

STUDY OF MEASURES USED TO ADDRESS
WEAKNESSES IN PUBLIC FINANCIAL
MANAGEMENT SYSTEMS IN THE CONTEXT
OF POLICY BASED SUPPORT.

FINAL REPORT

April, 2003

Peter Brooke, Bannock Consulting
Produced for: PEFA

Contents

| | Page |
|--|-----------|
| EXECUTIVE SUMMARY | 1 |
| 1 – INTRODUCTION AND BACKGROUND | 5 |
| Background | 5 |
| Definitions | 5 |
| Agencies/Donors encompassed | 6 |
| Approach taken | 6 |
| 2 – REVIEW OF CURRENT PRACTICE | 8 |
| Use of aid instruments | 8 |
| Attitude to risk | 8 |
| Short term measures applied by agencies/donors | 9 |
| Comparison of measures adopted under different forms of aid instrument. | 11 |
| 3 – ANALYSIS OF CURRENT PRACTICE | 13 |
| Comments on Specific Experiences | 13 |
| Perceptions of Impact | 13 |
| Degree of Risk Protection Acquired | 14 |
| Impact on Longer Term Financial Management Development | 16 |
| 4 – A POTENTIAL FRAMEWORK FOR CONSIDERING MEASURES | 18 |
| Is a framework for short term measures needed? | 18 |
| Potential Objectives for Short Term Measures | 20 |
| Criteria for short term measures | 22 |
| Impact on Fiduciary Risk | 23 |
| 5 – MODES OF IMPLEMENTATION AND NEXT STEPS | 26 |
| Framework for platform design | 26 |
| Measuring Impact/Robustness | 27 |
| Next steps | 28 |

While there has been considerable consultation about the contents of this report it reflects the views of the author and not necessarily those of the PEFA partners.

LIST OF ABBREVIATIONS

| | |
|-------|---|
| ADB | Asian Development Bank |
| AG | Accountant General |
| BS | Budget Support |
| CFAA | Country Financial and Accountability Assessment |
| CIDA | Canadian International Development Agency |
| CPAR | Country Procurement Assessment Review |
| DAC | Development Assistance Committee |
| DFID | Department for International Development |
| EU | European Union |
| EC | European Commission |
| GOU | Government of Uganda |
| GVN | Government of Vietnam |
| HIPC | Highly Indebted Poor Country |
| IADB | Inter American Development Bank |
| IDP | International Development Partner |
| IFMIS | Integrated Financial Management Information System |
| IMF | International Monetary Fund |
| MOF | Ministry of Finance |
| MTEF | Medium Term Expenditure Framework |
| NGO | Non Governmental Organisation |
| OECD | Organisation for Economic Cooperation and Development |
| PEFA | Public Expenditure and Financial Accountability |
| PER | Public Expenditure Review |
| PFM | Public Financial Management |
| PRSC | Poverty Reduction Support Credit |
| ROSC | Report on Standards and Codes |
| SIDA | Swedish International Development Agency |
| SWAP | Sector Wide Approach |
| UNDP | United Nations Development Programme |
| WB | World Bank |

EXECUTIVE SUMMARY

This study was commissioned by PEFA* with the support of DFID funding. It is intended as a contribution to improvements in donor harmonisation and building a sustainable basis for increased use of policy based aid instruments. The study focuses on short term measures of protection and improvement sought by donors in the light of increased reliance on national resource management systems where they are entering into policy based aid assistance and those systems are weak. However, it considers these requirements in a broader policy, institutional and governance context. It proposes a development in the approach to such measures.

Review of existing practice

A review of existing practice found a wide range of measures required by donors/agencies. Some 60-70 different types of measure were identified. Not only are they of a widely divergent nature, but they are also applied in different ways.

To some extent, however, the situation reflects the relatively recent shift towards budget support and policy based instruments of aid. Most donors/agencies regard themselves in transition and in the process of establishing their detailed working practices under the new paradigm. Most envisage a greater reliance on Government owned and led reform of resource management systems and are trying to find ways to position their measures to protect against immediate weaknesses in that context.

The report analyses the views of the donors/agencies approached and the implications of the picture discovered. The principal conclusions are that:

- Donors have come a long way in their thinking and are seeking to change their approach to such measures to balance the need for short term fiduciary comfort with longer term developmental objectives.
- However, the pattern remains one of a fragmented and partial approach to the selection of such measures.
- That requirements are very much individual ‘measure’ based rather than programmatic and there is little consistency of approach – either between donors/agencies or sometimes even within individual donors.
- The fragmented and partial nature of the measures in relation to the problems of financial management (increasingly being identified more effectively by improved diagnostic tools) means that they are of dubious effectiveness in providing substantive fiduciary protection.
- Their nature also weakens their potential role in providing a sound launch point for the Government led programmes of reform on which reliance is increasingly being placed.
- In particular, they may inadvertently distort the calls made on the limited capacity available in many countries to take resource management reform forward and undermine the development of a realistically sequenced programme of reform.

The analysis of donor requirements was supplemented by a review of impact carried out in a small sample of countries. This review suggested that the relationship between Government, donors and stakeholders generally has a critical impact in both shaping the selection of such measures and their effectiveness. Government embracing of the fiduciary concerns of donors is likely to be critical to the emergence of a well-rounded and holistic approach to such measures that will also serve to build longer term reform.

** PEFA is a partnership program of the World Bank, the European Commission, the UK Department for International Development, the Swiss State Secretariat for Economic Affairs, the International Monetary Fund, and the Strategic Partnership with Africa. The PEFA Secretariat is located in the World Bank offices in Washington, DC.*

Consideration of a new approach

The report suggests a re-positioning of measures sought by donors to focus on building those relationships and achieving effective forward momentum towards holistic reform. If sensible dialogue is not established early on and progress towards improved resource management not achieved there is a real risk that credibility will be undermined and implementation will falter, based on a lack of trust. There is a need to be realistic about the degree of fiduciary comfort that can be obtained in the short term, deliver that comfort effectively, but focus on enabling forward momentum as a basis for trust.

It suggests a role for such measures defined in terms of a ‘platform’ that considers an appropriate and sustainable package of measures rather than one that is focused on individual measures. Financial management reform should be considered as a series of realistic step changes (‘platforms’) defined in terms of what they enable by way of resource planning, deployment, control and accountability from which will emerge improved development outcomes as well as more effective fiduciary protection to all partners. The important thing is that each platform establishes a clear basis for launching to the next. Sequencing can be better addressed by articulating the position that these platforms are targeted to achieve (what sort of situation they enable) rather than simply setting out a timeline for individual measures. It proposes that the design and selection of short term measures be considered in terms of establishing the first of these platforms. There can then be some flexibility in the individual measures selected to achieve that platform based on local leadership, circumstances and starting points.

It is envisaged that the potential value of such an approach could also be in providing greater clarity to both the Governments and donors about the rules of engagement and disbursement and what each expects of the other in the partnership. It is suggested that this clarity in itself would be of benefit and provide greater consolidation and focus around which donors could harmonize. The focus becomes the definition of the platform as a basis for launching longer term developments, but in a way which also gives a degree of initial fiduciary assurance to all the partners including the Government. At the same time, the identification of later platforms down the developmental path could also be the basis for helping Governments to define their longer-term development plans as a series of milestones described in terms where they aim to be and the standards achieved by each milestone.

The platform approach recognises the fiduciary concerns of donors/agencies, but that these cannot be solved immediately and the implicit acceptance of a degree of risk. It seeks to put in place an initial platform of measures to reduce those risks in key areas and to allow the partnership with Governments to function effectively while building the foundation for subsequent platforms that will gradually reduce that risk further over time.

The report further proposes that the role of the initial ‘platform’ approach should be focused on underpinning the basic means of dialogue upon which the new forms of aid depend – what each requires in order to launch that dialogue successfully, including basic assurances to both the Governments themselves and to donors/agencies. Measures appropriate to this sort of platform will include establishing the integrity of very basic data and control systems, avoiding technical complexity and relying primarily on measures that require political support and mandate rather than capacities that are unlikely to exist at the beginning. The report suggests criteria to form the foundation of such an approach.

The report goes on to suggest a framework for applying the approach suggested and monitoring its impact within the context of the longer term development of resource management systems. The approach suggested in the framework is intended as a potential development of existing diagnostic instruments such as the World Bank’s CFAA, CPAR and Institutional and Governance Reviews rather than as an addition to them. It would draw on the diagnosis provided by those instruments with a view to helping shape the dialogue and action plans that emerge from them and keep them focused on realistic step changes. As these instruments become increasingly harmonised the framework could potentially play a bridging role since it encourages attention to institutional and motivational issues as well as resource management processes and capacities.

The report provides an illustration of the sorts of measures that might be appropriate to achieving an initial platform targeted along the lines suggested. It bases these suggestion on a set of criteria that it applies to the existing measures identified and the identification of other measures that might add a degree of essential ‘glue’ for the platform construction. A summary of the sort of package that might be appropriate is given below. In practice, there will be a considerable element of judgement involved in selecting such a list. A degree of opportunism must also be accommodated, to allow for windows of opportunity that open up because certain measures achieve greater resonance with the senior officials who are in a position to implement them. In giving some examples, what matters more than the individual measures is the overall purpose, balance and cohesiveness that is sought.

Examples of Possible Measures That Might Fit Within an Initial Platform

BUDGET PLANNING

Macro budget framework/ model for planning and controlling overall resource management.

BUDGET FORMULATION

Greater comprehensiveness of coverage ((improvements in capture of significant public resources and deployment)

Simple and targeted performance data that flows from what already exists

BUDGET EXECUTION

Budget risk management plan (to minimise impact of unforeseen difficulties, but including monitoring of significant commitments)

Basic improvements of controls within key transaction processing systems (e.g. payroll and procurement processes)

Simple but meaningful aggregate statements bringing financial and service performance together

Some initial delegation and flexibilities based on assessed ‘readiness’ of budget units to assume responsibility.

