DFID Department for International Development

A DFID practice paper

How to note

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Managing Fiduciary Risk when Providing Financial Aid

Introduction

1. This How to Note provides **operational guidance** on how to manage fiduciary risk when providing financial aid[1]. It updates and replaces previous guidance[2]. (Annex 1 highlights matters of special relevance to Budget Support).
2. A standard FRA evaluating the national PFM system is **mandatory** where Financial Aid is being provided or considered. It will also be useful in countries where financial aid is not yet being considered, as it can help in monitoring partner government's PFM reforms and provide a basis for dialogue on future financial aid. It also helps in understanding the fiduciary risk environment faced by other development partners who might provide financial aid.
3. This note is for staff involved in Fiduciary Risk Assessments (FRAs), PEFA Framework assessments, and programmes aimed at improving public financial management, strengthening domestic financial accountability, and fighting corruption. It aims to provide a consistent and holistic approach to fiduciary risk management in DFID country programmes.
4. This version of the guidance has been revised to reflect DFID's Strengthened Approach to Budget Support. It expands our assessment of partner Government's commitment to improving public financial management, strengthening domestic financial accountability, and fighting corruption, by including specific assessments of the commitment to strengthen external audit and legislative scrutiny and to undertake regular PEFA assessments. It also strengthens our approach to managing fiduciary risk in federal states.
5. The How to Note includes clarification on signing off FRAs and Annual Statements of Progress (ASPs) before submission for central scrutiny, and strengthens the linkage between risks identified in FRAs and monitoring in ASPs.

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[1] Financial Aid (FA) to a partner government is a grant, the subject of a formal written arrangement under which the partner government is responsible for expenditure (Blue book, section 10). FA includes both budget support and non-budget support FA. Budget support makes use of all elements of partner governments' PFM systems, while non-budget support FA may partially use partner governments' PFM systems, e.g. it may use partner government Treasury systems but not be audited by government audit systems.

[2] This note updates and replaces the most recent consolidated How to Notes: 'Managing fiduciary risk when providing financial aid' (December 2009 and March 2009); 'Managing Fiduciary Risk in DFID's bilateral aid programmes' (Jan 2008).

6. Aid accounts for only part of the resources available to any developing country and in many cases only a small proportion of the total budget. Fiduciary risk is a risk for many stakeholders, not just DFID. The most sustainable way to reduce fiduciary risk to DFID financial aid is to work with partner countries to improve the financial accountability environment. This note focuses on assessing, mitigating and monitoring risks associated with national PFM systems.

7. This note does not address the management of risks outside the fiduciary and corruption fields in depth, although these may be closely connected – for example, political and governance factors[3]. Nor does it provide advice on assessing the benefits of different approaches to delivering aid. These issues need to be considered in designing effective aid programmes but they are not addressed in detail here[4].

8. For further information on issues relating to DFID processes and the management of fiduciary risk, please contact Finance and Corporate Performance Division (FCPD) using the e-mail address FRA-ASPCentralScru@dfid.gov.uk. For advice on issues relating to PFM performance and reform at the partner country level, please contact the Financial Accountability and Anti-Corruption (FACT) team.

Structure of this note

9. The areas covered in this How to Note are:

DFID's approach to managing fiduciary risk (p.5)

This section sets out the principles underpinning DFID's approach to managing fiduciary risk and explains how they translate into work processes. It also explains when a non-routine reassessment of fiduciary risk may be required.

Understanding fiduciary risk (p.12)

This section provides guidance on evaluating public finances and PFM systems and associated risks at the national level and sub-national level. It explains the relationship between FRAs and PEFA Framework assessments and provides guidance on how to make both as robust as possible. It also provides guidance on assessing the financial impact of key fiduciary risks.

Mitigating fiduciary risk (p.24)

This section provides guidance on assessing partner government commitment to improving PFM, strengthening domestic financial accountability, and fighting corruption. It outlines basic design principles which should underpin support to reform programmes designed to mitigate fiduciary risk in the long term. It also provides guidance on the use of short term safeguards.

Monitoring fiduciary risk (p.37)

This section provides guidance on the use of indicators to monitor fiduciary risk and government-donor dialogue on reforms and safeguards. It also explains the process for completing ASPs and monitoring partner government use of funds.

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[3] Further guidance on assessing governance can be found in the Country Governance Analysis HTN, July 2008

[4] Further guidance will be available from the Aid Effectiveness team in FCPD

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Definitions

Public Financial Management (PFM) is the system by which financial resources are planned, directed and controlled to enable and influence the efficient delivery of public service goals[5] PFM includes the systems and processes of budget formulation, implementation, accounting and reporting, audit and accountability, covering both revenue and expenditure (including procurement). PFM systems exist at all levels – national, regional, local and state owned enterprises.

Fiduciary risk – DFID defines fiduciary risk as the risk that funds are not used for the intended purposes; do not achieve value for money; and/or are not properly accounted for. The realisation of fiduciary risk can be due to a variety of factors, including lack of capacity, competency or knowledge; bureaucratic inefficiency; and/or active corruption.

Corruption - Transparency International defines corruption as 'the abuse of entrusted power for private gain'. Corruption risk is the likelihood of corruption occurring, as opposed to the other factors (lack of capacity, inefficiency etc) which determine fiduciary risk.

PEFA is the Public Expenditure Financial Accountability Programme – an international programme aimed at strengthening public financial management and accountability systems in partner countries[6]. More information is available at www.pefa.org

The PEFA Strengthened Approach has three elements: a country-led PFM reform strategy and action plan; a co-ordinated IFI-donor, multi-year programme of work that supports and is aligned with the Government's PFM reform strategy; and a shared information pool, provided through the PEFA Performance Measurement Framework.

PEFA Public Financial Management Performance Measurement Framework (the 'PEFA Framework') consists of 28 high-level indicators designed to measure the performance of national PFM systems, processes and institutions; and 3 indicators which measure donor performance.

Residual Risk means the portion of an original risk or set of risks that remain after mitigating measures have been applied.

[5] Definition from the Chartered Institute of Public Finance and Accountancy (CIPFA)
[6] PEFA is a multi-agency partnership programme sponsored by the World Bank, the International Monetary Fund, the European Commission, DFID, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, and the Swiss State Secretariat for Economic Affairs. The PEFA Secretariat supports the PEFA Programme's work and a Steering Committee, comprising members of the sponsoring agencies, oversees the Programme.

Section 1: DFID's Approach to Managing Fiduciary Risk

Principles

10. DFID's **Strengthened Approach to Budget Support**[7] sets out four partnership commitments on which our aid relationships are based. These are:

    (i) poverty reduction and the Millennium Development Goals

    (ii) respecting human rights and other international obligations

    (iii) improving public financial management, promoting good governance and transparency and fighting corruption

    (iv) strengthening domestic accountability.

11. Fiduciary Risk Assessments (FRAs) are a key tool used to assess elements of the third and fourth partnership commitments. Specifically they help us to assess and monitor partner government **commitment to improving Public Financial Management (PFM) (including fiscal transparency), strengthening domestic financial accountability, and fighting corruption**. FRAs should be read in conjunction with Country Governance Analyses (CGAs) and macro-level political economy analysis (where available) which provide information on government commitment to promoting good governance, including strengthening wider domestic accountability.

12. Our approach to managing fiduciary risk is designed to allow us to work effectively with partner governments to support them in strengthening their PFM and accountability systems and fighting corruption.

13. DFID's approach to managing fiduciary risk is based on three mutually reinforcing principles:

    - **Understanding** the fiduciary risk environment
    - **Mitigating** risks to the proper use of funds
    - **Monitoring** risks, performance and use of funds on an on-going basis.

14. This approach underpins the management of **all DFID financial aid** in a country programme. The three elements feed into each other – a good understanding of fiduciary risk should inform the design of our aid programme, including whether any mitigating measures are required to help safeguard funds. Monitoring progress reinforces our understanding and allows remedial action to be taken quickly if problems arise. The three elements of fiduciary risk management should be undertaken as part of a **continual process** as illustrated in figure 1.

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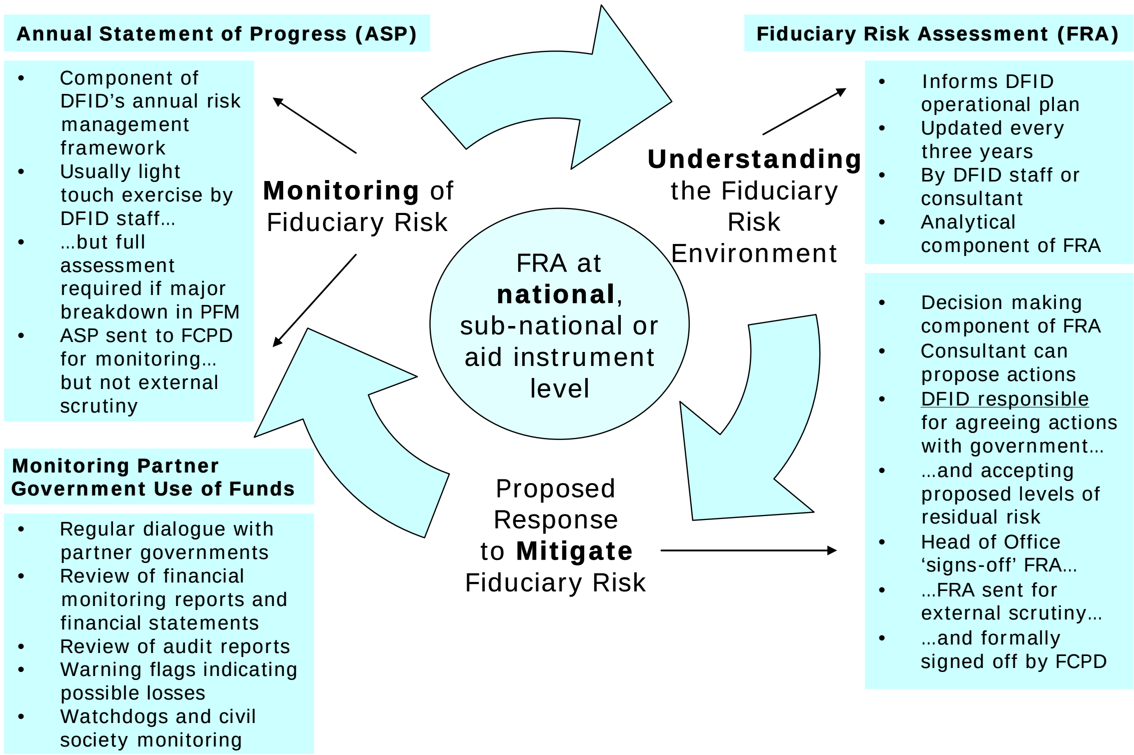
[7] 'Strengthened approach to budget support: technical note,' 1st March 2011

Figure 1: Fiduciary Risk Assessment as a Continual Process



Processes

15. This section sets out the way in which the three principles translate into DFID work processes. Certain elements are **mandatory** and require key documents to be produced on a cyclical basis to provide evidence that DFID is managing risk appropriately. Other elements represent good practice and will vary according to country circumstances. Annex 2 summarises the work processes involved and notes where further guidance can be found.

Understanding the Fiduciary Risk Environment

16. Country offices need to develop an understanding of fiduciary risk at two levels:

- The national PFM system
- Any additional or specific risks associated with individual aid instruments, including support to sub-national governments, sector programmes and cash transfer schemes.

17. A standard FRA evaluating the national PFM system is **mandatory** once every three years where Financial Aid is being provided or considered. The standard FRA, focused on the national PFM system, will:

- Feed into DFID's country level operational planning process and help determine the options for aid instruments
- Act as an assessment for general budget support (if provided)

- Help in assessing the risk for any other aid instruments delivered through government systems.

18. In reaching an initial view on whether or not DFID might provide Financial Aid, our past experience of the country will be important and information drawn from the Country Governance Analysis (CGA) will be useful. Both the CGA and FRA help to inform the choice and mix of aid instruments and provide information on the partner government's commitment to improving public financial management, strengthening domestic financial accountability and fighting corruption. There should be a two-way relationship between CGAs and FRAs. The wider analysis on the quality of governance undertaken in the CGA should feed into key assessments in the FRA – especially in relation to the risk of corruption and the credibility of reform programmes. Likewise, the detailed analysis in the FRA will generate information that the CGA can draw on in areas such as revenue mobilisation, PFM and corruption. Country offices should take advantage of these synergies to streamline, rather than duplicate analytical work.

19. A further standard FRA, in addition to the national level FRA, is **mandatory** for all **projects over £10 million where the funds are managed by a PFM system significantly different from the national PFM system**. The most likely example is support to sub-national governments in a federal state in which sub-national governments have largely autonomous financial management systems and may be subject to their own financial management laws. A further example is ring-fenced support to cash transfer schemes or welfare systems with their own financial management arrangements. Such FRAs should be based on an appropriate PEFA assessment where possible (e.g. a sub-national PEFA assessment), or the standard DFID template assessing the 8 Good Practice Principles and 15 benchmarks (see Annex 14). Support to sectors where funds are managed by the national PFM system (or a system which is not significantly different from it) do not require an additional FRA (see below).

20. It is **mandatory** for all projects (including sector support) to have an assessment of risk at the project design stage within the Business Case. For financial aid instruments, this risk assessment must include an assessment of fiduciary risk. The content of a such an assessment for individual financial aid instruments will normally be less standardised than for the FRA to assess national PFM systems. The approach adopted will depend on factors such as the general PFM environment, and the nature of risks associated with the particular sector or programme. The analysis to support the design of individual aid instruments will vary from country to country but should be informed by the national level FRA and supplemented by consideration of any fiduciary risks particular to the sector, level of government or specific programme..

21. Country offices may carry out these analyses in conjunction with the national level FRA or as separate exercises. They may follow the approach for standard FRAs if considered cost effective. Where FRAs are undertaken at these levels the standard DFID template assessing 8 Good Practice Principles and 15 benchmarks should be used in the absence of an appropriate PEFA assessment. Assessment against the PEFA indicators purely for the purposes of the FRA should **not** be undertaken. Guidance on conducting fiduciary risk assessments for individual financial aid instruments is provided at Annex 11.

Mitigating Fiduciary Risk

22. It is not sufficient to simply identify PFM weaknesses and fiduciary risks. Country offices must consider how fiduciary risks can best be mitigated and balance this against the potential development benefits of different options. Country offices should bear in mind the four approaches to mitigating individual risks: **transfer**, **treat**, **tolerate** or **terminate**. Aggregate risks can be managed more effectively by **risk-spreading** and **portfolio management**.

23. Fiduciary risk is difficult to **transfer** to another organisation. Working through other development partners or managing agents may provide distance between DFID and the fiduciary risks, but ultimately the risks, including reputational risks, are still borne by DFID. Where DFID relies on others, such as the World Bank, to manage risks, DFID needs to ensure they are doing what they have undertaken to do, and to ensure appropriate remedial action is taken where necessary.

24. Fiduciary risks can be **treated**, in the short term by the use of safeguards (at national or aid instrument level), and in the longer term through effective PFM and anti-corruption reform programmes. The time for reforms to reduce risk levels is likely to be medium to long term (five to ten years would not be uncommon). In the shorter term, that is, within the life-span of many aid instruments, country offices need to evaluate whether additional short-term safeguards are appropriate to mitigate key fiduciary risks. In so doing, country offices should bear in mind the trade-off between short term safeguards and longer term development of PFM capacity.

25. Some level of fiduciary risk will need to be **tolerated** whenever financial aid is provided: the level of tolerance acceptable will depend on the expected development benefits from providing financial aid. The purpose of fiduciary risk assessments is not to eliminate fiduciary risk but to ensure we understand, accept and own the risks we are taking, and manage risks effectively. It is important, in this context, that financial aid programmes operating in high risk environments are able to closely monitor and document the development benefits achieved through the funding, to provide evidence to justify taking the associated risks.

26. Fiduciary risk can be **terminated** by channelling funds outside government systems, for example through NGOs (though this gives rise to financial and development risks from working with NGOs). Such decisions should be based on wider considerations than just fiduciary risk, for example development effectiveness risks and financial risks inherent in relying on the financial management systems of other partners. Typically in a country with high levels of corruption, there are significant risks in funding through any channel.

27. **Risk-spreading** can be used to reduce overall risk. For example substituting a large programme with a number of smaller ones could reduce overall risk, provided that the risk factors for the smaller programmes are not closely related (e.g. are not all determined by the same trigger). Country offices often chose to spread risk by using a variety of aid instruments and working across different sectors.

28. **Portfolio management** can also be used to reduce total exposure to risk. This has two dimensions. First, the balance between the number and value of aid instruments with different risk levels across the country programme. For example, aggregate risk may be reduced by channelling more funds into lower risk

29. Decisions about the shape of the overall aid portfolio necessarily need to consider a broad range of issues in addition to fiduciary risk; the Operational Planning process sets out the rationale for programme choices at the country level, and the Business Case then covers this in more detail at the project/programme level.

