beginning of the fiscal year and actual disbursement delays [weighted] have not exceeded 50 percent in two of the last three years.) Score D

Dimension (i) annual deviation of actual direct budget support from the forecast provided by the donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature (or equivalent approving body)

Direct budget support disbursements, as shown in the table below, have not fallen short of the budget support forecast provided by donors during the three years 2010–2012. Instead, the outturn exceeded the forecasted amounts by 20.1 percent, 6.7 percent, and 28.7 percent in 2010, 2011, and 2012, respectively.

The table incidentally shows that the budget support budgeted by the Palestinian Authority during the period was well above the donors' forecasts by 30.4 percent, 35.6 percent, and 56.2 percent in 2010, 2011, and 2012, respectively.

Table 6 Variations in Direct Budget Support by Donors (in USD Million)

	Donor Forecast Provided by Donors	Actual Disbursements	Deviation of Actual Budget Support from Donor Forecast	Budget Support Budgeted
2010	953	1,145	**20.1 percent**	1,243

2011	713	761*	**6.7 percent**	967
2012	642	826*	**28.7 percent**	1,003

**Note: A payment that was disbursed in early 2012 was earmarked for expenses occurred in 2011. On that basis budget support for 2011 amounted to $814 million and budget support for 2012 to $775 million, thereby indicating a steady decline in budget support.*

However, information about these forecasts was not necessarily provided in a timely manner[107] to the government during the period 2010–2012 and monthly forecasts for the full amount of forecasted budget support were only provided in 2012. More importantly, disbursement estimates do not agree due to the absence of a systematic ex-ante forecasting and registration process.

It is worth noting that the forecasts for budget support provided by donors mentioned in the table above are those that were facilitated by the IMF on the basis of publicly available information (publicized budget support announced by donors) and by feedback provided directly from donors (this process is co-facilitated by the Local Aid Coordination Secretariat). The forecast includes all donors providing budget support.

Viewed in isolation, the assessment of this first dimension tends to indicate a satisfactory provision of budget support from donors, as actual disbursements are significantly above pledges. However, in absolute terms, actual budget support declined by 32 percent between 2010 and 2012, from $1,145 million to $775 million (taking into account the allocation of budget support towards fiscal years as explained in the table below). This decline in absolute terms was only partially reflected in the government's budget forecast (by up to 20 percent). The gap between the government's budget support forecast and actual budget support thus increased to some $200 million by 2012, thereby effectively blanking out a growing budget deficit.

There is little evidence suggesting that the budget support forecasts provided by the donors influenced the MoF's budgeting for external budget support during the period. On the contrary, it appears that the government's budget support forecast[108] reflects more the budget's recurrent deficit on a cash basis for each year, rather than expected budget support payments.[109] The calculations of this budget support only at the aggregate level also support this observation. As a result, the gap between the budget support forecast provided by donors and the MoF's own budgeted forecast is widening since actual budget support is decreasing.

According to the IMF, the process of registering budget support has improved for 2013 and the budget forecast is increasingly based on available information about forecasted budget support. The use of the MoPAD's aid information management system (DARP) by the donors could also help improve the predictability of the budget support forecasts.

[107] PEFA requires providing the donor forecast six weeks prior to the submission of the budget.

[108] "External financing for recurrent expenditure" is the PA's terminology for direct budget support.

[109] Very minor modifications were introduced for 2012, which did not, however, alter the overall equation whereby budgeted external support for recurrent expenditures equals the budgeted recurrent deficit.

Dimension (ii) in-year timeliness of donor disbursements (compliance with aggregate quarterly estimates)

The quality of in-year registration of budget support improved during the period 2010–2012. For 2010, monthly forecasts were provided within the overall budget support forecast compiled by the IMF for the first six months, while only aggregate figures per donor were provided for the remainder of the year. For 2011, monthly forecasts were provided for the entire year within the overall budget support forecast, but monthly data only covered some 31 percent of the total forecast (while the remaining 69 percent was provided on an annual basis only). For 2012, the entire forecast was disaggregated by donor and month, thereby significantly improving in-year predictability.

As mentioned under the first dimension, annual (and monthly) forecasts compiled by the IMF are not in line with the amounts budgeted (even when information was provided at least six weeks prior to the submission of the draft budget to the presidency). In practice, the budget support is being budgeted by the Ministry of Finance at an aggregate level (on an annual basis for all donors combined) and is mainly based on past support and discussions at the Ad Hoc Liaison Committee.

Compared to the 2007 PEFA, the forecasting of budget support by donors has improved significantly. In 2012, the complete forecast was for the first time available on a disaggregated basis by donor and month. Since there is no evidence, however, that the forecast is registered by the MoF, there is no basis for an agreed-upon quarterly disbursement plan.

D-2 Financial Information Provided by Donors for Budgeting and Reporting on Project and Program Aid

The indicator measures the extent to which government receives adequate financial information on donor executed programs and projects. Information received on a regular and timely basis is important to allow the government to properly allocate resources towards priorities, to balance the distribution of aid on a sectoral and geographic basis, and to estimate the recurrent cost implications.

	Minimum Requirements (Scoring Method M1).	
	2007	2013
D-2 Financial Information Provided by Donors for Budgeting and Reporting on Project and Program Aid	Score C (i) Score C (ii) Score C	**Score D** (i) Not all major donors provide budget estimates for disbursement of project aid at least for the government's coming fiscal year and at least three months prior to its start. Score D (ii) Donors do not provide quarterly reports within two months of end of quarter on disbursements made for at least 50 percent of externally financed project estimates in the budget. Score D

Donor reporting on programs and projects in West Bank and Gaza is inadequate. The provision of information to the government is neither comprehensive, nor detailed, nor timely, nor accurate. Neither the major five donors nor others provide annual budget estimates or comprehensive quarterly disbursement reports on programs and projects. Some donors are, however, unaware that such information was requested by the government.

Dimension (i) completeness and timeliness of budget estimates by donors for project support

Based on the OECD's 2011 disbursement data for development programs and projects in West Bank and Gaza, the five largest donors are United States, Germany, European Union institutions, United Kingdom, and Spain (see table below).[110]

Table 7: Disbursements for Development Programs and Projects (USD Million)

Donor	Disbursements for Development Programs and Projects
United States	291
Germany	115
European Union Institutions	91
United Kingdom	85
Spain	47

According to the MoPAD (which is in charge of aid management and coordination) and its aid information management system, DARP, donors do not provide complete and timely budget estimates for programs and projects. One major donor's technical assistance for developing the rule of law system (up to $100 million annually) is not reported to DARP, while another major donor last updated DARP in July 2011. Information provided to DARP encompasses mostly ongoing projects and rarely upcoming projects. The information provided to the system on disbursements and expected expenditures is not accurate, nor is it provided on a regular and timely basis. While MoPAD's assessment on donors' budget estimates were confirmed by some major donors (EU, U.K., and U.S.), some other major donors were not providing the government with budget estimates (sometimes due to a lack of communication with the MoPAD).

