

# **Financial Management Issues for Programme Support Methodologies**

**A: Diagnostic Practices  
B: Financial Reporting and Audit**

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**Crown Agents**



SWEDISH INTERNATIONAL DEVELOPMENT  
COOPERATION AGENCY

Methods Development Unit



## Foreword

This study has been carried out at the request of the Methods Development Unit of Sida by Crown Agents. It describes, analyses and discusses various diagnostic instruments and the processes on their use in assessing financial management systems in partner countries.

The report is one in a series of working papers reflecting the different facets of “programme support.” It is meant as an input into the work of Sida’s task team on “programme support”, which was established in 2001. Its task is to support the operating departments of Sida in their participation in different forms of programme support processes.

For this series of working papers we will use the term “programme support” for different forms of development cooperation such as sector programme support (SWAP), debt relief, general budget support and core funding of organizations. These various forms of cooperation are characterised by strong leadership on the part of the cooperating country or organization, strive towards basket funding, coordination in all steps and harmonization of procedures; all within a framework of one single strategy.

We hope that the report will be of interest to other cooperating partners who are concerned about the issues identified in the report, and stimulate debate and further development of the use of diagnostic instruments.

*Stockholm, August 2002*



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## Acronyms and Abbreviations

<b>CA</b>	Crown Agents
<b>PCS</b>	Procurement & Consultancy Services
<b>ADB</b>	Asian Development Bank
<b>BMZ</b>	The German Development Agency
<b>CAS</b>	Country Assistance Strategy, a country programme prepared by the World Bank
<b>CFAA</b>	Country Financial Accountability Assessment, a World Bank diagnostic instrument
<b>CONTACT</b>	Country Assessment in Accountability and Transparency, a diagnostic instrument developed by UNDP
<b>CPAR</b>	Country Procurement Assessment Report, a World Bank diagnostic instrument
<b>DAC</b>	Development Assistance Committee, Organisation for Economic Co-operation and Development
<b>DFID</b>	UK Department For International Development
<b>DGIS</b>	The Dutch Development Agency
<b>FM</b>	financial management
<b>FMIP</b>	Financial Management Improvement Programme
<b>FTC</b>	Code of Fiscal Transparency, an IMF diagnostic instrument
<b>GA</b>	General Assessment, a USAID diagnostic instrument
<b>IDA</b>	International Development Association
<b>IFAC-PSC</b>	International Federation of Accountants, Public Sector Committee
<b>IGR</b>	Institutional and Governance Review, a World Bank diagnostic instrument
<b>IMF-GFS</b>	International Monetary Fund – system of government financial statistics
<b>INTOSAI</b>	International Organisation of Supreme Audit Institutions
<b>HIPC</b>	heavily indebted poor countries
<b>NGO</b>	Non-Governmental Organisation
<b>OCSPR</b>	Procurement Sector Board, Office of Core Services, World Bank
<b>PEFA</b>	Public Expenditure and Financial Accountability Unit, a technical group set up by EC, the World Bank, IMF, DFID and SPA
<b>PER</b>	Public Expenditure Review, a World Bank diagnostic instrument
<b>PETS</b>	Public Expenditure Tracking Surveys

## Acronyms and Abbreviations

<b>PREM</b>	Poverty Reduction and Economic Management, a network within the World Bank
<b>PRSP</b>	Poverty Reduction Strategy Paper
<b>ROSC</b>	Reports on Observance of Standards and Codes
<b>SPA</b>	Strategic Partnership with Africa
<b>SWAP</b>	Sector-Wide Approach
<b>TOR</b>	Terms of Reference
<b>UNCITRAL</b>	United Nations Commission on International Trade Law
<b>USAID</b>	US Agency for International Development

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# 1. Purpose and Structure of the Report

## 1.1. Background

This report has been prepared for Sida by Crown Agents within the framework of Sida's development of methods for programme support, and in accordance with the TORs (see Appendix I), this study has two parts (A and B). This is a dynamic area of study with initiatives taking place in several places, notably the World Bank, OECD-DAC and DFID (outside Sida). The topics discussed here are constantly being reviewed and discussed as international donor positions emerge. The reports introduction and background sections cover the need for public finance management diagnosis and international harmonisation issues.

## 1.2. Assignment A

Under assignment A1 (sections 4 to 9) the report describes the purposes and uses of diagnostic assessment. The report describes and analyses key features of the diagnostic practices (instruments and procedures) currently used by major donors to assess the state of public financial management (FM) in partner countries. It makes proposals to Sida on its own position with regard to these diagnostic practices in relation to its own methods of programme support (general programme assistance and sectoral programme assistance). A2 (sections 10 and 11) examines the process of diagnostic usage. Proposals arising from section A are presented in section 12.

## 1.3. Assignment B

The report develops criteria and points of departure for financial reporting and audits with the presentation of concepts for consideration in standard clauses in agreements. Characteristics of best practice in financial management are listed and discussed. The main conditionality for any agreement is likely to be the inclusion of a financial management capacity building programme. These are covered under Sections 13 and 14 of the report.

## 1.4. Instruments and Procedures

The study reviews the instruments and procedures used by:

- The World Bank Group, which has an array of instruments in various stages of development (details in appendix A)
- IMF – the Code of Fiscal Transparency (appendix B)
- UNDP – the CONTACT checklists (appendix C)
- Asian Development Bank questionnaire (appendix D)

- UK Department for International Development (DFID) (appendix E)
- US Agency for International Development (USAID)(appendix F)
- HIPC exercise (appendix G)

Other multilateral and bilateral donors have not responded to a request by the DAC Task Force (Sub-Group on Financial Management and Accountability) to submit details of their diagnostic tools and methods. It is considered, however, that the above list is sufficiently comprehensive for a usable analysis and recommendations.

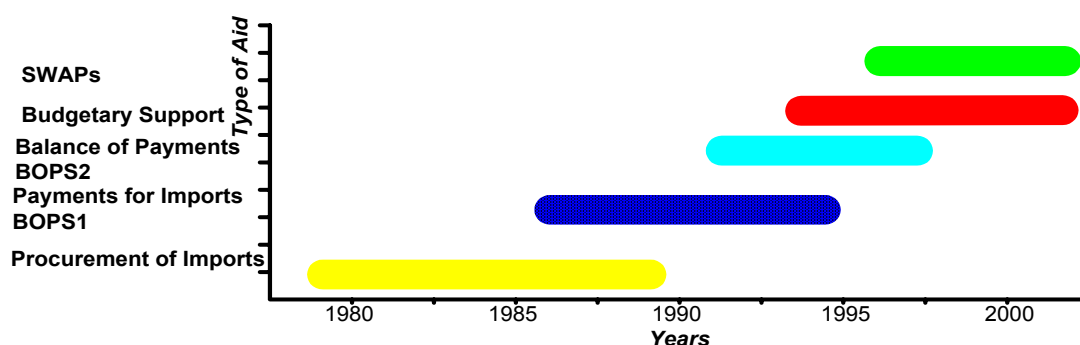
# Introduction and Background

## 2. The Need for Public Financial Management Diagnosis

### 2.1. Introduction

Programme aid is defined by DAC as assistance made available to a developing country without specific sector allocation for general development purposes, i.e. balance of payments, general budget support and commodity assistance.

**Figure 1: Evolution of Programme Aid**



BOPS 1 was payment of imports: many donors made funds available (including WB and DFID) to support allocated forex imports and letters of credit opened for the transactions. These were real time, current imports where the funds were used directly to support the LCs and draw down took place to meet the cost of claims against the LCs. As forex became liberalised this was no longer feasible as there was less central bank micro-control and replaced with BOPS 2;

BOPS2 was reimbursement of completed import transactions. This was usually justified against customs bills of entry showing eligible imports (i.e. not luxury goods, defence equipment, or previously aid-funded imports) had been imported over, say, the previous six months. (Certain donors theoretically tied this form of aid to eligible source countries or had additional stipulations such as they would not reimburse imports for the tobacco industry.

Programme aid has evolved over the past twenty years from micro-managed procurement of imports, through balance of payments support or commodity import support (in support of structural adjustment – principally foreign exchange liberalisation), including reimbursement of completed import transactions, to budgetary support. Budgetary support has, for certain donors, included reimbursement as justification of resource transfers. Arguably, the previous balance of payments and early examples of budgetary support had far less accountability than is currently envisaged.

With the increasing use of programme aid and sector-wide approaches by many donors, there is greater attention being paid by donors to the capacity of recipient governments to manage the procurement and financial management processes, to ensure that their fiduciary obligations are satisfactorily met. In September 2000, the World Bank set out a

proposed fiduciary framework for programme lending, which dealt almost exclusively with financial accountability issues. Other donors have argued that procurement should also form part of the fiduciary framework, and that minimum standards need to be specified for financial accountability and procurement effectiveness.

Widespread awareness of mis-governance in recipient countries, and the resulting scepticism of the value of aid, have concentrated attention on improving its effectiveness. Four main responses have been:

- A shift to a programme and multi-donor focus;
- Increasing attention (and not just lip service) to the ownership of aid programmes by the national authorities;
- The elevation of poverty eradication as the main goal – even overriding pure economic growth; and
- Wider participation in the formulation of programmes, including the private sector and civil society.

## 2.2. Medium-Term Programmes

The trend since the late 1980s has been away from a focus on projects to a broader focus on medium-term programmes covering economic sectors or sub-sectors<sup>1</sup>. The disadvantages of ring fencing are now widely recognised and have added to the case for the programmatic approach<sup>2</sup>. Compared with projects, programmes and sub-programmes have the advantage of addressing more of the policies and institutions<sup>3</sup> that bring about results. Programme aid has evolved from procurement of imports, balance of payments support towards budgetary support and sector support over the past twenty years (Donor Accountability Report, Crown Agents 2001 page 5). All major donors support the concept of comprehensive sector programmes as frames of reference for all external assistance within those sectors, though some donors are more constrained than others in the application of the concept.

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<sup>1</sup> In Sida, there has been a reverse trend, as programme aid has declined from 20 per cent of the total in 1990 to 5 per cent in 1997, but this has been largely the result of programme aid being treated differently from other aid and more susceptible to the global squeeze on total aid. White, Howard (1999) *Dollars, Dialogue and Development*, pp.14–18.

<sup>2</sup> It is widely agreed that donors have added to the administrative burden on national authorities by their various regimes of accountability. A country such as Tanzania, which is supported by about 50 donors, each having its own requirements for project formulation and approval, accounting, reporting and audit, faces a daily barrage of donor agency staff and consultants wanting to meet its top officials and an administrative workload that taxes its best personnel and undermines domestic reforms. Project implementing units suck the best and brightest national personnel out of their existing jobs by paying them higher salaries, which cannot be maintained after the projects are completed.

<sup>3</sup> 'Institutions' is used here in its wider sense of all the laws, regulations and codes, formal and informal, that help to determine the actual behaviour of public officials.

## 2.3. National Ownership

This approach is allied with a growing emphasis on national ownership, which is expressed in various ways. Ownership means that the relevant national authorities<sup>4</sup> are *committed* to the supported programmes; ideally they are the authors and drivers of the programmes and are willing to make substantial budget allocations to them. Commitment may be assessed through techniques such as stakeholder analysis and reform readiness analysis,<sup>5</sup> though there is little evidence of their use as both donors and recipients are under pressure to conclude agreements and continue aid flows irrespective of ownership.

Ownership usually also means that the national authorities *manage* and *take responsibility* for the supported programmes, using their own management systems of budgeting, procurement, accounting, reporting and audit (national execution). National ownership and empowerment of partner governments have been found to be important determinants of the effectiveness of aid. All donors stress their importance, but use them in varying degrees in their aid programmes.

## 2.4. Poverty Eradication

A third shift is a sharper focus on poverty eradication as the overarching goal. Each heavily indebted poor country (HIPC) seeking debt relief is required to prepare a poverty reduction strategy paper (PRSP). This requirement will be extended to all countries eligible for the Poverty Reduction and Growth Facility (the IMF's concessional lending arm) and for resources from IDA. The PRSP is endorsed by World Bank and IMF as the framework for all lending operations. As the main integrating context for all external support to a country, this has taken over from the Comprehensive Development Framework piloted by the World Bank in the late 1990s.

## 2.5. Participation

One of the defining characteristics of much of the present thinking on PRSP-based assistance is wide participation in the development of strategies. Wide participation not only spreads ownership, it brings greater transparency and accountability. While policy discussions are typically confined to donors and governments, NGOs are gaining some increasing recognition in the policy dialogue. In particular, they bring field experience of monitoring service delivery, involvement with local civil society groups with generally a more inclusive approach of wider stakeholder involvement.

## 2.6. Major Accountability Problem

The shift from projects to programmes and from donor management to national management has created a major problem of accountability. Whereas donor-supported

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<sup>4</sup> 'National authorities' include government at all levels, public enterprises, domestic NGOs and CBOs.

<sup>5</sup> See, e.g. World Bank Commitment to Reform diagnostic, available on website <http://wbln0018.worldbank.org/PREM/ps/iaamarketplace.nsf>

projects have traditionally been tightly managed in accordance with donor standards, programmes cannot be ‘ring fenced’ in this manner.<sup>6</sup> Donor agencies are accountable to their own constituents, and to wider stakeholder groups. Thus they have to assure themselves that their resources (potentially indistinguishable from other sources of funds in a general pool) are used for legitimate purposes (agreed programmes or, where aid is entirely untied, programmes that have been authorised by national law) and that they are used effectively.