ACCOUNTING

Basic reconciliation between central accounts, local accounts and bank balances

Simple data aggregation techniques

Classification improvement within existing code structures (better identification of object)

Recovery of backlog of accounting statements

Providing access to financial management training based on ‘demand pull’ – linked to ‘readiness’ based incentives)

SCRUTINY AND ACCOUNTABILITY

Fund flow tracking exercises (to be systematically repeated)

Sample joint procurement reviews (with SAI)

Sample joint transaction reviews (with SAI)

Acceleration of production of audit reports.

More effective follow up arrangements for audit recommendations.

INSTITUTIONAL MEASURES

Targeted staffing improvements in key areas

Development and commencement of a staff development plan for resource management skills.

The report goes on to suggest how an initial platform of this sort might be set in the context of subsequent reform platforms once the initial platform has been achieved. It provides an illustrative sequence, some comments on factors that will influence it and also indicates the potential impact on fiduciary risk at each stage as it gradually reduction over time. Although the approach outlined in the report is primarily aimed at support to countries with relatively weak financial management systems, the concept potentially also applicable to countries that have already made progress. Where substantive progress has been made in achieving the first platform, consideration might be given to how a country stands in the sequence of subsequent platforms suggested with a view to helping it make further progress.

The approach suggested is potentially different from the existing situation in three very important ways:

- It focuses the dialogue between donors and Governments on defining a step change in the quality of financial management, in terms of ‘where we aim to be’, while putting the Government in the driving seat in programming the activity that it decides upon to achieve it.
- It focuses on the inter-connection between specific measures and their ability to be mutually supportive.
- It encourages thinking about a sustainable migration path towards technical improvements that might ultimately be desirable, but which are not realistic in the short term and looking for small steps that will create momentum.

If such an approach is taken whether achieving an initial platform should be a condition of aid is for individual donors to assess. Consideration may include their view of the acceptability of the risks involved including the risks that their policy based dialogue with the Government never takes off in a satisfactory way. The view of this risk may colour their attitude to whether they insist on the achievement of the initial platform at a prior condition or are content to rely on general understandings and assurances that Government is moving in the right direction. A key factor in making that judgement is the degree of confidence in a particular situation about the ability to achieve sufficient forward momentum on FM reform.

1. INTRODUCTION AND BACKGROUND

Background

- 1.1 Effective systems of public financial management and accountability make a critical contribution to the achievement of development outcomes. Increasing amounts of development assistance are now provided in the form of direct financial transfers into the recipient government's account, either as grants or as loans. This approach places the emphasis on achieving better use of all public resources, not just those funded by development agencies. The strongest case for aid instruments such as budgetary support in terms of policy objectives such as poverty reduction often occur in countries which have weak public financial management systems.
- 1.2 In response to such weaknesses, development agencies have typically required governments to take measures, both short term and long-term, to reduce the likelihood of funds being wasted or misappropriated. These remedial measures take many different forms. Some apply to the government's systems as a whole. Others (particularly those relating to sector support) may require additional measures or parallel systems that may only apply to donor funds.
- 1.3 There is widespread acknowledgement that parallel systems may exacerbate weaknesses in core systems, imposing additional costs and removing skilled staff from the government system. Although donors have derived a degree of assurance about the use made of donor funds, this has often been at the cost of weaker management of much larger sums. At the same time, there is some evidence to suggest that the best examples of measures that are applied to the whole of the system, or even to the incremental donor funds, can provide a platform for longer term and sustainable improvements in public financial management systems.
- 1.4 The aim of this study was to prepare an inventory of short-term remedial measures required by different developmental agencies to address perceived weaknesses in public financial management, procurement and financial accountability systems, and to evaluate them in terms of their impact in the short term and on longer term improvements in government-wide systems. The study was concerned with weaknesses that arise in all parts of the resource management cycle and those that are put in place with or without technical assistance.
- 1.5 Budget support as an aid instrument will be judged ultimately in terms of its development impact. The robustness of a Country's resource management systems is only one factor that will determine the success of policy based support in that respect and the comments and suggestions made in this paper should be seen in that light.

Some definitions

- 1.6 Development agencies tend to have their different terms and related processes for managing aid. For the purpose of this study, the following definitions have been used:

Short term has been taken to include the following:

- Prior actions required before the release of initial funding in a programme.
- Where tranching takes place, actions that are required by release of the second tranche. A number of donors make first tranche releases based on IMF conditionality and tackling of macro-economic stabilisation. It is typically at the second release point that considerations of how money is being used tends to kick in under these arrangements.
- Both measures of improved financial management and any additional requirements specifically for the purposes of accountability to donors.
- Measures already in hand by the Government from which initial comfort is taken.

In the course of the study and a workshop held to discuss the initial findings it was suggested that 'short term' implies a short life and impact rather than measures that might be a foundation for further development and improvement. The term 'up-front' was suggested as an alternative which perhaps conveys better the focus of the study. While some measures may be 'up-front' in this sense, they may

not necessarily be short life. Some of them may continue as a ‘core’ of longer term development.

Budget support has been taken to include the following:

- HIPC debt relief
- World Bank and other multilateral development banks: adjustment lending, including PRSCs
- EU: budget support grants
- DFID and other bilateral donors: grants in the form of programme aid, direct budget support and sector budget support
- IMF: PRGF

Sector/ programme aid has been included where the aid is policy rather than project based.

Agencies Encompassed

1.7 In discussion with PEFA, it was decided to seek the cooperation of 17 multi-lateral and bilateral agencies. These were selected with a view to giving a representative range of agencies and policy positions. A particular objective was to select agencies that were known to have engaged with budget support instruments and likely to encompass a different range of views and experiences in that respect. The agencies selected were as follows:

| Multi Laterals | Bilaterals |
|-----------------------|-------------------|
| World Bank | DFID |
| IMF | NORAD |
| UNDP | USAID |
| | SIDA |
| | DANIDA |
| | Dutch Aid |
| Regionals | CIDA |
| ADB | French Aid |
| IADB | Swiss Aid |
| European Commission | German Aid |
| | Irish Aid |

Approach taken

- 1.8 The first stage of this work focused on taking stock of the different measures applied by the cooperating agencies. A four strand approach was adopted:

Drawing upon earlier reviews and existing material: It was clear that moves towards both various forms of budget/ programmatic support and donor harmonisation are topics of considerable interest at the present time. With the help of all the agencies contacted a map was developed of relevant studies and materials. This included papers arising from related efforts such as the OECD DAC process.

Questionnaire: A questionnaire was formulated and sent to all participants. It was never envisaged that it would provide all the information sought because it was necessary to reach down to specific examples on a country by country basis. However, it was intended that it would be an initial point of engagement and provide a platform for subsequent discussion. The questionnaire was in two sections:

Section A – Background to each organization’s attitude and response to reliance on domestic financial management systems in the countries supported and the impact on their aid policy.

Section B – Specific measures taken/required to address the perceived front end risks involved in reliance on those systems where they are considered to be weak.

Meetings and discussions: In each case, the questionnaire was followed up by discussions either through visits to the bigger donors or telephone conversations with the others. These interviews were undertaken within a semi-structured framework based around deepening the response to the questionnaire. They focused on two areas:

Extending the range and understanding of country specific examples quoted.

Gathering perceptions about the impact and effectiveness of the measures implemented.

Review of agency specific material: The agencies cooperating provided a range of policy documents and materials related to specific examples. These were analysed. For the bigger agencies a structured review was also undertaken of conditionality/requirements related to financial management included in support operations in recent years. This review focused on prior actions required. The agency specific work was then consolidated into a review of each donor’s attitudes and approaches.

- 1.9 The second stage of the work focused on developing an analysis of the impact of measures and suggesting an approach to their rationalisation and orientation towards both developmental objectives and the underlying fiduciary concerns of donors. This stage of work also drew upon visits to a small sample of countries to consider the overall impact of short term measures required by the donor community in that country.

2 REVIEW OF CURRENT PRACTICE

- 2.1 The findings with regards to existing measures required by agencies will be set out in this Section. A general point is emphasised. Many of the respondents viewed themselves as being in a process of change of paradigm. Therefore, what they described was at two levels – what they have actually required and where they see themselves as going. In describing what they have actually done in the past they emphasised that this may now be incompatible with emerging policy.

Use of aid instruments

- 2.2 The response to the questionnaire confirmed that many of the respondents are seeking to place more emphasis on policy based and less on project based support. Of the 11 bilateral respondents 9 have implemented budget support instruments and 8 have also been involved with SWAP or SWAP like programmes. In one case, however, a bilateral donor had implemented a budget support arrangement, but was now concerned about the exposure. They had retained a programmatic approach, but moved back to earmarking.
- 2.3 An issue that emerged in discussion with many of the agencies was the continuing role of SWAPs in the context of budget support and whether sector based approaches may now be redundant where more general budget support is being given.