As a result, not all major project donors provided budget estimates for project disbursements for fiscal 2012.

Dimension (ii) frequency and coverage of reporting by donors on actual donor flows for project support

According to the MoPAD, the major donors do not provide quarterly disbursement reports for programs and projects. One major donor's official development assistance to rule of law (up to $100 million annually) is not reported at all to DARP, while another major donor last updated DARP in July 2011; the last time others updated DARP was in mid-2012.

[110] Detailed data on programs and projects is provided by all OECD donors on an annual basis, currently up to 2011; development programs and projects do not include budget support and humanitarian aid.

The picture provided by MoPAD on budget estimates was confirmed by major donors (EU, U.K., and U.S.). Some of them cited they were not aware that the government requested quarterly disbursement reports.

In conclusion, donors do not provide quarterly reports within two months of end of quarter on disbursements made for at least 50 percent of externally financed project estimates in the budget, which justifies the score D for this subindicator.

In PEFA 2007, the narrative provided for D-2 suggests a rating D (instead of C). From that perspective there is no tangible improvement in 2013.

D-3 Proportion of Aid That Is Managed by Use of National Procedures

Donor procedures frequently pose an additional burden on the already constrained capacities of national authorities. Furthermore, utilizing national procedures helps to strengthen these procedures. The indicator therefore attempts to assess the degree of alignment with national procedures in the management of official development assistance. National procedures are reviewed with respect to procurement, payment/accounting, audit, and reporting.

	Minimum Requirements (Scoring Method M1)	
D-3 Proportion of Aid That Is Managed by Use of National Procedures	2007	2013
	Score C	**Score D**. Less than 50 percent of aid funds to central government are managed through national procedures.

According to information provided by the three largest donors (who are also among the five largest project donors), significantly less than 50 percent of aid funds to central government are managed through national procedures. Earmarked budget support is also subject to donor supplemented auditing procedures, which also reduces the utilization of national systems.

Data are extremely difficult to gather since the total of aid for 2012 is not yet known.[111] However, an evaluation is possible on the basis of the following: the total aid disbursed in 2012 reported in the MoF in annual reports was approximately $900 million (this amount does not include aid unreported as outlined in indicator PI-7). On this basis most donor-financed projects ($150 million in fiscal 2012) are implemented according to specific rules defined by each donor. The World Bank's trust fund ($225 million in fiscal 2012) and the budget support provided by Arab donors ($267 million in fiscal 2012), which are the two main donors for budget support amounting to approximately 60 percent of the total budget support, are not following all national procedures. In addition, earmarked budget support is also subject to donor supplemented auditing procedures, thereby significantly reducing the use of national systems. Overall, it is estimated that at least 70 percent of reported aid (i.e., approximately $640 million out of $900 million) is not managed through national procedures, and for the remaining 30 percent, the implementation of national procedures is doubtful for the vast majority of the projects. In particular, it is

[111] PEFA assessment for this indicator is made on the basis of the latest competed fiscal year, 2012. Data will be provided with the upcoming OECD's aid statistics for development programs and projects for fiscal 2012.

ascertained that the national audit procedures are not implemented for any of them, and that the situation is mostly the same regarding national procedures for procurement. Any score above D would require that at least 50 percent of total aid funds should be managed through national procedures. These PEFA findings are in line with the findings of the Paris Declaration Monitoring Survey 2010 regarding the utilization of national implementation procedures.

According to the narrative provided for D-3 in 2007, there was no information available on D-3. The indicator should thus have been classified as "not rated" instead of C.

Section 4 – GOVERNMENT PFM REFORM PROCESS

A. Current Arrangements for PFM Reforms:[112]

The PA has defined its approach for PFM reform around three strategic objectives: (i) to develop the PA's own resources and reduce dependence on international aid; (ii) to create a transparent, accountable, and regulated financial system; and (iii) to achieve financial stability. These objectives have been worked out by the PA, the IMF, and the other relevant donors through a PFM Reform Framework agreed upon in 2009. It includes: (i) the legal and regulatory framework for PFM; (ii) budget integration reforms; (iii) PFM infrastructure reforms; and (iv) external accountability.

Progress with PFM reform identified by the current assessment reflects the findings of previous PFM reviews, in particular of the IMF. It includes:

- increased role of the MFU, in particular for issuing macroeconomic and fiscal projections;
- continued work on improving the program budgeting mechanism, although several issues remain to be addressed, particularly in terms of budget classification;
- budget and fiscal operations statements prepared on GFSM 2001 basis;
- improved detailed monthly statements reflecting the fiscal operations of government, although commitments' recording is not aligned with international standards;
- enactment in 2011 of the new Law on Procurement, although implementing regulations have not yet been issued;
- establishment of internal audit units in most ministries with MoF providing training and guidance through the Central Harmonization Unit, and;
- 2010 financial statements finalized in January 2012 and audited by the SAACB with several qualified opinions in December 2012.

Lack of noticeable achievements in some priority areas has also been highlighted. It includes:

[112] This section 4-A draws on some findings of the most recently available "PFM Progress Review" by the Middle East Regional Technical Assistance Center (METAC), IMF, January 2013.

- slow progress in updating the regulations related to budget execution, commitment control, and accounting procedures;
- insufficient move towards establishing a proper link between the annual budget process and the three-year national planning process;
- need for further improvement of donor coordination, in particular to inform more comprehensively and accurately the DARP database held at the MoPAD for all projects and programs, which are currently recorded only partially and are not integrated with the IFMIS;
- lack of progress in cash planning to address the current fiscal situation and shortage of cash, and;
- persistent weaknesses of accounting policy and procedures such as those mentioned in the recent SAACB report for presenting arrears.

B. Institutional Factors Supporting PFM Reform Planning and Implementation

The challenging political and fiscal circumstances have not stopped the PFM reform agenda. After several difficulties due to political conditions and fiscal crises, the period since mid-2007 has generally been a fertile period for reform under the Caretaker Government and has provided opportunity to improve systems. During this period, leadership of MoF in the reform agenda have been facilitated by the dual function of the prime minister, who has also been Finance Minister.

The PA's PFM reform strategy has been defined in the Palestinian National Development Plan (NDP) 2011-2013. Discussions about the plan have been widely held and used as documents to define the National Policy Agenda. Sectoral strategies, including the PFM reform strategy, have been widely circulated among various public institutions, in particular the MoF and line ministries. The PFM reforms included in the NDP were also closely linked to other policies for economic and social development, ensuring ownership by the administration. A new plan for 2014-2016 is under preparation and will include again a sector strategy related to PFM.

A major drive for PFM reform in the PA has also come from the donor community. With the PA needing substantial external financing for the recurrent budget, development partners have supported comprehensive PFM reforms that would give them comfort in disbursing budget support. Donor assistance has also been a key driver for improvement in the national planning process and program budgeting, as donors have sought more information on how budget support is being used. Development partners have provided strategic advice on the PFM reform agenda, notably through regular missions of the IMF/FAD since 2007.