## 2.7. Fungibility

Donors have long been aware of the fact that their aid is fungible. Aid to a government allows the government to reallocate its own resources. This is regardless of how it is configured, whether it is tied or untied, and whether tying is to particular projects, programmes, sectors, or to the import of particular products and/or from particular countries, and whether it is given in the form of cash or in kind. Where the recipient government has *different* values and priorities from the donor, the resulting fiscal pattern could *differ* from the donor’s intention, *unless* the aid is conditioned on the desired resulting pattern. For instance, where aid is intended for the health sector, if it is not conditioned on increased health spending, it *may* result in increased spending on, say, making war on a neighbouring country, funding terrorist groups, or reducing taxes.

## 2.8. Conditionality

The practical possibilities of conditionality vary from case to case. The higher the dependence on aid, the greater the need of the host country to accept such conditions and the greater justification the donors can show for their demands. It should also be noted that the condition applies to the ex post fiscal pattern, not to the plan or budget, given the possibilities of budget slippage. Donors such as the World Bank, IMF and USAID are being more selective in their allocation of aid funds and therefore more prescriptive: they prefer governments that follow their prescriptions (conditions) and are doing more towards ‘good governance’. They are rewarded with higher shares of aid funds.

The downside is the possible loss of national sovereignty and democratic governance. All conditionality intrudes on local decision making, but this is the price of external support. The price is not significantly high, perhaps, if donor agencies and national authorities share the same values and governance priorities. However, if there is a major difference in values held by donors and national authorities, and donor conditionality is not voluntarily accepted (perhaps grudgingly accepted as the price that has to be paid) there is a loss of sovereignty. If the national authorities are democratically elected, there is a loss of democratic governance. Under these circumstances conditionality may override the will of the people.

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<sup>6</sup> The disadvantages of ring fencing are now widely recognised and have added to the case for the programmatic approach.

## 2.9. The HIPC Example

An example is provided by the debt relief initiative in heavily indebted poor countries. 25 HIPCs were examined to assess their ability to track the use of resources made available by reductions in debt service into poverty-reducing spending (as defined by each country). 'Tracking' here has two meanings: checking that spending on poverty-reduction programmes shows an increase over a base case, and checking that the spending was effective, i.e. that poverty indicators improve. Most HIPCs do not yet have the FM systems to track either expenditures or outcomes. The World Bank is helping with public expenditure tracking surveys (PETS) and its regular public expenditure reviews.

## 2.10. Diagnostic Appraisals

In other countries, donors seek assurance that their funds will be properly used by means of a diagnostic appraisal or benchmarking of the sectoral and national systems and procedures for public funds management. In addition assurance is sought from the commitment of the national authorities to reforming their systems and building their capacity where the appraisal reveals fiduciary weaknesses.

## 2.11. A need to Develop Common Tools

What is now needed is a procedure for diagnosis of a country's governance framework, including its financial management arrangements, which will be accepted by all donors (a 'harmonised' procedure) and by the national authorities (ownership) at minimum cost to host countries and maximum effectiveness of supported programmes. The benefits of harmonisation to donors are that a single shared set of measures (such as in a CFAA) can be adopted and recognised as the irreducible minimum diagnostic tool.

Recipients will have clarity of recognition of the scope of diagnosis, the reasonable assurance of minimal disruption and the aspiration that donor energies will be focused on the release of targeted budgetary support rather than the minutiae of accountability. Diagnostic arrangements will evolve over time and be the subject of partnership discussions between donors and recipients. Consideration can be given to using independent indigenous resources in recipient or local countries to carry out diagnostic activity in order to develop the local skills base. The development and use of common diagnostic tools will also deliver benefits to both donors and partner governments in terms of greater efficiency in resource utilisation.

### 3. International Harmonisation Initiatives

Early efforts by the UN and UNDP highlighted the need for harmonisation, but were unable to influence the donor agencies<sup>7</sup>. More broad-based initiatives are now under way.

#### 3.1. SPA

The Strategic Partnership with Africa (SPA) is a network of donors and sub-Saharan countries. In 2001 it established a Financial Management and Accountability Task Team, chaired by a bilateral donor, which reports to a Technical Group, co-chaired by DFID and EC, and an annual Plenary, headed by the World Bank Vice-President – Africa. SPA donors agreed with the Bank to undertake joint CFAAs in Malawi and Burkina Faso in 2001 to assess the CFAA process and see how it might be improved. The final report on these pilots is awaited.

#### 3.2. OECD-DAC

The Development Assistance Committee of OECD, which represents most of the bilateral donors, set up a Task Force on Donor Practices in January 2001 to identify practices that would reduce the transaction cost of aid management to the host countries and improve aid effectiveness. The Task Force is examining pre-programme diagnostic practices and programme monitoring, reporting and audit practices. It has proposed a Protocol to facilitate optimal collaboration with development partners in carrying out diagnostic work on financial accountability.

#### 3.3. Multilateral Development Banks

The World Bank and four regional development banks<sup>8</sup> created a Multilateral Development Bank (MDB) Working Group in February 2001 to address the harmonisation of their policies and practices in FM (public and private), including diagnostic reviews. They aim to collaborate in planning, conducting and sharing the results of diagnostic reviews in financial management and accountability. The Working Group has proposed to IFAC Public Sector Committee (PSC), the setter of international standards of financial reporting for the public sector, that donors require in future the

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<sup>7</sup> United Nations Department for Development Support and Management Services and INTOSAI established a working group, funded by a group of like-minded bilateral donors. Their work was reported in United Nations, DDSMS, Division of Public Administration and Development Management (1996) *Aid Management and Accountability Initiative, 1991–1994*. This focused more on downstream accountability requirements than on pre-project diagnostics. The work was transferred to UNDP in 1995 and led to the production of a diagnostic instrument called CONTACT. See UNDP (2001) *Country Assessment in Accountability and Transparency: Self-Assessment Guidelines to Evaluate the Financial Accountability and Transparency of a Recipient Country*. Bureau for Development Policy, Institutional Development Group, Programme for Accountability and Transparency.

<sup>8</sup> African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development and Inter-American Development Bank. The Islamic Development Bank has expressed a desire to join.

same general-purpose reports as other users of government financial statements, in place of the multiplicity of special reports they require at present.

### 3.4. IFAC

The Working Group has also proposed that a separate standard should be issued by IFAC-PSC on ‘Accounting for Development Assistance’. This would cover:

- (i) accounting for and reporting aid in the form of cash (including special accounts), direct payments to suppliers by donors, and in kind (including physical assets);
- (ii) accounting for and reporting liabilities and debt service arising under loan aid, including grace periods and the proposed change in valuation of liabilities to their ‘fair value’;
- (iii) accounting for assets where their fair value is less than cost, e.g. due to restricted procurement or overvaluation (as a condition of aid), or to corruption.

The DAC Task Force has endorsed this proposal.

# Assignment A1

## 4. A1: Purposes and uses of Diagnostic Assessment

The central purpose of a harmonised diagnostic instrument should be an assessment of the risk that the development goals of the country's Poverty Reduction Strategy Paper are not realised because of fiduciary weaknesses. It should assess the risk that funds are not used cost-effectively for the agreed purposes or, where resources are not tied to particular purposes, that they are not used legitimately. Fiduciary risk is a part of developmental risk. If, for instance, financial statements are late or unreliable, there is a risk of overspending and fiscal instability, inappropriate allocation of resources and inefficient use of resources, all of which detract from PRSP goals.

Fiduciary risk is the risk to a provider of funds (taxpayers, donors) that the funds will not be used for the purposes intended by the provider. For the World Bank, this is predicated on the Bank's constitution, which requires that "The Bank shall make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations". Similarly, DFID is responsible to the UK Parliament for ensuring not only the propriety and regularity of the funds entrusted to the Department but also for seeking economy, efficiency and effectiveness in their use. Other donors have similar responsibilities. So fiduciary risk is concerned not only with ensuring that resources are used 'for the purposes intended', but also that the recipients achieve value for money<sup>9</sup>. VFM deals with expenditure and the achievements of socio-economic goals and MDGs. This is evidently a component of 'developmental risk', since development depends on programme effectiveness within the resources available.

The bottom line for all major donors is 'development', most often measured in terms of economic growth and eradication of poverty (recognised in the Millennium Development Goals for example). The substantive coverage of a fiduciary assessment in its widest sense can hardly be distinguished, therefore, from a total governance assessment. Financial management is merely one discipline that can contribute to an overall assessment. A governance assessment also needs general economists, fiscal economists, institutional economists, political scientists, procurement and electoral experts.

The assessment should provide baseline data, as objectively as possible, against which future progress can be assessed.

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<sup>9</sup> Value for money, also called cost-effectiveness, is the ratio of results (effectiveness, impacts) to expenditure (inputs). Economy, efficiency and effectiveness are partial measures that usually (but not necessarily) reflect value for money.

#### 4.1. From Diagnosis to Prescription

A diagnostic assessment is not necessarily a prescriptive instrument, as diagnosis, prescription, negotiation, financing, implementation, monitoring and evaluation are all distinct phases in the development process. In fact, most diagnoses do go part of the way to prescribe what should be done as each phase should lead into the next. The CFAA guidelines, for instance, call for suggested actions to address identified weaknesses, ‘desirably set out in a prioritised and time-bound action plan’. This is intended to avoid vague and general recommendations, e.g. ‘greater attention should be paid to...’. The greater danger is that recommendations are articulated by the authors in advance of the government response on prioritisation of issues, strategies of reform and programme formulation, and that opportunities for national ownership are thereby lost. This may happen because the process is driven by donors according to their own timetables, which do not allow adequate time for the reconciliation of conflicting interests and pressures within the government

The proposed DAC Task Force Protocol supports this argument. It states that the diagnostic report should suggest actions to address identified weaknesses and include the views of the government on the report’s findings. Following the report, the next steps toward implementation are:

- Workshops to discuss the findings;
- Formulation of an implementation strategy, action plan and monitoring system;
- Identification of possible funders; and
- Negotiation with them<sup>10</sup>.

National ownership and commitment can grow only at their own pace and in accordance with local decision-making processes. Adequate time should be allowed between a diagnosis of FM weaknesses and the final prescription of how they are to be treated, in which the national authorities should play the lead role. Scepticism about the ability of conditionality to promote reform in countries where there is no strong local movement in that direction should apply also to the promotion of action plans. The same thinking should be applied to proposed financial management reforms in the list of conditions. These are driven by the need for fiduciary responsibility, but do not allow for the failure of unilateral conditionality.

#### 4.2. Fiduciary Purposes are also Developmental

It is often said that a diagnosis of FM has two purposes – fiduciary and developmental. This reflects the fact that the diagnosis lays the foundation for a programmatic approach by improving the financial management of the recipient country and, at the same time, provides fiduciary information to the donor.

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<sup>10</sup> Protocol to facilitate an optimal collaboration with development partners in carrying out diagnostic work in the field of financial accountability (undated, ?2002)

Fiduciary assessment may be regarded as each donor's 'due diligence' check to satisfy itself that its funds are used for agreed (or legitimate) purposes. As such it is usually driven and owned by the donors. This may affect the scope and inter-country comparability of assessments, as well as their ownership. The scope of an assessment that is purely fiduciary, for instance, would cover only expenditure. Revenue issues are not relevant to an assessment of the risk of misuse of donor funds – stakeholders need to know only the risk to the pool of funds to which they are contributing. The taxpayers in a recipient country also need fiduciary assurance but the assessment is more particularly directed at the needs of donors.

## 5. Frequency

Assessments of risk are outdated by changes in the fiduciary environment. Governments change, new leaders emerge, new governance institutions are established and former weaknesses are met. All these may be grounds for a fresh assessment. The World Bank has decided that all major borrowers should have CFAAs done, if not already done within the last five years, by June 2004. This implies a five-year frequency. Bilateral donors may wish to consider how they can incorporate CFAAs as the essential building blocks in the monitoring process with more regular progress reviews undertaken at perhaps a less intense level of intervention. The need to balance assessment demands with the need to minimise intrusion has to be carefully managed.

## 6. Coverage

All fiduciary diagnostic instruments cover the cycle of public FM – financial planning, programming and budgeting, procurement,<sup>11</sup> payment systems, payroll, accounting, internal control and audit, reporting and external audit<sup>12</sup>. Treasury functions (banking and cash management) should also be included. Recent additions to the CFAA coverage complete the accountability cycle with 'legislative review' and 'public access to fiscal information'. The latter should include a review of the ways in which beneficiaries and other outside stakeholders such as NGOs participate in planning, budgeting and monitoring, particularly in social sector programmes.

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<sup>11</sup> The World Bank CFAA does not cover procurement as this is covered by a separate instrument, the Country Procurement Assessment Report, produced by procurement specialists. The merits of merging CFAAs and CPAR continue to be debated by donors.

<sup>12</sup> The USAID General Assessment focuses on internal controls within the executive, and makes little reference to oversight agencies such as the state auditor or legislature.

## 6.1. Fiduciary Coverage

Strictly, a fiduciary assessment covers *all* agencies spending from the pool of public funds, directly or indirectly. At least in principle (though not often in practice because of time and money constraints) a fiduciary assessment covers central and local government agencies and statutory bodies (together making up ‘general government’ as defined by IMF-GFS). It also covers public enterprises, and also non-government organisations insofar as they receive subventions from the government, and private firms insofar as they receive public funds, e.g. funds on-lent through development banks. If the scope of an assessment is limited by a government, it may be directed away from areas where the government fears embarrassing disclosures. In some countries, sensitivity to external assessment is very high. The fiduciary need is potentially adversarial. The dilemma facing all donors is the need to reconcile fiduciary due diligence with the trust implied in the partnership concept. Donor strategy is to emphasise the developmental benefits while ensuring that fiduciary risks are adequately covered.