Monitoring Performance on an Ongoing Basis

30. It is essential to monitor performance on an ongoing basis to:

- Ensure partner governments remain committed to improving PFM, strengthening domestic financial accountability and fighting corruption
- Check that planned reforms and agreed safeguards are being implemented effectively
- Monitor key residual risks and be alert to indications of significant losses occurring, e.g. audit reports that identify suspected misuse of funds and are not followed up
- Identify any new fiduciary or corruption risks or changes in circumstance.

31. **It is mandatory to complete an Annual Statement of Progress (ASP) on fiduciary risk for each standard FRA**. An ASP is therefore required for the standard FRA assessing national PFM systems, as well as any additional standard FRA required under paragraph 19 above. In the period between carrying out full FRAs, the ASP will be the primary way in which we monitor a partner government's commitment to strengthening financial management and accountability. **ASPs are therefore essential to timely identification of potential breaches of a partner government's commitment to improving PFM, strengthening domestic financial accountability and fighting corruption**, and enable early dialogue with partner government's to implement corrective action and agree an appropriate response. Unless there is evidence of significant problems emerging, an ASP should be a relatively light touch exercise, largely based on information from routine project monitoring and normal contacts with government counterparts. For a template, see Annex 13.

32. Monitoring risk at the individual aid instrument level is also **mandatory** under the arrangements described in the Business Case guidance.

Non-routine Reassessment

33. In circumstances where there are stable public finances and strong partner government commitment to improving PFM, strengthening financial accountability and fighting corruption a full FRA only needs to be completed every **three years.**

34. However, where we are faced with a potential breach in the partnership commitments, we may need to carry out a full and immediate reassessment of fiduciary risk to clarify the latest position and feed into the process of deciding whether the existing aid relationship remains appropriate. Any potential breach

[8]. Triggers which could lead to a full reassessment of fiduciary risk include major changes in circumstance or events with the potential to undermine the commitment, such as:

- Significant changes in the partner government's PFM reform programme, including any related anti-corruption reforms (such as could happen with a change in government)
- Significant changes in partner government's PFM systems
- Availability of new diagnostic work providing significantly different perceptions of fiduciary risk or the risk of corruption (e.g. a new PEFA assessment)
- A serious corruption scandal challenging the overall credibility of partner government's PFM systems and related reforms
- A significant deterioration in a partner government's fiscal stability or public finances (such as the emergence of hyperinflation, unsustainable debt, or a collapse in aggregate government revenues)
- Decisions by other international partners to suspend, discontinue or change how they deliver aid because of PFM or corruption issues.

35. This is not intended to be a comprehensive list and there is no precise definition of a significant event. Where any unusual event or circumstance gives cause for concern, country offices should consult with FCPD and the FACT team on whether a full reassessment of fiduciary risk is needed.

Central Review and Support

36. **All FRAs are subject to central scrutiny and review**, including those required under paragraph 19 above. The review provides assurance to the Accounting Officer and Ministers and strengthens consistency and lesson learning across DFID. The process is led by FCPD (contact via: FRA-ASPCentralScru@dfid.gov.uk) and supported by a panel of independent PFM experts. The key objectives of the central support and scrutiny process are to gain assurance that:

- The FRA complies with the operational guidelines set out in this How to Note
- There is consistency across countries and FRAs in the application of this HTN
- Judgements are explicitly presented and consistent with reasonable evidence.

Annex 3 sets out in more detail the issues on which the review will focus.

37. FCPD monitors the completion of ASPs by country offices. However, as the ASP is intended to be a light touch update of progress, rather than a full reassessment of fiduciary risk, a full central quality assurance process of the content of ASPs **is not** undertaken.

38. All FRAs submitted to central scrutiny, and all ASPs submitted to FCPD for monitoring, should include in the foreword or introduction a statement that the

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[8] 'How to Note: Implementing the UK's Conditionality Guidance, May 2009'. For the current partnership commitments, refer to 'Strengthened approach to budget support: technical note', 1st March 2011.

Head of Office is satisfied that the document has been prepared in accordance with this How to Note.

39. At the aid instrument level, any additional fiduciary risk analysis and risk mitigation plans must be detailed in the Business Case and reviewed and approved through line management channels according to the delegated authority limits set out in the Blue Book (Sections B5 and B7). FCPD welcomes consultation and will provide advice and support on request. However, given the large number and varied nature of aid instruments, there will not be a standardised scrutiny process at this level by central teams.

40. Additional assurance is provided to DFID's Accounting Officer by the Internal Audit Department (IAD). As part of its project management audit work, IAD regularly reviews risk identification, mitigation and monitoring carried out by country offices and recorded in FRAs and ASPs.

41. In monitoring FRAs and ASPs, FCPD will request information annually from country offices regarding the number and timing of returns. Directors' Statements of Assurance (DSA) also include a confirmation that all FRAs have been completed and sent for scrutiny, and all ASPs have been shared with FCPD.

Section 2: Understanding Fiduciary Risk

42. This section provides guidance on preparing the standard FRA to assess national (or exceptionally, other) PFM systems and on how to approach additional assessments of fiduciary risk at the aid instrument level.

The Standard FRA to Assess National PFM Systems

43. The FRA assesses the level of fiduciary risk associated with the national PFM system in a standard way. Table 1 sets out the recommended content of the FRA. Individual country contexts will determine the extent of material under each heading but it is important that all sections are covered. It is expected that FRAs will be in the order of 40 to 50 pages long (excluding annexes), with an Executive Summary of up to 5 pages. It is essential that the Executive Summary records the country office's assessment of overall fiduciary risk, corruption risk, and partner Government's commitment to improving PFM, strengthening domestic financial accountability and fighting corruption.

Table 1: Content of the Standard FRA

Ch.	Content	Detail
1	Table of Contents Abbreviations **Executive Summary**	**Overall assessments** of levels of residual risk (i.e. after short term safeguards): • Fiduciary risk (L/M/S/H) • Corruption risk (L/M/S/H) • Partner government commitment to improving PFM, strengthening domestic financial accountability and fighting corruption (credible / mixed commitment / not credible). Brief narrative covering: • Summary of overall PFM performance and identification of key fiduciary risks. • Summary of key fiduciary risks not addressed by existing reform programmes. • Conditions or recommendations to address any concerns about partner government commitment to improving PFM, domestic (financial) accountability and anti-corruption reforms. • Summary of short-term safeguards recommended to mitigate fiduciary risks. • Summary of residual fiduciary risks when providing financial aid, accepted by the country office, and implications for design of individual aid instruments. • Summary of how dialogue with partner governments on short term safeguards, PFM conditions and reform recommendations will be taken forward • Summary of monitoring arrangements (including through ASPs and review of partner government financial reports).
2	Country context: Historical, governance, and political economy	Analysis of the wider context in which national PFM systems operate, drawing on governance and political economy analysis.
3	Analysis of the public finances and performance of PFM systems	Analysis of the government's public finances, including macro economic performance, analysis of debt and identification of major revenue and expenditure systems. Summary of overall PFM performance, and description and trajectory of change (where available) of fiduciary risk levels across the different elements of PFM (either the six core PEFA dimensions or the 8 Good Practice Principles) based on

		either: • PEFA Framework indicators and performance report; **or** • DFID's 15 benchmarks and related narrative where no PEFA assessment available. Statement on whether the PEFA assessment (if applicable) has been quality assured by the PEFA Secretariat. Analysis of how elements of the PFM system and the wider governance environment interact to create fiduciary risks for public funds, including aid funds. May include a separate analysis of procurement systems. **Overall assessment of fiduciary risk**: low / moderate / substantial / high (before safeguards). Identification of key fiduciary risks (high value/impact, high risk).
4	Assessment of the risk of corruption	Analysis of the drivers and risks of corruption to public funds. Summary of the evidence from national and international studies. Analysis of the trajectory of change on corruption. **Overall assessment of corruption risk**: low / moderate / substantial / high (before safeguards).
5	Assessment of the financial impact of risks	Identification of key fiduciary risks (high value/impact, high risk) and where available, evidence on the possible financial impact of key risks and quantification of potential risks to DFID financial aid.
6	Assessment of PFM, accountability and anti-corruption reforms	Summary of current PFM, domestic financial accountability and anti-corruption reform initiatives. Assessment of the credibility of current reform programmes, including if previous reform programmes have been implemented as planned: • Overall PFM reform, including commitment to undertaking regular PEFA assessments • Reforms to strengthen Supreme Audit Institutions and Parliamentary Scrutiny of public finances • Anti-corruption reforms Identification of key fiduciary risks not addressed by existing reform programmes, and weaknesses in planned reforms. Conditions or recommendations to address concerns about partner government commitment to improving PFM, strengthening domestic financial accountability and fighting corruption. **Overall assessment of partner government commitment to improving PFM, strengthening domestic financial accountability and fighting corruption**: credible / mixed commitment / not credible.
7	Safeguards and residual risks	Safeguards recommended to mitigate key fiduciary risks; their contribution to strengthening PFM capacity and the planned exit strategy from safeguards. National-level residual risks when providing financial aid, accepted by the country office, and implications for design of individual aid instruments.
8	Dialogue and monitoring	Summary of how dialogue with partner governments on safeguards and reforms will be taken forward. Summary of how short term safeguards, PFM conditions and reform recommendations will be monitored (including through ASPs), including identification of specific indicators. Summary of plans for monitoring partner government use of funds.
9	Bibliography	Note of information sources used.

44. A clear record should be kept of all sources used in the FRA, including partner country reports and findings from key diagnostic studies, noting when each report

45. Country offices often contract consultants to help with the analytical component of FRAs. However, the DFID country office must own the FRA, be responsible for dialogue with partner governments on PFM conditions and recommendations, and explicitly sign-off on the levels of residual risk when providing financial aid. Annex 4 provides generic Terms of Reference for contracting consultants to assist in developing a FRA.

46. The content of the FRA applies to all countries where DFID works, but the circumstances of individual countries may affect the depth of information which is available to inform the analysis and the approach used to develop the FRA. In most countries, a significant amount of diagnostic material will be available to draw on. The main exceptions will be countries which have recently emerged from conflict or other problems and where the international community has not been active for some time. Less will be known about their PFM systems and, almost inevitably, government capacity to participate in new diagnostic studies, and implement the numerous recommendations which may emerge, will be low. **DFID recommends that the PEFA Framework is used as a starting point in such circumstances**. Future references in this HTN to the use of a PEFA Framework should be taken to mean one that is complete and has been quality assured by the PEFA Secretariat. The PEFA Framework helps develop a shared understanding and build a partnership between the government and international partners. It provides a high-level overview of the main weaknesses in the PFM system, including in many cases gaps in information which will need to be filled by further detailed analysis.

FRAs and PEFA Assessments

47. As far as possible, the national FRA should draw on information from a country's most recent national PEFA assessment. One of the objectives of PEFA assessments is to measure and monitor the standard of PFM systems. DFID strongly supports using PEFA assessments to inform fiduciary risk assessments. Where there is no PEFA assessment, Country Offices should the possibility of carrying one out, with Government and other partners.

48. The scope of a national level FRA should be the management of all government funds. The scope of a PEFA assessment is a single level of government, either central government, a specific sub-national government (i.e. a particular state, district or municipality), or a cross-section of sub-national governments (e.g. a sample of local authorities) to give an overview of PFM performance at that level of government. In many cases use of a PEFA assessment of central government to inform a national level FRA will be most appropriate. However, country offices should consider whether this provides an adequate understanding of risk across the whole government, or whether additional analysis is required. Depending on the structure of the state, and the importance of decentralised revenue and expenditure, additional analysis may be required. For example, in a unitary country information from a national PEFA might be supplemented by information on PFM performance at the local level. In federal countries where state level PFM systems vary significantly from the national PFM system, additional standard FRAs for states receiving financial aid (directly or via the national treasury) may

49. FRAs and PEFA assessments both examine PFM systems but have different objectives. A PEFA assessment cannot replace the FRA, which is needed for DFID's own decision making and accountability purposes. The PEFA Framework is an indicator-based evaluation which provides **information** about the current strengths and weaknesses of the national PFM system. The FRA uses this and other information to inform **judgements** about the levels of fiduciary and corruption risk in using national PFM systems and records how risks are being managed. Annex 5 lists the PEFA indicators. Annex 6 sets out the relationship between PEFA and the FRA in practice, highlighting how PEFA assessments feed into the assessments which need to be included in a FRA.

50. As PEFA Framework evaluations are a key source of information for FRAs, it is important they are of a **high quality with sufficient evidence to justify the indicator ratings**. Guidance on carrying out PEFA assessments is available on the PEFA website www.pefa.org, including through the PEFA Framework handbook and the PEFA note 'Good Practices in Applying the PFM Performance Measurement Framework'. The PEFA Secretariat provides an information pack to guide those commissioning a PEFA assessment through the process and can be contacted through its website. **DFID recommends that all PEFA concept notes and terms of reference and draft PEFA assessments are sent to the PEFA Secretariat to be quality assured, and that the quality assurance process is disclosed in the final PEFA assessment report.** It is also recommended that DFID country offices make all possible efforts to encourage partner governments to publish final versions of PEFA assessments. Confirmation that a PEFA assessment used to inform the FRA has been quality assured by the PEFA Secretariat should be provided in section 3 of the FRA (see Table 1).

51. Annex 7 summarises key issues which country stakeholders should address to produce a robust PEFA Framework report[9]. DFID's central review process will look for assurance from country offices about the quality of underlying PEFA assessments.

Other Information

52. Not all the information needed for an in-depth assessment of fiduciary risk will be available from the PEFA assessment. PEFA does not drill down into specific areas of the PFM system (such as procurement) or examine PFM performance within every government department and agency, nor does it provide a diagnosis of the reasons for strong or weak performance. Understanding the historical, governance, institutional and political economy context of partner governments' PFM systems and processes is also critical for an effective assessment of risk. Use of information outside the PEFA assessment is particularly necessary for assessing the risk of corruption.

[9] Lessons are drawn from the PEFA Secretariat's 'Report on Early Experience from Application of the Framework', November 2006, and the 'Good Practice in Applying the PFM Performance Assessment Framework', 2009 The full reports are available at www.pefa.org

53. A wide variety of source material and other analysis is likely to be available at country level to feed into the FRA. Annex 9 notes common forms of partner government analysis as well as international diagnostics on PFM and corruption issues which may be available.

Consultation

54. A PEFA assessment should be the main mechanism for gathering data on PFM performance, and provides important input for discussions with government and other partners on PFM reform priorities. In preparing a FRA, Country offices should avoid duplicating what has been done via the PEFA assessment. However, consultation on the development of the FRA is encouraged as a means of promoting dialogue with government and other partners on critical governance issues and developing a transparent and open relationship. Dialogue about the emerging conclusions in a DFID FRA will indicate to others how we interpret information available from the PEFA assessment and other sources and allow us to understand their views.

55. In the absence of a PEFA assessment, the FRA should follow the 8 Good Practice Principles and 15 benchmarks (see Annex 14). When using these, the 4 point risk rating set out in box 1 should still be applied.

Contents of the FRA Document

56. The assessments in the FRA are a matter of judgement, and should take a wide range of factors and influences into account. There is no formulaic 'right' answer which can be applied in every case. The FRA must be able to stand alone from any PEFA assessment and therefore should summarise (but not repeat in full) key PEFA findings. If this is not done reviewers cannot form an opinion on the risk ratings and trajectory of change. This section sets out advice on things to consider in reaching a judgement on the issues involved.

Country context: Historical, Governance, and Political Economy (FRA Chapter 2)

57. Understanding PFM and the prospects for reform requires an evaluation of both formal and informal systems. To manage fiduciary risk, country offices need to be aware of differences between the design of the formal PFM system and the way in which it works in practice. Assessments of the credibility of partner government commitment to strengthening PFM and accountability need to be informed by an understanding of the national governance and political economy contexts, the incentives of groups and individuals (within and outside government), and the drivers and barriers to reform of PFM and accountability systems.

58. Findings and conclusions from DFID Country Governance Analysis and macro-level political economy analysis should feed into, and be informed by, the FRA. In addition, country offices may find it useful to conduct policy level political economy analysis of public financial management reform. More information on these issues can be found in the DFID how to note 'Political Economy Analysis', and the DFID Briefing 'Understanding the Politics of the Budget'.

Analysis of the Public Finances and Performance of PFM Systems (FRA Chapter 3)

59. The purpose of this section is two fold: to understand the big picture of the partner country's public finances; and to understand the performance of the systems used to manage the public finances. Both elements are essential to managing fiduciary risk. This analysis, combined with an understanding of the broader context for PFM, forms the basis of DFID's overall assessment of fiduciary risk.

The Public Finances

60. This section should draw on government budget documents and expenditure reports (covering national and sub-national government) and assessments of macro-economic performance such as those by the IMF as well as national level Public Expenditure Reviews, to summarise macro-economic factors impacting on the public finances, aggregate fiscal discipline and the overall credibility of the budget. Much of this information for central government can be obtained from the PEFA PFM performance report (section 2: Country Background Information). It should also help the reader to 'following the money', explaining where and how money is raised and spent, between national and sub-national levels of government, and through different components of the PFM system. In doing so it will help inform decisions on whether national PEFA assessments need to be complemented by additional information on PFM performance within different states and across local governments. The content of this analysis should be proportionate to the complexity of the public finances and will be determined by country circumstances, but could include coverage of the issues highlighted in table 2. Input from the country economist is essential.