Many institutional and administrative platforms for PFM reform coordination have been put in place. The role of the IMF/FAD in facilitating aid and technical assistance coordination in relation with the implementation of the plan has been instrumental. In particular, the PFM Reform Framework agreed in 2009 with the PA was monitored by the IMF/FAD and served as a guide for the authorities and for donors to define and coordinate technical assistance activities and commitments of the donor community. The annual IMF PFM reviews have provided assessment of the implementation of the reforms and basis for recommendations. Regular discussions are held with main partners and TA providers on the basis of

this PFM reform framework. Regular meetings also take place on a quarterly basis under the coordination of the Local Aid Coordination Secretariat (LACS). The main forum for this coordination is the quarterly Joint Economic Strategy Group and Fiscal Sector headed by the Prime Minister and the Minister of Finance where the IMF, the World Bank and some other donors present reports on the fiscal situation and projections of the economic and fiscal situation. This group is also linked to the Ad Hoc Liaison Committee for West Bank and Gaza (AHLC) which meets regularly under the UN supervision. The MoPAD also organizes quarterly Public Administration and Civil Service Sector Working Groups to update partners on the move of PFM reforms, in particular as part of the preparation of the new NDP. Finally, the IMF and the World Bank also co-organize quarterly coordination meetings to inform development partners on achievements with donor funded technical assistance programs and findings of various assessments conducted.

The box below summarizes the activities of main donors in providing technical assistance to the PA.[113]

Box 1: Development Partners' Support for PFM Reform

The main sources of donor support for PFM reforms are as follows:

- **IMF:** Annual FAD mission to review progress with the PFM reforms. One to two missions each year from METAC to provide advice on specific technical issues.
- **European Union:** Support for development of internal audit and control functions and strengthening organizational structure and capacity development in the SAACB. The EC is also assisting with the development of a long term customs strategy and the implementation of the Automated System for Customs Data (ASYCUDA).
- **United Kingdom (DFID):** Assistance to MoF with: revenue reforms, macro fiscal analysis and forecasting, program budgeting. Assistance to MoPAD in the areas of preparation of PNP, project monitoring and evaluation systems, and capital expenditure management.
- **France (ADETEF**): Support to the establishment and operation of a Palestinian Authority Public Finance (training) Institute.
- **United States (USAID):** TA to enhance capacities in the income tax and property tax departments.
- **World Bank:** Broad support to implementation of the PFM reform agenda including: procurement reform, cash planning and management, and application of IPSAS accounting standards. The Bank is also supporting governance reform, including civil service reform.
- **Japan (JICA):** Support to fiscal decentralization reform with focus on property tax.
- **UNDP/PAPP:** Support to fiscal decentralization and increasing own-source revenues for the local governments units through tax reform projects.

The PEFA assessment shows the need for better prioritizing the PFM reform agenda to address the current challenging fiscal situation. The PFM Reform Framework above includes four dozen recommendations under four main pillars, not all of them requiring technical assistance from development partners. While all these measures are needed, there is room for concentrating more efforts on some areas

[113] January 2013 IMF/FAD/METAC report (page 11) mentioned above.

particularly exposed to the risks raised by the fiscal crisis. A particular focus should be put on budget preparation, execution, and accounting as some systemic weaknesses have been identified by the current PEFA assessment.

The key PFM weaknesses identified by the current PEFA assessment that need to be addressed in the medium term are centered on:

- Shifting towards a more "top down" budget preparation process, to ensure line ministries build their budget estimates in a more realistic way. Increased MoF/MoPAD coordination is required to ensure sector strategies are linked to a credible MTFF, from which annual budget ceilings would be derived;

- Developing cash planning and commitment control, building on the good understanding of these concepts among budget operators, utilizing the related functionalities in the IFMIS, and the network coverage of the internal and financial controllers over line ministries; such reform should bring the budget execution more in line with the cash resources and curb the continued generation arrears;

- Improving accounting policy in particular for the presentation of arrears as a new fiscal target for and for budget monitoring purposes, and;

- Improving the realism of the budget support budgeted by the PA by providing for closer dialog with the development partners during the budget preparation process.

The current PEFA assessment outlines a strong link between the various reforms that require a more integrated technical assistance approach. Many of these reforms are to be implemented together with other interconnected reforms in order to produce effective results. This underscores the challenging context in which these reforms have to be implemented, but also the opportunity to create synergy and impetus between, and ownership of, the various components of the reform agenda. For instance, tackling the continued generation of arrears, which undermines the overall credibility of the PFM system, requires the following: (i) the full presentation and accounting of arrears (arrears data capture, age profile, automatic carryover) which requires a comprehensive exercise to identify total arrears and adequate works on the accounting system and IFMIS; (ii) the control of expenditures in order to reject commitments in excess of forecast cash availability requires implementing a system of commitment control and developing cash planning; (iii) the budget preparation process needs strengthening by issuing hard aggregate budget ceilings early in the procedure in order to fix the ministerial budgets ceilings in a more realistic manner than currently is implemented.

Most of these reforms are well identified and, for some of them, underway, but are not implemented in a sufficiently integrated manner. The important reform of commitment control and cash planning launched in 2010, but then stopped operating for unknown reasons, could be easily revived. Technical assistance on cash planning by the World Bank is underway. Scrutiny of the accounting policies and practices by the recent SAACB Audit report of the 2010 financial statements has highlighted the need for the MoF to improve arrears' reporting and to implement a system of commitment control as the only credible approach to address arrears' generating. Required works on the accounting system and

IFMIS to reach these objectives are well understood by accounting staff and budget operators involved in line ministries and financial control network. The recent set up of the MFU tasked with multiyear fiscal forecasts will help improve the budget preparation procedure and introduce a more top down approach, as a precondition for a smoother budget execution. Regarding donor contribution to the PA, the budget support for the 2013 budget has been calibrated in a more realistic way than during the previous years with assistance from the IMF.

Notwithstanding the risks that the fiscal crisis worsens and impede the implementation of the PFM reform agenda, there is an avenue for a more integrated technical assistance in moving forward this agenda. In this regard, the current PEFA assessment should be understood as a tool to rationalize technical assistance programs of development partners for better results.