Inter-country comparability of assessments is undermined where the scope of assessments is subject to mutual agreement and therefore not standardised. It would not be possible, for instance, to make a defensible rating of fiduciary risk where each country is assessed in different areas (or by a different set of standards). At present, this has not become an issue. Any donor ratings of accountability are kept closely confidential<sup>13</sup> and there is no great pressure for transparency of findings. Only independent agencies, such as Transparency International, Freedom House, Heritage Foundation and International Country Risk Guide, publicise their ratings.

## 6.2. State, Regional and Local Coverage

Diagnostic instruments do not necessarily cover *sub-national* levels of government explicitly. They are not excluded, however. The rationale is that the same standards apply and the same questions can be asked at each level. Whether an assessment goes down to sub-national levels would depend on the risk at those levels (roughly indicated by the proportion of their spending to total ‘general government’ spending, and special factors applying at those levels). High risk would justify the allocation of additional analytical resources, or a reasonable share of a fixed allocation. It may be noted that including local authorities is likely to add considerable travel and subsistence expenses. In the Bangladesh CFAA, the section on local authorities was based on a sample which had been examined by a local firm of consultants.

The same approach is applied to public enterprises and NGOs in receipt of government grants, subsidies or capital injections. Their FM arrangements are included, and their risk is assessed, if the incremental benefit exceeds the incremental cost.

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<sup>13</sup> Such as the World Bank’s Country Policy and Institutional Assessment annual ratings, made on all borrowers. Assessments are made subjectively by country teams and moderated centrally.

### 6.3. Private Sector Accountants and Auditors

Up to about 2000, CFAAs examined the professional infrastructure of accountants and auditors – their numbers, professional status, education and training, and the adoption and enforcement of financial reporting and audit standards. This subject is now one of the Reports on Observance of Standards and Codes (ROSC) series, a joint initiative of the IMF and World Bank. This particular ROSC is done by World Bank staff, but it is quite separate from the CFAA. In fact, it has only marginal relevance to public FM (see below).

### 6.4. Public Sector Accountants and Auditors

In most developing countries, the public sector has very few (if any) qualified accountants, due to low public sector salaries and the preference given to planning and budgeting functions to those with high academic qualifications. ‘Strengthening the profession’ has more impact on foreign investment than on public FM<sup>14</sup>.

The cadres that need strengthening include: budget officers, accounts officers procurement officers, cashiers, internal auditors and external auditors. These are the people whose knowledge, skills, attitudes and incentives determine the quality of public FM. The recent CFAA Guidelines require an assessment of the numbers of professional budgeting/accounting/procurement staff in the public sector. This should be expanded to include internal and external auditors. Nor should coverage be limited to professional levels, as most public FM work is handled by non-professionals. Technician and bookkeeper levels should be included. Procurement staff and activities are regarded as very much part of the public expenditure process. If capacity is inadequate, a major recommendation of a country assessment is likely to be the building of public FM capacity, so the assessment should include a preliminary assessment of training needs and recommendations for meeting them.

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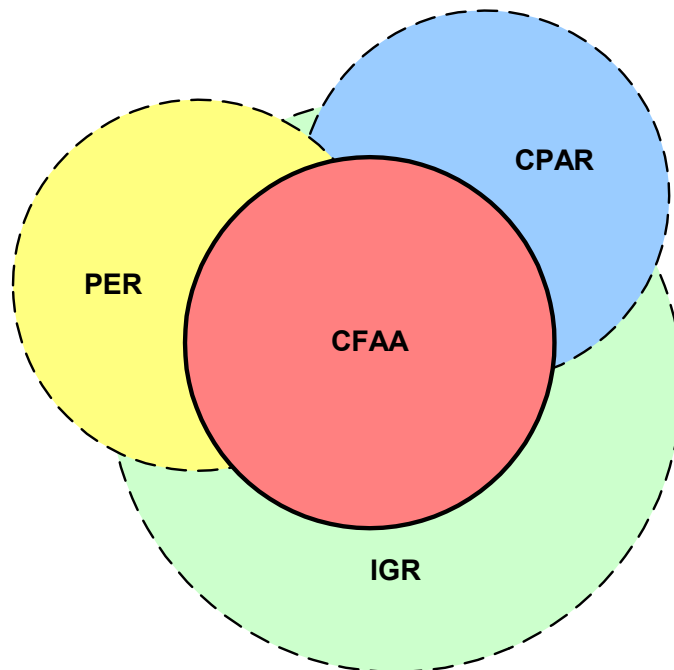
<sup>14</sup> See also Sida (2002) Study No. 6, Programme Support and Public Finance Management: A New Role for Bilateral Donors in Poverty Strategy Work, pp.142/3.

## 7. Overlapping World Bank Instruments

A recurring complaint is that, even if donors agreed on a harmonised diagnostic procedure or instrument, the World Bank conducts a multiplicity of diagnoses in the public FM area, which overlap. Successive teams come to the government of a country to do a Public Expenditure Review (PER), Institutional and Governance Review (IGR), Country Procurement Assessment Report (CPAR) and a Country Financial Accountability Assessment (CFAA). In the past, the overlap (see diagram below) has resulted in the same questions being asked repeatedly of the same public officers.

The elements of overlap vary according to instrument, with each focusing on budget execution. The CFAA coverage incorporates budget oversight, reporting and execution. The PER incorporates budget policy, preparation, execution and reporting while the focus of the CPAR is primarily on budget execution. It should be emphasised that the instruments are not fixed in time or content, they are evolving constantly to fit new paradigms and emerging situations, so exact detail on overlaps is difficult to define.

**Figure 2: Overlapping World Bank Diagnostic Instruments**



The justification for multiple assessments is that public FM is not a matter only for accountants. The World Bank brings different professional disciplines to bear on the FM problems of a country, including fiscal and financial economists (PER), institutional economists and political scientists (IGR), procurement and supply professionals (CPAR), and accountants (CFAA). The danger of overlap is a real one but it can be reduced by ensuring either that assessments by different teams are done jointly (where this is logistically possible), or that each team has access to earlier work, even in draft form.

If the work is adequate for the team's purpose, the team builds on it, thus avoiding duplication. Each assessment has to begin with an Initiating Memorandum (Concept Paper) which forces the team leader to review what others have done and arrange for future co-ordination. The Memorandum is reviewed and approved by the respective subject networks and the Country Director, who controls the allocation of funds for all such economic and sector work. Assessments are integrated ex post, in the dialogue on Country Assistance Strategy, and in the formulation of public sector reform programmes.

There is an obvious interrelation between the PER and the CFAA. Neither instrument is standardised in practice. There are no guidelines for undertaking a PER (see Appendix A). However, the review is structured on the Campos-Pradhan analysis, whereby the three purposes of public expenditure management are fiscal discipline (so as to achieve macroeconomic fiscal and monetary goals), resource allocation (in accordance with strategic plans such as the PRSP), and economic efficiency. The PER examines a country's public FM institutions to determine how they contribute to each of these general purposes. A full review covers the legal framework for public FM, the role of the government (vis-à-vis the private sector), budget coverage and structure, budget planning and preparation, budget execution, aid management, accounting systems, auditing, evaluation, FM information systems and performance measurement.

This covers almost all of the CFAA content, though the PER gives more weight to planning and budgeting issues, and the CFAA gives more weight to 'downstream' issues of budget execution, accounting, reporting and audit. PERs have changed over time from omnibus-type exercises done once every three years to more narrowly focused analyses, such as public expenditures in social sectors and public sector pay. Some PERs have been prepared jointly by Bank staff and country counterparts. However, less than a quarter of PERs in recent years have adequately focused on institutional issues.<sup>15</sup> Ideally, PERs and CFAAs would be integrated and assessment teams would include both economics and accounting/audit skills. Together with other donors, the World Bank is pursuing the concept of an 'integrated fiduciary assessment' that would bring together the findings of CFAAs, CPARs and PERs.<sup>16</sup>

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<sup>15</sup> World Bank Poverty Reduction and Economic Management (PREM) network, Note 20, April 1999.

<sup>16</sup> A Public Expenditure and Financial Accountability (PEFA) Unit has been set up by the EC, World Bank, IMF, UK-DFID and the Strategic Partnership with Africa. It has a \$4 million, 3-year program financed by the Bank's Development Grant Facility, the EC and UK-DFID. The PEFA Secretariat is located in the Bank. Efforts are being made to bring in more partners, multilateral and bilateral, engaged in helping developing countries modernise their public expenditure and financial accountability systems and/or in harmonising international standards and benchmarks in this field. It provides financial and staff resources for carrying out pilot assessments of countries that are seeking to adopt a more co-ordinated and integrated approach to assessing and reforming public expenditure, procurement and financial accountability systems. It also aims to help the Bank and partner organisations strengthen diagnostic tools and approaches in the field and develop relevant performance indicators and benchmarks.

## 8. Standards of Comparison

The main sources of standards<sup>17</sup> in each area of FM are shown in Appendix H<sup>18</sup>. In the past decade there has been an increasing stream of new studies, standards and codes of best practice. At present, there is considerable agreement among the international community as to what constitutes ‘best practice’ as at present though this is under continuous development. This can be seen by comparing the various instruments. On any given subject, the standards are substantially the same, varying only in terminology, level of detail, or stress. They are summarised in section 13 below.

Some standards are set by assessment agencies. Their diagnostic instruments set standards by asking normative questions to which a ‘no’ answer implies a fiduciary weakness. No standard setting body has powers of enforcement, though assessment bodies that are also major funders of governments have an indirect influence on compliance.

The sensitivity to disclosure of fiduciary weakness has muddied the waters on the selection of standards. It is sometimes claimed that particular countries or regions should be assessed on standards that take into account their history, culture and level of development<sup>19</sup>. The preference is for standards that are less out of reach, more ‘reasonable’ and generally kinder. This misses the point of assessment, which is to disclose risks that need to be prioritised even if the time frame of treatment may be long-term.

The main difference between diagnostic instruments, apart from their scope, is their level of detail (see table below). For 25 heavily-indebted poor countries (HIPC) seeking debt relief from creditors, a short list of 15 standards was considered adequate to assess the risk that funds freed up by debt relief would not be used for poverty reduction programmes, such as preventive health care and primary education.<sup>20</sup> On each standard a country was rated on a scale of A (little upgrading required) to C (substantial upgrading required). This grading system could be used to quantify fiduciary risk, and to measure progress of aspects of a FM reform programme.<sup>21</sup> However, the country’s position – A, B or C – on only 15 standards can not possibly provide sufficient information on the strengths and weaknesses of public FM to formulate a prioritised set of recommendations. It should also be noted that the HIPC standards relate mainly to the country’s capacity to present reliable and up-to-date accounts of poverty expenditures. Other aspects of FM are not covered. At the other extreme, CONTACT (all modules) contains 605 questions.

Another difference is that some questionnaires offer alternative answers (multiple choice), or are scaled in some way, while others require only yes or no answers (‘is this standard followed?’). Scaling allows more precise responses. This helps the respondent, and also

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<sup>17</sup> Standards may also be called benchmarks, norms or best practices.

<sup>18</sup> A more complete account is provided by the OECD-DAC Task Force on Donor Practices, SubGroup on Financial Management and Accountability (2002) *An Inventory of Relevant International Standards*

<sup>19</sup> See, for instance, Sida Study No. 6, para.6.3.1. This equates uniform standards with donor insistence that all the standards be adhered to with equal priority, without first getting the basics right.

<sup>20</sup> OECD-DAC (2002) op.cit. pp.12–15

<sup>21</sup> OECD-DAC (2002) op.cit. recommendation 2 is that this work be developed by PEFA.

allows the conversion of responses into a numerical rating if this is desired (e.g. for inter-country comparisons).

<b>Diagnostic</b>	<b>No. of questions</b>	<b>Multiple choice?</b>
HIPC	15	No
DFID	16	No
IMF Code of Fiscal Transparency	84	Yes
World Bank Public Expenditure Mgt Handbook – checklists	117	No
World Bank Public Expenditure Mgt Handbook – questionnaire	101	No
World Bank Pub Exp. Institutional Assessment	252	Yes
ADB Managing Public Expenditure, Appendix 11	172	No
CFAA (typical questionnaire)(excluding procurement)	105	Yes
CPAR	235	No
CONTACT (all modules, incl. anti-corruption)	605	No

The CFAA instrument (Appendix A) has been adopted by SPA for joint testing by donors and governments and as a starting point for an eventual harmonised instrument. Though it needs further development, and is not yet a public document, it appears to be a good basis for further harmonisation.

## 9. Disclosure

Most diagnoses are open only to the parties involved, but can be published with the agreement of the government concerned. The Bank encourages governments to involve a wide range of interested stakeholders in the CFAA process and to disseminate the results to these groups. As a minimum, a government is encouraged at the start to agree to a grey cover report (publicly available without being widely distributed). A red cover report (wide public distribution) is also considered.

The IMF has been criticised for keeping confidential the results of its Article IV consultations (about 130 surveillance reports a year). These include fiscal transparency assessments. In 2001, the IMF itself adopted a more transparent policy. Most fiscal transparency assessments are now posted on its web site with government consent (33 countries out of 38). Full transparency is difficult as the IMF is not only an independent rating agency; it has a second role as an adviser to governments. It could not perform that role if its private consultations with ministers of finance were to be publicly available.