Attitude to Risk

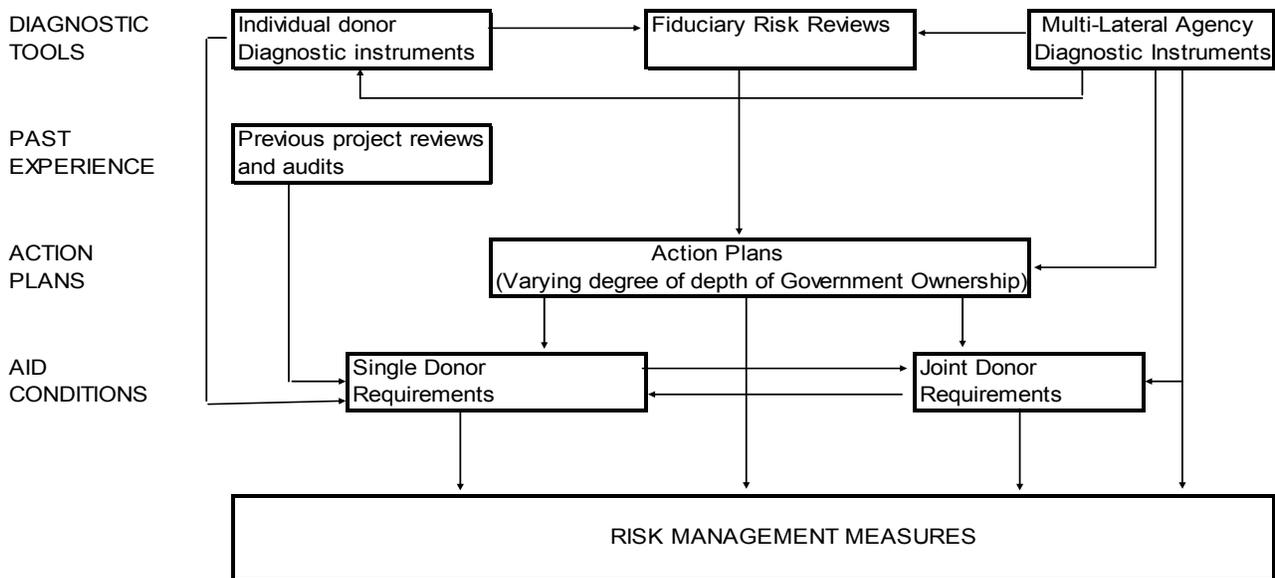
- 2.4 Of the 17 respondents, only 6 had an explicit policy towards fiduciary risk arising from reliance on local systems and procedures. Another 6 acknowledge it within a broader policy context. Others choose to largely set aside the concept in favour of the broader developmental arguments behind budget support. All of them seek to place increased emphasis on relying on Government ‘ownership’ of an agreed financial management reform programme which they believe is the best way to reduce risk in the longer term.
- 2.5 Of those who specifically acknowledge fiduciary risk as an issue, there are again many different views about the nature of such risk. Definitions include:
- That funds provided will not reach the point of deployment into national budgets.
 - Failure of financial management systems and processes to ensure that resources are deployed in accordance with national policies as expressed in the budget.
 - That the budget might not adequately express priorities or an effective use of resources.
 - Some donors, such as Norway, emphasise their lack of tolerance of corruption although primarily from a developmental perspective rather than as a direct link to fiduciary risk. They require specific corruption evaluations and use them extensively in basing their approach to aid.
 - Others place a lot of emphasis on the ‘reality’ of system performance at the individual transaction level through their emphasis on audit scrutiny.
- 2.6 An important factor in the position taken appears to be the relationship between the centre of the agencies and their local/regional offices. Many of the agencies are increasingly decentralised and place decision making powers for specific aid programmes at local level. This makes for a much more varied pattern of what is done in practice depending on the nature of central/local relationships and, in many cases, the attitudes of individuals.
- 2.7 Another important influence in the case of the bi-lateral donors appears to be the attitude of their State Auditor. In almost all cases respondents indicated that the State Auditor do not take a specific position on the appropriateness of using instruments such as budget support on the grounds that it is a policy issue and that they will only comment on the way in which policy is implemented and administered.

However, some of the State Auditors will comment on the general control environment and the balancing of risks and this appears to affect the attitude and approach of the donors in question.

Short Term Measures Identified

2.8 Discussions based on questionnaire responses identified a wide range of measures that would meet the definitions of ‘short-term’ and ‘budget support’ set out earlier. It is again emphasised that these reflect the transitional situation that many donors regard themselves to be in between one aid paradigm and another and are a mixture of the ‘old’ and the ‘new’. Some of these measures might currently be eschewed under new or proposed modalities. Some might be applied in a different way than they have been in the past. For example, increasing reliance might now be placed on the certificate of the local State Auditor rather than externally imposed auditors.

2.9 The route by which these measures come about varies. The diagram below gives an impression of the complexity of the position and probably helps to explain some of the problems of fragmentation referred to later:



2.10 In order to understand the shape formed by the different measures identified they were classified into groups of like measures. A total of ten groups were identified for this purpose. This categorisation is not perfect and there are many overlaps and examples of measures that contribute to more than one category. But it was felt important to give at least some framework to the responses. The categories developed for this purpose were as follows:

Technical/Process Measures

- 1) Requirements as to implementation of specific technical measures such as budgetary and accounting controls.
- 2) Implementation of legislation relating to improved financial management.

Institutional/Capacity Related Measures

- 3) Capacity enhancement measures including implanting of technical expertise

- 4) The introduction of incentives relating to improved financial management (for example greater resources or management flexibility upon meeting specified standards of financial management).

Fund Flow Targeting Measures

- 5) Earmarking of funding to identifiable expenditures.
6) Direct channelling of funds to implementing agencies / point of service delivery rather than through central systems.

Information Flow and Access Measures

- 7) Additional information flow about both financial deployment and achievement.
8) The introduction of additional control or co-ordination units.
9) Additional audit scrutiny.
10) Other forms of external scrutiny/visibility such as fund flow tracking exercises and the introduction of a ‘Virtual Poverty Fund’ by tagging lines of expenditure to policy objectives.

2.11 Within these categories a total of around 60-70 individual measures were identified from questionnaire returns and subsequent discussion. These are shown in **Annex 1** along with examples of donors who applied them and in which countries. These are examples only. Even at this level of analysis there are still many variants of each measure particularly as to the form of application.

2.12 Each of the measures is further classified as to whether it was seen as:

- A priority resource management reform action (e.g. improved macro fiscal model, implementation of process for monitoring large commitments and contingent liabilities, strengthen bank reconciliation processes) – 15 types of measures identified.
- A transition/bridging arrangement that can strengthen or substitute for systems in the short term while the long term improvements are being developed and implemented (e.g. virtual poverty fund, expenditure tracking surveys) – 29 types of measure identified.
- Accountability arrangements to meet donor requirements (e.g. quarterly reporting to budget support donors, additional audit requirements) – 24 types of measure identified.

2.13 In order to be as clear about what is included in each of the categories and the 60-70 items within them, **Annex 2** sets out and comments in more detail on some examples. These examples are as follows:

| CATEGORY OF MEASURE | EXAMPLE OF MEASURE |
|---|--|
| Requirements as to implementation of specific technical control measures. | Uganda, budget support, introduction of commitment monitoring. |
| Implementation of legislation relating to improved financial management. | Moldova, structural adjustment support, requirement for amendment to legislation relating to financial management. |
| Capacity implants to bolster specific areas of financial management. | East Timor, budget support, reliance placed on substantial capacity enhancements in financial management (including international people) provided through UNDP. Uganda, procurement, WB, Budget Support (PRSC related), appointment of external agents to manage the procurement function. |
| The introduction of incentives relating to improved | Vietnam, budget support (PRSC), multi-donor group, A group of donors agreed to provide a fund to provide local |

| | |
|---|---|
| financial management. | control over implementation of financial management improvements. |
| Earmarking of funding to identifiable expenditures. | Ghana, budget support, earmarking of support to specified lines in the budget. |
| Direct channelling of funds to implementing agencies / point of service delivery rather than through central systems. | Ghana, Education Sector, Sector Support, allocation of funding direct to spending units, bypassing central ministries. |
| Additional information flow about both finances and achievement. | Malawi, Budget support, additional information to flow between Government and donors as a basis for monitoring/ dialogue. |
| The introduction of additional control or co-ordination units. | Zambia, Budget Support, appointment of a team to coordinate implementation of financial management improvement measures in response to EC audit findings. |
| Additional audit scrutiny. | Burkina Faso, budget support, EC (part of a multi donor operation), audit follow up. Azerbaijan, programme support, WB, additional audit (Oil Fund) |
| Other forms of external scrutiny such as fund flow tracking exercises. | Sierra Leone, budget support, expenditure tracking. |

- 2.14 The measures identified in **Annex 2** are a mixture of sector and budget based support. In the case of sector support the distinction between that and project support has been taken to be the deployment of a pool of money that Government draws from to implement its policies and strategies rather than where the use is specified from the start. But in practice, the distinction is not always that clear and judgements have had to be made.
- 2.15 The measures identified are not necessarily ‘conditions’ of the aid instruments. In some cases they are developments in financial management that have been initiated by Government, with or without the help of donors, or were being developed under another programme, but were taken as a source of fiduciary comfort in preparing the aid programme in question. In other cases, short term requirements were picked up from conditionality included under previous aid programmes or where audits of those previous arrangements suggested particularly vulnerable areas. In some cases requirements expressed elsewhere (another facility or by another donor in the same country) were taken as a comfort for an aid programme being prepared. For example, bilateral donors generally rely on WB and IMF release conditions/ milestones, including those related to financial management improvement, in providing their own poverty focused support. In the case of some SWAPs, it seems as if requirements ‘evolved’ from a coming together of project based requirements and reflected an amalgamation of the conditionality from those earlier programmes. The point is that the specific examples quoted are by no means ‘self-contained’.
- 2.16 In addition to the measures listed, some donors mentioned ‘softer’ aspects of their relationship with the countries in question as potential sources of fiduciary comfort. For example, SIDA cited their emphasis on twinning as giving a degree of insight and involvement which was important to them (both the EU and JICA also have a lot of twinning activity). NORAD seeks to support its policy of zero tolerance of corruption by supporting surveys and opinions of corruption as part of its work to encourage the development of effective anti-corruption activity.

Comparison of measures adopted under different forms of aid instrument

- 2.17 The summary of short term measures given in **Annex 1** focuses on the types of measures adopted. Another way of looking at the measures, however, is to consider how they vary under different forms

of aid instrument. Some examples are shown in **Annex 3**. They have been selected to illustrate the range of different approaches taken and how they are derived and packaged.