ANNEXES

Annex 1: Summary Table of the Performance Indicators

Indicator	Scoring	Brief Explanation and Cardinal Data Used
1. Aggregate expenditure outturn compared to original approved budget	A	Actual primary expenditure (excluding donor funded projects) deviated from original the budget appropriations by more than five percent only in 2010 (5.1 percent); deviation was less than five percent in 2011 (2.7 percent) and 2012 (3.3 percent).
2. Composition of Expenditure Outturn Compared to Original Approved Budget	C+	Variance in expenditure composition exceeded 15 percent in one of the last three fiscal years (Score C). Actual expenditure charged to contingency vote was on average less than three percent of the original budget over the last three years (Score A).
3. Aggregate Outturn Revenues Compared to Original Approved Budget	B	Actual domestic revenues as a percentage of the approved budget were 92 percent in 2011; in 2010 and 2012 the percentage difference was less, 100 percent and 94 percent, respectively.
4. Stock and Monitoring of Expenditure Arrears	D	The stock of arrears exceeds ten percent of total expenditure (Score D). There is no reliable data on the stock of arrears from the last two years (Score D).
5. Classification of the Budget	B	Budget formulation and execution is based on administrative, economic, and functional classification (using ten main, high level functions consistent with COFOG classification) and can produce consistent documentation with GFSM/COFOG standards. However the program classification is not in line with GFSM/COFOG subfunctional classification.
6. Comprehensiveness of Information Included in	B	Six elements for the assessment criteria for annual budget documentation out of the nine benchmarks of PEFA are included in the General Budget Law for Fiscal Year 2012. The three elements not

Budget Documentation		included are related to debt stock (although the information is available actually in various in-year reporting documents), financial assets, and explanation about new fiscal initiatives.
7. Extent of Unreported Government Operations	C+	The level of unreported extra-budgetary expenditure (other than donor funded projects) is insignificant (below one percent of total expenditure) (Score A). Complete income/expenditure information for all loan financed projects (marginal in WBG) is included in fiscal reports; however serious deficiencies affect the information of grant financed projects (Score C).
8. Transparency of Inter-Governmental Fiscal Relations	D+	The horizontal allocation of at least 50 percent of transfers from central is determined by transparent and rules based systems (Score B). Reliable estimates on transfers are issued after SN government budgets have been finalized, or earlier issued estimates are not reliable (Score D). There is no fiscal consolidation of SN fiscal information with Central Government information (Score D).
9. Oversight of Aggregate Fiscal Risk from other Public Sector Entities	D+	All major AGAs/PEs submit fiscal reports to central governments at least six monthly, as well as annual audited accounts, and central government consolidates fiscal risk issues into a report at least annually (Score A). No annual monitoring of SN governments' fiscal position takes place or it is significantly incomplete (Score D).
10. Public Access to Key Fiscal Information	B	The government makes available to the public three of the six listed types of fiscal information (Score B). The information not publicly available is: (i) a complete set of annual budget documentation upon submission of the budget to the president; (ii) contract awards for public works; and (iii) information on resources available to primary service delivery units.
11. Orderliness and Participation in the Annual Budget Process	C	A clear annual budget calendar exists, but some delays are often experienced in its implementation. The calendar allows MDAs four weeks to meaningfully complete their detailed estimates (Score B). A budget circular is issued to MDAs, including individual ceilings; the budget estimates are reviewed and approved by the cabinet only after they have been completed by MDAS, thus seriously constraining the cabinet's ability to make adjustments (Score C). The budget has been approved with more than two months delay in the two of the last three years (Score D).
12. Multiyear Perspective in Fiscal Planning, Expenditure Policy, and Budgeting	D	Forward estimates of fiscal aggregates have not been undertaken during the assessment (Score D). No debt sustainability analysis has been undertaken in the last three years (Score D). Sectors strategies do not include consistent costing consistent with aggregate fiscal forecasts (Score C). Budgeting for investment and recurrent expenditure are separate process with no recurrent cost

		estimates being shared (Score D).
13. Transparency of Taxpayer Obligations and Liabilities	C+	Legislation and procedures for some major taxes are comprehensive and clear, but the fairness of the system is questioned due to substantial discretionary powers of the government entities involved in particular for Income Tax (Score C). Taxpayers have easy access to comprehensive, user friendly and up-to-date information on tax liabilities and administrative procedures for some of the major taxes (Property Tax), while for other taxes (Income Tax, VAT and Customs) the information is limited (Score B). A tax appeals system of administrative procedures has been established, but needs substantial redesign to be fair, transparent, and effective (Score C).
14. Effectiveness of Measures for Taxpayer Registration and Tax Assessment	D+	Taxpayers are registered in database systems for individual taxes, which may not be fully and consistently linked (Property Tax, Income Tax, VAT and Customs databases are not linked). Linkages to other registration/licensing functions may be weak (only for Property Tax has some links with business registration or electricity bill payment) but are then supplemented by occasional surveys of potential taxpayers (Score C). Penalties for noncompliance are generally nonexistent of ineffective, even though the penalties may be significant on paper (Score D). Tax audits and fraud investigations are undertaken on an ad hoc basis, if at all (no risk based assessment for property and income taxes) (Score D).
15. Effectiveness in Collection of Tax Payments	D+	The debt collection ratio in the most recent year was below 60 percent and the total amount of tax arrears is significant (i.e., more than two percent of total annual collections).The stock of arrears for the sole tax income equals some 50 percent of all revenue in 2012 (Score D). All tax revenue is paid directly into accounts controlled by the treasury or transfers to the treasury are made daily (Score A). Complete reconciliation of tax assessments, collections, arrears and transfers to treasury takes place at least annually, within three months of end of the year (Score C).
16. Predictability in the Availability of Funds for Commitment of Expenditures	D	Cash flow planning and monitoring are not undertaken (Score D). MDAs are provided commitment ceilings for less than a month (Score D). Significant in-year budget adjustments are frequent and not done in a transparent manner (Score D).
17. Recording of Cash Balances, Debt, and Guarantees	B	Domestic and foreign debt records are complete, updated, and reconciled on a monthly basis with data considered of high integrity. Comprehensive management and statistical reports (cover debt service, stock and operations) are produced at least quarterly (Score A). Most cash balances on the two main treasury account are calculated and consolidated at least weekly (actually daily for one of them), but some extra budgetary funds, in fact the donor's fund account at Arab Bank, remain outside the arrangement (Score B).

		Central government's contracting of loans and issuance of guarantees are always approved by a single responsible government entity, but are not decided on the basis of clear guidelines, criteria or overall ceilings (Score C).
18. Effectiveness of Payroll Controls	B+	Personnel data and payroll data are not directly linked, but the payroll is supported by full documentation for all changes made to personnel record each month and checked against the previous month's payroll data (Score B). Up to three months' delay occurs in updating of changes to the personnel records and payroll, but affects only a minority of changes. Retroactive adjustments are occasional (some two percent) (Score B). Authority and basis for changes to personnel records and the payroll are clear (Score A). A payroll audit covering all central government entities was conducted in 2011 by the Internal Audit Unit at MoF (Score B).
19. Transparency, Competition, and Complaint Mechanisms in Procurement	C+	The new legal and regulatory framework for procurement, under implementation, meets all six of the listed requirements (Score A). At least 80 percent of the value of contracts awarded by methods other than open competition, are justified in accordance with the legal requirements (Score B). At least two of the key procurement information elements are made public for 50 percent of procurement operations (by value) (the general supplies department, provides information on bidding opportunities, contract awards, and bidding documents; the public works ministry only for bidding opportunities (Score C). At present, there is no independent procurement complaints review body. The implementation of the new law will provide for this mechanism (Score D).
20. Effectiveness of Internal Controls for Nonsalary Expenditures	D+	Commitment control systems are generally lacking (Score D). Other internal control rules and procedures consist of a basic set of rules for processing and recording transactions, which are understood by those directly involved in their application. These rules and procedures do not constitute a comprehensive set of controls (some are duplicating) (Score C). Rules are complied with in a significant majority of transactions, but use of simplified/emergency procedures in unjustified situations (such as advances for staff and NGOs) is an important concern (Score C).
21. Effectiveness of Internal Audit	C+	Internal audit is operational for the majority of central government entities and substantially meets professional standards: it is focused on systemic issues (at least 50 percent of staff time) (Score B). Reports are issued regularly for most government entities but may be not submitted to the MoF and the SAI (Score C). A fair degree of action taken by many managers on major issues (rate of implementation approximately 30 percent) but often with delay (Score C).