## Assignment A2

### 10. A2: Process

#### 10.1. Desk Review

For almost any country there is a tremendous amount of relevant information readily available<sup>22</sup>. A desk review of this information should always precede field visits, as a matter of cost-effectiveness, partnership with other stakeholders, and courtesy to national counterparts. To ensure that all topics are covered, *the desk review should be matched against standard questionnaires*, such as those of the CFAA, PER, IMF-FTC and CONTACT. This should result in a reduced set of questions for each official, tailored to country institutions and terminology.

#### 10.2. Questionnaires

It is sometimes recommended that standard questionnaires be sent in advance to the respective country officials for self-assessment and followed up with personal interviews as an application of due diligence. This approach may promote ownership and acceptance of the results where the political directorate has already made a commitment to reform and this is accepted by respondents. It is less likely to promote acceptance, and may harden opposition to external interventions, where officials have no incentive to change, e.g. where corruption is endemic. The countries that have the greatest weaknesses are the ones that have the least interest in self-assessment, and the greatest incentive to hide their weaknesses, especially where they expect aid flows to depend on 'good governance'<sup>23</sup>.

#### 10.3. Face to Face Interviews

Whether standard questionnaires or tailored interview guides are sent out in advance, they need to be followed up by face to face interviews, conducted by consultants who are familiar with international standards, local institutions and conditions and can interpret questions to national respondents. Consultants can go further into defining the underlying causes of weakness, the *obstacles* to reform and possible *options* that would not be revealed by any questionnaire alone.

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<sup>22</sup> Assessments and other reports by donor agencies, supervision reports on donor projects in the country, government budget documents, audit reports, reports by legislative review committees, government websites, and data from the websites of private or non-governmental organisations such as Transparency International, Freedom House, Heritage Foundation, International Country Risk Guide, Economist Intelligence Unit.

<sup>23</sup> The UN International Conference on Financing for Development in Monterrey (2002) has reinforced the trend to tighter linkages between aid and governance. The increase in aid pledged by the US is intended only for countries that are committed to good government (and open their markets to foreign competition) (New York Times, 24 March 2002).

## 10.4. Assurance

*A diagnosis is a limited scope review, not an audit.* ‘Reasonable assurance’, in an audit sense, may be unattainable in many developing countries. Increasing the scope and depth of the review may only increase the level of assurance that *no* reliance can be placed on national systems. In such a case, the value of the review lies in identifying treatable weaknesses.

The selection of interviewees is judgmental. Agencies and activities where risks are thought to be significant may be weighted more highly. In a diagnosis for sectoral budget support, interviews should normally be held with the head of each selected sector agency, with heads of finance and internal audit (if any) and with persons outside the agency who deal with the agency and who can corroborate the inside story. For instance, the World Bank’s procurement review normally includes information from private sector suppliers. The aim is to ascertain actual practices, not what rules and regulations prescribe. It may be necessary to confirm answers by inspecting key records, such as the cashbook and the latest reconciliation with bank statements.

USAID goes further. Their General Assessment is more like an audit than the CFAA in that the entity-level assessment is based on a sample of transactions selected from its records and on supporting documentation. However it is not an audit of financial statements. The contractor (typically an independent firm of accountants) is required to provide an opinion on the general accountability environment, and on whether the assessed organisations meet generally acceptable management and accounting standards. The TOR for the joint CFAA in Malawi similarly included ‘reality checks’, which they made one of the functions of the national counterparts.

## 10.5. National Counterparts

The dynamics of national ownership are still little understood. One factor that is likely to increase the chance of national ownership and effective implementation is the early identification and participation of national counterparts. These may be the respondents to questionnaires, typically senior officers who would be involved in policy changes emerging from the process. Alternatively, they may be selected officers at operational levels. If counterparts feel that they have been personally selected for their experience, drive and reform orientation, this helps them identify with the objectives of the diagnosis and prescription. Counterparts may assist in the field study, verify the facts, and participate in workshops and assist in monitoring implementation.

## 10.6. Summary of the Process

Following the analysis above,<sup>24</sup> the indicated procedure may be outlined as follows:

- The national authorities and all other key stakeholders<sup>25</sup> in a given country agree to adopt a common approach, in which *all assessments* bearing on risks to development

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<sup>24</sup> This draws also on Torun Reite (2001) Lessons learnt from donor participation in Country Financial Accountability Assessments, Discussion paper for an SPA meeting, November 1991

goals arising out of weak financial management arrangements are to be collapsed into one assessment undertaken jointly. This follows general agreement on the objectives, procedure, timetable, budget and funding, selection of lead donor, appointment of national liaison officer, and publication of results. This agreement may be arrived at through existing machinery such as Consultative Group meetings, or by specifically arranged roundtables. The objectives will determine the required components of the assessment (legal, financial, procurement, personnel, fiscal, institutional, integrity) and their scope. These agreements are designed to promote national ownership and participation in the process and acceptance of the final outcomes.

- The lead donor mobilises and briefs the diagnostic team, including relevant skills and national/international mix. Supporting donors may be required to approve consultants' CVs.
- The diagnostic team collects and shares all available relevant documentation and undertakes a desk review. Using standard comprehensive questionnaires and knowledge acquired in the desk review, they select agencies and interviewees and develop individual interview guides (IGs), with questions tailored specifically to the country, agency and person. The purpose of the IG is to ascertain the present risks to public funds, their significance for development goals, and any present plans to reduce risks (including ongoing reforms), obstacles to reform and possible options for the future. If necessary, national consultants may be given training in the use of the IGs. Supporting donors should also be consulted on IGs before they are finalised.
- National consultants undertake in-country interviews and report back to the full diagnostic team on actual practices, risks, options, etc. Contact details of each interviewee/counterpart are retained for any subsequent clarification or verification that may be needed
- Diagnostic team prioritises issues, develops implementation strategies and initial proposals for a financial management improvement (risk reduction) programme
- Diagnostic team presents the issues, strategies and proposals at a national workshop to relevant government officers, counterparts, representatives of oversight agencies, donor country offices and other stakeholders including the private sector and civil society, with the aim of building consensus and involving key decision makers. More than one workshop may be needed to reach all relevant persons and to allow time for support to grow. It may be advantageous to hold mini-workshops on a modular basis.
- The lead donor formally presents the national authorities and supporting donors with the diagnostic report, workshop report(s), proposed workplan (including key performance indicators) and costing, and invites their responses

A similar set of arrangements may be made for subsequent phases: negotiation of the aid agreement, monitoring implementation, and programme evaluation. The lead donor may

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<sup>25</sup> These include the Ministry of Finance and representatives of major donor agencies as a bare minimum, but could be expanded to include other donors, accountability oversight bodies such as the Supreme Audit Institution, Parliamentary Committees concerned with public finance, NGOs such as the local chapter of Transparency International and the media (if representative of taxpayers). There is inevitably a trade-off to be made between wider participation and the time.

change for each phase of the development process. No single donor should dominate the process, and each phase should be planned jointly and agreed by all stakeholders. The national authorities should take the lead where they are able and willing to do so. There should be full transparency and sharing of documents in each phase among all stakeholders.

## 11. Application of Assessment Results to Programme Assistance: Management of Risk

### 11.1. Definitions

Programme assistance is defined as ‘all contributions made available to a recipient country for general development purposes, i.e. balance-of-payments support, general budget support and commodity assistance, not linked to specific project activities’ (OECD 1991, Principles for Programme Assistance, p. 5). To this definition, debt relief can be added as this also releases resources for general development purposes.

Sector budget support<sup>26</sup> is normally tied to an agreed sector policy and programme and is disbursed against execution of the agreed policy and expenditure. It is not, however, tied to specific projects or activities. It is therefore within the OECD definition.

Thus, there are two modalities to consider: general programme assistance and sector programme assistance. Within these categories there are many other distinctions. These include whether or not the government is aid dependent, whether the government is the main financier (typically in health, education and roads) or not (typically in agriculture), whether a sector falls under a single ministry (e.g. education) or multiple ministries (e.g. environment), whether sectoral institutions have a common accountability framework or not (e.g. a ministry, statutory bodies and public enterprises).

Risk is the probability of the intended purposes of assistance not being achieved. Purposes are expressed in any of four ways:

- The planned outputs or outcomes of a programme, where funds are tied to spending on that programme, as in sector programme assistance (and project assistance)

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<sup>26</sup> Sector programmes have accumulated a variety of names over the past few years, including sector investment programme and sector-wide approach (SWAp), particularly in the health and education sectors. The term SWAp is now used to denote a financial instrument that supports a single sector policy and programme under government leadership, that relies on (or progresses towards relying on) government procedures to disburse and account for all government expenditure. Donors may put funds into a common pool (co-financing) or disburse separately against expenditure statements (parallel financing). SPA donors seem to prefer ‘sector programme’ as a generic name that is not connected with any particular institution.

- Expenditures incurred in accordance with national laws and regulations and agreed policies, where funds are not tied to any particular uses, as in general programme assistance
- Macroeconomic or government fiscal parameters (e.g. fiscal deficit within x% of GDP)
- Formal statements of policy, draft legislation, or other process indicators, typically in adjustment lending.

Public FM diagnosis is concerned mainly with assessing risk in the first and second categories. However it has relevance to the third (fiscal targets require fiscal discipline) and to the fourth (process indicators in the FM field, such as progress milestones in a FM improvement programme).

In all diagnostic instruments, risk is assessed by comparing actual FM practices with internationally accepted standards or, where these do not exist, with 'best practices' as selected by the assessing agency. The comparison may be broken into two parts: a comparison of national laws, regulations and standards with international standards, then a comparison of actual practices with national standards (i.e. the level of compliance). Often national laws, regulations and codes of conduct need some upgrading to bring them nearer to international standards, but the main source of risk is more usually low levels of compliance with domestic standards.

Gaps and shortfalls are defined as FM weaknesses and have to be assessed individually. If, say, fiscal data in the government accounts are not reconciled with monetary data in the respective bank accounts, what adverse developmental impacts might result? How large are these impacts and what is their probability? At present, there is no methodology of risk assessment and management<sup>27</sup>.

## 11.2. Fungibility Risk

Given that all resources are fungible, donors need to ensure that the resulting pattern of spending is satisfactory to them as well as to the government. Funding is intended to be spent *additionally* to a hypothetical base case. The label attached to programme assistance (general or sector) makes no difference to the ex post pattern of public spending, revenue and deficit, *unless* it is conditioned on that overall result<sup>28</sup>. In the case of *general programme assistance*, overall fiscal conditionality can and should be applied unless the government's values and priorities are deemed to be sufficiently close to the donor's that the use of the total pool of resources will be capable of being justified to the donor's constituents.

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<sup>27</sup> COSO (1992) (Committee of Sponsoring Organisations of the Treadway Commission: Internal Control – Integrated Framework) and other models of risk management apply at the corporate level. Rating agencies such as Standard and Poor and Moody are concerned with overall country risk on external account. There is no model for risk management at the government-wide level. COSO has been adopted by the World Bank for managing its own corporate risk, but is having problems applying it to its loan portfolio.

<sup>28</sup> This is not to say that the label is totally irrelevant: the form of programme assistance affects the potential for aid dialogue and technical assistance and for donor influence in national policymaking.

In the case of sector programme assistance, funding is similarly intended to be spent additionally to a hypothetical base case. An overall fiscal conditionality is as necessary for sectoral budget support as for other forms of programme assistance.

The 'base case' is hypothetical and not immediately apparent. If there is a medium-term expenditure framework, this is a good indicator of government intentions though it normally includes externally financed expenditures that have been pledged, or are in an advanced state of negotiation. In the absence of a realistic plan, donors look to past patterns of expenditure and try to project them into the future.

### 11.3. Risk of Failure of Fiscal Conditionality

In programme assistance, the risk lies in the lack of *timely and reliable evidence* of:

- Actual government expenditures (general programme assistance) or expenditures on the target programme (sector programme assistance)
- Outputs (sector programme assistance), and
- Outcomes (sector programme assistance).

With respect to evidence of actual expenditures (outturns), audited financial statements are often long delayed, so risk is assessed *ex ante* by checking:

- that agreed expenditures are planned, and that the following three conditions have been met in past years:
- Expenditure plans translated into budgets;
- Expenditure outturns corresponded sufficiently closely with budgets; and
- Audits confirmed the reliability of financial statements.

With respect to outputs (e.g. vaccinations given) and outcomes (e.g. infant mortality), data are subject to information systems that are independent of the FM systems and not covered by CFAAs (or even most PERs). It is probable that the risks of expenditures not translating into outputs, and outputs not translating into outcomes, are at least as high as expenditures not being made additionally<sup>29</sup>. Tracking surveys assess this risk. A radical alternative is that donors may disburse against sector indicators (outcomes), or at least against reported outputs, rather than against additional spending. This is an attractive idea, as it reduces the risk that spending does not translate into outcomes, but it is difficult to implement. This outcome-based conditionality has been pioneered in Burkina Faso by the SPA donors, led by the EU.

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<sup>29</sup> The case of Uganda is often cited. There, adjustment loans specifically supported increased spending in health and education but expenditure tracking surveys showed that less than 30% of the funds budgeted for non-salary spending on schools actually reached the schools (district authorities used most of it), and salaries were considerably delayed (Ablo and Reinikka 1998, PRWP 1926).