Table 2: Issues to Consider to Understand the Public Finances

Macro-economic performance	Summary of recent macro-economic trends and projections, including growth, inflation, and exchange rates, and implications for public finances.
Aggregate fiscal discipline	Summary of trends and projections for the annual budget deficit and the stock of public debt. Summary of additional off-budget expenditure, unrecorded liabilities and contingent liabilities. Results of any debt-sustainability analysis.
Credibility of the budget	Summary of whether the annual budget and medium term fiscal framework (if available) are credible based on the above. Summary of key risks to budget credibility.
Fiscal structure of government	Federal or unitary state; other unusual state structures. Split of revenue and expenditure responsibilities between national and sub-national governments. Main systems for inter-governmental fiscal transfers (vertical and horizontal, block and earmarked, revenue equalising or incentivising).
Main sources of government revenues and borrowing	Analysis of main **revenue** sources and split between central and sub-national government. Balance of revenue between taxation, natural resource rents and development assistance, and breadth of the tax base, including implications for state-citizen relations (the social contract) and for domestic accountability. Risks to main revenue sources. Reliance on external **borrowing** and main sources of borrowing. Major borrowing conditions and implications for PFM reform.

Main forms of government expenditure	Analysis of government expenditure according to administrative classification. Calculation of proportion of government expenditure at different levels of government. Analysis of government expenditure according to economic classification. Calculation of proportion of government expenditure incurred through payroll, procurement, cash transfer, and other systems.
Identification of key revenue and expenditure systems	Based on the above, identification of the most financially important revenue and expenditure systems used to manage public funds, identifying whether these systems are managed nationally or by different spending units or sub-national governments.

Performance of PFM Systems

61. The analysis in this section should draw on the findings of the PEFA assessment (where available), particularly the PFM performance report summary assessment and the high level performance indicator set. First, it should set out a strategic picture of PFM performance highlighting the impact of the PFM system on the achievement of aggregate fiscal discipline, strategic allocation of resources and efficient service delivery. Second, key fiduciary risks and the trajectory of change from the previous assessment (where applicable) should be summarised and rated according to the six core dimensions of PFM (or the 8 DFID good practice principles where no PEFA is available). Table 3 summarises the six core PEFA dimensions and the fiduciary risks that could arise from poor scores. Examples of how PFM performance, trajectory of change and key fiduciary risks can be shown are included in annex 15 (when there is no PEFA assessment) and annex 16 (when a PEFA assessment is used).

Table 3: The Six Core PEFA Dimensions and Implications for Fiduciary Risk

A. PFM Out-turns: Credibility of the budget (PEFA Indicators 1-4)	This dimension considers the extent to which the budget, as a plan, is a good indication of what happens in practice. It examines the variance between budgeted and actual expenditure and revenue and whether actual reported expenditure is distorted by unpaid/undisclosed bills. Poor scores point to the possibility that resources may not in practice reach the policy priorities reflected in the budget to the extent intended.
B. Key Cross-cutting issues: Comprehensiveness and Transparency (PIs 5-10)	This dimension examines the extent to which instruments such as the budget and accounts of the Government reflect the totality of public finances. It examines the extent to which Government makes available information, in a suitable form, through which it can be held accountable for the way it manages resources. Poor scores indicate fiduciary risks due to unreported operations and other fiscal risks diverting resources from policy priorities; and the absence of opportunity for Government to be held accountable by its own population that transparency otherwise makes possible.
C(i) Budget Cycle: Policy-Based Budgeting (PIs 11-12)	This dimension reflects the extent to which budget allocations are made following a clear process and in a strategic context reflecting agreed policies and priorities, with due consideration to the longer term impact of decisions. Low scores indicate weak planning, prioritisation and linkage to policy objectives suggesting inefficient use of resources. They would also suggest vulnerability to imbalances between types of expenditure and inefficient use of resources due to ’stopping and starting’ of projects.

C(ii) Budget Cycle: Predictability and Control in Budget Execution (PIs 13-21)	This dimension considers the functioning of the tax system and the extent to which managers and service providers inside the public service receive and can deploy resources provided in the budget with certainty and timeliness and within a control framework that ensures the regularity of expenditure and contributes to aggregate financial discipline. A low score here indicates the risk that tax revenues are not properly collected and accounted for, as well as vulnerability to leakage, lack of discipline and inefficient use of resources due to those resources not being in the right place at the right time or applied in the right way.
C(iii) Budget Cycle: Accounting, Recording and Reporting (PIs 22-25)	This dimension reflects the adequacy of overall accounting controls which ensure the integrity of financial information, and the adequacy of financial reports on the use of resources. Weak performance here implies vulnerability to sub-optimal usage of resources and can undermine the basis for internal and external accountability.
C(iv) Budget Cycle: External Scrutiny and Audit (PIs 26-28)	This dimension reflects the nature and coverage of external audit of government activities, as well as scrutiny by the Legislature of both the annual budget and the use of resources. Low scores indicate weak accountability for the use of resources and exacerbate the risk that funds will be used for purposes other than those intended and will not achieve value for money. It increases the risk that controls designed to provide a check on other parts of the PFM system may not function as intended and increases fiduciary risks in all areas.

Assessing Procurement Systems

62. In view of the fact that anything between 20% and 70% of total Government expenditure in developing countries passes through government procurement systems, this is an area particularly prone to corruption and extra vigilance is required when assessing the level of fiduciary risk in this area. Corruption can occur at any point in the procurement cycle and is not always easy to detect even by local audit staff who may lack the necessary expertise. Application of best practice procurement principles can help reduce corruption by increasing transparency and accountability but provide no guarantee.

63. Evidence shows that country procurement systems are often fundamentally sound in design but weak in execution, compliance, monitoring/oversight and enforcement. This and the traditionally high levels of corruption associated with procurement contribute to high levels of fiduciary risk.

64. The PEFA Framework deals with procurement specifically in indicator **PI-19** which examines **transparency, competition and complaints mechanisms in procurement**. PI-19 is a comprehensive indicator of the strength of national procurement systems, covering the design of, and compliance with, the legal framework. While the procurement system operates within its own framework, it is affected by the overall control environment in the PFM system, including public access to information, internal controls operated by implementing agencies, and external audit. The procurement system contributes to many aspects of the PFM system, providing information that enables realistic budget formulation, providing access to information to stakeholders that contributes to public awareness and transparency, and supporting efficiency and accountability in delivery of government programs. The following indicators impact on or are influenced by procurement: PI-4, PI-10, PI-12, P-20, PI-21, PI-24, PI-26 and PI-28.

65. PI-19 draws heavily on information collected as part of assessments conducted using the OECD-DAC Methodology for Assessing Procurement Systems (MAPS) tool. The MAPS assessment methodology is based around four critical areas or ‘pillars’ of a procurement system: ‘legislative framework’, ‘integrity and transparency’, ‘institutional capacity’, and ‘operations and markets’. The assessments can be conducted either as a self-assessment (in which case some form of independent validation is required) or jointly with a donor(s).

66. MAPS now forms an integral part of the World Bank Country Procurement Assessment Report (CPAR), and both these assessments now form the primary source of procurement information for PEFA PI-19 as well as providing a very useful insight into the level of fiduciary risk presented by the public procurement system.

67. The MAPS tool incorporates two types of indicators. Baseline Indicators deal with the formal and functional features of the system, while compliance indicators attempt to monitor the level of compliance. In practice there is often insufficient data to make a valued judgement on this, however things are slowly improving as e-procurement systems make it increasingly easier to collate and analyse data.

68. MAPS does not attempt to measure overall system performance or if the system is delivering Value for Money. New indicators are under development and should be integrated into the MAPS methodology during 2011/12. Further information is included at Annex 8.

69. **The MAPS assessment tool – whether conducted by the partner government or by the World Bank as part of the CPAR process – was designed primarily for assessing systems at the national level.** It will not therefore provide a detailed perspective as to what is happening at sub-national or sectoral level or at procurement entity level and a separate assessment should be considered. This is particularly important with sector budget support in cases where central procurement systems are not used. The MAPS methodology can still usefully be deployed at sectoral level and DFID procurement agents can be called down from the DFID Capacity Building Framework Contract to assist in the process. The methodology is not appropriate for lower level use e.g. at programme or local government level and a different approach will have to be adopted. In such situations, Programme Teams are advised to consult with Procurement Group in FCPD or local DFID Procurement agents where present.

Box 1: Explanation of Risk Ratings

Risk level	Detail
Low	Represents a situation where the structure of the PFM system broadly reflects good international practice and there is routine compliance with the majority of controls within the system.
Moderate	Represents a situation where the structure of the PFM system broadly reflects good international practice, although there may be some gaps or inefficiencies. There is basic compliance with controls within the system, and although regular exceptions occur, these are not financially significant.
Substantial	Represents a situation where the structure of the PFM system falls short of good international practice in a number of areas and/or there are numerous and/or material weaknesses in compliance with many of the controls within the system.

High	Represents a situation where the structure of the PFM system shows a significant divergence from good international practice and/or there is widespread lack of compliance with many of the controls within the system. Inefficiencies and leakage from the system may be financially significant.

What is the Overall Level of Fiduciary Risk?

70. The overall level of fiduciary risk is the risk that additional funds passed through the Government's PFM system will not be used for the intended purposes, will not achieve value for money, and/or will not be properly accounted for. The FRA should provide an overall assessment of the level of fiduciary risk following the four point scale in box 1. The narrative justification for this score should reflect:

- The fiduciary risk assessments for the six core dimensions of PFM and how interactions between them impact upon the overall level of fiduciary risk.
- The strategic picture of PFM performance and the impact of the PFM system on fiscal discipline, resource allocation and efficiency in service delivery.
- Whether levels of transparency and accountability off-set or exacerbate fiduciary risks in other areas
- The impact of the overall historical, governance, institutional and political economy environment on fiduciary risk.

Identification of Key Fiduciary Risks

71. Key fiduciary risks should be identified from the above assessment, taking into account the risk (or likelihood) and potential value (or impact) of financial losses and inefficiencies. Particular focus should be paid to the risk and potential value of leakage from financially significant revenue and expenditure systems such as tax collection, payroll and procurement systems. Attention should also be paid to weaknesses in the PFM system which undermine the credibility of the budget as an instrument of government policy, prevent service delivery units from utilising resources effectively, and reduce the levels of transparency and accountability which otherwise help to ensure resources are used effectively and for the purposes intended.

Assessment of the Risk of Corruption (FRA Chapter 4)

72. An assessment of the strength of PFM systems should be complemented by a broader analysis of the risks of corruption. Such risks can occur at a variety of levels, and there is a need to consider not just the potential of corruption in relation to funds passing through the PFM systems, but also the wider political economy of the country and how this affects levels of corruption (for example, whether grand corruption is driven by party political financing or neo-patrimonialism). Moreover global trends (such as the spread of organised crime, the ease of international financial transactions, the race for natural resources, etc) are increasingly driving and facilitating corruption and need to be assessed.

73. DFID's Country Governance Analysis is an important input to an assessment of the risk of corruption. This, combined with the UN Convention against Corruption (UNCAC), provides a useful framework for assessment both of levels of

Table 4: Framework for Assessing Corruption Risks

Country Governance Context	**What is the level of state capability, accountability and responsiveness?** What signals does the broader governance climate suggest about the levels of corruption in the country? Are corruption trends monitored in any way, either domestically or through international indices such as those used by Transparency International? Has the country signed and ratified the UN Convention Against Corruption, and if so, to what extent is it known to be compliant (as stated in its own self-assessment, any gap analyses that have been conducted, or any reviews under the UNCAC review mechanism)?
Preventive measures	**What is the strength of the package of preventive measures currently in place?** This will include: public sector ethics and procedures; public procurement; public financial management; public reporting; access to information and whistleblower protection; public education; private sector standards including accounting and auditing standards; money laundering (is the country a member of a regional anti money laundering body, and if so, has there been an assessment of its compliance with international anti money laundering standards as set out by the Financial Action Task Force?).
Criminalisation and enforcement	**Are provisions in place to criminalise the key corruption offences and take enforcement action?** This will principally include: bribery (domestic or foreign), embezzlement, trading in influence, abuse of functions, illicit enrichment, laundering of proceeds within or outside of the country, and obstruction of justice. Are there any figures available on the rate of investigations and prosecutions against reported cases of corruption?
International Drivers and International Co-operation	**How significant are international factors in driving in country corruption?** This will include: foreign bribery, money laundering, and organised crime. Are mechanisms in place and being used to allow international co-operation with other countries on cases of bribery and money laundering, including recovery of stolen assets?
Technical Assistance and Information Exchange	**What is the extent and nature of external support on anti-corruption?** Who provides it (does it come through UNCAC, IFIs, regional bodies or bilateral donors)? Does it match key areas of need?

74. Annex 8 sets out key dimensions of corruption covered by UNCAC. Annex 9 notes common sources of information about corruption levels and measures to address corruption. Material on corruption is often difficult to gather and verify. Where there is a shortage of hard data, evidence based on informed local opinion and other professional observers can be useful. This may be used in the assessment of corruption risk where other diagnostic material is not available and such evidence is confirmed by more than one source. The FACT team can provide guidance on where to source specialist advice on corruption issues.

75. Where hard evidence is limited and the assessment of corruption risk relies on anecdotal evidence, this should be **explicitly stated**. Similarly, where evidence indicates that the level of corruption risk is not what would normally be expected, given the standard of the PFM systems, or where or evidence in this area is

Assessment of the Financial Impact of Risks (FRA Chapter 5)

76. Country offices should carefully consider **the possible financial impact of weaknesses** in PFM systems with a view to **quantifying the impact on and risks to all funds managed by partner country systems, including DFID funds**. Attention should be paid to how weaknesses identified in PFM systems could translate into leakage or inefficiency. While predicting actual waste or losses will be difficult, a first step in managing fiduciary risk is to identify the value of funds exposed to significant levels of risk. Matching the results of PFM diagnostics to an understanding of the flow of funds through partner country systems provides a starting point to assess the risk of leakage or inefficiency.

77. DFID recommends against predicting losses or inefficiencies from PFM systems based on subjective risk assessments. Instead, results of available studies focused on specific financial systems should be used to estimate anticipated leakage and inefficiency from those systems. Country offices should seek to build up their understanding of the financial impact of risk through advocating additional studies into high risk, high value PFM systems. Such studies should be conducted in partnership with partner countries and other donors where possible, and take a considered approach to the costs and benefits of data collection.

78. The findings of such studies should inform the management of fiduciary risk, including agreeing priority actions with partner governments, designing additional short term safeguards, selecting appropriate aid instruments and prioritising the monitoring of risk. Perceived risk in the use of country systems should be weighed against the expected benefits of using country systems.

79. The central review and scrutiny process will consider the extent to which FRAs assess the possible financial impact of weaknesses in PFM systems. Annex 17 provides further guidance on assessing and documenting the financial impact of risk in the use of country PFM systems.

Section 3: Mitigating Fiduciary Risks

Assessment of PFM, Accountability and Anti-Corruption Reforms (FRA Chapter 6)

80. DFID's Strengthened Approach to Budget Support sets out four partnership commitments on which our aid relationships are based (para. 10). This section of the FRA records country offices' assessment of partner government's commitment to improving public financial management, strengthening domestic financial accountability, and fighting corruption.

81. In addition to the general requirement to improve public financial management, the strengthened approach to budget support introduces two specific requirements for a positive assessment in this area:

    - A credible programme to improve Supreme Audit Institutes and Parliamentary Scrutiny
    - A commitment to undertake regular PEFA assessments (at least once every five years).

    It further requires that assessments give greater weight to recent progress (the trajectory of change) in judging the credibility of future reforms.

Assessing High Level Reform Commitment: A Political Economy Perspective

82. Reforms to improve PFM, strengthen domestic financial accountability and tackle corruption go to the heart of the political negotiations that reflect the underlying power struggles between competing social forces. Successful reforms need sufficient support to overcome powerful informal processes including clientelism, patronage and rent seeking.

83. The history of budgetary reform in OECD and emerging economies suggests that sustainable reform to the public finances requires a strong underlying motivation for reform. History points to three main drivers of government commitment to improving the public finances and public financial management, shown in box 2.

Box 2: Historical Motivations for PFM Reform

(i) **Financial crisis** – such as New Zealand in the 1980s, Sweden and East Asia in the 1990s, the UK and Ireland in 2010

(ii) **Political ideology**, or political imperative to maintain legitimacy – such as that of the UK and US in the 1980s, Vietnam under the Doi Moi (renovation) process.