22. Timeliness and Regularity of Accounts Reconciliation	B	Bank reconciliations for all bank accounts take place at least monthly, usually within four weeks from end of month (Score B). PI-22(ii) relating to suspense accounts and advances is Not Applicable.
23. Availability of Information on Resources Received by Service Delivery Units	D	No comprehensive data collection on resources to service delivery units in any major sector has been collected (Education and Health) and processed within the last three years.
24. Quality and Timeliness of In-Year Budget Reports	C+	Comparison of actuals to budget in financial reports is possible with some aggregation and for main administrative headings; however, expenditure is captured only at payment stage (Score C). Reports are prepared quarterly or more frequently and issued within four weeks of end of the period (Score A). There are some concerns about the accuracy of the information (e.g., recording of commitment is not comprehensive) which may not always be highlighted in the reports but this does not fundamentally undermine their basic usefulness (Score C).
25. Quality and Timeliness of Annual Financial Statements	C	A consolidated government statement is prepared annually. Information on revenue, expenditure, and bank accounts balances may not always be complete (not comprehensive coverage of bank accounts balances of donors or Petroleum Authority), but the omissions are not significant (Score C). The statements are submitted for external audit within 15 months (actually 13 months for the 2010 statements) of the end of fiscal year (Score C). The Statements are presented in consistent format over time with some disclosure of accounting standards (IPSAS) (Score C).
26. Scope, Nature, and Follow-up of External Audit	C+	Central government entities representing at least 75 percent of total expenditures are audited annually, at least covering revenue and expenditures (not financial assets). A wide range of financial audits are performed and generally adhere to auditing standards, focusing on significant and systemic issues (Score B). Audit reports are submitted to the legislature within twelve months of the end of the period covered and in the case of the financial statements from their receipt by the audit office (actually 11 months for the audit of the 2010 statements) (Score C). A formal response is made, though delayed or not very thorough, but there is little evidence of any follow-up (Score C).
27. Legislative Scrutiny of the Annual Budget Law	**Not used**	
28. Legislative Scrutiny of External Audit Reports	**Not used**	

D1. Predictability of Direct Budget Support	D+	In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than five percent. Outturn exceeded the forecast by 20.1 percent, 6.7 percent, and 28.7 percent in 2010, 2011, and 2012, respectively (Score A). The requirements for score C (or higher) are not met.[114] Information on quarterly disbursement were as follows: 2010 monthly forecasts provided for the first six months, while only aggregates per donor for the remainder of the year; 2011 monthly forecasts provided for the entire year, but monthly data only for 31 percent of the total forecast; 2012 forecast disaggregated by donor/month, thereby significantly improving in-year predictability (Score D).
D2. Financial Information Provided by Donors for Budgeting and Reporting on Project and Program Aid	D	Not all major donors provide budget estimates for disbursement of project aid at least for the government's coming fiscal year and at least three months prior to its start. Actually three out of the five main donors (U.S., Germany, EU, U.K., and Spain) provide information, but not in due time (Score D). Donors do not provide quarterly reports within two months of end-of-quarter on disbursements made for at least 50 percent of externally financed project estimates in the budget (Score D).
D3. Proportion of Aid that is Managed by Use of National Procedures	**D**	Less than 50 percent of aid funds to central government are managed through national procedures. Overall, it is estimated that at least 70 percent of reported aid (i.e., approximately $640 million out of $900 million) is not managed through national procedures; for the remaining 30 percent the implementation of national procedures is doubtful for the vast majority of the projects (Score D).

[114] Score C: Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 50 percent in two of the last three years.

Annex 2: List of Officials Who Met during the Mission

Ministry of Finance
Ms. Laila Sbaih-Eghreib, Acting Director General of International Relations and Projects, PEFA Counterpart representing the Palestinian Authority
Ms. Hiba Dajani, Finance Officer, Ministry of Finance
Mr. Qassam Barghouthi, Project Coordinator, International Relations and Projects Department

Budget Department
Mr. Farid Ghannam, Director General of Central Budget Department, and his team

Treasury
Mr. Yusef Qaddah, Director General of Treasury and General Accountant, and his team, in particular:
Ms. Zahira Ibrahim, Director General
Ms. Mai Suliman, Director, and Ms. Khawla Apudayaa, Manager, Cash and Debt Management
Mr. Asad Awashra, Director, Financial reporting
Mr. Mohammed Harashe, Manager, Financial Systems
Mr. Abd Al Jabar, Director, Payroll

Properties
Mr. Ahmed S. Sabah, Director General of Properties

Revenue
Mr. Yusef Zamer, Director General of Revenues, and his team, in particular:
Mr. Mahmoud Nofal, Director General Property Tax
Mr. Hamzih Zalloun, Director of Income Tax
Mr. Ahmed A. Al Helou, Director general of Customs, Excise, and VAT
Mr. Steve Crout, Lead Advisor Revenue
Mr. Glenn Wood, Customs and Tax Advisor
Mr. Richard Wolfe, Tax Reform Advisor
Mr. H. Taha, Tax Reform Project
Mr. Mohammad Musleh, Tax Reform Project

Macro Fiscal Unit
Ms. Dana Mbayed, Head of the Macro Fiscal Unit
Mr. Ali Dreidi, Economist

Supplies Department
Ms. Khawla Shahrour, Director General of Supplies Department (by telephone interview)
Mr. Abdulla Suwan, Deputy of Director General of Supplies Department
Mr. Naser Al Khatib, Manager, Bids Department

Internal Audit
Mr. Azmi Yaseen, Acting Director General of the Internal Audit
Mr. Ahmad A. Hadi, Acting Director General of the Central Harmonization Unit (internal audit)
Mr. Hazem Sababa, and Mr. Abdelkarim Mahmoud, Advisory Services Ernst and Young, internal audit experts

Ministry of Planning and Administrative Development
Mr. Mutassem Y. Awad, Head, Governance Sector
Mr. Khalil Nijem, Advisor
Mr. Fahed Al-Sheikh, DARP, Coordinator of Arabic Countries Departments
Mr. Mafdi Sulaiman, Financial Manager