- 2.18 The first table in **Annex 3** shows three budget support operations:
- An example of an EC style operation where measures arising from audit findings under an earlier operation form a condition of further support.
 - An example based on prior actions required as part of an operation where the World Bank is in the lead.
 - An example based on a multi-donor operation where the requirements reflect several donors interests, but there is a lead donor.
- 2.19 The second table shows three examples of SWAP or SWAP type operation:
- Where a basket of funds exists, but different donor conditions and requirements apply within it.
 - Where all the donors have agreed for their funds to be commingled and to share the conditions and arrangements for fund management.
 - Where funds are made available to the government in the form of budget support, but with the understanding that the government will partake in SWAP type arrangements at the sectoral level.
- 2.20 There are certain similarities between the different examples: Reporting and dialogue seems often to be set up on a quarterly cycle: Time bound conditionalities and prior actions still features quite heavily in most of the examples: A number of the examples (particularly the SWAPs) contain sanctions upon the event of non-supply of data. In a couple of the examples this extends down to local units supplying information to the centre where donor money is to be withheld from those units if they consistently fail to meet reporting and accounting deadlines. In the case of the SWAPs, the convergence between donor requirements and Government systems appears to be at least in part through a process of system implants induced by the donors to bridge gaps.
- 2.21 But there are also differences between the various examples and the most obvious one is the greater reliance on Government commitment to a financial management improvement plan of some kind in the more recent multi-agency/ commingled/budget support cases, combined with greater reliance on Government wide systems. Some of the differences clearly reflect the starting point of the countries concerned. But there are also differences in emphasis, where the reasons appear to owe more to the attitudes of local negotiators on both sides.

In summary, the review carried out suggested that:

- There are many different sorts of measures that donors seek to bring to bear and rely upon when entering into policy based instruments.
- They come about in a wide variety of ways.
- Their application varies from country to country in ways that may be due to many factors that go beyond simply country context and there is little overall consistency or shape to what is required.

3 ANALYSIS OF CURRENT PRACTICE

- 3.1 Consideration will now be given to the findings described in Section 2 and its impact in providing fiduciary protection (to both Governments and donors) and on the longer term development of improved financial management systems. It is again emphasised that donor thinking has already come a long way in moving towards greater reliance on Government led reform programmes. The discussion in this section is about the continuing role of measures required by donors in that context and the overall impact and shape of the situation created.

Comments on specific experiences

- 3.2 **Annex 2** takes a number of the examples of short term measures revealed by the questionnaire, gives more detail about how each measure has been deployed and comments on perceived impact. For practical reasons it doesn't cover all of the types of measure identified. But it does take at least one example from each category in order to illustrate at a more concrete level what is happening.
- 3.3 While these examples cover only 12 out of the 60-70 measures identified they do serve to illustrate the wide range of practices, some of the thinking that has gone in to them and their apparent impact. It indicates that for many of the examples, the results were not as intended (they sometimes had perverse effects), encountered difficulties in sustainability or had led to 'paper' rather than substantive compliance. On the other hand, some measures such as expenditure tracking surveys appear to have had a significant impact and been the foundation of other improvements.

Perceptions of Impact

- 3.4 Donors/ agencies were asked generally about their perceptions of the impact of these various measures. **Annex 4** summarises the views expressed about both the degree of protection afforded by the short term measures identified and the impact on longer term development.
- 3.5 To some extent, the perceptions reflect ambivalence about the need for short term measures at all. They also reflect a realisation that it is the overall impact that matters more than the individual measures themselves: But also a sense of frustration about the need to require at least some degree of protection from weak financial management systems without believing that individual measures can necessarily be effective. There is a realisation that it is perfectly possible to be 'tick the box' in observance of individual requirement, but to have little impact on overall standards of resource management because other things have failed to happen or undermined progress.
- 3.6 It is emphasised again that the comments quoted reflect the impressions of those responding to the questionnaire on behalf of the donors/agencies usually sitting at donor HQ. They are, therefore, largely anecdotal in nature. In order to complement this view, perceptions at the Country level (both Governments and donors) were gathered in visits to two Countries – Ghana and Uganda. The main issues that emerged are set out in **Annex 5**.
- 3.7 One of the key differences noted between the two countries visited was the extent to which the Governments appeared to have embraced an understanding of the fiduciary concerns of donors. In Uganda, the encapsulation of that understanding in an overarching agreement between Government and donors has shaped the measures taken by Government and accepted by donors. The impact of that has been a more holistic range of short term improvements that are seen as complementary and helpful to Government and not just donors. A significant step change in the standard of resource management is perceived to have been achieved. In Ghana, at national level, the impact of donor requirements is felt much more as the summation of requirements arising from individual aid packages and instruments and has much less shape and consistency than in Uganda. Requirements at sectoral level (though SWAP arrangements) have a degree of internal consistency and have achieved

some progress, but that does not appear to have been carried through to national level where there are significant perceived weaknesses and less sense of impetus for improvement.

Degree of Risk Protection Acquired

- 3.8 Clearly, only a limited package of the measures identified are ever applied in individual cases. To what extent do they convey effective management of fiduciary risk in the short term? A critical point is that in few cases could the particular package of measures be described as comprehensive or holistic. Perhaps what is happening can best be explained by reference to comments made during discussion pointing to different motivations at work:
- In some cases it seems as if the requirements are largely rolled forward to look as much like the project based controls in which donors have previously taken comfort.
 - In other cases it is clear the motivation is about buying enough 'room' with the donors own domestic stakeholders to allow longer term developments to have some effect. Therefore, enough must be seen to be done to buy this space even if there is a consciousness that the degree of genuine assurance is slight.
 - Sometimes there is the sense of a wish to seek implementation of certain short term measures as a sign that the Government is serious about longer term measures.
 - In some cases the expressed intent was to cover areas of the most glaring weaknesses in Government systems in the belief that this will at least minimise risk.
 - And in some cases there is an underlying a belief that the measures proposed, although partial, help to build a platform for the longer term.

Individually, it is possible to see that each measure has the best of intentions. Any one of them addresses a legitimate concern of Government and donor alike. They may have a positive impact on the immediate weaknesses that they seek to address. The problem (often perceived by respondents themselves) really comes from their fragmented nature in relation to the broad underlying weaknesses in financial management systems that diagnostic reviews reveal. This may mean that individual measures are not sustainable or not followed through. The measures required may depend for their effectiveness on developments in other areas that do not happen, so that even if they are achieved they are ineffective. Taken together, they may give the comfort of an appearance of progress in tackling weakness, without the reality, largely because there is no sense of how the measures link together to form a coherent package and constitute an effective step change.

- 3.9 This may explain the phenomena commented on by a number of respondents that the same conditionality about tackling financial management weaknesses appears in successive aid operations and sometimes in the conditionality of different donors. Also, there is a feeling that even if progress is made in some areas, problems emerge in others to undermine their impact. There is disappointment that the measures required are not enabling a situation upon which longer term measures can build.
- 3.10 It is this sense of such measures having proved to be something of a 'fig-leaf' when applied to project/programme based instruments that causes such measures to be increasingly rejected in favour of reliance on Government commitment to a longer term package of reform. In turn this has caused increasing focus on the diagnostic process as a tool for underpinning those programmes. Almost all the respondents had either developed their own diagnostic instruments, were in the process of doing so, or were increasingly relying on the reviews undertaken by other agencies (for example the World Bank's CFAA process). Efforts to harmonise processes in this respect were recognised as gathering momentum and genuinely welcomed.
- 3.11 While a lot of progress is being made in developing diagnostic tools less has been achieved in assessing the extent of risk that arises from the weaknesses identified and translating that into a coherent risk management strategy in the shorter term. Some respondents also felt that the diagnostic tools needed to be balanced with a review of how processes work in institutional terms including

incentives inherent in those systems, and transaction based ‘reality checks’ to understand how systems are performing and developing in practice.

- 3.12 Respondents were also less clear about the continuing need for short term measures and the sequencing of reform to minimise initial risk and to create momentum for longer term measures. There were some who felt that short term measures would only be a distraction to the longer term programmes. They indicated concerns about the potential of short term impositions of donors to undermine ownership of the reform process by Governments. Others were concerned about short term exposure, but were unclear about what would be sustainable and helpful in the context of their wish to support Government owned programmes for the longer term.
- 3.13 There was a realisation of the need to address institutional as well as technical issues, but a feeling that these are inherently more difficult to define and pin down. The list of measures identified in **Annex 1** include examples of attempts to introduce both incentives (for example greater resources or management flexibility upon meeting specified standards of financial management) and sanctions (such as holding back of funds from budget holders who fail to account within agreed timescales) to encourage improved resource management. But these examples are relatively limited. The experimentation with incentives was generally encouraging and capable of wider application. Some respondents acknowledged the weakness inherent in sanctions that involve stop and go on a programme as a whole. There was some thinking that a more carefully thought through and sensitive approach to the escalation of sanctions is required to avoid creating fiscal instability.
- 3.14 The more holistic approach to short term measures that appears to have been achieved in Uganda by Government and donors working together (see **Annex 5**) has achieved a degree of transparency of public finances which has been essential to building the trust on which policy based support depends. An important component of this approach has been the adoption of sector based expenditure reviews and tracking exercises which are Government led, but in which donors have direct involvement. This sense of shared involvement of stakeholders, seems to be a significant source of fiduciary comfort and ‘buying of time’ even though there are some frustrations about impact on expenditure effectiveness and a realisation that improved reporting and financial management processes are yet to have an impact on underlying problems of corruption. Recent Government decisions to increase defence spending beyond previously agreed limits is presenting some difficult challenges to the policy based aid concept in Uganda, but some comfort is at least taken from the transparency of those decisions and the financial management systems that bring it to the surface.
- 3.15 The relationship between budget support and programmatic support (including SWAPs), is an issue that many respondents were thinking about. Given the reality of fungibility, if budget support is being provided is there any sense in continuing sector based operations? Considerations seemed to include the following:
- Fungibility is not absolute and subject to the forces of inertia.
 - Sector management perceive SWAP directed support in a different light and may engage more fully on the basis of it.
 - SWAPs can be a way of supporting the development of improved systems at sectoral level that may be more easily tackled at that level, but become more widely replicable.
 - The greater intensity of dialogue possible at the sectoral level may itself be a source of fiduciary assurance/comfort.
 - On the other hand, the experience in one of the countries visited (Ghana) suggested that there had been little success in drawing upon SWAP based experiences in building better systems at national level.