#### 11.4. Risk of Agreed Plans not resulting in Corresponding Expenditures

In most developing countries, FM practices fall a long way short of international standards and the risk of late and unreliable data is high<sup>30</sup>. Funding agencies vary in their responses. At one extreme, risks are ignored on the ground that development co-operation is inherently risky and that good projects and programmes are too vital to development to be held up while a government puts its house in order. At the other extreme, risks are minimised by the donor retaining execution of the project (ring fencing) which provides the illusion of control. More rationally, risks are 'managed'. The funding agency can justify itself to its own audit agency and critics if the following conditions are met:

- The national authorities are committed to a credible programme of risk reduction, short term and long term
- The donor agency itself adopts risk reduction modalities of aid management, and
- The temporary and residual risks are acceptable in view of high developmental benefits.

A programme of fiduciary risk reduction implies a programme of financial management improvement (FMIP). For a general programme, a FMIP would normally aim at the strengthening of government-wide FM systems. For a sector programme, an FMIP would still have to strengthen government-wide FM systems, but also strengthen their application in agencies that would be charged with implementing the programme, and the building of sector-specific systems. These might include the strategic planning and monitoring systems that would ensure productive use of pooled funds. An FMIP may be formulated within a sector programme, even if part of it is implemented by central agencies such as the ministry of finance and audit agency. Alternatively, it may be planned as a stand-alone programme, particularly if there are extensive weaknesses at the central level.

It is vital that this programme has government commitment, otherwise it is liable to be treated as another form of conditionality imposed by a donor<sup>31</sup>. A pre-condition of programme assistance is a macroeconomic and fiscal projection that will reduce the risk that the government will not be able to meet its counterpart commitments or continue to sustain the programme after external support terminates. The IMF/World Bank seal of approval is usually required.

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<sup>30</sup> An IMF/World Bank review of public FM in 25 heavily indebted poor countries (HIPC) showed that most failed to meet the most basic tests. IMF (2001) *Tracking of Poverty-Reducing Public Spending in Heavily Indebted Poor Countries*.

<sup>31</sup> The less-than-success of economic and political conditionality in the past, more particularly for institutional reform, is not a good augury for success of a FMIP (Killick (1991), p.165).

## 11.5. Donor Actions to Reduce Fiduciary Risk

Donors themselves can reduce fiduciary risk by appropriate conditions in aid agreements and by their own flexibility. Great care should be taken, however, that additional conditions (covenants) do not add to the burden on host countries.

- If the government banking and payment systems cannot provide assurance that aid will be used for the purposes intended and without undue delay, aid funds should be deposited in an external account. This need not affect use of government budgeting, accounting and audit systems, provided donors report inflows and outflows to the government in real time
- Earmarking (where aid is notionally attached to particular projects, but without bypassing government systems) reinforces the government obligation to meet its own commitments
- Disbursement may depend on satisfactory progress in implementing the FMIP, as indicated by pre-agreed milestones
- Disbursement should be phased or tranced, so that conditions are more enforceable
- Exogenous shocks to the programme may be counteracted by donors pledging to release their funds flexibly according to needs. The basket should be more stable than any single source.
- Disbursements for direct expenditure (payments direct to contractors and consultants) and reimbursements of eligible government expenditures (which can be pre-audited) are less risky than cash advances to governments. Where reimbursement is combined with an initial advance (the imprest system), risk is reduced by keeping the advance small and reimbursements frequent, though administrative costs are higher. These methods of disbursement are associated with project aid, but could be extended into programme support where the programme is well defined and stable, so that there is no loss of government autonomy in programme management
- Risk is reduced by regular and timely audit reports, starting at an early stage. For instance, auditors should be appointed *before* the programme becomes effective, and the audit TOR should include an *initial review* of the relevant systems of internal control. Also, audits may be more frequent, e.g. twice a year, so that weaknesses and irregularities are brought to attention earlier
- The state audit body's mandate would normally include audit of the assisted programme. In some countries state audit does not have sufficient independence, or skills or workload capacity. In this case, risk is reduced by agreeing with the government to appoint an external firm (such as a local office of one of the international accounting firms) that would undertake the audit, preferably with a representative of the state audit body (for capacity building and partnership reasons). The audit report should go directly to all stakeholders by predetermined deadlines. The state audit's constitutional responsibilities are in no way affected. It may rely on the external audit or supplement it in any way it thinks fit.

## 12. Proposals for Sida Arising from Assignment A

1. The move by SPA donors to adopt the CFAA as a starting point for harmonisation of fiduciary appraisals should be supported (sections 3 and 8). The CFAA appears to have the most widespread support, while at the same time its scope for further development is still high. However this is not a preference for CFAA over other diagnostic instruments, as no instrument at present will meet all the needs in any country. Stakeholders in a particular country should pick what is relevant from the various instruments and questionnaires available, undertake a desk study, and determine what further information and verification is needed, as outlined in section 10.6.
2. The further development of the CFAA, in particular its integration with the CPAR and PER, and ultimately with a wider governance diagnosis, should be made the responsibility of a technical and independent body representing a wide spread of donors, multilateral and bilateral, so that the CFAA becomes a global tool that the development community can rely on.<sup>32</sup> At present the Public Expenditure and Financial Accountability (PEFA) Unit, set up by the EC, World Bank, IMF, UK-DFID and the SPA donors, appears to have a mandate and an initial budget for this.<sup>33</sup> (section 7).
3. The CFAA should be publicly available<sup>34</sup> (section 9).
4. A pre-requisite to any programme assistance should be a satisfactory macroeconomic and fiscal projection that shows that the government can meet its counterpart commitments and continue to sustain the programme after external assistance finishes (section 11.1).
5. The coverage of the assessment should be tailored to its expected use. General programme assistance requires a general fiscal assessment. Sectoral programme assistance requires both general and sectoral fiscal assessments. The latter requires that the team drill down to the ministries and other agencies that would be implementing the programme (section 11.4).

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<sup>32</sup> If major standard-setting bodies such as IFAC and OECD endorsed the tool, at least with regard to their own standards, and more particularly if developing countries also participated, this would promote global acceptance.

<sup>33</sup> The PEFA Secretariat is located in the Bank but is independent of the Financial Management Sector Board. Efforts are being made to bring in more partners, multilateral and bilateral, engaged in helping developing countries modernise their public expenditure and financial accountability systems and/or in harmonising international standards and benchmarks in this field. It provides financial and staff resources for carrying out pilot assessments of countries that are seeking to adopt a more co-ordinated and integrated approach to assessing and reforming public expenditure, procurement and financial accountability systems. It also aims to help the Bank and partner organisations strengthen diagnostic tools and approaches in the field and develop relevant performance indicators and benchmarks.

<sup>34</sup> See proposal by the OECD-DAC Task Force Sub-Group on Financial Management and Accountability for a one-stop shop.

6. Sub-national authorities, public enterprises, other statutory bodies and NGOs should be included in the scope of the assessment insofar as they contribute to the overall risk to the pool of public funds (section 6.2).
7. The CFAA should include a preliminary assessment of FM capacity building needs in the public sector and strategies for meeting the needs (section 6.4).
8. The CFAA should adopt standardised questionnaires, as in CONTACT and the Code of Fiscal Transparency, but these should be used primarily at the desk review stage by the CFAA team to produce questionnaires tailored to the country and to the selected respondents, i.e. interview guides for the field work. Standard questionnaires for self-assessment should be issued only to a country that asks for them (section 10.2).
9. The assessment is of actual practices, not regulations. The design of the assessment exercise should allow time for verification of key facts and findings by reference to documentary and other evidence where there is reason to believe that respondents are unsure, unclear or wrong. For instance, a statement that monthly returns are up to date could be tested by examining the latest return received (section 10.4).
10. Adequate time should be allowed for local workshops to discuss the assessment's findings before definition of a FM improvement programme and its elaboration under national ownership (section 4.1).
11. Analytical tools are snapshots of selected areas and issues of administration at a point of time. They should be used, not only to assess risk and provide information for programme formulation, but also to set baseline values of indicators on which progress can be measured.
12. Accountability to beneficiaries, especially in social sector programmes, is a potentially valuable supplement to vertical accountability through the executive and legislature. The CFAA should include an assessment of this lateral accountability under the heading 'Public access to information' (section 6).
13. Assessments of a country should be made as required but not less frequently than every five years (section 5).
14. All programme assistance should be contingent on agreed government plans and budgets (i.e. satisfactory to donors as well as to national authorities) and on commitment to a FM improvement programme that would provide assurance that outturns reflect budgets (section 11.4).
15. National commitment, political feasibility and sustainability should be assessed using the World Bank commitment to reform diagnostic, or equivalent.
16. Multiple assessments cannot be avoided, but multiple missions for gathering information and follow up can be reduced by better co-ordination among donors and, within the World Bank, better co-ordination between different assessment teams. Co-ordination may be by joint missions, or by a building block approach, whereby an initiating memorandum defines all the stakeholders, all reports go to all stakeholders

(even at the draft stage) and successive missions build on the previous missions (sections 7 and 10.6). There is a need for greater dialogue between all stakeholders, including co-operation with private sector practitioners and professional organisations.

17. National counterparts should be identified at the outset to participate in the diagnostic exercise and in consensus-building workshops, and assist in monitoring implementation (section 10.5).
18. Standards should not be modified for countries with higher or lower levels of governance. The prescriptions should be modified to ensure that the basics get priority (section 8).
19. The table below presents a possible fiduciary framework for different modalities of assistance (project, sector programme and general programme support). Any fiduciary framework should be based on the understanding that programmes are staged, with governments being motivated to participate in various institutional and systems strengthening procedures by the receipt and promise of appropriate levels of financial assistance.

### Possible Fiduciary Framework for Different Modalities of Assistance

<b>Fiduciary Characteristic</b>	<b>Project Assistance</b>	<b>Sector Programme Assistance</b>	<b>General Programme Assistance</b>
Basic eligibility requirements	Minimum standard of project management <u>or</u> corrective action plan	(1) Agreed sector policies, (2) Minimum standard of management in implementing agencies <u>or</u> agreed management reform programme, and (3) Satisfactory macroeconomic and fiscal projection	(1) Agreed national policies, (2) Minimum standard of management <u>or</u> commitment to agreed public sector reform programme, and (3) Satisfactory macroeconomic and fiscal projection
Diagnostic tools	Project Management Manual	Sectoral CFAA, CPAR and PER	Public sector-wide CFAA, CPAR and PER
Budget requirements	Project budget for inputs, outputs/ milestones, and procurement plan	Agreed programme budget for inputs, outputs/milestones, and procurement plan	Agreed government budget
Reporting requirements	Quarterly reports on expenditure, procurement, progress/outputs, and annual financial statements of project and implementing agency	Quarterly reports on expenditure, procurement, progress/outputs, and annual financial statements for each implementing agency	Government financial statements
Audit requirements	Appointment of acceptable auditor, TOR to include internal controls in implementing agency and receipt of audit reports by due dates	Audit report on each implementing agency by national audit agency (or, in default, by acceptable private auditor), TOR to include internal controls in implementing agency and receipt of audit reports by due dates	Audit report by national audit agency
Disbursement basis	Eligible expenditures on the project	Agreed % of programme expenditure, and conditional on satisfactory outputs or outcomes (of previous period if necessary), and satisfactory progress in reform programme	Policy conditions met, and satisfactory progress in reform programme
Fungibility	Not addressed	Condition of minimum expenditure in the targeted programme (making donor funds fully incremental)	Condition of agreed expenditure pattern (making donor funds fully incremental)

## **Assignment B1**

### **13. B1: Specific Reference Points and Conditions for Programme Assistance**

#### **13.1. Introduction**

This section deals with the issues specified in Section B of the Terms of Reference, namely the development of a commonly accepted reference for Sida and other donors leading to requirements and conditions for the following aspects of financial management issues in programme assistance:

- Budgeting
- Transfer of funds
- Budget execution
- Accounting
- Financial reporting
- Internal control
- Audit.

These aspects also cross-refer to the preceding chapters, particularly those addressing fiduciary risk, but are highlighted here specifically in compliance with the terms of reference. Inevitably there is a degree of overlap between the headings discussed.

The characteristics outlined here represent our current view of financial management best practice. These represent the targets to which recipient governments should be aspiring or moving towards. It is unlikely that any developing country will be able to meet them all as conditions for any aid package. Thus the only meaningful condition to be applied in these circumstances would be for governments to develop programmes of risk reduction and capacity building to address these weaknesses. The identification of weaknesses, support in implementation and monitoring of progress could readily be supported by donors.

## Summary – Characteristics of Financial Management best Practice

<b>Budgeting</b>	<ol style="list-style-type: none"> <li>1. Clear set of budgetary rules</li> <li>2. Comprehensive budget</li> <li>3. Budget allocations to reflect policy priorities</li> <li>4. Budget should be reliable guide to actual expenditure</li> </ol>
<b>Transfer (release) of Funds</b>	<ol style="list-style-type: none"> <li>1. Transfers to be agreed, timely and expedient</li> <li>2. Simple payment mechanisms preferred</li> <li>3. Avoid additional accounts creation</li> <li>4. Promote proper exchequer arrangements</li> </ol>
<b>Budget Execution</b>	<ol style="list-style-type: none"> <li>1. Promote effective treasury management (cash flow forecasting, cash handling, debt management etc.)</li> <li>2. Economic, efficient and effective procurement</li> <li>3. Timely disbursement, reporting and monitoring of funds in the public interest</li> </ol>
<b>Accounting</b>	<ol style="list-style-type: none"> <li>1. Clear statement of government accounting principles and practices in accessible manuals</li> <li>2. International best practice to be incorporated (IFAC standards)</li> <li>3. Automated accounting systems preferred</li> <li>4. Accounts prepared in a timely fashion and available for independent audit</li> </ol>
<b>Financial Reporting</b>	<ol style="list-style-type: none"> <li>1. Established mechanisms for external and internal reporting</li> <li>2. External reporting on an annual basis</li> <li>3. Internal reporting on monthly basis for management information</li> <li>4. Donors to completely avoid all additional requests for non-standard reports (or provide resources to undertake special exercises)</li> <li>5. Strict application of virement rules</li> </ol>
<b>Internal Control</b>	<ol style="list-style-type: none"> <li>1. Reinforcement of management control ethos</li> <li>2. Develop internal audit function in support of senior management</li> <li>3. Utilise the COSO internal control framework</li> </ol>
<b>(External) Audit</b>	<ol style="list-style-type: none"> <li>1. Ensure professional financial audit of public accounts by independent SAI (may need capacity building or direct support)</li> <li>2. Ensure public audit findings are acted on or recognised</li> </ol>

### 13.2. Budgeting

The formulation of budgets is key to initiating proper financial controls for good financial management. A budget is not an aspirational end in itself but an important and transparent tool for proper financial control and management. However brilliant the budget formulation it is useless without thorough analysis of outcomes or outturn in relation to it, and incorporation of actual figures into the process of future formulations.