State Audit and Administrative Control Bureau (SAACB)
Dr. Samir A. Abuznaid, President of Bureau
Mr. Jamal Fawzi Abu Baker, General Manager
Mr. Ismat Abu Rabea, Director of Auditing on Economy Sector
Mr. Bernd Gindl, Team Leader/Audit Expert
Mr. Bages Z. Petro, Audit Expert

General Personnel Council (GPC)
Mr. Jamal Abu Shanab, IT Department

Ministry of Education
Mr. Mushir H. Sharif, Manager, Accounting Department
Ms. Sara Hammoudeh, Director, Budget Department
Mr. Izzam Izzet, Director of Hashimiyah Secondary School

Ministry of Health
Mr. Abd Elkareem Moh. Hamadneh, Director of Finance
Mr. Bassem Rimawi, Health Director for Ramallah District
And staff of Beit Reema Primary Health Center (Ms. Laila Nazal, Head Nurse)

Ministry of Public Works
Mr. Fayeq Deek, Deputy Minister
Mr. Bassam Abu Gharbieh, Director General, Financial Affairs
Mr. Bassam Jaber, Director General, Central Tendering Department

Ministry of Local Governments
Mr. Shukri Radaideh, General Director of Administration
Mr. Hassan Ghassan, Director, Budget

Ramallah Municipality
Mr. Sameh Abed El Majeed, Acting Mayor
Mr. Maher Hanania, Council Member
Mr. Ahmed K. Abu Laban, General City Director
Ms. Maha Shihadeh, Public Relations Director
Mr. Suleiman Ghneim, Director of Finance Department
Mr. Maher Al Natour, Internal Controller

Birzeit Municipality
Mr. Hassib S. Kalieh, Mayor and his financial team

Bank of Palestine
Mr. Hani Salah Naser, Assistant General Manager
Mr. Hatem G. Mustafa, Middle Regional Manager

Bisan Systems Company

Mr. Michael Quffa, General Manager

AMAN – Coalition for Accountability and Integrity
Mr. Ghada Zughayar, Director

Palestinian Businessmen Association
Mr. Mohamed Masrouji

All donors providing direct budget support and supporting development projects, in particular
Junghun Cho, Program Manager, World Bank
Strahan Spencer, Economic Adviser, DFID
Fadi S. Abdellatif, Senior Program Manager & Adviser, USAID
Clifford Aims, INL Deputy Director
EUREP, Thomas Boyer, Programme Manager Economic Issues
France: Benoit Tadie, French General Consulate; and Malika Dahou, ADETEF
UNDP, Etambuyu Gundersen, Governance Analyst

Annex 3: Sources of Evidence for Each Indicator (2013)

Indicator	Indicator Description	Documentary Evidence	Supporting Interviews
PFM OUTTURNS: CREDIBILITY OF THE BUDGET			
PI-1	**Aggregate expenditure outturn compared to original approved budget**	Approved Annual Budget and Financial reports for 2010, 2011 and 2012	Budget Department and MFU
PI-2	**Composition of Expenditure Outturn Compared to Original Approved Budget**	Same	same
PI-3	**Aggregate Outturn Revenues Compared to Original Approved Budget**	Same	Revenue Department and MFU
PI-4	**Stock and Monitoring of Expenditure Arrears**	Same + 2010 Financial Statements and SAACB Audit report.	Budget and Accounting departments. SAACB. Line ministries. Bisan Cie.
KEY CROSS-CUTTING ISSUES: COMPREHENSIVENESS AND TRANSPARENCY			
PI-5	**Classification of the Budget**	Budget and Accounting documents for 2012	Budget and Accounting Departments. DFID TA project team at MoF.
PI-6	**Comprehensiveness of Information Included in Budget Documentation**	Budget documentation for 2012	Budget Department
PI-7	**Extent of Unreported Government Operations**	Financial reports for 2012	Budget and Accounting departments. MFU. Department of International Cooperation. MoPAD. SAACB. Donors. AMAN.
PI-8	**Transparency of Intergovernmental Fiscal Relations**	Documentation of transfers and financial reports (for weighing)	Min. of Local Gov. Ramallah and Birzeit municipalities. Accounting Department at MoF for consolidation.
PI-9	**Oversight of Aggregate Fiscal Risk from other Public Sector Entities**	For AGAs/PEs: annual report of Public Investment Fund For SN: documentation on loans/guarantee for SN (Financial Regulations/Debt Act and Local Government Act. Also WB reports on electricity distribution system	PIF financial Director. Palestinian Petroleum Authority. MLG and Ramallah and Birzeit municipalities.

PI-10	**Public Access to Key Fiscal Information**	Budget Law for 2012	Budget Department. Supplies department at MoF. Ministry of Public Works. SAACB. Primary School and Health Center at Ramallah and Birzeit municipalities. AMAN.
BUDGET CYCLE			
Policy-based budgeting			
PI-11	**Orderliness and Participation in the Annual Budget Process**	Organic Budget Law and Budget circular.	Budget Department. Line ministries (Education, Public Works, and Health).
PI-12	**Multiyear Perspective in Fiscal Planning, Expenditure Policy, and Budgeting**	PNDP and all related documentation for planning and costed strategies.	MoF (Budget, International Coop), MoPAD, and Line ministries (above). DFID TA project team at MoF.
Predictability and control in budget execution			
PI-13	**Transparency of Taxpayer Obligations and Liabilities**	Documentation about main taxes (Property, Income, VAT/Customs)	Revenue Department and specialized departments for each tax, including LTU. USAID TA project team at MoF. Private sector representatives.
PI-14	**Effectiveness of Measures for Taxpayer Registration and Tax Assessment**	Same	Same
PI-15	**Effectiveness in Collection of Tax Payments**	Same	Same + Treasury Department.
PI-16	**Predictability in the Availability of Funds for Commitment of Expenditures**	Practices. 2013 WB report on cash Planning	Treasury (CDMD), LMs, and Bank of Palestine.
PI-17	**Recording of Cash Balances, Debt, and Guarantees**	Recording documents of Debt. Financial Statements. SAACB audit report of 2010 FSs.	Cash and Debt Department, SAACB, Bank of Palestine.
PI-18	**Effectiveness of Payroll Controls**	Operational documentation and 2012 Internal audit report 2012	MoF (Director of Payroll; Department of IT system, Head of Financial Controllers and Internal Audit Unit). GPC.
PI-19	**Transparency, Competition, and Complaint Mechanisms in Procurement**	New Law on procurement (December 2011)	MoF (Supplies Department). Ministry of Public Works (Deputy Minister and Central Tender