The view that is taken on this question is important to any framework of short term measures. If budget support and sector operations are to coexist, the design of that framework should build on potential synergies between them.

- 3.16 Another question that some respondents felt had implications for the selection and effectiveness of measures was the relationship between their headquarters and in-country staff. The relationship clearly varies as does the degree of referral and obligation to follow centrally mandated policies. Many respondents considered their organisations to be on a path towards increasing decentralisation.

This was felt to be an explanation for some of the internal variations in approach that were apparent. Some also felt that variations resulted from the difficulty of providing the necessary specialist skills appropriate to the new paradigm across a disbursed organisation. Some of these factors were considered to be at least as likely to explain the variations as any attempt to address the specific contextual needs and inherent risks in different countries.

Impact on Longer Term Financial Management Development

- 3.17 Although some of the categories of safeguard outlined above appear more developmental than others, a case could be made for most of them individually. Many address requirements that are appropriate to effective financial management systems. Some of the measures identified clearly address basic underlying areas of weakness that must be tackled if progress is to be made. Some address important building blocks such as improved legislation which are fundamental enablers of progress. Others seek to establish a process of accountability that is critical to longer term improvements and better use of resources. Some measures seek to create positive internal incentives for effective participation in reform. Even where donors ask for additional data, if this arises from dialogue with Government and is useful to Government in the process of managing development it is potentially helpful.
- 3.18 The experience of individual types of measure is not universal. For example, measures in the 'capacity implant' category drew a wide range of experiences from agencies. Some thought that these had helped to enable a step change in Government processes. Others thought that the results were disappointing and had actually hindered the development of indigenous capacity or had promulgated unsustainable technical approaches. Discussion suggested that critical factors had been the quality and interpersonal skills of the individuals involved in providing technical assistance, but also the way that the implant had been set up in the first place. Some examples were quoted where the incentive structure surrounding those implants had proved to be counter productive.
- 3.19 The potential danger of the measures becomes clearer upon stepping back and looking at overall impact, sequencing and demands on scarce capacity. One of the explanations for disappointment in past results lies in their fragmentation and lack of shape and balance. One respondent commented on their experience that donor emphasis on treasury management measures had caused scarce capacity to be drawn away from budget management which has weakened focus on the effectiveness of resource deployment. The emphasis is not necessarily wrong, but it is typically an unforeseen result rather than a conscious decision that has been made about the logical sequencing and balancing of reforms.
- 3.20 Others expressed concern that conditionality is inevitably 'measure' focused and related more easily to process than to the softer issues of organisation, incentives and motivation which are much harder to tackle, but critical to longer term development. This phenomenon is probably reflected in the balance of measures listed in **Annex 1**.
- 3.21 Another respondent commented that donors sometimes inadvertently pull the Government in different directions. For example, the impact of one donor's requirements may have a centralising affect while others seek comfort from channelling their resources nearer to the point of service deployment. This tension can sometimes be seen between SWAP operations and donors operating at the macro level such as the IMF. For example, short term cash management measures encouraged in response to the IMF requirements may be unplanned and unpredictable and fundamentally undermine budget management because budget allocations become meaningless in an environment where budget releases are unpredictable and where those releases are subject to often opaque judgements.
- 3.22 The disjointed nature of donor requirements may also inadvertently have an undermining affect on the sequencing of reform. Donor requirements often make heavy demands on the limited and shallow capacity that exists in many countries. For example, a requirement to focus in the short term on setting up commitment recording systems is an understandable requirement for achieving financial stability, but it will, in many cases, draw on the same pool of resources that are likely to be required to lead broader accounting reforms. Individual donors are not in a position to plan the best use of the capacities available. Only the Government itself can do that and donor focus on a particular area may have the effect of undermining those judgements.

- 3.23 Almost all the respondents emphasised their commitment to capacity development and training. But in many ways, this is an area where the fragmentation is easiest to see. Training supported by donors is rarely planned and co-ordinated from a holistic view of capacity development priorities or impact on the time of what may be a relatively small pool of experienced staff. Unfocused training drawing staff out of their normal functions can easily become part of the problem rather than the solution. The impact of such interventions may often quickly dissipate for the lack of a working environment that encourages them to stick or other measures that are needed to allow and encourage people trained to implement the knowledge acquired.
- 3.24 Another emerging emphasis from the discussions based on the questionnaires is that ‘how’ a measure is expressed and implemented is as important as ‘what’ the requirement is. For example if there is an audit requirement, who undertakes the audit is seen as having important implications. The analysis set out in **Annex 4** has, therefore, tended to be based on how individual measures have been implemented in the past although respondents have also commented on how they might be implemented in the future.
- 3.25 Part of the fragmentation and lack of coherence referred to stems from the multitude of donors at work in many countries and differences in attitude and requirements although this is becoming less as more multi-donor support activities are undertaken. Generally speaking, the World Bank and IMF are in the best position to take an overview and achieve a more coherent approach. A number of donors increasingly draw on their conditionality in negotiating their own support to a Country. But even here, issues of appropriate sequencing and the realism of demands on scarce local capacity still arise.
- 3.26 The survey of in-country experiences summarised in **Annex 5** indicates a number of differences in approach which may point to potential variations in longer term impact. It is likely that a significant factor in the achievement of improved financial management systems in Uganda has been the strength of the mandate for reform given to and embraced within the MOF. This has been assisted by a period of political stability which many countries do not experience. Furthermore, while significant progress has been made in Uganda in transparency of reporting and quality of data, more so than in Ghana, it also has a significantly greater amount of expatriate implants at the centre than Ghana and an exit plan for that support will be important. But what does seem to be an important distinction in the experience of the two countries is the extent to which reforms are being tackled in the ‘vertical’ ...between the central ministries, line ministries, local bodies etc. Perhaps because of its greater ownership of the reform process, Uganda has begun to make these linkages which are so important to final expenditure effectiveness. In Ghana, however, some very worthwhile improvements achieved at line ministry or local level have not been drawn upon by the central ministries, perhaps because they were largely donor induced.
- 3.27 Some of the above observations may be at least part of the explanation for many years of assistance provided in this area, and conditionality required, with limited progress in many countries, but also why better progress seems to be achieved in some countries than others.

In summary:

- While some measures appear to have been more effective and developmental than others problems arise more from the lack of shape and realism in donor requirements as a whole.
- Progress is being made in this respect as donors move more towards harmonisation, multi-donor assistance and encouragement of Government led programmes of RM reform.
- More synergy between measures is required as improvements are packages and sequenced and more attention to how measures relate to and support each other.
- The way in which these issues are discussed with Governments and the embracing by Governments of donor fiduciary concerns is vital.
- How individual measures are implemented is at least as important as the measures themselves.

4 A FRAMEWORK FOR CONSIDERING MEASURES

- 4.1 In this Section attention moves to what might be done about the pattern of existing practices. It seeks to establish an analytical framework without making specific proposals about the future treatment of individual short term measures. In particular, it does not seek to establish that one measure is good and another bad. Rather, what matters is the context for an individual measure and how it potentially comes together with other measures to create an initial step change in resource management to enable all stakeholders to derive comfort that development benefits will be supported.

Is a Framework Needed?

- 4.2 Is there any point trying to rationalise the broad range of short term measures identified? The donors have already come a long way in shifting their focus to the development plans of Government and away from reliance on separate measures. Should it just be accepted that increasing emphasis on a Government led work programme on financial management (including procurement, anti-corruption etc) is developmental and will provide any fiduciary comfort required especially if related to tranche releases to provide incentives based on break points? For the moment, should they be recognised as simply a response to individual country circumstances and starting points?

Donor perspective

- 4.3 A number of the respondents (probably the majority) expressed nervousness about any sense of there being a ‘minimum standard’ of financial management system before donors should be prepared to engage. The poorest countries also tend to have the weakest systems and to set a minimum standard would potentially undermine development aims.
- 4.4 On the other hand, the experience of achieving substantive reform as a result of financial management reform programmes and conditionalities is not good and the amounts of aid involved in budget support and SWAPs is potentially large. There are risks of bad cases in the future undermining the sustainability of a more ‘facilitative’ approach to aid. Two cases were mentioned by different respondents where budget based aid had been stopped, albeit probably more for doubts about policy and corruption than specific financial management failures. Even where conditionalities have been met there is often a lack of clear overall progress in practice. There are likely to be many explanations for this. Lack of ownership by Governments is clearly one of them. Capacity problems are another. But also, the lack of context for individual measures in which they ‘take root’ alongside other measures seems to play an important part. If individual technical measures are isolated and have nothing else to support them the experience is that they will quickly erode and degrade.
- 4.5 Furthermore, earlier donor reluctance to withhold funding based on non-performance raises questions about the credibility of an approach that uses the possibility of withholding funds as an incentive for effective action and keeping agreed resource management reform programmes on track. This is causing some donors to consider tying release of policy based aid tranches to performance on both policy objectives and delivery of management system improvements.