(iii) **External pressures** – such as the requirements for EU membership faced by Eastern European countries in the 1990s and 2000s, and HIPC debt relief in the 2000s. Whether PFM conditions attached to concessional lending and aid constitutes an effective external pressure for sustainable PFM reform should be considered on a case-by-case basis.

84. While some reforms have been achieved in the absence of the above by working with dedicated public officials, large scale reforms which threaten the established balance of power and resources are unlikely to be sustained without such powerful motivating forces. In assessing the overall commitment to reforms,

Assessing the Credibility of Reform Design

85. The FRA should include an assessment of the credibility of the reform programmes. Country offices should note that a reform programme does not necessarily need to be captured and explained in a single reform document: reforms often start as piecemeal and fragmented, and may be easier to manage in this form initially. However, mechanisms to coordinate diffuse reforms and ensure they are working towards consistent objectives will be beneficial at some stage in the reform process. Many countries have tried to capture all ongoing PFM reforms in a single document, to provide a high level overview of individual reforms.

86. Box 3 highlights seven general features of a credible reform programme. Annex 10 provides further guidance with a set of related questions to help assess the extent to which these features exist. This guidance is not exhaustive and is not designed as a checklist but rather provides a suggested framework to promote a consistent assessment approach across country offices. It is unlikely that reform programmes will meet all of these criteria. What is important is that weaknesses within the reform programme are identified and explicitly stated to enable informed decision-making and to contribute to strengthening reforms.

Box 3: General Features of a Credible Reform Programme

Reform programmes should:	
1.	Be government led: enabling full political ownership and leading to effective harmonisation of donor support.
2.	Be realistic and achievable: based primarily on available local capacity and set within an appropriate timeframe.
3.	Integrate individual measures of improvement within a comprehensive framework which is effectively sequenced.
4.	Be relevant and sustainable: adapted to the specific country context, targeted to meet key fiduciary risks and avoiding over-reliance on external technical assistance.
5.	Focus on developing local capacity: capacity development strategies should be a central component of the programme, considered from the outset of reform design.
6.	Build demand for change: promoting a sustainable track record of improvement based on previous successes, to develop a momentum and impetus for change.
7.	Include specific performance indicators – with effective monitoring and evaluation against relevant targets and milestones.

87. The FRA should provide a summary of the reforms to improve PFM, strengthen domestic financial accountability and tackle corruption, including connections to programmes such as Public Sector reform and Local Government reform.

Good Practice Approaches to Reforms

88. In the medium to long term, the most sustainable way to manage fiduciary and corruption risk is to work with partner countries to improve their PFM systems and overall control environment. Annex 18 outlines two approaches to PFM reform: the **PEFA strengthened approach** and the **platform approach**. These approaches emphasise different dimensions of good practice in reform and change management.

Recent Progress on Reforms

89. The assessment of reform commitment should give appropriate attention to recent progress actually achieved. Evidence of previous successful reforms is one of the best indicators that a government is genuinely committed to reforms, and capable of implementing them. This is particularly relevant in countries where there appears to be **reform stagnation**: constant promises of improvement being just around the corner, which never actually produce tangible results.

90. Where possible, FRAs should record the trajectory of change (against the previous FRA) relating to PFM, domestic financial accountability and anti-corruption. The templates in annexes 15 and 16 can be used for recording the trajectory of change in relation to PFM and domestic financial accountability at the outcome level. Where there has been more than one national PEFA assessment, country offices should contact the FACT team who can provide a comparison of PFM performance over time based on the PEFA data. As PFM outcomes, measured by PEFA indicators, are only likely to change over the medium to long term, country offices may also consider it useful to summarise progress on major reforms since the previous FRA. ASPs will provide useful information in this regard. A summary of key reforms, commitments made and progress to date may provide useful additional information to complete the picture on recent reform progress. Triangulated data on levels or perceptions of corruption should also be used to provide evidence on recent progress on anti-corruption reforms.

91. The FRA should record progress since the previous FRA using an arrow system.

Positive progress	↑
No change	↔
Negative progress	↓

The arrows should not anticipate future progress. The assessment of what past performance means for the future should be made in the narrative of the FRA as part of the assessment of the credibility of reforms. While what has been achieved to date can be a useful indication of what may happen in the future, significant events such as a change in government, a financial crisis, emergence of a political consensus to reform, or completion of the design of a reform programme may make future reform progress more likely even when recent reform progress has been stagnant. In cases where recent progress on reforms has been limited but the government is now considered to have a credible commitment to reform, the **FRA should include a clear reasoned argument for why current reforms are considered credible**.

92. Conversely, country offices should be mindful of the opposite situation, where recent progress has been positive but adverse events suggest that there may no longer be a credible commitment to reform.

Assessing Components of Reforms

Public Financial Management Reforms

93. The first element of the assessment of partner government's reform commitment focuses on public financial management reforms, excluding commitment to strengthening supreme audit institutions and parliamentary scrutiny, which is assessed separately (see para. 101 below). This assessment focuses on PFM components covered by the first five dimensions of the PEFA framework (performance indicators PI-1 to PI-25) and focuses on the elements of the PFM system managed by the executive branch of government[10]. PEFA PFM performance reports should contain a summary of recent and ongoing reforms, and information which should assist in forming a view on the credibility of reforms.

94. To track PFM performance within a country over time and ensure reforms are contributing to PFM performance improvements requires periodic assessments of PFM performance. DFID considers this an essential component of a credible commitment to improving PFM. The most widely used and accepted tool for tracking PFM performance is the PEFA performance measurement framework. In assessing a government's commitment to PFM reform, DFID requires a commitment to undertake **PEFA assessments at least once every five years.** Government participation in previous PEFA assessments and plans for future assessments will be taken as a credible commitment to regular PEFA assessments. Where countries have not undertaken PEFA assessments previously, e.g. newly formed countries or countries emerging from conflict, a government commitment to start a first PEFA assessment within the next 12 months can be taken as a credible commitment (and should be monitored as a formal PFM condition).

95. A key feature of the PFM system is the level of **fiscal transparency**, which acts as a basis for both effective external accountability and public participation in the budget process. While some information on fiscal transparency is contained in PEFA PI-10 (Public access to key fiscal information), this may usefully be supplemented by additional information drawn from the Open Budget Index and country level survey results[11].

96. Within the scope of PFM reforms, some areas are likely to be of significant interest due to their importance in managing fiduciary risk and tackling corruption, and possible barriers to change posed by vested interests. In these cases, country offices should draw on existing 'drill-down' tools[12] and political economy analysis (where available) to form a deeper understanding of the prospects for reform.

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[10] The Supreme Audit Institute (SAI) should ideally be independent of government, reporting directly to Parliament and not considered part of the executive branch of government. In practice in many countries the SAI is not completely independent and may be part of the executive.

[11] http://www.internationalbudget.org/what-we-do/open-budget-survey/

[12] E.g. the OECD-DAC Methodology for Assessing Procurement Systems (MAPS); the Debt Management Performance Assessment tool (DeMPA).

Procurement Reform

98. The commitments made at the 3rd High Level Forum in Accra to accelerate and deepen implementation of the Paris Declaration (PD) on Aid Effectiveness require increased donor collaboration behind country led procurement reforms. Engagement in this process will provide an invaluable insight into the risk associated with using local procurement systems, as well as the opportunity to influence reform including any safeguards which may be necessary.

97. The outcome of procurement reviews based on the OECD-DAC MAPS tool should be used to produce an agreed joint procurement reform strategy aimed at increasing partner government capacity and reducing longer term fiduciary risk from procurement. The credibility of the assessment will be enhanced if it is done in partnership with donors and subject to independent verification. Ongoing monitoring of the progress of the reform programme will be essential.

98. MAPs assessments have already been conducted or are planned in most of DFID's priority countries. The reports should be freely available from the partner government or can be found on the Procurement Department page of the OECD website (www.oecd.org) or the UNDP Procurement Capacity Development Centre website: http://www.unpcdc.org/home.aspx

99. Assessment results will help in identifying risks. If these are addressed by reform programmes, fiduciary risk should decrease over time. Where no assessment exists, Country offices should press for one to be carried out, as basis for reform and capacity development (with donor support, as necessary), in order to reduce fiduciary risk.

100. Annex 8 lists the main sources of additional guidance on assessing procurement systems, including an OECD 'Checklist for enhancing Integrity in Public Procurement' (a recently developed OECD/DAC assessment tool) and the Nordic+ Joint Procurement Policy document.

Domestic Financial Accountability Reforms: Supreme Audit Institutions and Parliamentary Scrutiny

101. The effectiveness of external audit by the SAI and scrutiny of the annual budget law and external audit reports by Parliament is of critical importance for managing fiduciary risk. In the case of budget support, DFID funds can not be audited separately from the audit of other partner government funds. In the case of non-budget support financial aid, it may be possible to audit DFID or multi-donor funds separately but it may be more effective to rely on the SAI to undertake such audits as part of its annual audit plan than to appoint another independent auditor.

102. In the countries where DFID works, few SAIs have sufficient capacity to audit all government entities on an annual basis. Few Parliaments have adequately resourced budget committees and Parliamentary Accounts Committees (PACs) – with appropriate administrative and analytical support – to provide proper scrutiny of the budget and of external audit reports. Strengthening these partner government systems is therefore key to the effective management of fiduciary risk. Box 4 below summaries common weaknesses and provides a basis for thinking about the adequacy of the scope of reforms.

Box 4: Common Weaknesses in External Audit and Scrutiny Systems

- **Limited SAI independence:** due to limitations in the SAIs operational or financial independence, the executive is able to exert control over the activities of the SAI, including non-release of budgeted funds and restrictions on staff recruitment.
- **Inadequate funding:** to enable the SAI to fulfil its mandated responsibilities.
- **Limited audit coverage:** significant public bodies are not audited each year; some high risk public bodies are never audited.
- **Weak audit planning:** SAI's annual audit plan and the conduct of individual audits do not follow a risk based approach, leading to inefficient allocation of audit resources.
- **Reduced scope of public audit:** compliance and basic financial auditing is undertaken by most SAIs; however the use of performance auditing (which examines the value for money of public expenditure) is less widespread.
- **Poor timeliness of audit reports:** long delays in the preparation of financial statements and conduct of audits means that audit reports are often produced more than a year after the period to which the audit relates. In some countries delays can be many years, making the implementation of recommendations impossible.
- **Limited publication of audit reports:** while the SAI's annual report (a summary of its audit activities and key findings) is published in most countries, more could be done to publish the detailed audit reports of specific public bodies, which are often more relevant to stakeholders interested in specific areas of public expenditure.
- **Extensive in-year amendments to the budget without prior approval by the Legislature:** the intentions of the original budget approved by Parliament are undermined by regular and significant in-year budget amendments made by the executive and only approved retrospectively by the Legislature.
- **Limited scrutiny of the budget and external audit reports by Parliament:** Parliamentary committees which scrutinise the budget and discuss the audit reports of the SAI are established in most countries. However, they are often poorly resourced and have limited administrative and technical support; members (who change frequently) receive little training on their role; and they meet infrequently – sometime only once or twice a year – to discuss the draft budget law and SAI's annual report. The time allowed for their scrutiny is often squeezed which prevents detailed examination of the budget and external audit reports.
- **Weak follow-up of audit recommendations:** SAI reports usually include a large number of recommendations, from reclaiming irregular government expenditure to recommendations to improve financial systems and adjustments to government accounts. In many countries most audit recommendations are not implemented, and neither the SAI nor the PAC is effective in enforcing audit recommendations.

103. Additional guidance on assessing the quality of Strategic Development Plans and Development Action Plans for SAIs is provided at annex 19.

Anti-Corruption Reforms

104. The credibility of anti-corruption reforms, like the other areas above, depends not only on laws being passed or new institutions being established, but also on how effectively they function in reality. The trajectory of reform can be assessed systematically using UNCAC as a framework (see Table 5 below).

Table 5: Framework for Assessing Trajectory of Anti-Corruption Reforms

High level anti-corruption reforms	**What steps is the government taking to address high level weaknesses in its anti-corruption regime?** • If the country has signed and ratified the UN Convention Against Corruption, does it have a clear implementation plan for addressing gaps in compliance, and how is this being executed? UNODC may be able to provide information relating to this. • Does the country have a national anti-corruption strategy, how clear are the objectives and outputs, and is it being implemented? • Have there been any high level corruption scandals recently and how has the government responded to them? Are there plans to rectify weaknesses identified as a result of the scandals? • Are trends in overall corruption levels improving or deteriorating? How about in individual high risk sectors relevant to DFID programmes?
Preventive measures	**Is the government tackling weaknesses in corruption prevention?** • Where there are clear weaknesses in corruption prevention, does the government have plans to address these and if so how? (e.g. public sector ethics and asset declarations; access to information and whistleblower protection; public education; private sector standards including accounting and auditing standards). Global Integrity has information on the existence and enforcement of several preventive measures in various countries. • Does the country have a plan in place to tackle weaknesses in its anti-money laundering (AML) regime and is this assessed to be credible/progressing by the relevant regional anti money laundering body (ESAAMLG for East and Southern Africa, GIABA for West Africa, APG for Asia and Pacific, MENAFATF for Middle East and North Africa, and CFATF for Caribbean)? (Countries that have non-compliant AML regimes are meant to provide annual progress updates on remedying deficiencies).
Criminalisation and enforcement	**Is the government addressing gaps in criminalisation of key corruption offences, and is it taking enforcement action?** • Where clear weaknesses have been identified in criminalisation of corruption offences (e.g. bribery, embezzlement, illicit enrichment, laundering of proceeds), does the government have a clear plan in place to address these and does it seem to be on track? (UNODC should be a useful source of information) • Are there improvements in the rate of investigations and prosecutions/sanctions against reported cases of corruption? (as reported by the anti-corruption commission or relevant body)
International Drivers and International Co-operation	**Mechanisms to allow international co-operation on corruption cases** • If there are shortcomings in mechanisms to allow international co-operation with other countries on cases of bribery and money laundering, including recovery of stolen assets, does the government have a plan to address these and what progress is it making? (UNODC may be a useful source of information on this. Implementation may also be checked against actual number of cases that have progressed each year).

105. Where there is a shortage of hard data, evidence based on informed local opinion and other professional observers can be useful. The FACT team can provide guidance on where to source specialist advice on corruption reforms.

106. Where hard evidence is limited and the assessment of the direction of corruption reform relies on anecdotal evidence, this should be **explicitly stated**. Consideration may be given to putting in place better monitoring systems so that evidence can be gathered to inform future assessments of progress (which can also be useful material for political dialogue with partner governments).

Recording the Assessments

107. Using the classifications of “credible” / “partially credible” / “not credible”, the FRA should record separate assessments reflecting the commitment to and plans for:

- Improving public financial management (including procurement and fiscal transparency, but excluding external scrutiny and audit)
- Undertaking regular PEFA assessments
- Strengthening domestic financial accountability – focusing on strengthening external scrutiny and audit
- Fighting corruption

108. Table 6 below provides guidance on the meaning of the different classifications, as well as the implications of each classification for the way in which we provide aid and monitor performance.

Table 6: Assessment of Reform Credibility

	Credible	Partially Credible	Not Credible
Meaning	Reasonable commitment to reform and design of reforms considered credible. Performance improvements expected over the medium to long term.	Reforms credible in some areas but major concerns about scope and design of reforms, and / or overall commitment to reforms. Mixed performance improvements expected over the medium to long term.	Commitment to reforms lacking at highest level and/or reform programmes not credible. Stagnant or deteriorating performance expected over the medium to long term.
Implications for provision of aid	Additional recommendations may be made to strengthen reforms. Financial aid can be provided without any PFM conditions.	Formal conditions required to justify use of financial aid, e.g. • Changes to reform programmes; and/or • Timely completion of agreed policy actions; and/or • Evidence of performance improvements Implemented through: • Conditions before entering into or renewing financial aid agreements • Triggers for future disbursements • Performance tranches • Results compacts	Partnership commitments not met. If financial aid currently provided, report as breach of partnership commitment and follow Conditionality Guidance on responding to a breach of the partnership commitments. If financial aid not currently provided, can not enter into new financial aid agreements.
Monitoring	Routine monitoring of PFM reforms and performance through ASPs, including action on recommendations.	More intensive monitoring of conditions, reforms and performance formally linked to specific aid instruments. Failure to achieve agreed conditions constitutes a breach of the partnership commitments.	Review commitment to reforms for evidence of possible improvements which might alter our judgement of partner government reform commitment.

109. Based on the individual components of the assessment, the FRA should record the country office's overall assessment of the credibility of the partner government's commitment to and plans for improving PFM, strengthening domestic financial accountability, and fighting corruption according to the following classification:

- Credible
- Partially credible
- Not credible

In rare cases, such as a new states and states emerging from conflict where DFID and other development partners have little experience, a classification of 'too early to tell' may be applied in a country's first FRA. In such cases it will be important to try to establish some benchmarks and seek to make a judgement on reform credibility in future ASPs and FRAs.