DFID (2002) has identified a number of desirable characteristics of budget formulation that merit repetition here.

Firstly, the budget process should be governed by a clear set of rules. Budget law clearly defines the roles and responsibilities of the relevant institutions. There should be annual budget guidelines, a robust timetable and standard procedures on budget preparation. Budget guidelines should be reviewed and improved as appropriate.

Secondly, the budget should be comprehensive, incorporating all public revenue and expenditure and any outstanding balances held by central government entities separately. The role of the budgetary co-ordination agency (usually the Ministry of Finance) should be sufficiently strong to ensure participation and compliance of all other government departments. Development and recurrent budget processes should be integrated. Donor planned expenditure should be included (and plans actually complied with). All revenue sources (including non-tax and quasi-fiscal) should be incorporated. Priority spending areas should be protected.

Thirdly, budget allocations should reflect policy priorities. Ideally this is achieved through the proper implementation of a Medium Term Expenditure Framework (MTEF) that links policy objectives to resource allocation. This should enable reviews of budgetary allocations that highlight poverty reduction and other desirable attributes. The budgetary classification system should facilitate a programmatic rather than project based approach.

Finally, the budget should be a reliable guide to expenditure. Actual outturns should be close to forecasts with spending and revenue departments employing effective planning and budgeting techniques (supported by appropriate technical assistance where necessary). Donors can give added meaning to budgets by releasing funds in proportion to the expressed budgetary levels of expenditure (wherever this is not damaging). The service delivery impacts of poor forecasting and costing should be made explicit. Donors should recognise their own obligations and deliver programme assistance in a reliable and timely fashion in accordance with budgetary expectation.

### 13.3. Transfer (release) of Funds

The transfer or release of funds should be timely and expedient reflecting pre-determined drawdown arrangements that have been agreed between the parties. Where conditionalities apply they should be explicit and reasons for non-transfer of funds are clearly stated with as much prior notice as possible.

Mechanisms for the transfer of funds should be as simple as possible with the use of international correspondent banks preferred. Recognition of the point at which tracking of funds is no longer possible (at the government consolidated fund or international correspondent bank levels) should reduce the need for intrusive extensions of donor activities into recipient financial management systems. Donor creation of additional accounts or the duplication of accounting structures outside government budgets and/or standard financial arrangements should be avoided. The full incorporation of Central Banks into the flow of funds provides essential local safeguards and accountability. Proper exchequer arrangements by governments should ensure that an adequate funds trail is available.

Where cash accounting is utilised recipient governments should take care to observe proper handling of receipts at or near the year-end. Rules for transfers should be explicitly stated in government accounting manuals.

### 13.4. Budget Execution

The efficient management of financial resources (i.e. treasury management) is a critical point of departure for budget execution. Cash flow forecasting and cash handling techniques are important here to enable the optimal use to be made of any idle or surplus national cash balances. Investment of such balances and monitoring of reserves are important central bank functions. Maintenance of funds through currency and bond auctions requires central bank and Ministry of Finance co-operation and economic understanding. Debt management (by the relevant entities, such as Debt Management Offices) will be a significant and regular feature of cash-flow forecasting activities. Efficient prioritisation of debt repayments and all other expenditure demands is a skill requiring constant attention.

The timely disbursement and monitoring of budget funds across government is critical to good financial management and service delivery. Revenue estimation and cash management capabilities may require strengthening here in order to predict realistic outcomes. Flexible donor disbursement profiling can assist where government cash flows are uneven. Strengthening internal audit functions and the management of internal controls will assist in the instilling of budget discipline, and assist with procurement planning and management.

Reporting of expenditure should be timely, accurate, relevant and public (where possible). The cycle of reporting, audit and budgeting for subsequent years should be explicit and predictable so that all stakeholders can participate fully.

### 13.5. Accounting

Government Accounting principles and practices should be clearly stated in accessible manuals. These should incorporate international best practice as identified in accounting standards (IFAC for accounting and INTOSAI for auditing). Government Accounts should be automated using reliable systems. The definition and scope of accounts should be logical and allow for reporting on a streamlined basis.

Accounts should be completed in a timely fashion (say three months after year end) and be available for independent audit by the SAI, and presented to an appropriate forum for discussion (on an exception basis).

### 13.6. Financial Reporting

There are two prime objectives of financial reporting. Firstly there is the external reporting of financial accomplishments by the government to parliaments, assemblies, the public and donors for primarily democratic purposes. Ideally this would be limited to an

annual summary event to provide basic assurance that funds were being spent in accordance with planned purposes. Donors should ensure that government account formats are sufficient for their purposes and avoid additional requests for information. If additional exercises are required they should be fully funded and resourced by donors with minimal planned intrusion into government management activities.

Secondly, there are internal management accounting reasons for financial reporting. Ideally the same systems used to produce annual accounts can produce management information. The internal management information is essential for the exercise of internal controls and the management of service delivery. Reporting maybe more comprehensive for management purposes but it should be designed for a non-expert audience with simplicity in mind.

As stated above financial reports of any kind have to be timely, accurate and relevant. In order to rectify any budgetary problem management need proper information before they can act. Donors may need to support accounting activities through professional capacity building to enable governments to develop reasonable accounting and reporting systems. Donors should avoid making requests for non-standard financial reports.

Rules for proper financial reporting have to be clearly stated and adhered to. In particular rules of vires and virement have to be developed and applied rigidly for effective and consistent reporting. Vires relates to the definition of spending categories as determined by the government and democratic institutions. Spending definitions have to be sufficiently reasonable for day to day management but sufficiently robust to encompass the government's intentions. Rules and levels of virement may be defined in such a way as to allow the transfer of money from budget heads in surplus to those in deficit. There needs to be an appropriate system of authorisations and levels of authority to allow for a degree of flexibility without a complete breakdown of budgetary structure.

### 13.7. Internal Control

Internal control is a relatively under-developed area for consideration by donors. At its heart is an understanding of the internal control mechanisms necessary to promote an economic, efficient, effective and corruption free financial management environment. In essence internal control consists of the normal activities that any management would undertake to ensure the proper running of its specified activities, with special attention on mismanagement and fraud. Internal controls are best supported by an internal audit function that acts as a resource for very senior management in the exercise of their duties.

The definition of internal control most often used is derived from the Committee of Sponsoring Organisations of the Treadway Commission (COSO).

“Internal control is a process that is carried out by an entity's directors, management and other personnel for the purpose of gaining reasonable assurance of achieving objectives in three broad areas relating to:

- Efficiency and effectiveness of operations (an entity's basic business objectives, performance and outputs, and safeguarding of resources);

- Financial Reporting (the reliability of published financial statements, including where applicable, interim and condensed financial statements and related financial data);
- Compliance (compliance with laws and regulations to which the entity is subject).”
- The Internal Control Framework has five key elements:
  - The control environment;
  - Risk assessment;
  - Control activities;
  - Information and communication;
  - Monitoring.

There is considerable scope for donor support to the maintenance and development of internal audit functions in recipient governments.

### 13.8. (External) Audit

There are two relevant aspects to this arena of the study. Firstly the independent, timely and professional financial audit of public accounts. Supreme Audit Institutions may not be capable of delivery of a sufficient calibre of audit across all government activities. Their capacity and independence may require strengthening and maintaining. In the short term they could be encouraged to contract out audit work to local companies as long as robust standards are upheld. Donors may want to undertake their own independent audit activities on a temporary basis whilst promoting institutional strengthening. They will also wish to see effective sanctions to deal with mismanagement and fraud.

The second major area of concern with external audit is the degree of reaction by governments and Parliaments to audit findings. The Parliament or National Assembly should be active in its scrutiny of public finances in order to expose incompetence and corruption. Audit findings should be acted upon and weaknesses exposed with those responsible subject to appropriate penalties. The remit here can get quite broad but might amount to the training of parliamentarians, and the generation of interest and pressure groups within civil society (especially in the media).

Consideration should also be given to donor promotion of a widening of the scope of public audit in recipient countries to include value for money or performance audit and systems audit. This would enable far more intensive audit activity in the fields of economy, efficiency and effectiveness of government financial management. It would also open up government financial affairs to a far greater level of scrutiny and accountability than allowed under financial audit alone. NB this is in addition to the promotion of good financial management practice across all government activity that includes the active consideration of value for money in all financial decision making.

## Assignment B2

### 14. B2: Proposals for Comprehensive Requirements and Conditions

The best practice topics suggested above represent the ideal situation where long-term interventions have resulted in robust systems. These attributes are unlikely to be present in many circumstances faced by donors but they represent what Crown Agents consider to be the essential minimum for deriving comfort from government financial management systems.

Where these attributes cannot be met, it is of no use putting them into an aid agreement as conditions. Donors should instead ensure that the national authorities are committed to a credible programme of risk reduction (see section 11.4 above). The aid agreement may then be conditioned on reasonable progress in implementation of that programme. As most financial management improvement programmes are likely to require a medium-term period (say three to ten years), the continuation of assistance, whether general or sector programme assistance, will require a satisfactory agreement on the milestones and other indicators to be used in monitoring the successful implementation of the programme and the reduction in fiduciary risk. As the stakes may be high, there should be independent assurance on progress. The lead donor for monitoring implementation should be responsible for this aspect.

In addition, as suggested in section 12, the aid agreement would be conditional on agreement on policies (sectoral or national as the case may be), satisfactory macroeconomic and fiscal projections and government budgets (showing that donor funds are fully incremental), and delivery of financial statements and audit reports on a timely basis (insofar as current government capacity allows). Donors may need to assist, e.g. with initial macroeconomic and fiscal projections, but cannot take over national responsibility for continuing processes such as annual budgeting, accounting, reporting and audit, which are the subject of a separate financial management improvement programme.

Crown Agents do not consider it possible to generate a detailed set of financial management conditions for inclusion in aid agreements. In essence the only substantive condition to be added to relevant agreements is for the recipient or partner country to undertake a financial management and audit capacity building programme designed to coincide with the budgetary or other support. Programme assistance can be staged to incentivise and motivate further government participation in institutional and systems strengthening. Donor monitoring and participation in the strengthening of financial institutions and systems is an essential part of the partnership arrangements.

# Appendix A

## World Bank Diagnostic Instruments and Procedures

The World Bank and IDA lend funds to the governments of eligible countries through a variety of loan agreements. Initially, all loans were to projects: detailed guidelines covered the assessment of the financial management arrangements of entities responsible for project implementation<sup>35</sup>. The introduction of adjustment lending in 1980 enabled the Bank to accelerate the flow of lending and keep ahead of mounting debt repayments by poor countries, but it created what was later recognised as an ‘accountability gap’. Until the mid-1990s, there was no explicit assessment of the risk that loans would not be used productively. In fact, large loans were made to countries notorious for corruption.

The Bank also supports sector programmes mainly with earmarked investment lending that is subject to the Bank’s lending procedures for projects.

The mounting concern about corruption, which was proved to reduce investment and growth and increase poverty, led the Bank to a realisation that only effective public administration would improve delivery of services to the poor, promote economic growth and raise citizen awareness. The Bank mounted a wide-ranging anti-corruption programme. The Country Financial Accountability Assessment (CFAA) and Country Procurement Assessment Report (CPAR) were developed to guide financial and procurement specialists in assessing their respective areas, and there was a move to include these assessments and recommendations for reform in country programmes (Country Assistance Strategies, CAS). The Public Expenditure Review (PER) started including more consideration of the institutional structure of public expenditure management. New instruments were developed by other disciplines: the institutional economists and political scientists developed an Institutional Governance Review and the World Bank Institute developed survey instruments for measuring corruption and determining its incidence in a country. The Bank is now working with the Public Expenditure and Financial Accountability Unit to develop the concept of an ‘Integrated Fiduciary Assessment’ that brings together the findings of CFAAs, CPARs and PERs. New lending instruments have been developed to provide general budget support such as the Public Expenditure Reform Credit.

Interim guidelines have been issued by the Procurement and Financial Management Sector Boards on the treatment of their subject areas in Country Assistance Strategies (June 2001). A team of finance and procurement specialists who are familiar with the country, in consultation with PREM staff working on governance, corruption and public expenditure issues, make a written assessment of risk and actions proposed to deal with it in the next CAS period, and discuss this with the Country Director and CAS team.

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<sup>35</sup> And still do. A high proportion of new loans is still for project investment lending. See ‘Assessment of Financial Management Arrangements in World Bank-financed Projects: Guidelines to Staff’, issued by the Financial Management Sector Board, June 2001.