			Committee).
PI-20	**Effectiveness of Internal Controls for Nonsalary Expenditures**	Law No. 7 of 1998, regulating general budget and financial affairs	Accountant General. Head of Financial Controllers at MoF. Internal Audit Unit. CHU. SAACB. Bisan Cie (for commitment control).
PI-21	**Effectiveness of Internal Audit**	Charter of Audit Charter (regulation No. 11/2011) and audit reports review.	IAU and CHU at MoF. SAACB. EU TA project team at MoF.
Accounting, recording, and reporting			
PI-22	**Timeliness and Regularity of Accounts Reconciliation**	Accounting regulations and FSs for 2010	Accountant General (Accounting Department). SAACB. Bank of Palestine. Bisan Cie.
PI-23	**Availability of Information on Resources Received by Service Delivery Units**	Operational documentation and reporting practices review.	Health primary care center and primary school.
PI-24	**Quality and Timeliness of In-Year Budget Reports**	Financial reporting documentation.	Financial reporting Department. Accounting Department. MFU. Bisan Cie
PI-25	**Quality and Timeliness of Annual Financial Statements**	-	Accounting Department. SAACB and EU TA project team at MoF.
External scrutiny and audit			
PI-26	**Scope, Nature, and Follow-up of External Audit**	Law on SAACB – SAAB website. External audit documentation.	SAACB team. SAACB and EU TA project team at MoF.
PI-27	**Legislative Scrutiny of the Annual Budget Law**	-	-
PI-28	**Legislative Scrutiny of External Audit Reports**	-	-
DONOR PRACTICES			
D-1	**Predictability of Direct Budget Support**	Financial reporting (MoF and MoPAD). OECD statistics. Donors practices.	MoF (Budget Department, Financial Reporting, International Cooperation). MoPAD and majors Donors.
D-2	**Financial Information Provided by Donors for Budgeting and Reporting on Project and Program Aid**	same	same
D-3	**Proportion of Aid that is Managed by Use of National Procedures**	same	same

Annex 4: Data Analysis Tables for PEFA Indicators PI-1 and PI-2

Calculation Sheet for PFM Performance Indicators PI-1 and PI-2 (as revised January 2011)

Step 1: Enter the three fiscal years used for assessment in table 1.
Step 2: Enter budget and actual expenditure data for each of the three years in tables 2, 3, and 4 respectively.
Step 3: Enter contingency data for each of the three years in tables 2, 3, and 4 respectively.
Step 4: Read the results for each of the three years for each indicator in table 5.

Step 5: Refer to the scoring tables for indicators PI-1 and PI-2 respectively in the Performance Measurement Framework in order to decide the score for each indicator.

Table 1 - Fiscal years for assessment

Year 1 =	2010
Year 2 =	2011
Year 3 =	2012

Table 2: Recurrent Expenditure (less public debt service), Budget by Entity

Note Table 2 is in USD.
Source: General Budget Law 2010; Financial Report Dec 2010,

	Data for year =	2010	USD thousand								
	Administrative head	budget	actual	adjusted budget	deviation	absolute deviation	percent				
1	Min. Interior and Security	756,666	813,355	664,416	148,939	148,939	22.4%	27%			Budget
2	Min Education	544,050	525,975	477,722	48,253	48,253	10.1%	19%			Total Exp.
3	Min Social Affairs	317,017	235,735	278,368	-42,633	42,633	15.3%	11%			total recurrent
4	Min Health	323,295	344,445	283,880	60,565	60,565	21.3%	11%			total dev
5	Retiree Pensions	197,368	183,573	173,306	10,267	10,267	5.9%	7%			debt service
6	Min Local Government	28,112	27,260	24,685	2,575	2,575	10.4%	1%			
7	Pal. Water Authority	11,704	8,069	10,277	-2,208	2,208	21.5%	0%			Actual
8	Min Energy & NR	2,800	2,685	2,459	226	226	9.2%	0%			Total Exp.
9	Presidents Office	53,582	61,922	47,049	14,873	14,873	31.6%	2%			total recurrent
10	Min Public Works	15,115	13,050	13,272	-222	222	1.7%	1%			total dev
11	Min Finance	34,083	31,747	29,928	1,819	1,819	6.1%	1%			debt service
12	Min Agriculture	23,480	20,487	20,617	-130	130	0.6%	1%			
13	Embassies	46,816	45,758	41,108	4,650	4,650	11.3%	2%			
14	PLO Institutions	34,533	28,634	30,323	-1,689	1,689	5.6%	1%			
15	Min Religious Affairs	35,486	31,033	31,160	-127	127	0.4%	1%			
16	Min Youth and Sports	9,919	8,519	8,710	-191	191	2.2%	0%			
17	Min Jerusalem Affairs	31,395	163	27,567	-27,404	27,404	99.4%	1%			
18	General Personnel Office	29,860	28,448	26,220	2,228	2,228	8.5%	1%			
19	Min Nat Economy	13,959	13,069	12,257	812	812	6.6%	0%			
20	WAFA	4,158	4,049	3,651	398	398	10.9%	0%	89%		
21	Other (= sum rest)	326,570	65,754	286,756	-221,002	221,002	67.7%			2,513,398	2,427,976
	allocated expenditure	2,839,968	2,493,730	2,493,730	0	591,212					
	contingency	18,526	217,573								

contingency = 'financial reserves' in MoF budget/financial repor

total expenditure	2,858,494	2,711,303	-147,191	
overall (PI-1) variance				5.1%
composition (PI-2) variance				23.7%
contingency share of budget				7.6%

Table 3: Recurrent Expenditure (less public debt service), Budget by Entity

Source: General Budget Law 2011; Financial Report Dec 2011, Table 6B

Data for year =	2011	NIS Thousand								
	administrative or functional head	budget	actual	adjusted budget	deviation	absolute deviation	percent			
1	Min. Interior and Security	3,008,633	3,124,190	2,915,885	208,305	208,305	7.1%	27%		
2	Min Education	2,351,798	2,129,627	2,279,298	-149,671	149,671	6.6%	21%		
3	Min Social Affairs	1,081,069	1,014,535	1,047,743	-33,208	33,208	3.2%	10%		
4	Min Health	1,228,075	1,196,733	1,190,217	6,516	6,516	0.5%	11%		
5	Retiree Pensions	676,000	944,129	655,161	288,968	288,968	44.1%	6%		
6	Min Local Government	133,834	93,941	129,708	-35,767	35,767	27.6%	1%		
7	Pal. Water Authority	48,308	31,514	46,819	-15,305	15,305	32.7%	0%		
8	Min Energy & NR	10,838	10,149	10,504	-355	355	3.4%	0%		
9	Presidents Office	237,371	228,049	230,053	-2,004	2,004	0.9%	2%		
10	Min Public Works	53,752	52,276	52,095	181	181	0.3%	0%		
11	Min Finance	141,041	132,618	136,693	-4,075	4,075	3.0%	1%		
12	Min Agriculture	91,882	79,513	89,050	-9,537	9,537	10.7%	1%		
13	Embassies	199,319	153,310	193,175	-39,865	39,865	20.6%	2%		
14	PLO Institutions	242,334	247,087	234,863	12,224	12,224	5.2%	2%		
15	Min Religious Affairs	139,968	115,559	135,653	-20,094	20,094	14.8%	1%		
16	Min Youth and Sports	36,795	31,430	35,661	-4,231	4,231	11.9%	0%		
17	Min Jerusalem Affairs	37,050	32,349	35,908	-3,559	3,559	9.9%	0%		
18	General Personnel Office	109,387	109,183	106,015	3,168	3,168	3.0%	1%		
19	Min Nat Economy	53,487	51,123	51,838	-715	715	1.4%	0%		
20	WAFA	17,654	93,613	17,110	76,503	76,503	447.1%	0%	89%	
21	Other (= sum rest)	1,218,471	903,429	1,180,909	-277,480	277,480	23.5%			9,898,595 9,870,928
	allocated expenditure	11,117,066	10,774,357	10,774,357	0	1,191,731				
	contingency	21,568	65,132							
	total expenditure	11,138,634	10,839,489	-299,145						
	overall (PI-1) variance						2.7%			
	composition (PI-2) variance						11.1%			
	contingency share of budget						0.6%			