110. An overall assessment of "credible" (covering all the four dimensions noted in para. 107) is expected for a country to be considered eligible for financial aid. Financial aid can be provided when the assessment is "partially credible", but in these cases **formal conditions** (designed to address the specific weaknesses across all four dimensions) must be agreed and monitored to justify continuing provision of financial aid.

111. The FRA should record any conditions and/or reform recommendations made, including their status (whether yet discussed and agreed with government), and monitoring plans.

Safeguards and Residual Risks (FRA Chapter 7)

112. Fiduciary risks can be transferred, treated, tolerated or terminated, as noted in paragraph 22. In the long run, the best approach to treating fiduciary risk is to strengthen PFM, governance, transparency, domestic accountability and anti-corruption measures. Guidance on this in provided in Annex 18. However, such reforms often take five to ten years to significantly reduce risk. Over the life time of most financial aid instruments, short term safeguards may be necessary to help mitigate fiduciary risk.

113. In the short term, where there is high or substantial fiduciary risk, safeguards may be necessary at either the national level or around individual aid instruments. Decisions to use safeguards should consider their impact not only on fiduciary risk, but also development effectiveness.

114. **Safeguards need to be used intelligently**, not in a simplistic 'problem-solution' way. Research indicates that individual safeguards can be fragmented and ineffective in providing protection[13], particularly where numerous donors each impose their own requirements. In considering the appropriateness of safeguards, care should be taken to avoid potential negative impacts on the PFM system as a whole. Parallel systems can undermine long term systemic improvement, attract skilled staff away from essential government posts or create over-reliance on

[13] 'Study of measures used to address weaknesses in PFM systems in the context of policy based support', PEFA website http://www.pefa.org

short-term external technical assistance. Instead, safeguards should focus on strengthening and enforcing the checks and balances within and outside partner government PFM and accountability systems.

115. Safeguards should mitigate fiduciary risk and strengthen PFM systems. Well designed safeguards should contribute to managing fiduciary risk in both the short-term, by reducing the risk of leakage and inefficiency in the use of funds, and the long term, by strengthening PFM systems.

Types of Safeguard

116. Safeguards which achieve these short and long term objectives are those focused on enhancing:

- Transparency;
- Accountability (both internal and external); and
- Participation.

Table 7: Focus Areas for Short-Term Safeguards

Transparency implies openness and visibility. It is the foundation upon which both accountability and participation are built. **Information in the public domain**, presented and communicated effectively, is the "currency" of transparency and, together with **open and visible decision-making processes**, signals that there is nothing to hide. Transparency facilitates good governance; its absence provides cover for conflicts of interest, self-serving deals, bribery, and other forms of corruption.
Internal accountability implies probity in how resources are mobilized and used, and for what ends. It involves issues of **financial accountability**, efficiency, and effectiveness in the collection of taxes and other revenues and in the **delivery of basic services**. It includes the way organisations are governed; how management exercise **supervision** throughout the organisation; the design and implementation of systems of **internal control**; and the role of **internal audit**.
External accountability refers to the responsiveness of Ministers and public officials to citizens, including accountability for delivery and quality of basic services and for the stewardship of public funds and other public assets. It requires Ministers and public officials to be **answerable** to citizens and to **suffer sanctions** for poor decisions or criminal acts. It includes **vertical accountability** through which the state is held to account by citizens, including formal processes such as elections, and informal processes such as lobbying, as well as **horizontal accountability** systems through which bodies such as Parliamentary Committees, Supreme Audit Institutes, inspectors and ombudsmen hold state organisations to account.
Participation is the "**demand side**" of good governance, and implies that people should have a **voice** in the decisions that may affect them; that they should be treated fairly and equally. Participation includes the **involvement of citizens** and civil society groups in all stages of the budget process, from decisions about how resources are raised and allocated, to **monitoring the delivery of public services**. It can help reduce corruption when supported by effective complaints mechanisms, and extend to **direct democracy** where decisions are made directly by citizens rather than through their representatives.

117. Safeguards can use existing checks and balances within and between public bodies, or – with appropriate transparency – strengthen the role of civil society in holding the state to account. Alternatively, with partner government agreement or civil society engagement, new checks and balances can be introduced. Annex 12 provides some commonly used safeguards in these areas.

Design of Safeguards

118. To be effective safeguards need to be designed in a balanced and proportionate way, not just individually, but in terms of how they fit into the overall picture. Careful attention needs to be paid to the interaction of short term safeguards with the underlying national system and on-going reform programmes.

119. In designing safeguards, country offices should be careful to ensure the preconditions for effective operation of the safeguard are in place. This requires **thinking about public financial management as an interdependent cycle**, as shown in figure 2 below, rather than as discrete activities.

Figure 2: The Public Financial Management Cycle

120. Thinking holistically about the links between components of the PFM cycle helps in choosing effective safeguards, for example

- Civil society engagement in policy making will be more effective where the budget has clear linkages to government policy.
- Increased participation and transparency in budget preparation will be more effective where there is a system to compare actual expenditure to budgets.
- Civil society engagement in public expenditure tracking surveys will be more effective where the accounting system accurately records the flow of funds.
- Supreme audit institutions will be more effective in holding the government to account where basic record keeping and financial systems are in place.

121. **Safeguards should take into account the need to strengthen weak links in the PFM cycle**. Safeguards which promote demand for good governance can be effective in stimulating an accountable and responsive government to address these weaknesses. Civil society engagement in budget preparation may lead, in the longer term, to increased pressure for the government to report on how the budget was actually spent.

122. How safeguards are designed and implemented, as well as the selection of safeguards, is important in contributing to strengthening PFM systems. Where

possible, **safeguards should contribute to building sustainable capacity**. They should be designed and implemented in a way that contributes to building and sustaining the knowledge, competency and skills of people within (and interacting with) the PFM system. This will be easier when safeguards are implemented by government staff or civil society, or by external agents acting within rather than outside partner country systems. Where parallel systems are deemed necessary, these should seek to replicate what should work in a well functioning PFM system to contribute to building staff capability. The following are some safeguards implemented by external agents which can contribute to capacity building.

- Joint audit arrangements between the Supreme Audit Institution and external audit experts which facilitate skills transfer and mentoring.
- External procurement agents checking compliance with procurement procedures in partnership with national procurement inspectors or auditors.
- External experts assisting Parliamentary committees in their review of the annual budget through improving the analytical techniques of committee members.
- International NGOs working with civil society organisations to develop skills such as advocacy, community-based monitoring and social auditing.

Documenting Decisions about Safeguards

123. The extent and nature of fiduciary and corruption risk varies from one country to another and within a single country, from one sector or organisation to another. It is impossible to be prescriptive on how to mitigate fiduciary and corruption risks in every circumstance. There is no definitive list of which safeguards and measures for improvement are appropriate for which risks. Similar measures may result in different impacts in different situations, depending on the context in which they are implemented. The effectiveness of any risk mitigation measure depends on the way it is implemented, not just on the technical nature of the measure itself. A solution that might work in one environment could fail in another.

124. Safeguards should have a clear rationale, linked to a clearly identified risk. The rationale and safeguard should be discussed and communicated transparently to partner governments. **Safeguards should be designed to be temporary**, making clear the actions or results – where possible linked to partner country reform plans – that would enable removal of the safeguard. The appropriate project documentation should set out **details of any short-term safeguards** agreed with the partner government and the donor group, either at the national level or as part of individual aid instruments.

Accepting Residual Risks

125. In some environments, safeguards may be ineffective in reducing fiduciary risk, or may not be cost effective to implement. In other environments, governments may not agree to the use of proposed short term safeguards, or the risk that safeguards pose to government led PFM reforms may be deemed too great. In most cases, there are likely to be some **residual risks** at the national and/or aid instrument level which are not mitigated in the short term. Where country offices decide to accept some residual risks, programme documentation should **list the key residual risks** and provide **a reasoned narrative of why**

126. An assessment of the relative benefits and risks of using partner country PFM systems may lead to a decision not to provide financial aid. In these cases, country offices should still remain supportive of any credible government commitment to strengthen PFM systems, as a core development objective in itself.

Section 4: Monitoring Fiduciary Risks

Dialogue and Monitoring of Fiduciary Risks (FRA Chapter 8)

Performance Monitoring Indicators

127. The FRA should identify a selection of performance indicators to enable monitoring of key areas relating to fiduciary risk, specifically:

(i) Progress on key PFM, anti-corruption and domestic financial accountability reforms, including any specific **conditions** related to financial aid

(ii) Implementation of agreed safeguards

(iii) Triggers or warning flags that indicate possible significant losses in areas identified as key residual risks

128. The chosen indicators should be drawn from existing monitoring mechanisms where possible. Across a country programme, PFM indicators will be built into individual aid instruments, and aspects of PFM may also be monitored through indicators connected to broader mechanisms such budget support and Poverty Reduction Strategies.

129. Where possible, indicators, targets and milestones should be drawn from partner government's own reform programmes. Where the partner government has no relevant reform programme, or reviews have identified weaknesses in the programme, indicators should cover establishing or strengthening reform programmes, as well as anticipated reform milestones. Likewise, where the monitoring frameworks for reform programmes are weak and not in line with good practice[14], then the Country Office team should consider whether it is necessary to use other existing indicators in the FRA.

130. In order to prevent this situation from occurring, teams should seek to influence the monitoring framework for PFM and related reform programmes at the design stage. However, there is a trade off between ensuring that there are sufficient suitable indicators to meet our needs for managing fiduciary risk and overloading the monitoring framework, which undermines its effectiveness.

131. Where DFID has the opportunity to influence indicator design, it should seek to include both outcome and output indicators. Guidance on designing log frames for PFM reform projects, which includes suggested indicators at the impact, outcome and output level, should be useful here[15].

132. The following table provides guidance on issues to consider when designing and selecting indicators.

Table 8: Using Indicators to Monitor PFM Reforms

Outcome issues, that is, the desired results of the PFM	Where possible, these should be described in terms of the PFM cycle. For example, improvements in budget preparation might be a desired outcome. This would be a common outcome where establishing an improved budget

[14] See DFID How to Note (2011) "Guidance on Designing Log Frames for Public Financial Management Reform Projects". Available as Quest number 2772021

[15] Ibid.

reform project	process or a Medium Term Expenditure Framework (MTEF) is part of the PFM reform programme. PEFA indicators are likely to be the best source for monitoring such outcomes. The fact that such indicators are not available on an annual basis is in fact appropriate: we might not expect changes at the outcome level to be demonstrable on an annual basis. This is why outputs should also be monitored and should be used to flag potential areas of concern in the Annual Statement of Progress.
Output issues, that is, what is being delivered by the PFM reform project?	Monitoring outputs of the PFM reform project should help to signal where desired outcomes are unlikely to be achieved. Output indicators should describe things which are being directly delivered by the PFM reform project, such as changes in skills and organisations, changes in laws and procedures and changes in incentives and controls. Examples of such outputs are available in the How to Note on log frames for PFM reform projects[16].

Dialogue with Partner Governments

133. Dialogue with partner governments is essential for effective management of fiduciary risks at two levels. First, strengthening PFM, anti-corruption and domestic financial accountability reform programmes. Second, designing and implementing safeguards (at the national and/or aid instrument level) to treat key fiduciary risks in the short term.

134. In many countries, suitable government-donor dialogue mechanisms will already exist at the national (or sub-national) level. These may be around long term Development Partnership Agreements, joint budget support groups, governance groups or specific PFM groups. The FRA should identify the appropriate mechanisms for dialogue on both reforms and safeguards. It is important that appropriate officials from the relevant executive and legislative branches of government are included in these fora. Historically a common weakness has been the lack of inclusion of officials from the Supreme Audit Institution and relevant Parliamentary Committees in dialogue. Country offices should consider whether existing dialogue mechanisms include all the relevant stakeholders, and whether additional fora are required, such as a government-donor group on domestic financial accountability.

135. Joint government-donor dialogue fora should meet regularly, be attended by officials from both sides who have a suitable level of authority, and should be able to demonstrate a track-record of delivering on agreed priorities. Where this is not the case, or where there is no established dialogue mechanism, country offices should question whether the conditions for an effective development partnership are in place.

136. While dialogue with partner governments is a continual process, it may not always be feasible to conclude dialogue on reforms and safeguards before an FRA is submitted for central scrutiny. Where this is the case, FRAs should make clear that additional reforms and safeguards are **recommendations** rather than agreed actions, and implementation should be monitored closely and reported in ASPs.

[16] Ibid.

Annual Statements of Progress (ASP)

137. A Fiduciary Risk Assessment is **not a one-off exercise**: maintaining a good understanding of fiduciary risk is a continuous process. It is essential to monitor performance on an ongoing basis to:

(i) Ensure partner governments remain committed to improving public financial management, strengthening domestic financial accountability and fighting corruption

(ii) Check that planned reforms and agreed safeguards are being implemented effectively

(iii) Monitor key residual risks and be alert to indications of significant losses occurring

(iv) Identify any new fiduciary or corruption risks or changes in circumstance.

138. The information required to monitor fiduciary risk at the national (or sub-national) level should be gathered continuously through review of government reports and regular dialogue with partner governments, other donors and civil society organisations, and at the aid instrument level as an inherent part of good project management.

139. Monitoring risk at the individual aid instrument level is **mandatory** under the arrangements described in the business case (management case, risk assessment guidance). It is also important to keep the wider, country perspective of fiduciary risk up to date and to systematically monitor progress on reforms, safeguards and key residual risks identified in the FRA. For each FRA it is **mandatory** to complete an **Annual Statement of Progress** (ASP) on fiduciary risk and send it to FRA-ASPCentralScru@dfid.gov.uk. The ASP is the primary way in which we track a partner country's continuing commitment to improving PFM, domestic accountability and fighting corruption. The ASP will either provide assurance that our overall programme strategy remains appropriate from a fiduciary risk perspective, or warn of potential problems. Unless there is evidence of significant problems emerging (in which case FCPD should be consulted and a full FRA will probably be necessary), this should be a relatively light touch exercise. Annex 13 sets out a template of information to include in the ASP.

140. The ASP should also highlight positive examples of PFM and anti-corruption achievements. It is important for DFID to be able to demonstrate the results flowing from our support to partner countries in a robust and evidenced way. This will help us to show that we are managing the UK aid programme effectively and build support for working through rather than around country systems.

Monitoring Partner Government Use of Funds

141. DFID is accountable to the UK Parliament for how it uses public funds and active management of fiduciary risk is critical to meet this requirement. The NAO conducts an annual financial audit and reports to Parliament on DFID's financial statements and its use of funds. The NAO also carries out 2 to 3 Value for Money studies annually examining the economy, efficiency and effectiveness of different aspects of DFID's management of resources.

142. The NAO uses a two-part concept of **audit discharge** to underpin its financial audit work:

- **Accounting (or financial) discharge** relates to evidence that funds have been paid to the intended recipient; and
- **Fiduciary discharge** relates to evidence that funds have been spent as Parliament intended.

143. As part of its fiduciary responsibilities, DFID needs to be able to provide the NAO with evidence that financial aid has been properly accounted for, used for the purposes intended by Parliament and provided value for money. The overall approach to managing fiduciary risk set out in this note supports these objectives.

144. At the level of each aid instrument, DFID should review the partner government's use of funds to ensure they have been used for the intended purposes. The preferred monitoring tools are the partner country's own reports, including budget monitoring reports, financial statements and audit reports. Where such reports are weak or non-existent, DFID should encourage partner government's to produce or improve these reports, and provide appropriate assistance. Additional reports, such as donor-commissioned audits of projects or individual government organisations, should only be used when the national system is unable to produce relevant and reliable reports. The purpose, and potential use, of the most common forms of government financial reports is shown in table 9 below.