## A Country Financial Accountability Assessment

The CFAA has evolved considerably in the last few years, and is expected to evolve further and be integrated with other diagnostic instruments. The present position is as follows:

### *Issuing Authority*

Financial Management Sector Board, Operational Core Services

### *Document Title/Date/Status*

Guidelines to Staff, Discussion Draft March 2002. Internal Bank document, with further development expected

### *Objectives*

- To meet the bank's *fiduciary* responsibilities, by identifying the strengths and weaknesses of financial accountability arrangements in the public sector so that the risks that these may pose to the use of Bank funds can be assessed and managed
- To meet *development* objectives, by facilitating a common understanding by the borrower, the Bank and where possible development partners of the country's public financial management arrangements thus facilitating the design and implementation of capacity building programmes to improve public financial management.

### *Assessment undertaken by*

WB staff and consultants with national authorities. Other donors and their consultants if CFAA is done jointly with them.

### *Ownership*

National participation and ownership "as far as possible": process tends to be WB-led.

### *Country Coverage/Frequency*

The Bank is aiming for all major borrowers to have CFAAs by June 2004. At June 2001, 28 CFAAs had been completed, 15 were under way and 11 were being discussed. The CFAA is used by other donors, eg. CFAAs have been prepared jointly by SPA donors in Malawi and Burkina Faso, and it is intended to continue these pilots and possibly expand donor coordination into the implementation phase. Expected frequency is every five years, but this is flexible.

### *Linkage to Financial Management Reform Programme*

Report includes recommendations for reform, "desirably set out in a prioritised and time-bound action plan" and costed. Followed up in CAS dialogue.

### *Linkage to Aid Flows*

No explicit linkage. Poverty Reduction Support Credits have CFAA as a pre-condition (PRSC Interim Guidelines, May 2001) and there is a move to require CFAAs for all

adjustment lending, and for all Country Assistance Strategy statements (section on risk assessment) (MIC paper, April 2001)

#### *Substantive Coverage*

All phases of expenditure management and limited coverage of revenue management in central government, with at least minimum coverage of statutory bodies, public enterprises, sub-national levels of government, subvented NGOs, and Bank-financed projects, plus legislative review and government accounting & auditing human resources. NB. The CFAA has recently been re-scoped to include all uses of public funds, and to exclude assessments of private sector accounting and auditing (since these are now the subject of a separate ROSC) and corporate governance. The Guidelines stress that the scope of CFAA work should be reduced to take into account diagnostic work already done, eg. by a PER, but the CFAA report should be sufficient for the Bank, taking all diagnoses into account, to make a broad assessment of risk.

Procurement, corruption, organisational capacity, public expenditure (fiscal stability, funds allocation and value-for-money issues), and the accounting/auditing profession are covered by separate instruments (there is a move to integrate the CFAA with some of these).

#### *Country Risk Rating*

Report includes overall rating (high, significant, moderate, low) with reasons. Move to develop with other donors an agreed method of risk rating.

#### *Performance Indicators*

None. Generic indicators of public FM performance are being developed for setting baseline values and monitoring progress.

#### *Transparency of Process/Disclosure of Final Document*

Transparent only to participants, but Bank encourages wide participation; document published only with government consent.

#### *Length*

Executive summary 5 pages, body of report not more than 50 pages, annexes as needed.

#### *Inputs*

Desk documentary review.

Discussions/workshops in the field with national audit office, government financial agencies, spending ministries, etc.

Government response to draft recommendations

### *Quality Assurance*

Peer review of draft CFAA by Bank staff, country management unit and (latterly) co-donors. Independent Bank evaluation of finished document. Quality Assurance Group (QAG) has provided a 37-point guide to this evaluation.

### *Questionnaires*

Many available. Content and use not standardised. A typical set of questionnaires contains 105 questions.<sup>36</sup>

### *Cost (US\$)*

Average in medium-size country \$125,000.

## **B Country Procurement Assessment Report**

The main objective of CPARs is to review existing compliance with laws and regulations on public procurement, make recommendations and promote dialogue with the government on the reforms necessary to make their systems more efficient and transparent and more in line with internationally accepted principles and practices (eg. the UNCITRAL Model Law on Procurement, the European Directives, the World Trade Organisation Agreement on Government Procurement). The issuing authority is the Procurement Sector Board, Operational Core Services.

The CPAR procedure is detailed in a memo from OCSPP of June 1998 (latest?). It is similar to the CFAA procedure and has the same implications for both resource flows and remedial action programmes. It covers the whole of the public sector and, in general outline, the private sector. There are 23 checklists, as follows:

- Legal framework
- General features (23 questions)
- Basis of transparency (15)
- Basis of accountability of procurement officials (4)
- Trade practices (19)
- Financial framework (9)
- Public sector procurement of goods/works
- General risk assessment (7)
- Organisation (13)
- Process – planning (8)
- Process – document preparation (11)
- Process – pre-qualification (7)
- Process – advertisement (2)
- Process – communications between bidders and procuring agency (5)

- Process – receipt of bids and opening (5)
- Process – bid examination and evaluation (8)
- Process – contract award and effectiveness (5)
- Process – contract administration (16)
- Process – record keeping (4)
- Public sector selection of consultants (18)
- Procurement performance
- Volumes (4)
- General experience (3)
- Experience with WB-assisted projects (8)
- Private sector procurement (16)
- Comparison of national competitive bidding with WB policy (25)

The CPAR is prepared in two volumes. Vol. 1 summarises the main findings about the effectiveness and transparency of the existing system and makes recommendations. It is confidential to the Bank and the government concerned. Volume 2 contains factual information and analysis of the present system, and is open to anyone with a legitimate interest in procurement in that country.

### C Public Expenditure Review

The PER is an instrument that has been used for many years, and is currently being reinvented by the Bank's Poverty Reduction and Economic Management (PREM) network, Public Expenditure Thematic Group. No guidelines are yet available, but the institutional part of the review is covered by a diagnostic developed by the PREM Public Sector Thematic Group (see Institutional and Governance Review, following). The main approach is explained in *Public Expenditure Management Handbook* (1998). This includes 11 checklists of 'points to look for' (ie. standards), as follows:

- Law and rules (13 points)
- Budget coverage/structure (9)
- Budget policy and planning practices (11)
- Budget preparation practices (15)
- Budget execution practices (13)
- Aid management practices (10)
- Accounting sub-system practices (9)
- Auditing system practices (14)
- Evaluation practices (6)

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<sup>36</sup> World Bank (1999) Country Financial Accountability Assessment. Loan Department, December 17.

- Integrated FM information system practices (10)
- Performance measurement practices (7)

There is also a diagnostic questionnaire containing questions pertaining to aggregate fiscal discipline (19 questions), expenditure prioritisation and allocative efficiency (48), and technical efficiency (34).

The PER is a major vehicle for analyzing public sector issues. It is intended to help countries establish effective and transparent mechanisms to allocate and use public resources in a manner that promotes economic growth and reduces poverty. It provides input to the Bank's country assistance strategy (CAS), and serves as background economic and sector work (ESW) for future adjustment operations and/or investment loans. Recommendations of the PER are used to develop loan conditionalities either through project loans or policy-based loans. A PER may be requested by other donors. It could also be requested by a government and timed to provide input to a country's budget process.

Most PERs focus on the effectiveness of resource allocation. Topics include analysis and projection of revenue, determination of the level and composition of public spending, inter- and intra-sectoral analysis, financial and non-financial public sector enterprises, structure of governance, and the functioning and efficacy of public institutions.

Some PERs are sector-specific; these are called sectoral PERs. These reports provide a framework for project (and increasingly non-project) lending so that the latter is consistent with sectoral priorities as well as with overall macroeconomic policies. Within the specific sector, they analyze the client country's development problems, existing policies, expenditure priorities and management, and public institutions. However, these sectoral reviews rarely address the issue of resource fungibility across sectors which, in most cases, could only be covered satisfactorily within a public expenditure review covering the entire government budget.

In recent years, the World Bank has been carrying out 20 to 25 PERs a year. A survey of all PERs carried out in 1992 showed that the average cost of a PER was 88 staff weeks (\$250,000). Increasingly, the strategy has been to undertake narrowly focused annual reviews on a few pressing issues, rather than depend on a major review with comprehensive coverage every three years. Most PERs are done in the Africa region. This region is shifting to annual PERs in several countries that are more focused on specific topics than large omnibus reports.

To promote domestic ownership of reform proposals, a wide range of stakeholder groups are consulted and participate throughout the review.

After the PER has gone through the Bank's management clearance process the report attains 'grey cover' status in the Bank and is in the public domain. While the report is discussed with the client country's government earlier at the green cover stage and its clearance is sought, very few task managers plan for an effective dissemination strategy in the client country after the grey cover stage.

## D Institutional and Governance Review

This is a relatively new instrument, developed by PREM Public Sector Thematic Group and the World Bank Institute. Also called National Institutional Review, or Institutional and Organisational Capacity Review. There are a number of guidelines available on website: <http://wbln0018.worldbank.org/PREM/ps/iaamarketplace.nsf> Their purpose is to assess institutional capability in a country for policymaking, service delivery and accountability, and the institutional impact and sustainability of an operation. They contain diagnoses and prescriptions for institutional strengthening in selected public sector issues.

Pilots have been prepared in a few countries. The cost of an IGR is variable. A full IGR (Armenia) cost \$288,000.

The guidelines comprise:

- Administrative and civil service assessment tool
- Assessing central government policy-making institutions in cabinet government
- Assessing constraints on service delivery
- Commitment to reform diagnostic
- Diagnostic framework for revenue administration
- Governance and poverty toolkits
- Intergovernmental relations institutional review
- Legal and judicial institutional review
- Public expenditure institutional assessment

The last of the above is very relevant to a FM diagnosis and fiduciary assessment. It is a 62-page questionnaire, structured according to the three purposes of budget management: fiscal discipline, strategic allocation of resources, and efficiency in service delivery. Poor performance at any of these levels is analysed by obtaining answers to the questions on the quality of institutional arrangements. Most questions require scaled answers (not at all, to some degree, etc), some are binary (yes/no). Its completion requires familiarity with the World Bank's Public Expenditure Management Handbook. It has been piloted in seven developing countries and two advanced countries. No evaluation of the pilots is available.

## Appendix B

### International Monetary Fund – Code of Fiscal Transparency

The Code of Fiscal Transparency was approved by the IMF in April 1998. Its purpose is to enable country authorities to systematically review the transparency of their fiscal management systems. Other codes cover transparency of monetary and financial policies (central bank operations, regulation of the financial sector, forex operations). Reports on Observance of Standards and Codes (ROSC), which started in 1999, include assessments of fiscal transparency using this Code.

The Code consists of 37 normative statements, in four groups:

- Clarity of government and government agency roles, responsibilities and relevant laws
- Public availability of information on fiscal objectives, policies, assumptions, risks, budgets, procedures, internal audit and outturns
- Open budget preparation, execution and reporting, ie. budget based on a comprehensive macroeconomic framework, fiscal objectives and assumptions, classified to facilitate policy analysis and accountability, and specified procedures for execution and reporting
- Assurances of integrity, ie. data quality and independent audit.

It is supported by an explanatory manual and a self-assessment questionnaire. The questionnaire contains 84 multiple-choice questions. The respondent is invited to add further explanations. These documents are available on IMF website [www.imf.org/external/standards/index.htm](http://www.imf.org/external/standards/index.htm). They cover the whole of general government, but it is recognised that data from sub-national levels of government may not be available. In such cases, the application of the Code is limited to central government.

Voluntary self-assessment is encouraged but, in many cases, completion of the questionnaire requires expert help, eg. by IMF staff on Article IV surveillance missions or (sometimes) external consultants. The completed questionnaire is reviewed by Area Department and Fiscal Affairs Division (Fiscal Transparency Unit).

Help is also needed where the authorities wish to draw up an action plans to remedy weaknesses. However there is no automatic linkage with reforms or with technical assistance.

The manual includes suggested basic requirements for a *minimum* standard of fiscal transparency, containing 16 normative statements, intended to address the concerns of some developing countries that an industrial country standard may be inappropriate.<sup>37</sup>

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<sup>37</sup> IMF Fiscal Affairs Department (2001) *Manual on Fiscal Transparency*, Box 1, pp. 4–5.

This has been accepted as appropriate priority in countries with weaker fiscal management systems.

The Code covers only fiscal transparency and accountability, but not other aspects of public FM. It is not, for instance, concerned with the efficiency of fiscal policy, or institutional practices that might promote sound FM, only that whatever is done should be visible.

While adoption of the Code is ‘voluntary’, it is a set of good practices<sup>38</sup> that the international community endorse: failure to move toward compliance can have negative affects on a country’s creditworthiness and access to concessionary finance, such as the Contingent Credit Line.

Disclosure of the results of assessments is encouraged. Out of 38 countries for which fiscal transparency assessments have been completed, 33 have approved publication.

The average fiscal transparency report requires 2 person-months of work.

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<sup>38</sup> ‘Best practices’ are set out in another code, the OECD Best Practices for Budget Transparency. These are more relevant for advanced economies. They are identified in the IMF Manual.

## Appendix C

### UNDP Contact

From 1995, the UNDP Programme for Accountability and Transparency (PACT) has spearheaded UN efforts to strengthen accountability, transparency and (from 1998) integrity in the public sector of developing countries and transition economies. In 2001, it issued CONTACT, Country Assessment in Accountability and Transparency, with funding from Netherlands-DGIS and Germany-BMZ. This is available in hard copy and CD-ROM. It is intended to be included in a one-stop shop for partner countries, donor staff and consultants.