Potential role of short term measures

- 4.6 There are clearly substantial judgements to be made about what should be done at the front end of budget support instruments and ‘trust’ in Government led reform programmes. It is too soon, even in the case of SWAPs to base those judgements on hard evidence, other than that the old project based paradigm was not effective. At the moment, a number of the respondents seem to make these judgements almost as an article of faith in the new paradigm. Even then, most seem to acknowledge that some sort of short term measures are desirable, but there is a lack of certainty whether they can be achieved without fundamentally undermining Government ownership and commitment.
- 4.7 Improved public resource management is a means to a developmental end and is only one of the likely ingredients of reducing poverty etc. If development goals such as poverty alleviation are achieved with the aid of policy based support and in spite of weak resource management systems, it may be argued that donors need not be overly concerned. Therefore, any argument for measures

agreed between Government and donors should focus on the need to enhance the possibility of that achievement and individual measures should be judged in terms of their ability to increase it.

- 4.8 It is, therefore, important to be clear about the role which measures required by donors are meant to play. Four potential roles suggest themselves:
- To provide fiduciary comfort where local resource management systems start from a weak base.
 - To provide a sound basis for the relationship between stakeholders – to build a degree of trust based on containment of risk that buys time and patience.
 - To consolidate the mandate for reform actions – setting out to achieve some realistic measures may actually help Governments to consolidate the mandate for reform that may otherwise be fragmented.
 - To create momentum for further reform actions – a perception of change which may be gradual, but which will build confidence and encourage further effort.
- 4.9 Resource management systems are interlocking and the system as a whole tends to be as strong as its weakest link. Since only limited measures are likely to be practicable in a weak environment in the early days of a reform programme it is important to be realistic about the degree of genuine fiduciary comfort that can be obtained, since weak links and vulnerable areas will inevitably remain and partial measures will simply push problems around the system as a whole. It is suggested that greater comfort in reality is likely to come from the other three areas listed above and all of these require a clear framework of action to be effective.

Modalities of a new framework

- 4.10 It is, therefore, worth considering how such a framework might be expressed. The potential value of that could be in providing greater clarity to both the Governments and donors alike about the rules of initial engagement and disbursement and what each expects of the other in the partnership. It is suggested that this clarity in itself would be of benefit and provide greater consolidation and focus around which donors could harmonize with all the perceived benefits of that. It would also create a situation where technical assistance could be provided on more of a ‘demand pull’ basis since the initiative and incentives for achieving that framework would clearly rest with Governments.
- 4.11 The aim should not be to seek some sort of ‘one size fits all’ approach. In encouraging Governments to develop coherent plans for financial management improvement in the longer term, sequencing of reform is a critical issue. Rather than concentrating on the specific technical solutions, it may be more effective to encourage thinking in terms of a series of platforms made up of packages of realistic measures where each platform becomes a launch pad to the next. Sequencing can be better addressed by articulating the position that these platforms are targeted to achieve (what sort of situation they enable) rather than simply setting out a timeline for individual measures.
- 4.12 It is then possible to view any short term measures in terms of the first of these platforms: One that allows the country/donor relationship to be put on a constructive footing, but also on a track placing greatest reliance on country systems. Achievement of that first platform would represent a step up in overall resource management performance. Providing there is clarity and realism about what that platform aims to achieve, there can then be flexibility about specific measures that go into it. The focus becomes the definition of this platform as a basis for launching longer term developments, but one which also gives a realistic degree of fiduciary assurance in the short term to all the partners including the Government. At the same time, defining subsequent platforms further down the developmental path can be the basis for helping Governments to define longer-term development plans – a series of milestones that express where they want to be at different stages along that path.
- 4.13 The platform approach recognises the fiduciary concerns of donors/agencies, but that they cannot be solved immediately and the implicit acceptance of a degree of risk. It seeks to put in place an initial platform of measures to reduce those risks in key areas and to allow partnerships to function effectively while building the foundation for subsequent platforms that will gradually reduce risk over time. To avoid establishing an ‘eye of the needle’ it is important to recognise that the initial platform may be set lower in some cases because of individual circumstances, but what is sought would be clear. In this event, a conscious decision would be made to waive a particular requirement

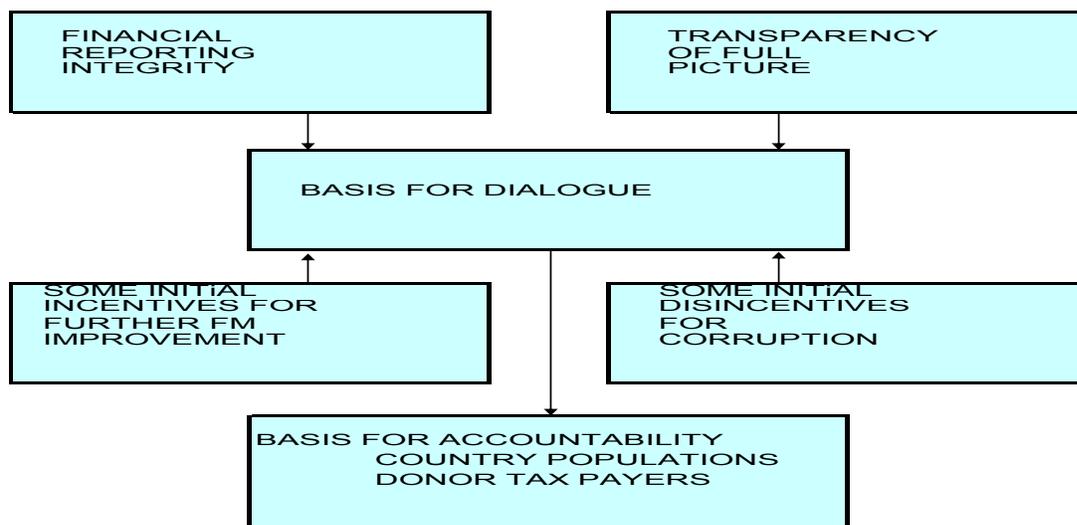
or to accept an intermediary for it, if that is what seems to be most appropriate. An example of where this might be the case is in post conflict situations.

- 4.14 But might even this be incompatible with a wish to avoid minimum standards being applied and delaying aid to the most needy? Maybe not, if what goes into the ‘launch platform’ concentrates on things that can be put in place without unrealistic effort and clearly build a coherent basis for longer term reform. This would argue for measures that require will and mandate rather than technical complexity and extensive capacity. Emphasis on the former rather than the latter will also help to ensure that ‘buy-in’ to financial management reform is achieved across the political and administrative spectrum. It would help to minimize the risk that longer term financial management reform programmes are signed up to without effective mandate by all the parties that must agree in a country for such programmes to be realised.
- 4.15 The corollary is that any measures that require capacity to do things that does not exist or will take time to establish or which are dependent on other more complex developments to be effective should generally be avoided. It may require things to be done and some (limited, but possibly intensive) help in doing them, but should be achievable in a relatively short space of time - certainly within the timescale of most budget support preparation operations. The view might be taken that the poorest countries may also be those where it is most difficult to mobilise focus and commitment to even the simplest of measures: Countries emerging from war for example. But without that will, relying on the gradual emergence of results from a Government owned programme of financial management reform must be in question. In such circumstances it would fall to individual donors or groups of donors to make the judgement about whether the benefits of policy based support in such circumstances justify the risks or whether the poor are best served short term by targeted interventions, possibly based around SWAPs where improved systems can be supported at a sectoral level. An assessment of the ability of the country to achieve a basic platform of reforms would at least help to inform the evaluation of that risk.

Potential Objectives for Short Term Measures

- 4.16 Under the approach suggested, it is important to be clear about the objectives of any initial ‘launch platform’. If these objectives are clear it is easier to envisage how the approach might be implemented while leaving considerable flexibility about specific measures. Diagram 1 sets out some suggestions about a set of objectives that might be helpful in this regard:

POTENTIAL AIMS OF SHORT TERM MEASURES



- 4.17 These objectives all flow from a presumption that the end goal of the initial platform is improved management and reduced leakage of all funds and not just donor funds. The objectives suggested are not, in themselves, absolutes. To achieve all of them absolutely is a task never fully achieved by developed let alone developing countries. They simply promulgate the need for initial steps focused

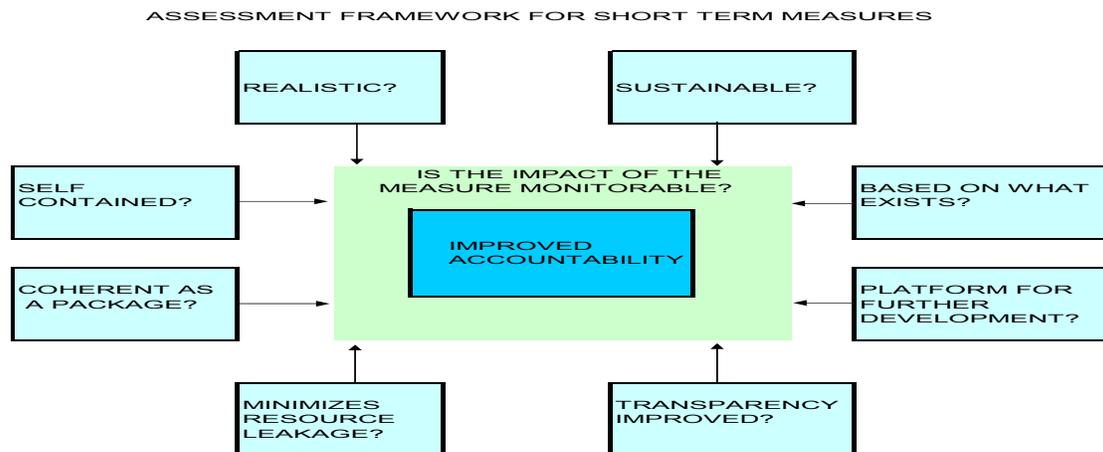
in those areas. Under the suggested model, all objectives centre around the need to create as early as possible the basis for dialogue, because this dialogue is fundamental to the trust and partnership on which new aid modalities rely. Experience reflected by a number of respondents is that policy based instruments can be fundamentally undermined if there is not from the start at least a basic confidence in the integrity of information and procedures that is the basis of such dialogue. Without that there is a danger that the partnership never gains or retains enough momentum to be effective or sustained.