Table 9: Purpose and Potential Use of Some Standard Financial Reports

Report	Purpose for Partner Government	Potential Use for Donors
Budget monitoring report	Provides up to date information on implementation of the budget, to enable management to take corrective action	Gives a timely view on whether funds are being spent for the purposes intended, and enables donors to see that the government is monitoring budget implementation effectively
Annual Financial Statements	Usually a statutory requirement. Provides a record of income and expenditure (or receipts and payments) for the year, and indicates the organisation's overall financial position at the end of the year.	Gives a less timely, but more accurate, picture of the use of funds during the year and the organisation's year end financial position.
Internal Audit (Annual) Report	Summarises findings of internal audit's work and may provide some assurance to management on the quality of the system of internal financial control. Should include recommendations to management on how to improve internal control.	As a report internal to management, may not be available to donors. If available, provides an assessment of the design and operation of systems of internal financial control, which if effective can reduce fiduciary risk. Potential early warning flag of the risk of significant losses from fraud and corruption.
External Audit Report: Audit Opinion on Financial	Usually a statutory requirement. Provides the auditors opinion as to whether the financial statements are fairly presented (i.e. no *material*	If the audit report is unqualified (clean), provides some assurance that the information in the annual financial statements is reliable and that there is no *material*[17] fraud or error in the

[17] The concept of materiality is fundamental for understanding financial audit reports and audit opinions. An item is considered material if its omission or misstatement could alter the view of a reader of the accounts. The level of materiality used for auditing is usually related to the level of income and expenditure, or value of assets, in the accounts. If these values are very large, materiality will be very

Report	Purpose for Partner Government	Potential Use for Donors
Statements	misstatements) and whether the auditor was able to gain sufficient audit evidence to complete the audit.	accounts. If the audit report is qualified in some way, provides a warning flag that should be investigated.
External Audit Report: Report to the Audited Body[18] **(Often covers financial and compliance audit findings)**	Summarises findings of external audit's work including cases of improper expenditure, and recommendations for recovering misspent funds and strengthening financial management systems.	Provides useful information on whether funds have been used for the purposes intended and whether financial management rules and regulations have been followed. Audit findings help identify weaknesses in PFM systems which may contribute to fiduciary risk. Whether or not recommendations are actioned by the executive is a good indication of the effectiveness of financial accountability and government commitment to strengthening PFM systems.
External Audit Report: Performance Audit Report	Examines the economy, efficiency and effectiveness of government policies and procedures, and provide recommendations to improve.	Useful for wider engagement with partner governments on the areas under review. Identifies opportunities to reduce fiduciary risk by improving value for money in government spending. May also identify potential improvements to core PFM systems.
Special Purpose Audit Report	Not routinely used. Purpose specified in the letter of engagement (e.g. ToRs). Sometimes used for forensic or other financial investigations.	Donors frequently commission the SAI and/or private sector auditors to undertake audits of ring-fenced donor funds or individual organisations receiving donor funds. Purpose defined in the ToRs: usually covers: • Whether funds have been used for the purposes intended • Compliance with financial management rules and regulations

145. Further guidance on monitoring partner government use of funds is provided in section C4 of the blue book and on MoneySight (Managing Programmes / Submitting your Business Case / Mandatory Audit Requirements).

146. For most financial aid, and all forms of budget support, it will not be possible (or meaningful) for the government to produce separate financial and audit reports related to donor funds. To ensure such funds have been used for the intended purposes (i.e. according to the budget approved by Parliament, and reflecting any spending commitments made by the government to its development partners), DFID should review partner governments' consolidated financial statements and related audit report(s). Teams should be aware of the following features of these reports:

(i) Financial statements are likely to be prepared on a cash or modified-cash basis (rather than an accrual basis as commonly used in the private sector): so expenditure figures may not include payment arrears or

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large, and thus errors – including those due to fraud and corruption – which are significant but are below the level of materiality may not be identified during audit work.

[18] Sometimes referred to as a Management Letter

unrecorded liabilities (e.g. construction work completed but not yet invoiced)

(ii) Financial statements may include only scant information about assets and liabilities, and are unlikely to show the full financial position of the government.

(iii) Reports should show the annual budget surplus or deficit, and the level of government debt. However, deficit figures may be understated due to arrears and unrecorded liabilities. The accuracy of debt figures will be dependent on the comprehensiveness and quality of the government's debt management system. Contingent liabilities may not be recorded.

(iv) Some countries produce consolidated financial statements which include all financial activities of lower tiers of government, while in other countries each sub-national government prepares its own separate annual financial statements. This makes it much harder to get an overview of the government's use of funds.

147. Guidance on reviewing a government's financial statements is provided in Annex 20.

Annex 1: Key Points to Note in Relation to Budget Support

On Budget Support

1. **DFID does not require partner countries to meet a minimum standard of public financial management performance** for the provision of Budget Support. However, there must be evidence of a credible commitment to improving PFM, strengthening domestic financial accountability and fighting corruption.

On Understanding the Risk Environment

2. Where Financial Aid is being provided or considered during the life of an Operational Plan, a current national level FRA must be in place to inform the design of the entire country programme. The national FRA will cover central government PFM systems and may cover local government systems where considered necessary. It will provide an adequate risk assessment for General Budget Support. Where budget support is to be provided to a sub-national Government, an FRA of the sub-national government should be carried out if its PFM system is significantly different from the national PFM system. Where Sector Budget Support is to be provided, Country offices must ensure they have an adequate understanding of any additional, different or specific risks related to the sector. The assessment of risk at this level should be tailored to the specific country circumstances, and can be carried out in conjunction with the Country level FRA or as a separate exercise.

On Mitigating Risks

3. The approach set out in Section 3 applies to Budget Support. There are no special points to note.

On Monitoring Performance

4. Once funds are granted to a partner government as Budget Support, DFID is not directly responsible for their use: this responsibility is passed to the partner government. In practice, once DFID has paid funds to the partner government, they will often be indistinguishable from the other resources available to the government.
5. The main sources of evidence about how the partner government is using funds, including (but probably not differentiating) Budget Support, will be its own annual financial statements and related Supreme Audit Institution (SAI) reports. DFID's standard Memorandum of Understanding for Budget Support requires partner governments to provide us with copies of these documents.
6. Guidance on monitoring partner government use of funds is provided in Paras. 141-147).
7. This type of monitoring should normally be carried out through established Budget Support performance monitoring mechanisms, with DFID acting as part of a wider donor group. Additional DFID requirements on partner governments should be avoided.

Annex 2: DFID Work Processes Related to Fiduciary Risk

Process/Document	When needed?	Mandatory?	Responsibilities	Further guidance
Understanding the fiduciary risk environment				
Standard national level Fiduciary Risk Assessment (FRA)	**At least every three years for all countries, regardless of Aid Framework,** where Financial Aid is being considered or provided	Yes	Country office responsible for preparation. FCPD responsible for central review	
Standard FRA for projects/programmes	Projects/programmes exceeding £10 million where the funds are managed by a partner government PFM system significantly different from the national system	Yes	Country office responsible for preparation. FCPD responsible for central review	
Risk assessments for individual aid instruments	All projects, as part of business case submission	Yes	Country office responsible for preparation	Annex 11 of this HTN. Blue Book B4
Mitigating risks to DFID funds				
Selection of aid instruments	In design of country programme	Yes	Country office responsible as part of developing operational plans	Guidance on Aid Instruments 2006
Change in use of aid instruments	In response to breach of conditionality guidance	Depends on circumstances	Country office responsible for preparation	Conditionality guidance 2009
Long-term support to PFM, domestic financial accountability and anti-corruption reform programmes	Dependent on country circumstances	No	Country office / line management	Section 3 of this HTN. Platform Approach to Improving PFM (July 2005)
Risk mitigation measures for individual aid instruments	Dependent on country circumstances	Depends on circumstances	Country office / line management	Section 3 of this HTN
Monitoring Progress				
Annual Statement of Progress (ASP)	Annually for each FRA (both country level and any additional mandatory FRAs)	Yes	Country office responsible for preparation FCPD responsible for collecting results	Section 4 of this HTN
Annual monitoring at project (aid instrument) level	Annually, via ARIES returns	Yes	Country office / line management	Blue Book B11

Annex 3: Central Review and Scrutiny Process for the FRA

1. The review will seek to ensure that FRAs adequately address each of the questions below:
   - Is there an explicit judgement on the **overall level** of residual fiduciary risk? (low / moderate / substantial / high)
   - Is there an explicit judgement on the residual **risk of corruption**? (low / moderate / substantial / high)
   - Is there an explicit statement on partner government **commitment to improving PFM, strengthening domestic financial accountability and fighting corruption**? (credible / partly credible / not credible)
   - Are there separate assessments of partner government commitment to reform under the four core dimensions:
     - Improving PFM (including procurement and fiscal transparency, but excluding external scrutiny and audit)
     - Undertaking regular PEFA assessments
     - Strengthening domestic financial accountability – focusing on strengthening external scrutiny and audit
     - Fighting corruption
   - Is there a summary of overall PFM performance and identification of key fiduciary risks?
   - Has the **possible financial impact** of weaknesses in PFM systems been considered?
   - Do the detailed narrative and related risk ratings provide reasonable and consistent **evidence** for judgements made?
   - Does the FRA identify conditions or recommendations to address any concerns about partner government commitment to improving PFM and domestic financial accountability and tackling corruption?
   - Does the FRA consider how **safeguards** respond to short-term risks; how they contribute to enhancing PFM capacity and whether they are designed with an exit strategy in mind?
   - Is the FRA clear on how dialogue with the partner government on short term safeguards, PFM conditions and reform recommendations will be taken forward?
   - Does the assessment of the **risk of corruption** consider overall trends of corruption in the country and the extent to which the country is compliant with international standards where relevant (in particular, the UN Convention Against Corruption and the Financial Action Task Force Anti-Money Laundering standards)

- Are **residual risks** not covered by current reform programmes, or which will only be addressed in the long term, clearly identified and accepted by the Country Office?
- Does the FRA set out how risks will be **monitored** (including through ASPs and review of partner government financial reports)?
- Has the FRA been signed-off by the Head of the Country Office?
- Is the FRA consistent with **current operational guidance**?

FCPD Opinion on the FRA

2. Based upon the results of the central review process FCPD will provide its opinion on the FRA in the following terms:
    - "FCPD has been consulted and is satisfied that the fiduciary risk assessment has been carried out in accordance with current DFID policy and operational guidance and that related judgements are explicitly presented and consistent with reasonable evidence", **OR**
    - "FCPD has been consulted and has raised the following issues…" (to be set out)
3. Once any further edits have been made to the FRA and FCPD sign-off has been received, the final version of the FRA should be sent to FCPD for record-keeping purposes. Documents should firstly be declared as a record on Quest before sending the link to the FRA-ASP Central scrutiny e-mail address.

Annex 4: Generic Terms of Reference for an FRA Consultancy

Objectives

DFID **[insert country office name]** is seeking to contract a team of consultants to deliver a Fiduciary Risk Assessment (FRA) for its **[country programme / sector / aid instrument]**. The primary objective of the FRA is to understand the fiduciary risk environment in **[relevant country / sector / aid instrument]**. The FRA should also provide guidance on mitigating any significant risks to the proper use of funds and outline a suitable process for monitoring performance.

Background

Cover issues such as:

- The broad development context of the country and DFID's engagement in it;
- For sector and aid instrument level FRAs, background information about the sector(s) or target groups and on-going programmes and reform efforts;
- Description of the Government's PFM reform agenda;
- Relevant prior diagnostics;
- DFID's approach to managing fiduciary risk **[refer to this HTN]** and how the FRA will contribute to it.

Approach

The consultants will follow the guidance set out in DFID's How to Note on Managing Fiduciary Risk of June 2011. (NB: if no completed PEFA assessment is available, the FRA will need to be undertaken using DFID's Framework of 15 Benchmarks instead of the PEFA indicators: see the format at Annex 14)

For Sector / Aid Instrument Level Assessments of Fiduciary Risk only

As the first stage of the assessment, the consultants will identify relevant sectoral / target group PFM performance indicators and risks to be assessed. The proposed approach will be approved by DFID [and other partners working in the sector if appropriate]. Indicators may be derived from relevant areas of the PEFA framework and sector specific analysis, such as technical reviews and financial management reports for existing programmes. (Guidance on conducting FRAs for individual aid instruments is available in Annex 11 of this HTN).

Sources of Information

The consultants should draw on existing sources of information as far as possible, particularly the PEFA assessment. Other key sources of information include **[add list of material available at country level]** (See Annexes 8 and 9 of this HTN for likely sources).

Consultation

The consultants should seek to minimise the burden on government counterparts and not duplicate the collection of information which is available from other reliable diagnostics. Interviews with key counterparts (government, civil society, and other donors) should be used to:

- Fill gaps in information and/or update old data
- Conduct a ‘reality’ check on analysis in existing diagnostics; and
- [if considered appropriate] Share DFID’s emerging perception of fiduciary risk issues and discuss options for moving forward.

Timing

Deadlines for delivery of key outputs **[development of indicators, fieldwork, draft report, final report, dissemination event as applicable]**

Reporting

The Consultancy team will report to **[insert name and title of DFID contact]**. The FRA should follow the structure defined in DFID’s How to Note of June 2011 and is expected to be in the order of 30 to 40 pages long (excluding annexes), with an Executive Summary of up to 5 pages. (Note: this applies to Country Planning level FRAs **only**; sectoral assessments of fiduciary risk may follow other formats, based on country circumstances and needs).

Skills and Expertise Required

The consultant team should have the following competencies:

- Significant expertise and experience of PFM and Accountability issues;
- A good working knowledge of DFID’s approach to managing fiduciary risk and its methodology for carrying out Fiduciary Risk Assessments and of the PEFA Framework approach;
- (ideally) a sound understanding of the political economy, technical and institutional aspects of PFM in **[insert country]**; and
- A sound understanding of the **[XX sector / target groups]** if relevant.

Add any relevant consultant requirements, e.g., on security or travel issues.

Key Tasks

Set out the key tasks the consultants should deliver. This may include:

- Agree a work plan with DFID **[insert country office name]** for the Country level /xx sector / aid instrument review, including the identification of interlocutors.
- Become thoroughly conversant with DFID guidance on managing fiduciary risk.
- Become thoroughly conversant with the findings and conclusions of existing diagnostic materials, including… **[highlight any particularly important pieces of analysis]**
- Understand the PFM system in **[insert country / sector / target group]** and identify and evaluate its strengths and weaknesses.
- Assess the overall level of fiduciary risk, including the risk of corruption and the credibility of existing reform programmes.
- Suggest possible short term safeguards where risks are not adequately addressed in existing programmes and set out pros and cons of using them.
- Outline the options for monitoring future performance.

This is not intended to comprehensive; you should add other relevant tasks.

Annex 5: PEFA Framework Indicators

A. CREDIBILITY OF THE BUDGET: PFM OUT-TURNS	
1.	Aggregate expenditure out-turn compared to the original approved budget
2.	Composition of expenditure out-turn compared to the original approved budget
3.	Aggregate revenue out-turn compared to the original approved budget
4	Stock and monitoring of expenditure payment arrears
B. COMPREHENSIVENESS AND TRANSPARENCY	
5.	Classification of the budget
6.	Comprehensiveness of information included in budget documentation
7.	Extent of unreported government operations
8.	Transparency of Inter-Governmental Fiscal Relations
9.	Oversight of aggregate fiscal risk from other public sector entities
10.	Public access to key fiscal information
C. BUDGET CYCLE	
i. Policy-based budgeting	
11.	Orderliness and participation in the annual budget process.
12.	Multi-year perspective in fiscal planning, expenditure policy and budgeting
ii. Predictability and control in budget execution	
13.	Transparency of taxpayer obligations and liabilities
14.	Effectiveness of measures for taxpayer registration and tax assessment
15.	Effectiveness in collection of tax payments
16.	Predictability in the availability of funds for commitment of expenditures
17.	Recording and management of cash balances, debt and guarantees
18.	Effectiveness of payroll controls
19.	Competition, value for money and controls in procurement
20.	Effectiveness of internal controls for non-salary expenditure
21.	Effectiveness of internal audit
iii. Accounting, recording and reporting	
22.	Timeliness and regularity of accounts reconciliation
23.	Availability of information on resources received by service delivery units
24.	Quality and timeliness of in-year budget reports
25.	Quality and timeliness of annual financial statements
iv. External scrutiny and audit	
26.	Scope, nature and follow-up of external audit
27.	Legislative scrutiny of the annual budget law
28.	Legislative scrutiny of external audit reports
D. INDICATORS OF DONOR PRACTICES	
29.	Predictability of Direct Budget Support
30.	Financial information provided by donors for budgeting and reporting on project and programme aid
31.	Proportion of aid that is managed by use of national procedures
For Sub-National Government Assessments only	
HLG-1	Predictability of Transfers from Higher Level of Government

Annex 6: Relationship Between FRAs and PEFA

Assessments needed in FRA	Information provided by the PEFA Framework
Analysis of the historical, governance and political economy context	The PEFA Framework should provide some background information on PFM reform but may not be very detailed. DFID assessment likely to be needed (Para. 57).
Analysis of the public finances and performance of PFM systems	This information should be taken from government budget documents, expenditure reports and macro-economic performance reports, as well as from recent PEFA assessments. It should include a summary of the state of public finances as well as performance of the PFM system in relation to the three PFM objectives and the six core PEFA dimensions. DFID's 8 good practice principles should only be used in the absence of a PEFA assessment (Para. 59-61).
What is the overall level of fiduciary risk (Low / Moderate / Substantial / High)?	PEFA will not answer this question directly, so DFID assessment is required. PEFA information about the performance of the PFM system should inform this assessment (Paras. 70).
What are the key risks?	PEFA may not answer this question directly, so DFID assessment is required. PEFA indicators will be helpful in identifying areas where current performance is weakest, which, all else being equal, would be the areas of greatest risk. However, judgement is required on the extent to which weak performance translates into risk, taking into account country context and the relative importance of different financial management systems (Paras. 71).
What is the overall risk of corruption?	PEFA will not answer this question directly and may not mention corruption explicitly at all, so DFID assessment is required (Paras. 72-75).
Is there a credible commitment to improving PFM, strengthening domestic financial accountability and fighting corruption?	The PEFA Performance Report should describe the PFM reforms (including financial accountability) but may not cover anti-corruption reforms. It should provide some assessment of whether key institutional factors are likely to support the reform planning and implementation process. However, it may not make a detailed assessment of the credibility of the reform programme, so DFID assessment may be needed (Paras. 80-111).
What risks are not addressed by existing programmes?	PEFA will provide information relevant to this question, but additional analysis by country offices is likely to be needed (Paras. 80-111).