contingency = 'financial reserves' in MoF budget/financial reports

Budget	NIS '000
Total Exp.	11,368,996
total recurrent	11,278,634
total dev	90,362
debt service	140,000
Actual	
Total Exp.	12,058,394
total recurrent	10,970,075
total dev	1,088,319
debt service	130,586

Table 4: Recurrent Expenditure (less public debt service), Budget by Entity

Source: General Budget Law 2012; Financial Report Dec 2012, Table 6B

Data for year =	2012	NIS Thousand					
	administrative or functional head	budget	actual	adjusted budget	deviation	absolute deviation	percent	
1	Min. Interior and Security	3,352,090	3,912,737	3,469,657	443,080	443,080	12.8%	30%
2	Min Education	2,353,645	2,206,330	2,436,194	-229,864	229,864	9.4%	21%
3	Min Social Affairs	1,132,003	1,295,974	1,171,705	124,269	124,269	10.6%	10%
4	Min Health	1,293,766	1,177,238	1,339,142	-161,904	161,904	12.1%	12%
5	Retiree Pensions	470,000	446,698	486,484	-39,786	39,786	8.2%	4%
6	Min Local Government	151,460	105,721	156,772	-51,051	51,051	32.6%	1%
7	Pal. Water Authority	45,400	40,988	46,992	-6,004	6,004	12.8%	0%
8	Min Energy & NR	83,685	44,641	86,620	-41,979	41,979	48.5%	1%
9	Presidents Office	234,468	251,498	242,691	8,807	8,807	3.6%	2%
10	Min Public Works	56,560	51,069	58,544	-7,475	7,475	12.8%	1%
11	Min Finance	142,187	143,075	147,174	-4,099	4,099	2.8%	1%
12	Min Agriculture	90,770	78,653	93,954	-15,301	15,301	16.3%	1%

Budget	NIS '000
Total Exp.	11,713,756
total recurrent	11,635,760
total dev	77,996
debt service	156,490
Actual	
Total Exp.	12,860,227
total recurrent	12,028,824
total dev	831,403
debt service	166,647

13	Embassies	182,549	185,206	188,951	-3,745	3,745	2.0%	2%			
14	PLO Institutions	268,993	300,874	278,427	22,447	22,447	8.1%	2%			
15	Min Religious Affairs	135,909	122,050	140,676	-18,626	18,626	13.2%	1%			
16	Min Youth and Sports	70,662	31,596	73,140	-41,544	41,544	56.8%	1%			
17	Min Jerusalem Affairs	37,064	29,448	38,364	-8,916	8,916	23.2%	0%			
18	General Personnel Office	112,813	108,243	116,770	-8,527	8,527	7.3%	1%			
19	Min Nat Economy	53,588	49,252	55,467	-6,215	6,215	11.2%	0%			
20	WAFA	17,933	84,185	18,562	65,623	65,623	353.5%	0%	93%		
21	Other (= sum rest)	1,168,988	1,190,798	1,209,988	-19,190	19,190	1.6%			10,285,545	10,665,476
	allocated expenditure	11,454,533	11,856,274	11,856,274	0	1,328,450					
	contingency	24,737	5,903					contingency = 'financial reserves' in MoF budget/financial reports			
	total expenditure	11,479,270	11,862,177	382,907							
	overall (PI-1) variance						3.3%				
	composition (PI-2) variance						11.2%				
	contingency share of budget						0.1%				

Table 5 - Results Matrix

year	for PI-1 total exp. deviation	for PI-2 (i) composition variance	for PI-2 (ii) contingency share
2010	5.1%	23.7%	
2011	2.7%	11.1%	2.7%
2012	3.3%	11.2%	

Score for Indicator PI-1:	A	In no more than 1 out of the last 3 years has actual exp. deviated from budgeted exp. by more
Score for Indicator PI-2 (I)	C	Variance in expenditure composition exceeded 15% in no more than one of the last 3 years
Score for Indicator PI-2 (II)	A	Actual expenditure charged to contingency vote was on average less than 3% of the original b
Overall Score for Indicator PI-2	C+	

Annex 5: Documents Consulted

Country Background Information

West Bank and Gaza, Country Financial Accountability Assessment, World Bank Report No. 28990-GZ, June 2004

PFM Reform in the MENA Region: West Bank and Gaza Case Study, World Bank Report 55061-MNA, June 2010

West Bank and Gaza Data – the World Bank data.worldbank.org/country/west-bank-and-gaza

Fiscal Developments & Macroeconomic Performance: Fourth Quarter and Fiscal Year 2012, Macro Fiscal Unit, Ministry of Finance, March 2013

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Annex 6: Disclosure of Quality Assurance Mechanism

The following quality assurance arrangements have been established in the planning and preparation of the PEFA assessment report for the West Bank and Gaza, final report dated 06/2013.

1. Review of Concept Note and/or Terms of Reference

- Draft concept note and/or terms of reference dated 29/01/2013 was submitted for review on 13/02/2013 to the following reviewers:

  - 1) Philip Sinnett, Head of PEFA Secretariat
  - 2) Jacque Charaoui, Regional Advisor to the IMF/Middle East Technical Assistance center
  - 3) Franck Bessette, Sr. Financial Management Specialist at the World Bank (MN)
  - 4) Andrew Bird, PFM expert, consultant.

  Final concept note and/or terms of reference: forwarded to reviewers on 03/08/2013, including a table showing the response to all comments raised by the reviewers.

2. Review of draft report(s)

- Draft report dated 06/2013 was submitted for review on 06/08/2013 to the following reviewers:

  - 1) Philip Sinnett, Head of PEFA Secretariat
  - 2) Jacque Charaoui, Regional Advisor to the IMF/Middle East Technical Assistance center
  - 3) Franck Bessette, Sr. Financial Management Specialist at the World Bank (MN)
  - 4) Andrew Bird, PFM expert, consultant

3. Review of final draft report

A revised final draft assessment was forwarded to reviewers on 14/6/2013 and included a table showing the response to all comments raised by all reviewers.