- 4.18 Suggesting an initial platform focused on creating the means of dialogue is not just about the Country/donor dialogue. It is equally important for the Country's own management of its finances since it is also fundamental to the accountability and transparency that are essential to achieving effective control. By making this the focus of the initial platform the fiduciary needs of the donors are brought together with the longer term development needs of the Country.
- 4.19 The objectives suggested in the above structure are described below:
- (a) **Initial financial reporting integrity:** This is not the absolute accuracy of financial data or its value for management purposes, but the ability of all partners to believe that what they are seeing and discussing bears a reasonable relationship to reality. Issues of improved strategic and management data comes later. Data that can be relied upon in perceiving trends and direction is essential not just to the Government//donor relationship, but to Governments own decision making processes on which developmental goals depend.
 - (b) **Transparency over the significant elements of public or sectoral finances:** The budget support instrument, because of fungibility, makes resources available to the whole of the public or individual sectors. It is therefore important that information that is the basis for dialogue reflects all significant elements of public finances.
 - (c) **Providing positive incentives for undertaking further improvement in financial management:** As commented earlier, some short term measures may detract from momentum for development in the longer term. It is important that a more focused package of measures should provide, by its nature and design, encouragement and a clear platform for those further developments. They should invite participation rather than direct it and, ideally, incentives should penetrate to all levels of the public service. Again, these measures can not be an absolute. But they should be selected to provide a catalyst for subsequent developments.
 - (d) **Providing disincentives for corruption:** There are no quick fixes to problems of corruption. But any short term measures built into the initial platform should give clear signals about how it is regarded and introduce some consequences for those who commit it as a signpost for future development.
- 4.20 The aim of each of these objectives is to contribute to a productive dialogue between the key stakeholders and through that dialogue a basis for accountability to the wider constituencies that they represent. This accountability comes through a shared reliance on national resource management systems and the data and control that they produce.
- 4.21 At this initial stage none of these objectives deal with improved deployment of resources. They simply seek to establish a viable starting point for the on-going dialogue that new aid instruments envisage and on which improved management of public finances depend. The phased longer term work programmes on resource management it is envisaged will be agreed under budget support arrangements should be the appropriate vehicle for improving resource utilisation based on systemic change that can only be achieved over a period of time.
- 4.22 In order to be clear about the potential role of an initial 'platform' it is perhaps necessary to also describe what subsequent platforms might be and how the initial platform might provide a step towards them. The difficulty is that both the number and sequencing of steps is likely to be highly dependant on local capacities. Nevertheless, **Annex 6** provides an illustrative sequence and some comments on factors that will influence it. It also seeks to indicate the potential impact on fiduciary risk at each stage and its gradual reduction over time.
- 4.23 Although the approach outlined is primarily aimed at support to countries with relatively weak financial management systems, the concept of creating a platform for further improvement by aiming

for a step change is potentially also applicable to countries that have already made progress. Application of the objectives of an initial platform described above, may suggest that such countries have already substantially achieved that platform. Others may have achieved certain aspects of it, but not others (for example to have introduced improved controls, but not yet made much progress in achieving improved accountability). Where substantive progress has been made in achieving the first platform, consideration might be given to where the country stands in the sequence of subsequent platform along the lines suggested in **Annex 6** to help the country to improve further.

Criteria for short term measures

- 4.24 Within these objectives, specific criteria may be applied to short term measures to assess their ‘fit’ to the initial platform of measures. The suggested overall theme is the contribution a measure might make to improved control and accountability. Control in this context means internal control – the ability of Governments to manage resources within an effective control framework. Accountability is of the public service to all stakeholders. Within this theme a number of criteria are suggested:



Is the measure realistic? : Is it appropriate technology at this stage in a Country’s development of financial management or does it require skills, experience and technology that simply don’t exist? Is it realistic in the country context given the background to the way that things are done in that country?

Is it sustainable? : Are there sufficient surrounding circumstances, capacities and incentives to make the measure self-sustaining? Will it take root as the natural ‘way to do things’? Is it capable of being embedded in other processes that have a well established cycle? Will it compete for scarce capacity with more basic requirements?

Is it reasonably self contained? Will it have a positive impact in its own right? Or is it dependant on lots of other developments which need to happen but won’t do so for a while?

Does it flow naturally from what already exists? Does it build on processes that people are familiar with and use concepts that they understand? Does it miss out intermediary steps that are important to understanding? Is it predicated on experience that isn’t there?

When put with other measures will it form part of a coherent package? Is it capable of drawing effectiveness from combination with other proposed measures? When put with those other measures will it look like a step change with clear impact and utility?

Will it minimize resource leakage? Perhaps ‘restrict’ is a better word since no system will reduce to an absolute minimum? But will it make leakage through inappropriate use of funds, corruption and gross inefficiency less likely? Will it have a material impact on perceived incentives in this regard inherent in the system?

Will it improve transparency? Transparency is vital to an aid paradigm based on Government ‘ownership’ of reform and use of resources, so visibility to the public served and to donors is an

important consideration. Will the measure tend to enhance and encourage that transparency? Will it help to encourage an element of ‘demand pull’ for openness and information?

When put with other measures will it constitute a firm platform for further development of resource management systems? Will the short term measure provide part of a launch pad for longer term and more systemic reforms in financial management? Will that launch pad be more soundly based as a result of this measure

- 4.25 The essential ‘glue’ for the platform as a whole is that it should be possible to assess and monitor the impact of individual measures so that the robustness of this initial platform, both as a launch point for more intensive reform of financial management systems and as a source of fiduciary comfort to all stakeholders should be as clear as possible. Recommendations will be made later about measurement of progress.

Potential Impact on Fiduciary Risk

- 4.26 None of these criteria directly address the issue of fiduciary risk. This is because protection against those risks can, in most cases, best flow from addressing control and accountability more broadly. This is the developmental argument behind increased reliance on longer term work plans ‘owned’ by Government and applies equally as well to short term measures. But nor do they exclude measures which have as their primary purpose a degree of safeguard, provided that other objectives are also served or at least, not undermined. A good example of this is the likely continuing ‘core’ donor requirement for being able to track and audit the flow of cash to the recipient Government up to the point of budget deployment (including the use of foreign reserves counter-parting the local currency equivalent). This is a fundamental point of concern for most donors to ensure that their funds at least enter the budget system. But it is also a natural concern for Governments too.
- 4.27 It is important to be clear about what level of fiduciary comfort would be conveyed by an initial platform focused in the way recommended. Firstly, it would provide assurance of the means of dialogue based on information with an understood degree of integrity and comprehensiveness. This dialogue would provide a basis for positive engagement about the achievement of policy objectives. Secondly, it would enhance some basic controls in particularly vulnerable areas. Thirdly, it would introduce some initial incentives from which comfort could be taken that further improvements in resource management will follow. In essence, fiduciary comfort is achieved through the momentum created for broader resource management reform.
- 4.28 What it does not convey is any comprehensive assurance about either potential leakage or the effectiveness of resource utilisation. It also only achieves accountability to Government and stakeholders in the broadest sense. Much more will remain to be done to deepen that accountability to the level at which policies and services are delivered. But then, none of the many existing measures listed in **Annex 1** could effectively deliver that. If a policy decision has been taken to rely on national resource management systems, fiduciary comfort can only come gradually as those systems are improved.
- 4.29 The approach suggested in the framework is intended as a potential development of existing diagnostic instruments such as the World Bank’s CFAA, CPAR and Institutional and Governance Reviews rather than as an addition to them. It would contribute most naturally between the diagnostic phase of those instruments and the development of action plans which they lead to. As these instruments become increasingly harmonised the framework could potentially play a bridging role since it deals with institutional issues as well as resource management processes and capacities.
- 4.30 The following table gives no more than a few examples of measures that might be expected to meet the criteria promulgated earlier and be good candidates for the initial platform. Conversely, it gives some examples of those that might not meet the criteria and should be avoided in the short term although they will be important elements of subsequent platforms. These are only examples intended to convey a better impression of the potential impact of the proposed approach. They are not a full definition of what the initial platform might consist of. Examples are given in terms of the different stages of the resource planning, allocation and review cycle. A fuller list of potential measures and how they meet the criteria suggested is contained in **Annex 8**.

| SHORT TERM | DOWNSTREAM |
|--|---|
| BUDGET PLANNING | |
| Macro budget framework/model for planning and controlling overall resource management | Sector based planning as a basis for resource deployment |
| BUDGET FORMULATION | |
| Comprehensiveness of coverage (improvements in capture of significant public resources and deployment) Simple and targeted performance data that flows from what already exists. | Efficiency and effectiveness of resource deployment Any attempt to be comprehensive about data coverage or deepening analysis |
| BUDGET EXECUTION | |
| Budget risk management plan (to minimise impact of in-year difficulties, but including cash management techniques and monitoring of large/significant commitments and contingent liabilities) Integrity of key transaction processing systems (e.g. payroll) | Detailed commitment accounting that requires significant system/capacity upgrades to be sustainable. Major system development/upgrade |
| ACCOUNTING | |
| Basic reconciliation Simple data aggregation techniques Classification improvement within existing code structures (for example, along the lines of the Uganda 'Virtual Poverty Fund' Recovery of backlog of accounting statements. | Large scale computerization of accounting Extending the code structure and increasing the layers of analysis. |
| SCRUTINY AND ACCOUNTABILITY | |
| Fund flow tracking exercise Sample joint procurement reviews (with SAI) Sample joint transaction reviews (with SAI) Simple but meaningful aggregate statements bringing financial and service performance together within a practical format drawing on data that already exists or can readily be collected or derived from existing data. | Effectiveness/Efficiency reviews Revamped procurement legislation/capacity Major improvements in SAI capacity Comprehensive reporting structures |

- 4.31 An essential part of the 'platform' approach, is a related understanding of short term institutional measures that would provide 'glue' for the integrity of the platform as a whole. This might include short term organisational changes that could be made without destabilizing existing structures and a Government owned capacity development plan. It might also include a plan for introducing incentives as catalysts that might be introduced early in the programme and cover incentives for:
- Improved data production (such as more predictable fund release).
 - Achieving better resource use (such as better access to development funds).
 - Acquiring skills (such as greater flexibility and managerial discretion).
- 4.32 The approach would encourage thinking about a sustainable migration path towards technical improvements that might ultimately be desirable, but which are not sustainable in the short term. For example, full incorporation in the budget of certain areas of public finance may be difficult to achieve in the short term, but could be covered in supplementary notes to the budget identifying their existence. This would at least achieve a more comprehensive framework. The approach would also encourage attention to the linkage between development measures and their sustainability as a package. For example, the need to ensure that short term cash management measures support rather than undermine the integrity of the budget process.