The objectives of CONTACT are to assist (1) governments in conducting self-assessments of their FM and integrity systems, and (2) consultants hired to conduct FM and integrity assessments. It can also be used as a tool for quality control and for performance measurement.

CONTACT comprises 12 substantive chapters providing information and explaining the main points to look for in a public FM assessment, and providing checklists of questions, framed normatively in accordance with generally accepted standards. Chapters cover:

- Accounting infrastructure (66 questions)
- Information management, incl. records management and information systems (92)
- Expenditure planning and budgeting (53)
- Internal control and internal auditing (20)
- Financial reporting (10)
- External auditing (45)
- Revenue administration (27)
- Debt management (24)
- Project and foreign aid management (37)
- Procurement and assets management (82)
- Improving integrity to prevent and control corruption (100)
- Cash management (49)

The coverage of a CONTACT diagnosis is determined jointly by the national authorities and donor agency(ies). It does not normally include any overall assessment or rating of risk.

CONTACT has been used, to a greater or lesser extent, in 22 countries. Assessment missions are funded by UNDP country offices on request from governments and their reports are followed up by UNDP country offices. The report is available only to the funding agencies and the government. No evaluation of its use has been seen.

## Appendix D

### Asian Development Bank

The ADB publication (1999) *Managing Public Expenditure* includes a questionnaire for the management of public expenditure management systems, based largely on the World Bank *Public Expenditure Management Handbook*. It is intended to be used in conjunction with the text as the basis for formal review of public FM. In 2000, ADB carried out studies of FM in seven developing member countries. No evaluation of the use of the questionnaire has been seen.

The 172 questions are, in effect, standards (a ‘no’ answer implies that remedial action may be necessary). They cover the following areas (numbers in brackets show the number of questions):

#### Institutional and legal framework

- Organic budget law (21)
- Legislative/executive relationships (9)
- Scope of the government budget (6)

#### Budget preparation

- Setting the framework
  - Macroeconomic and expenditure forecasting (7)
  - Ministry envelopes/ceilings (4)
  - Multi-year perspective (6)
- Process (11)
- Public investments (6)
- Presentation to the legislature (7)

#### Budget execution and monitoring

- Laws, regulations, or policies (4)
- Distribution of responsibilities (23)
- Cash management and treasury function (9)
- Public procurement (7)
- Accounting and reporting (10)
- Management control (7)

#### Audit

- Internal audit (6)
- External audit (10, including one question on legislative review)

#### Evaluation (5)

#### Performance monitoring (14)

## Appendix E

### UK Department for International Development

The UK Department for International Development (DFID) has a long history of programme aid, and is actively promoting participatory approaches and pooling of funds for general budget and sector support. It is committed to channelling more of its aid in the form of direct budget support and has made major commitments for sector programme assistance since 1997/98. This modality is growing rapidly. It continues, for the present, to earmark its funds to named uses for presentational reasons, but is conscious of the underlying fiction.

DFID has recently started implementing a new approach to managing fiduciary risk.<sup>39</sup> Until there is an international consensus on standards, fiduciary risk is assessed using 16 benchmarks drawn mainly from the IMF Manual on Fiscal Transparency and the HIPC exercise. These are as follows:

*A clear set of rules governing FM*

1. A budget law specifying FM responsibilities in operation.
2. Accounting policies and account classifications published and applied.

*A comprehensive budget*

3. All activities of general government (central, provincial and local, including statutory bodies other than public enterprises) included in the budget.
4. Extrabudgetary expenditure not material.

*The budget supports pro-poor activities*

5. Budget allocations broadly consistent with any medium-term expenditure plans for the sector or for the overall budget.

*The budget is a reliable guide to actual expenditure*

6. High level of consistency of actual outturn with the budget.

*Expenditure is controlled during the year*

7. In-year reporting of expenditure.
8. Systems operating to control virement (budget changes), commitments and payment arrears.

*Government purchases transparent and value for money*

9. Appropriate use of competitive tendering rules
10. Decisions recorded and auditable.

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<sup>39</sup> White Paper on Eliminating Poverty: Making Globalisation Work for the Poor, 2000, and internal DFID document on Budget Support: Managing Fiduciary Risk, dated 18 March 2002.

11. Effective action is taken to identify and eliminate corruption.

*Reporting of expenditure timely and accurate*

12. Reconciliation of fiscal and bank records done routinely.

13. Audited annual accounts submitted to parliament within the statutory period.

*There is effective independent scrutiny of government expenditure*

14. Government accounts independently audited.

15. Government agencies held to account for mismanagement.

16. Criticisms and recommendations by the auditors followed up.

Most of these benchmarks are *not* met in low- and middle-income countries. DFID then considers government commitment to a programme of FM reform. If this is satisfactory and if residual risk is acceptable having regard to expected developmental benefits, the agency agrees with the government how expenditures, outputs and outcomes will be measured and reported, using the government's own fiscal year and systems as far as possible. DFID may require certain agreed actions to be taken by the government before the aid agreement becomes effective.

DFID supports interdonor cooperation both in pre-programme assessment and in programme monitoring. It will not normally stop or reduce funding during the year, but rather give the government opportunity to address problems as they arise. The disbursement schedule may be modified to smoothen uneven cash flows. If there are serious unresolved problems, funding is reduced gradually.

## Appendix F

### US Agency for International Development

The USAID Office of Financial Management, Financial Analysis Division, has standard terms of reference for a General Assessment (GA) of a country. Nominally this is required every five years.<sup>40</sup> In fact, appropriated funds are given for general budget support only for political or humanitarian reasons (as in Macedonia), and only rarely for sector budget support. In recent years, a GA has been carried out in only one country (Egypt). This was to provide greater assurance for a school-building programme. There is a problem on the government use of counterpart funds (e.g. from commodity aid).

The purpose of a GA is to assess the general accountability environment in the host country, and to identify which methods of implementation and financing are suitable in that environment, including general budget support, general sector support and specific sector support. It assesses whether accounting, budgeting, financial management, procurement and internal control systems meet generally acceptable management and accounting standards. For USAID to have 'reasonable assurance', it requires evidence of a rational budget allocation and expenditure system, adequate to report both allocations and expenditures from the General Fund, with built-in controls to prevent fraud or diversion of funds. For general budget support, a Mission should have a 'high degree of confidence' that the country can meet reporting standards for budget allocations and expenditures from the General Fund. For sector support, general or specific, a Mission should have a 'medium-to-high level of confidence' in the financial and budgeting systems of the Ministry of Finance and of other ministries and agencies receiving support. The impact of a supported programme should be capable of being identified in the budget and accounts.

The GA has two parts: an overview of the country's accountability environment, and a detailed assessment of each recipient entity. The GA is more like an audit than the CFAA in that the entity-level assessment is based on a sample of transactions selected from its records, and on supporting documentation. However it is not an audit of financial statements. The contractor (typically an independent firm of accountants) is required to provide an opinion on the general accountability environment, and on whether the assessed organisations meet generally acceptable management and accounting standards. If the general accountability environment is satisfactory, the review may be limited to the internal controls in the implementing entity with regard to cash receipts, cash disbursements, procurement and contracting functions. Procurement practices are compared with AID contracting rules and regulations. The draft report includes findings on weaknesses and recommendations. USAID comments on these and the contractor finalises the report.

There is no participation or attempt at building local ownership of the assessment or recommendations. It is an 'outside-in' assessment.

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<sup>40</sup> USAID (1991) Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency, State 204588, June 21.

# Appendix G

## The HIPC Exercise

This was a one-off exercise on 25 heavily-indebted poor countries, carried out by World Bank and IMF staff in 2001. Each country was examined to assess its ability to track the use of resources made available by reductions in debt service into ‘poverty-reducing spending’ (as defined by each country). ‘Tracking’ here has two meanings: checking that spending on poverty-reduction programmes shows an increase over a base case, and checking that the spending was effective, ie. that poverty indicators improve.

A short list of 15 standards was compiled as follows:

- The budget coverage should be a close fit or better to the IMF-GFS definition of general government
- Extrabudgetary expenditure should not be substantial
- The level and composition of actual expenditure outturn should be quite close to the budget
- The budget should include both capital and current donor-funded expenditures
- The budget should be classified by function and/or programme
- The classification should identify poverty-reducing expenditure
- Multi-year expenditure projections should be integrated into budget formulation
- Payment arrears should be at a low level
- There should be an internal audit function (whether or not it is effective)
- There should be regular tracking surveys
- Fiscal and monetary data should be reconciled routinely
- Monthly expenditure reports should be provided within four weeks of the end of each month
- There should be timely reporting of expenditure by function
- Accounts should be closed within two months of the year end
- Audited accounts should be presented to the legislature within one year.<sup>41</sup>

These 15 standards were considered adequate to assess the risk that funds freed up by debt relief would not be used for poverty reduction programmes, such as preventive health care and primary education. On each standard, a country was rated on a scale of A (little upgrading required) to C (substantial upgrading required).

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<sup>41</sup> OECD-DAC (2002) Task Force on Donor Practices, Sub-Group on Financial Management and Accountability, An Inventory of Relevant International Standards, pp.12–15

This grading system could be used to quantify fiduciary risk, and to measure progress of aspects of a FM reform programme.<sup>42</sup> However, the country's position – A, B or C – on a mere 15 standards can not possibly provide sufficient information on the strengths and weaknesses of public FM to formulate a prioritised set of recommendations. It should also be noted that the HIPC standards relate mainly to the country's capacity to present reliable and up-to-date accounts of poverty expenditures. Other aspects of FM were not covered.

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<sup>42</sup> OECD-DAC (2002) op.cit. Recommendation 2 is that this work be developed by PEFA.

## Appendix H

### Scope of Various Instruments Involving Financial Management

Area	Sources of Standards	Included In			
		WB-CFAA	IMF-CFT	UNDP-CONTACT	WB-PER
Government Sector					
Macroeconomic planning	IMF-CFT & WB Public Exp. Mgt Handb'k				•
Legitimacy framework	IMF Code of Fiscal Transp'y	•	•	•	•
Financial planning and budgeting	IMF-CFT & WB Public Exp. Mgt Handb'k	•	•	•	•
Commitment: procurement	UNCITRAL Model Law, European Directives, WTO Agreement on Gov't Procurement			•	
: personnel	WB East Asia & Pacific Region Guide for Acc'g/Rep'g Systems	•			
Disbursement	EAP Guide for Acc'g/Rep'g Systems	•			
Cash mgt/Treasury operations	WB Public Exp Mgt Handbook			•	
Accounting/internal control	IFAC-PSC, INTOSAI	•		•	
Financial and performance reporting	IMF-CFT, IFAC-PSC exposure draft ED9, IMF-GFS	•	•	•	•
External audit	INTOSAI, IFAC/IAASB	•	•	•	
Legislative review	Comm. Parliamentary Association				
Public access to fiscal info	IMF-CFT				
Civil service ethics	OECD Council recommendations	•		•	
Bribery of government officials	OECD Convention (adapted)	•		•	
Monetary and fiscal policy	IMF Code on Transp'y in Monetary and Fiscal Policies				•

Area	Sources of Standards	Included In			
		WB-CFAA	IMF-CFT	UNDP-CONTACT	WB-PER
Regulation/supervision: banks	Basle Committee on Banking Supervision Core Principles				•
Regulation/supervision : insurance	Int. Ass'n of Ins. Supervisors principles				•
Regulation/supervision : securities	IOSCO statem. of objs. and principles				•
Foreign investment	OECD Code of Liberalization				•
CORPORATE SECTOR					
Corporate governance	OECD draft Corp. Gov. Principles				
Corporate ethics	Inst. for Global Ethics best practices				
Private sector acc'g/reporting	IASB			•	
Bank accounting/reporting	Bank for Int'l Settlements				
Private sector audit	IFAC-IAASB			•	
Insolvency	G22 Working Group guideline				
OTHER					
Professional accounting dev't	IFAC Membership Committee			•	
NGO governance	Comm. Found'n guidelines				

# Appendix I

## Terms of Reference

### Terms of Reference regarding Financial Management Issues

#### *Background*

Within the framework of Sida's project regarding development of methods for programme support the following activities have been identified

- Describe and analyse existing diagnostic instruments in the field of financial management
- Develop criteria and point of departures for financial reporting and audits including standard clauses for agreements

#### *Assignment*

##### **A**

1 On the basis of a review of primarily existing documentation (Sida studies no 6 incl annex, DAC's inventory, SPA, other documentation from World Bank and others), make a summarized *description* of existing diagnostic instruments within the area of financial management. The description shall clarify purposes and areas of usage

2 *Assess* the relevance in the diagnostic instruments and *develop proposals for Sidas positions* in regard to the use of these instruments (including which instrument Sida can and should use and in which contexts) both internally and externally and regarding the latter in relation to both cooperating partners (countries, organisations) and other donors.

##### **B**

1 On the basis of a review of primarily existing documentation (Donor accountability Study, Sida requirements in rules, regulation and standard agreements, DAC Task Force(existing/ongoing studies) and other existing documentation from World Bank and other donors) *develop proposals for points of departure and criteria*, that could form the basis for a commonly accepted reference for Sida and other donors, for

- budgeting,
- transfer of funds,
- budget execution,
- accounting,
- financial reporting
- internal control,
- audit.

2 On the basis of the proposals for points of departures and criteria, *develop proposals for requirements and conditions*, to be included in agreements regarding financial management issues in programme support.

The assignment shall be performed as a desk study.

#### *Reporting*

A draft report in English shall be submitted to Sida not later than 15 April. A final report, taken into account Sidas comments, shall be submitted not later than 30 April.







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