Annex 7: Lessons for Carrying out a PEFA Framework Evaluation

The following lessons have been drawn from evaluations of the early experience from application of the PEFA framework. The PEFA paper 'Good Practices in Applying the PFM Performance Measurement Framework'[19] includes further guidance on the following issues.

Nature of the Product

Countries have chosen to present the PEFA Framework report either as:

- A stand-alone product;
- A dual product, where the PEFA Framework report is produced in parallel with another type of evaluation, for example a Public Expenditure Review (PER); or
- An integrated product, where the PEFA Framework indicators are absorbed into wider analysis.

Countries have taken different approaches to how the PEFA Framework assessment is used to contribute to the design or modification of PFM reform programmes.

Early decisions need to be taken on these issues, so that the packaging and sequencing of measurement and diagnostic products and the reporting of the indicators is clear; the role of various parties is agreed and the resources needed are planned adequately.

The Role of Different Parties in Conducting PEFA Framework Evaluations

Stakeholders are partner governments and legislatures, civil society representatives, donors and consultants. Agreement needs to be reached on who will do what, for example, data collection, report drafting, quality assurance, and the dissemination of results, and where leadership, responsibility and decision making lies.

The PEFA Framework is intended to be applied in a decentralised and flexible way and the approach can be tailored to individual country circumstances. There is no single correct model for the roles of different parties.

DFID supports maximising the involvement of government partners in the evaluation and a key aim should be to promote government ownership as far as possible.

Financial and Time Resources Required

A review of PEFA assessments (led by different organisations) indicated that an assessment for a medium-sized country, covering only central government systems, but providing a full assessment, typically costs in the range of £50,000 to £75,000 and requires between 2 and 4 person-months. This does not include donor and government staff time for planning and administration, head office management and report reviews.

Personnel

[19] www.pefa.org

The quality of the PEFA Framework evaluation is influenced by:

- The number of team members;
- The number of person months allocated for the work; and
- The experience of team members (particularly the team leader) in use of the PEFA Framework and earlier PFM work in the country.

The subjects covered by the PEFA indicators are so diverse[20] that hardly any consultant will have the depth of experience to adequately assess them all. The team as a whole should include members with experience of all the indicator areas. Team members commonly include government officials, donor staff and consultants supporting donors and/or government.

One way to achieve this is to have two experts (including the team leader) during the entire evaluation. Typically one would be an economist covering planning, budget formulation and some execution issues; and the other an accountant covering the remaining execution issues, accounting and audit. Experts in areas that the two main assessors do not adequately cover, such as procurement or revenue, would provide additional focused inputs. A local consultant can be valuable, particularly to assist in initial data collection, mission preparation and follow-up after field visits.

The PEFA Secretariat can provide illustrative ToRs for recruiting consultants to support PEFA Framework assessments. The PEFA Secretariat also maintains a list of consultants with previous PEFA experience and those who have completed PEFA training modules.

Field Activities

Several field missions can be beneficial, particularly where:

- The government is mainly a passive partner;
- Local consultants are either not involved, are not experienced in using PEFA, or the time to collect data is limited;
- Access to information is difficult due to factors such as size of the administration, language issues or administrative culture.

A typical pattern for a PEFA evaluation is:

- An initial workshop for orientation and teambuilding among stakeholders, where it is particularly important to build country understanding and ownership as far as possible (the PEFA Secretariat can provide support via videoconference);
- The main stage of collecting data and producing a preliminary report;
- A follow-up stage to fill data gaps and discuss the preliminary report; and
- A final workshop for presenting and discussing the results of the assessment.

Stages can be completed in separate or combined missions, depending on the availability of funds and staff.

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[20] They cover planning, budgeting, treasury operations, internal controls, revenue administration, payroll, procurement, accounting, auditing, parliamentary oversight, aid management, fiscal risk oversight of parastatals and local government.

Quality Assurance

PEFA evaluations should provide a shared pool of information which all partners can rely on.

Draft reports should be subject to independent review. People who can contribute to the quality assurance process include:

- Government staff, Parliamentarians, civil society representatives and donors in country who have not been directly involved in preparing the report and have an informed but arms length view
- Specialist IFI / donor staff outside the country office
- PEFA Secretariat staff.

An **appropriate quality assurance mechanism** should be agreed at an early stage in the PEFA Framework planning process, identifying who will be involved and the agency/person responsible for managing the process and ensuring comments are taken into account. The lead drafter is best placed to manage the process.

DFID recommends that all PEFA assessment concept notes, terms of reference and draft assessment reports are sent to the PEFA Secretariat to be quality assured.

Report Disclosure Arrangements

Consideration needs to be given at the outset as to whether and how the final PEFA Framework report will be disclosed and publicised. Arrangements are likely to vary from country to country. Usually, the assessment will be published on a website of the partner government or one of the supporting donors. A full list of all published PEFA assessments, with links to the assessment, is maintained on www.pefa.org. PEFA recommends that Government's should publish the finalised assessment as soon as possible.

DFID encourages publication as a means of promoting transparency and accountability. As a minimum, PEFA Framework reports should be available to all donors in the country (even those who were not directly involved in the evaluation) to promote a shared understanding about the country situation and to avoid the repetition of information gathering exercises.

Care should be taken to manage expectations about what the PEFA report will reveal: analysis of early reports by the PEFA Secretariat indicates that scores fall largely in the C to D range. Ratings are only expected to improve slowly, typically over a 3 to 5 year period.

Most PEFA Framework reports will not be designed to provide detailed recommendations or even identify reform priorities. Rather they will provide information to support the development of a government led PFM reform programme and a harmonised programme of donor support to this.. In planning the PEFA Framework evaluation, teams should bear in mind how they are going to move forward and use the information.

Annex 8: Anti-Corruption and Procurement

United Nations Convention Against Corruption (UNCAC)

The UN Convention Against Corruption (UNCAC), is the only legally binding international instrument on anti-corruption. It covers five main areas: prevention, criminalisation and law enforcement measures, international cooperation, asset recovery, technical assistance and information exchange.

UNCAC came into force in 2005, it had 140 signatories, and all of DFID's main partner countries except the Democratic Republic of Congo and Sudan had signed and ratified it. Each country that has signed and ratified UNCAC will be peer reviewed on compliance.

A country's overall compliance with UNCAC is relevant for a fiduciary risk assessment because it gives an indication of the robustness of the national anti-corruption framework, and therefore, the likelihood of corruption being detected and deterred. Some articles within UNCAC are particularly relevant for a fiduciary risk assessment. These include:

- Managing the selection, training and rotation of individuals for public positions especially positions that are vulnerable to corruption (Art 7)
- Maintaining and strengthening systems that prevent conflicts of interest (Art 7)
- Facilitating reporting by public officials of acts of corruption (Art 8)
- Requiring public officials to make declarations including on assets and outside interests (Art 8)
- Publication and distribution of procurement procedures and contracts, including selection and award criteria; effective system of appeal; and measures to regulate personnel responsible for procurement (Art 9)
- Transparency and accountability in the management of public finances, including systems of risk management and internal control, and preserving the integrity of accounting books, records, and financial statements (Art 9)
- Making bribery (offering or accepting) of national and foreign public officials an offence. Criminalising other forms of corruption such as embezzlement, trading in influence, abuse of functions, illicit enrichment, laundering of proceeds, and obstruction of justice (Arts 15 – 25).
- Witness protection (Art 32)
- Prevention and detection of the transfer of the proceeds of crime (Art 52)

Procurement

More information on **Methodology for Assessing Procurement Systems (MAPS)** tool and how it is applied can be found on the OECD/DAC website www.oecd.org/dac/effectiveness/procurement

The Nordic + Joint Procurement Policy (JPP) Note and Implementation Guide

The JPP is a product of the Nordic+ Procurement Group. It outlines the commitments made by members of the Group, provides inputs to new policy initiatives (such as the Paris Declaration on Aid Effectiveness) and creates a base from which further work can be developed.

Four key principles underpin the JPP:

- Public procurement activities should ensure economy and efficiency while upholding the principles of equal treatment, transparency and zero tolerance towards corruption;
- Whenever a partner has the appropriate procurement capacity, and the partner and donor have agreed to use donor funds for procurement, procurement should be aligned to partner systems, i.e., the partner will undertake procurement activities;
- When procurement capacity is assessed as insufficient, donors will jointly support the partner's procurement capacity development in order to enable them to undertake procurement.
- The party that undertakes procurement activities should be fully accountable for its procurement actions and decisions.

This JPP policy guide is a tool for managing risk associated with transferring responsibility for procurement to recipient governments. It is intended to support donor alignment with country systems. The JPP Policy document and Guide can accessed from the Danish Ministry of Foreign affairs website:

http://amg.um.dk/en/menu/policiesandstrategies/procurement/joint+procurement+policy

The **Country Procurement Assessment Review** (CPAR, a World Bank tool) evolved from assessing procurement arrangements for Bank-financed projects to providing a comprehensive analysis of a country's procurement system, including an assessment of associated risks and a prioritised action plan. The World Bank now incorporate the MAPS tool into their assessment exercise.

Other Sources of Useful Advice and Guidance

The OECD website has a 'Checklist for enhancing Integrity in Public Procurement' which provides additional indicators to help with assessment. The U4 webpage shows mitigation measures for dealing with corruption in Procurement: http://www.u4.no/themes/procurement/mitigating-strategies.cfm

For further advice or clarification on any of the above, please contact the FACT Team or the Procurement Group.

Annex 9: Other Sources of Information

Partner Country Analysis

Information Generated by PFM Systems

- National Public Accounts
- Audit reports (including Value for Money audits)
- Public Accounts Committee (PAC) reports and response of the Executive
- Service Delivery Surveys
- Budget Execution Reports & Financial Tracking studies
- Public Expenditure Tracking Surveys
- Poverty Reduction Strategy (PRS) Progress Reports

Use of partner government analysis can help to improve government capacity, increase accountability and enable effective donor harmonisation. However, the depth and reliability of this information depends on factors such as the quality of PFM systems and related capacity

Information from other Country Level Sources

- Non-Governmental Organisations (NGOs), Civil Society Organisations, Professional Associations (e.g. accountancy bodies);
- Media sources.

Existing diagnostic studies may have already engaged these actors, for example through Public Expenditure Reviews or Public Expenditure Tracking Surveys.

A useful source for further information is the International Budget Project at www.internationalbudget.org

International Diagnostic Tools on PFM

Country Financial Accountability Assessment (CFAA)

The CFAA, a World Bank tool, provides information about the environment in which Bank funds may be disbursed. It focuses on describing and analysing the strengths and weaknesses of **downstream** financial management and controls, particularly around budget implementation, reporting and auditing. It includes an assessment of risk to WB funds (although it is not a pass/fail judgement) and includes recommendations and action plans for reform.

Public Expenditure Review (PER)

This is a traditional World Bank tool for analysing public expenditure, originally designed to assess fiscal trends and resource allocations. Its main emphasis is on **upstream phases** of expenditure management and includes review of political incentives. PERs also increasingly look at budget systems and implementation capacity development issues. In practice, a good PER will not entirely neglect budget execution, accounting and financial controls and there may be some overlap with CFAAs. It includes recommendations for reform.

Some PERs are conducted with an institutional component, in which case they are often referred to as **Public Expenditure and Institutional Reviews** (PEIRs).

Reports on the Observance of Standards and Codes of Fiscal Transparency (Fiscal ROSC)

This IMF tool describes a country's systems and procedures relative to the IMF's Code of Good Practices on Fiscal Transparency which has 4 key requirements: clear roles and responsibilities; full provision of information; open budget preparation and execution; and assurances of integrity. It provides prioritised recommendations for improvement. Its scope and coverage is similar to a CFAA, with a focus on downstream financial management.

Public Expenditure Tracking Assessment and Action Plan for Heavily Indebted Poor Countries (HIPC AAP)

This World Bank / IMF tool was developed in 2000 to help ensure resources freed by debt relief were used for poverty-reducing public expenditure as additional real resources. It assessed capability and performance of PFM systems against 16 benchmarks. Now replaced by the expanded PEFA Framework, new HIPC AAPs will not be carried out.

Note: Diagnostics available at the country level can be found on the Country Analytical Work website at www.countryanalyticwork.net, which collates material produced by a numerous IFIs and donors.

Open Budget Survey and Index

This biennial survey by the Open Budget Initiative (OBI) evaluates whether governments give the public access to budget information and opportunities to participate in the budget process at the national level. The survey comprises 91 questions regarding the public availability of budget information, upon which the index is based, and a further 32 questions on other accountable budgeting practices. The 2010 survey covers 94 countries. OBI is a global research and advocacy programme to promote public access to budget information and the adoption of accountable budget systems.

International Diagnostic Resources on Corruption and Measures Against Corruption

The UN Convention Against Corruption (UNCAC)

UNCAC is a comprehensive framework which provides common standards for national policies and practises and requires enhanced international co-operation to address cross border crime. In some countries UNCAC has been used as a means of benchmarking the status of anti-corruption efforts. Countries conduct self-assessments on UNCAC, and will be peer reviewed once every five years on their compliance. See http://www.unodc.org/unodc/en/treaties/CAC/index.html for more details.

Business Anti-Corruption Portal

A useful one-stop-shop from Danida and other donors on anti-corruption, aimed at companies operating in emerging markets, which brings together available data on a country by country basis. It analyses corruption problems by sector (judiciary, tax administration, etc.) and at the level of:

- The **individual**: corruption primarily taking place between individual citizens and public officials or state authorities;
- **Business**: corruption taking place between business enterprises and public officials or state authorities; and
- **Political**: corruption taking place at the higher levels of public administration and at the political level.

The portal highlights available data from surveys and other diagnostics on the perceived rates of corruption. Available at: www.business-anti-corruption.com

Corruption Perceptions Index (CPI)

A useful tool from Transparency International for broadly raising awareness, aggregating information from several surveys reflecting the perceptions of a range of international organisations on overall corruption levels. It does not however provide a clear view of the risks to PFM systems on the ground and may not show an accurate picture of progress in reducing corruption over time.

National Integrity System (NIS) Country Study

A Transparency International tool that is very useful where available. It provides an assessment of a country's key institutions dealing with corruption, including the executive, legislature, judiciary, supreme audit institution, ombudsman, independent anti-corruption agencies, public service, local government, media, civil society, private sector and international institutions. An NIS maps the formal architecture (laws and rules), that is, 'what should happen' and then assesses 'what actually happens in practice', highlighting deficiencies in the formal framework or its implementation. Available at www.transparency.org

Global Corruption Barometer

A Transparency International survey that assesses general public attitudes towards and experience of corruption. It covers all DFID partner countries.

Global Integrity Index

Reviews extent of integrity measures that governments have in place, and assesses extent to which these are actually enforced. Covers most DFID partner countries. See: www.globalintegrity.org/

Public Integrity Index (PII)

A Global Access tool that is very useful where available. It tracks corruption, openness and accountability in 25 countries. Reports focus on 6 areas: civil society, public information and media; electoral and political processes; branches of government; administration and the civil service; oversight and regulatory mechanisms; and anti-corruption mechanisms and the rule of law. By highlighting where institutions are weak, it indicates potentially high risk areas. Available at www.globalintegrity.org.

Governance and Corruption Diagnostics (GAC)

From the World Bank Institute, in-depth surveys of households, firms and public officials, gathering information on vulnerabilities within a country's institutions. The surveys aim to provide an initial benchmark of governance and public sector performance and permit subsequent monitoring. See: www.worldbank.org/wbi/governance/capacitybuild/diagnostics.html#guide

IDA Resource Allocation Index (IRAI) Assessments

Previously known as Country Policy and Institutional Assessments (CPIAs), this World Bank tool includes criteria relating to Public Sector Management and Institutions, including a consideration of the quality of budgetary and financial management, the efficiency of revenue mobilisation and transparency, accountability and corruption in the public sector. It draws on a wide range of primary and diagnostic sources to reach a WB view on how systems are performing.