In summary, this section of the report proposes a new approach to short term measures about resource management required by donors in the context of policy based support. The key features of that approach are:

- The merging of dialogue between donors and Government about such measures and the development of Government owned and led programmes of financial management reform.
- Basing that dialogue on targeting step changes in overall system performance and creating a platform for subsequent development, rather than the measures themselves.
- The report suggests a framework for defining an initial platform based on creating sufficient transparency, data flow, control and incentives for the policy based support to launch on a basis of trust and momentum for further development.
- It encourages attention to measures that require commitment and mandate for quick implementation rather than technical complexity.
- It also suggests how that initial platform might be set in the context of a 'ladder' of such platforms to support realistic and sustainable improvement once the initial platform has been achieved.

The approach is seen as a potential supplement to and bridge between existing diagnostic instruments and seeks to inform them rather than replace them.

5 MODES OF IMPLEMENTATION AND NEXT STEPS

- 5.1 Earlier sections of this paper have described the current position with regards to short term measures sought by donors, considered the impact of this situation and suggested a framework for developing a new and more harmonised approach that will also support the objective of fostering longer term improvements in financial management. This part of the report suggests how that framework might be implemented.
- 5.2 Suggestions are made in the following areas:
- A framework of guidance to support the development of the initial measures as a ‘platform’ in accordance with the concept described.
 - A consolidated set of parameters for measuring the robustness of that platform over time.

Framework for platform design

- 5.3 **Annex 7** to this paper suggests a process for arriving at an agreed ‘platform’ of measures. It seeks to offer a framework for applying the suggestions made earlier in this paper while avoiding a universal blue-print or a set of ‘one size fits all’ minimum criteria. In spite of its technical nature, this is not something to which a purely mechanical approach can be applied. Countries have different start points and cultural preferences that affect management style. Effective development of financial management involves institutional and managerial issues where there are no absolute ‘rights and wrongs’. A degree of opportunism must also be accommodated, to allow for windows of opportunity that open up because certain measures achieve greater resonance with the senior officials who are in a position to implement them. Subtle judgements are required and room must be left for them.
- 5.4 The approach suggested in the framework is intended as a potential development of existing diagnostic instruments such as the World Bank’s CFAA, CPAR and Institutional and Governance Reviews rather than as an addition to them. It would fit most naturally between the diagnostic phase of those instruments and the development of action plans which they are designed to lead to. As these instruments become increasingly harmonised the framework could potentially play part of the bridging role since, by its nature, it deals with institutional issues as well as resource management processes and capacities.
- 5.5 Although the framework is not intended for mechanical application, it is intended to provide a structured approach. There are several ways in which it is suggested a more structured approach will add value:
- It will enable donors/agencies to be clear about their expectations.
 - It will provide ‘shape’ to those requirements.
 - It will provide guidance to the non-specialists in both Government and local donor offices who will need to discuss it.
 - It will make it easier to seek the mandate for such measures that are essential to their delivery.
- 5.6 A more structured approach will also make it easier for Governments to learn from each others experiences and to compare different ways of implementing measures. It may also help in the process of encouraging Governments to take the initiative in embracing the fiduciary concerns of donors which seems to have been important to the development of the positive relationship between stakeholders that has been achieved in Uganda (see **Annex 5**).
- 5.7 Since it is not a blue-print, application of the framework is unlikely to arrive at the same set of recommendations country by country. Therefore, it isn’t appropriate to suggest a definitive list of measures that might be appropriate to creating the initial ‘platform’ in any specific country. In order to give the framework some ‘life’, however, **Annex 8** gives a number of examples of measures that might prove to be appropriate to the first platform in any given circumstances. The process by which these illustrative measures have been derived is:
- Firstly, the 60-70 measures identified in Annex 2 were assessed for ‘fit’ against the criteria suggested earlier. A number of them, such as the expenditure tracking exercises conducted in

some countries appeared to fit well as did the development of existing accounting classification structures to track expenditures (such as the virtual poverty fund in Uganda). Others, such as heavy reliance on imported or imposed capacity seemed to fit less well and were excluded.

- Secondly, consideration was given to whether at least aspects of the other measures contained in **Annex 1** might fit the criteria. For example, whether the transaction based scrutiny implicit in some of the auditing requirements had a role, even if the modalities need to be carefully considered.
 - Thirdly, thought was given to any important gaps that appeared to be left in the construction of the initial platform as defined given that it seeks to make a holistic and robust step change. An example of a measure included on this basis is improvement in the internal reconciliation of financial data because of its importance to the issue of data integrity.
- 5.8 The illustrative measures shown in **Annex 8** are accompanied by an explanation of why these particular measures have been shown, based on the above analysis and their potential contribution to the robustness of an initial platform. An essential part of the ‘platform’ approach, would be an understanding of short term institutional measures that would provide ‘glue’ for the integrity of the platform as a whole.
- 5.9 Since one of the purpose of the initial ‘platform’ is to provide a launch pad for longer term development of resource management systems an important criteria is that any such measures should be implementable relatively quickly (6-9 months is proposed as a guide) . This guideline would fit the typical preparation/negotiation period of a policy based aid programme.
- 5.10 Whether donors seek to make delivery of the initial platform a required condition of entry into the aid programme is a question for the donor or group of donors concerned. As at the moment, this may vary. Some may insist on prior completion for fiduciary reasons. Some may not insist on completion of the platform before starting to disburse but on the clear understanding that the measures will be introduced soon after initial disbursement. Others may view the developmental importance of policy based support in a particular situation to be such that they are content to rely on broad assurances about longer term action plan. Individual donors will want to continue to make their own judgements about acceptable degrees of risk. A key factor in making that judgement is the degree of confidence in a particular situation about the ability to achieve sufficient forward momentum on FM reform.

Measuring Impact/Robustness

- 5.11 The approach proposed would make it easier to test both the success of the short term measures taken, but also the robustness of the ‘platform’ created. To achieve this, the process of assessment needs to be simple so that it can be regularly repeated, but also multi-dimensional in order to provide a genuine ‘reality check’ on the achievement of the platform as a whole.
- 5.12 With regards to the initial platform and the measures taken to achieve it, it is suggested that four key aspects should be assessed:
- Quality of data available.
 - Robustness of basic controls.
 - Quality of dialogue facilitated between Government and donors.
 - Changes in attitude and perception amongst public servants.
- 5.13 The number of individual measurements taken under each of these categories would be small in number, but selected to give a balanced impression of the whole. **Annex 9** sets out some suggested measurements and how they would be assessed. Not all of these can be reduced to a specific value and some of them require judgement. But an attempt has been made to make them specific to reduce the element of subjectivity to a clear range. They are aimed at assessing the impact of the platform as a whole rather than the individual measures. This is important to avoid the sort of situation noted earlier where individual technical improvements have been implemented successfully, but have little impact or quickly degrade because other things that they rely upon are not in place.
- 5.14 Although the suggested measurements are related to the first ‘platform’ they might also act as a ‘core’ set of measurements for subsequent platforms as they are developed. New measurements

would be added to the original 'core' set as subsequent platforms are designed and implemented. In this way the measurement process will grow outwards to encompass broader issues such as effectiveness of resource utilisation. This sort of approach to performance assessment is rather like building a snowball. New layers are added as each platform builds to the next. It is a process that works best in a situation where development happens in several phases over a period of time and where room must be left for flexibility and opportunism.

- 5.15 It is envisaged that the process of assessment would be led by the Government based on an agreed timetable and regularity, using its own staff and supplemented by locally procured consultants as required (this may include international consultants as appropriate). Donors might make available funding to assist in this process. The process could be quality assured on behalf of the Government and donors by externally appointed agents selected by the Government and donors acting together.

Next Steps

- 5.16 Following discussion with PEFA it is proposed that the approach is first piloted in a country or countries where diagnostic processes and policy based support negotiations have reached a point where its application would be most appropriate. Since the essence of the approach is to inform existing processes and the emergence of Government owned programmes of reform the timing of the intervention is important and a number of countries are being considered from this point of view.

In summary, this final section of the report suggests:

- An analytical framework for implementing the approach promulgated in section 4 of the report. It seeks to do that allowing for flexibility to country context and scope for opportunism to help move some things forward faster than others.
- A framework for measuring progress and sustaining an initial platform of measures.

The report recognises that donors will wish to make their own judgements about whether the achievement of such a platform should be a prior condition or simply inform tranche release.