The Financial Action Task Force (FATF)

FATF is the main international body working to take action on anti-money laundering (AML). Its 40 + 9 recommendations for member states include: legislation to make money laundering a crime; use of asset freezing to confiscate the proceeds of laundering; and regulations to ensure that financial institutions check for unusual transactions and report such cases. The FATF monitors members through a process of peer review (termed Mutual Evaluation Reviews) which has already been undertaken in a number of developing countries. An examination of recent assessments by the FATF or FSRB (see below) will provide an indication as to how robust the country's AML regime is. A robust regime will act as a deterrent to corruption and facilitate detection but will not necessarily indicate a low level of corruption. Available at: www.fatf-gafi.org

FATF-Style Regional Bodies (FSRBs)

Virtually all DFID's main partner countries are members of FATF style regional bodies (FSRBs). FSRBs help many country jurisdictions to put national AML strategies in place and to conduct technical assistance needs assessments. The FATF is developing guidance to assist Low Capacity Countries (LCCs) to develop domestic AML regimes in a more sequenced manner to make better use of available resource and capacity and to address key vulnerabilities specific to their country. Implementation of the LCC guidance and technical assistance needs assessment will provide some indication of the level of commitment a government is showing to AML and countering terrorist financing. The findings of both can help indicate the overall risk of corruption: the development of an AML regime rarely happens in the absence of or in advance of other anti-corruption reforms. For regional anti-money laundering bodies, see: *www.**giaba**.org/ (West Africa), www.**esaamlg**.org/ (East and Southern Africa), www.menafatf (Middle East and North Africa), www.**apg**ml.org (Asia Pacific group on AML), and www.**cfatf**-gafic.org/ (Caribbean).*

Other Sources

A wide range of anti-corruption surveys and diagnostic exercises are often carried out at country level, for example, national anti-corruption surveys and household and bribery surveys. The **U4 anti-corruption resource centre helpdesk** (http://partner.u4.no) can assist in sourcing material. The FACT team can provide guidance on where to source specialist advice on international corruption issues.

The Asset Recovery Knowledge Center at the Basel International Centre for Asset Recovery provides country profiles on assets recovery and anti corruption - http://www.assetrecovery.org/kc/node/5c58b3d2-5c7c-11dd-8c6a-7bd68e2d933e.html

Annex 10: Assessing the Credibility of Reforms

Set out below is a list of seven features which a credible programme of reforms could be expected to have and some suggested questions to help come to a judgement on the extent to which they exist. **This is not intended as a complete checklist**. Its relevance is dependent on the country context.

1. Government Led

- Are there clear goals (or a clear vision) set out by government for improved PFM?
- Is there demonstrable political commitment to PFM improvement? Is there engagement of parliament / cabinet in PFM reform and related monitoring of progress?
- Is PFM reform a priority in the Poverty Reduction Strategy and any related Performance Assessment Framework?
- Does government take the lead in developing and monitoring the PFM reform programme? Is there an active steering group?
- Is there ownership of PFM reform across different parts of government in addition to the Ministry of Finance, e.g., in line ministries, sub-national government, parliament and the Supreme Audit Institution?
- Is there a champion of change for PFM improvement with effective incentives to push change through?
- Is the government investing its own funds to support PFM reform?
- Does the government play a leading role in diagnostic assessments, and view the results as important for their own purposes as well as to meet the requirements of donors?
- Is there effective donor harmonisation around PFM reform initiatives?
- How will commitment to reform be affected by a change in government and / or key stakeholders?

2. Realistic and Achievable

- Are current local capacity strengths and weaknesses taken in to account in the PFM reform programme design, including both formal and informal factors?
- Are human resource and institutional constraints assessed in conjunction with a broad human resource strategy and wider public sector reform?
- Does the PFM reform programme promote appropriate technology in relation to current systems and capacity (especially in relation to Financial Management Information Systems), or does it require skills and experience that are not available locally?
- Is the timeframe for improvement realistic? Is there flexibility in the timetable to enable the reform programme to respond to changing circumstances?

3. Integrated and Effectively Sequenced

- Are individual measures co-ordinated in a comprehensive reform framework? Are these measures complementary?
- Are individual measures self-contained or do they depend on other developments taking place? Does the reform programme take account of these dependencies?
- Is there a focus on 'getting the basics right' before more complicated PFM reform measures are undertaken?
- Has the reform programme given sufficient attention to the sequencing of individual measures?
- How far are other complimentary reform programmes taken in to account, such as public sector reform, anti-corruption reform and local government reform?

4. Relevant and Sustainable

- Are specific country context issues taken in to account in the PFM reform design process (such as historical, governance, institutional and political economy factors)?
- Does the PFM reform programme address the key risks identified in the fiduciary risk assessment (including risks related to corruption)?
- Is there adequate / over-reliance on external technical assistance?
- Are there sufficient capacities and incentives to make the reform programme self-sustaining?
- Are there sufficient financial and staff resources to deliver the reforms without undermining other important PFM work?

5. Includes Capacity Development Strategies

- Does the reform programme include a comprehensive capacity development strategy, with consideration given to the individual, the organisational and the institutional/political levels?
- Is capacity development addressed across a wide range of stakeholders (including Ministry of Finance, line ministries, Sub-National Governments, Supreme Audit Institution and Parliament)?
- Is there sufficient attention to monitoring the effectiveness of capacity development?

6. Builds Demand for Change

- Does the programme of improvement build on current strengths and successes? Does it build on processes that people are familiar with?
- Does the reform programme take account of related institutional and motivational aspects to build demand for change?

- Do measures to reduce incentives for PFM related corruption (e.g., poor pay, conflicts of interest) complement measures to reduce opportunities (e.g., internal controls) and increase constraints (e.g., effective judicial system)?
- Will the reform programme increase transparency and encourage demand for further improvement?
- Does the reform programme take account of existing wider demands for accountability and transparency?

7. Specific Performance Indicators

- Does the programme of improvement include specific and relevant performance indicators?
- Is there an agreed timeframe and process for effective monitoring and evaluation?
- Is there an effective review and reporting process in place?
- Is this process led by government and supported by a harmonised donor approach?

Annex 11: Managing Fiduciary Risk for Individual Financial Aid Instruments

Risk assessment requirements at the aid instrument level, including but not limited to fiduciary risk, are set out in the business case (management case, section E: risk assessment). The level of analysis required to assess fiduciary risk will vary according to:

- The existing level of knowledge about fiduciary and corruption risk in the area concerned;
- The level of funding involved; and
- The nature of the aid instrument.

As explained in para. 19, country offices may, in some circumstances, be required to undertake a standard FRA for an individual financial aid instrument.

This annex suggests a process for assessing and managing fiduciary risk for individual financial aid instruments (including sector budget support and non-budget support financial aid[21]) where a standard FRA is not required, beyond the national level FRA. It then considers issues relating specifically to assessments at the sub-national level and at the sectoral level.

Suggested Process for Assessing and Managing Fiduciary Risk at the Aid Instrument (Programme) Level

National PEFA assessments and FRAs (and in some cases sub-national PEFAs and FRAs) are the starting point for understanding and managing fiduciary risk. This is because individual financial aid instruments will generally rely on national (and in some cases sub-national) PFM systems, or aspects of them, so weaknesses in these systems may increase fiduciary risk for the programme. This reliance may be because programme transactions are carried out using the PFM system, or it may be more indirect. A programme might not function properly, despite good design and operational arrangements, because of deficiencies in the wider PFM system (e.g. revenue projections are too optimistic leading to a shortage of funds, or the disbursement system does not provide timely and predictable funds for the line ministry). The reforms necessary to rectify such problem may be beyond the scope of the programme's influence. These are reasons why it is necessary to take a broader view and why reviewing the national (and in some cases sub-national) PEFA or FRA is so important..

The detailed approach should be tailored to circumstances, but the following process is suggested

- Review the main findings of the national (and, if relevant and available, sub-national) PEFA and FRA. Review also any other relevant diagnostic or programme documentation (e.g. concerning the sector or entities involved).

[21] See Section B10 of the Blue Book for basic definitions; and Aid Instruments paper for more detailed information.

Consider the extent to which weaknesses identified are relevant to the programme, directly or indirectly.

- Understanding the structure of government and the flow of funds is key to managing fiduciary risk. Service delivery programmes, for example, often involve central finance authorities, sector ministries and agencies, a number of lower tiers of government and semi-autonomous public bodies. Assessing fiduciary risk requires an understanding of the flow of funds through the government system and the fiduciary risks associated with the main implementing partners; so:
    - Identify the main organisations delivering the programme (include all bodies involved in collecting and distributing the funds, implementing the services, regulating, setting policy, and exercising scrutiny and oversight). Identify to which level of government each organisation belongs.
    - Document the flow of funds in the programme (DFID, other donor funds and partner government funds)
- Consider the extent to which there may be differences between fiduciary risks relating to the organisations and flow of funds involved in the programme and the general level of fiduciary risk at that level of government, due to:
    - Differences in compliance with the national PFM system (which may be due to different capacity levels)
    - The existence of PFM sub-systems unique to the sector (e.g. drug procurement, storage and distribution systems in the health sector)
    - Risk factors or compensating controls which may be unique to the sector or more significant in it than across government generally (e.g. in the education sector, teacher absenteeism may be a particular risk, whilst additional scrutiny of expenditure provided by school management committees may be a significant control).
- Consider the extent to which existing FRAs (national, sub-national, other) adequately cover the fiduciary risks (including the risk of corruption) associated with the main organisations and flows of funds involved in the programme. In making this assessment, ensure that relevant governance and institutional factors are taken into account. Consider the need for any additional diagnostic work.
- If necessary, conduct additional diagnostic work to better understand the programme-specific fiduciary risks, including the risk of corruption. Additional diagnostic work can include adapting some of the PEFA indicators to the programme context (e.g. doing budget v actual comparisons for the specific sector or sub-national government involved in the programme). It may also involve analysis to assess sector specific risks which are not addressed in sufficient detail by the PEFA assessment (e.g. drug procurement in the health sector may need to be assessed in more depth)
- Identify key fiduciary risks, focusing, in particular, on high value, high impact risks.

- Consider the longer term reforms required to address them and the extent to which there are credible reform programmes which include such reforms.
- Consider whether these reforms include matters over which the programme will have little or no influence (e.g. reforms to wider PFM systems which are outside the scope of the programme) and the extent to which this may increase risk.
- Consider the possible need for short term safeguards.
- Determine the approach to monitoring fiduciary risks and conduct necessary dialogue with the partner government
- Record findings, conclusions and decisions in a suitable format.

In carrying out these steps, it will be helpful to draw on the guidance for a standard FRA (e.g. in relation to assessment of reforms, safeguards and residual risks and dialogue and monitoring).

Risk Assessment at the Sub-National level

This section outlines some considerations when applying the process set out above to assessment of fiduciary risk in programmes involving sub-national government.

Sub-national government can take many forms, from large regional administrations to tiny village level entities, and funds often flow down an administrative hierarchy.

The PEFA indicator set can be applied to any sub-national government with a decision making executive and separate oversight body. In March 2008, the PEFA Secretariat issued a draft indicator framework for application at the sub-national level. The draft guidance is available at www.pefa.org. Sub-national PEFA assessments have already been carried out successfully in some countries (e.g. Pakistan). A sub-national PEFA assessment covers the performance of a sub-national government in terms of how it implements its own PFM systems and interacts with the entities below it. In addition, it includes an additional indicator and narrative assessment covering the relationship with central government.

Below the first layer of sub-national government, it is unlikely to be feasible to carry out a detailed fiduciary risk assessment for every subsequent layer of government, although it is desirable to understand as much as possible about lower tiers. Practical ways in which country offices can obtain information are via:

- A review of financial information produced by or about lower tiers (typically their budget and audit reports);
- A review of any available diagnostics or performance reports relating to projects which lower tiers may have benefited from; or
- More detailed review of PFM at a sample of lower tier bodies.

A sampling approach will require more resources but should produce better information. A sample can be selected in various ways: for example, it could concentrate on the local bodies with the largest budgets, a geographically diverse sample or those which are perceived to be particularly good or bad performers. Any assessment of a lower tier sub-national government should be proportionate to its PFM role and responsibilities.

Depending on the mandate and function of sub-national government, all the PEFA Framework indicators could be relevant and appropriate. Assessments should consider what the local body's role is in budget preparation, implementation and reporting and how well it complies with this role. In addition, political economy and institutional factors, which may support or limit the scope for PFM strengthening, should be assessed.

Risk Assessment at the Sectoral Level

This section outlines some considerations when applying the process set out above to assessment of fiduciary risk in programmes focused on a particular sector.

It will normally be necessary to involve a range of partners in country, including government officials. The team should have enough PFM and sectoral expertise to identify and assess relevant fiduciary risks.

It may be possible and cost-effective to carry out some sectoral analysis as part of a wider PEFA Framework evaluation; for example, on relevant indicators, the PEFA evaluation could focus on how PFM systems are implemented in specific sectors. This would need to be agreed by the PEFA Evaluation team looking at central government systems and planned into its work schedule; it is not something which will emerge automatically from a central government PEFA Framework evaluation. Where it is done, the sectoral basis used for the PEFA assessment should be stated in the PEFA performance report.

Set out below are some issues to be considered when assessing fiduciary risk for a sectoral programme. This is not intended to be a comprehensive checklist, but a resource to stimulate thinking about relevant indicators and risk areas.

Sector Context

- How are issues raised in the PEFA / Country level FRA likely to affect the sector? What issues are likely to be of particular significance?
- What are the major sources of sector revenue and how stable and timely are they?
- What is the expenditure profile at national and sub national levels (main categories of expenditure and their value)?
- Does the nature of revenue and expenditure in the sector suggest particular fiduciary risks?[22]
- Is the sector financial management capacity adequate (at national and sub national levels) in terms of staffing, skills, infrastructure and overall institutional arrangements?
- What PFM reforms are under way in the sector (sector specific reforms or reforms which are part of a more general PFM reform programme) and how credible are they?
- What are the main corruption risks at sector level?

Credibility of the Sector Budget

[22] For example, Sector Support for Health may include funding for procurement of medicines, which may involve significant international procurement and funds held in foreign exchange.

- To what extent does actual **revenue and expenditure** for the sector deviate from budget? What has been the trend over the last three years?
- Are there any notable trends compared to other key sectors? If performance has been poor what are the reasons?
- Are the sector ministry and other relevant agencies able to **plan and commit expenditures** in accordance with the budget? (requires funds to provided by the Ministry of Finance in a predictable, timely and transparent manner).

Comprehensiveness and Transparency

- Does the sector use the main government classification system in line with Ministry of Finance guidelines for budget preparation and reporting?
- To what extent are different **revenue streams** relevant to the sector actually captured on budget? Are there significant sources of income, such as user fees, which are not included in the budget?
- To what extent does the sector budget include **all significant sector expenditures**, including those of sub-national governments and activities funded by donors?
- Is there effective coordination of budgeting at the sector level for **recurrent and investment** expenditures?
- Is adequate financial information provided by **donors** on significant sector funding and assistance in a timely manner? How close are the actual funds provided to forecasts?
- Is key fiscal information about the sector available to the public in an accessible format?

Policy Based Budgeting

- Is the **budget circular** (and related budget guidelines and procedures on budget preparation and execution), actually understood and implemented at sector level?
- Is there an effective relationship between the sector ministry and Ministry of Finance for **negotiating** the annual budget?
- Is there an effective **legislative sectoral committee** (e.g., Health Committee) that examines the sector budget appropriations? How much of the sector's total funds are shown on the budget presented to parliament?
- What is the relationship between **strategic plans, the budget and medium term financial planning**? Is the sector development strategy / SWAp consistent with the national development strategy (e.g., PRS)? Is the sector development strategy / SWAp effectively costed and does it feed in to national medium term expenditure plans?

Predictability and Control in Budget Execution

- Are there adequate **internal control** systems at the sector level (effective operation of government wide internal control systems and any additional controls needed to deal with sector specific issues), for which senior management takes full responsibility?

- Are the **roles and responsibilities** of different parties clearly defined and understood, particularly between the Ministry of Finance and the line ministry? Is there an effective working relationship between different actors?
- Where there are significant additional financial management arrangements in place (as may occur in a **SWAp**), consideration should be given to the adequacy of rules governing these processes and the extent to which this supports / undermines capacity development of normal government systems.
- Does the sector have authority to perform **virements** ('re-allocations within the budget')? If so, what controls are in place to ensure these are conducted in an open and transparent manner? What are the political and economic interests influencing virements?
- Is there effective **cash flow** planning, management and monitoring?
- Do any institutions within the sector have authority to undertake **borrowing**, and if so, what controls are in place to ensure this is performed in line with Ministry of Finance guidelines?
- Are there effective **payroll controls** for the sector? Are payroll records reconciled to human resource records ("the nominal roll")? Is there a strong system of payroll audit to identify control weaknesses and/or ghost workers?
- What is the estimated percentage of sector expenditure spent through procurement systems? What **procurement** systems are in place? Does the sector comply with the national procurement systems or follow separate procedures? Do regulatory institutions (e.g., tender board) provide effective oversight at the sector level?
- Where there are sector-specific procurement arrangements (as may occur in a SWAp), to what extent do these arrangements strengthen / undermine capacity development of national systems and institutions?
- Is there an adequate system of control over **non-payroll expenditure**? Is there a robust asset management system?
- Is there regular review of the internal control system in the sector through an effective **internal audit** function (a function based either within the sector itself or as part of the Ministry of Finance)?

Accounting, Recording and Reporting

- Are **accounting policies** at the sector level consistent with those of the Ministry of Finance?
- How effective are linkages (e.g., IT interfaces) between sector and central financial management reporting systems (especially Ministry of Finance)?
- Are there additional reporting requirements specific to the sector (as may occur in a SWAp agreement)? Do these requirements utilise and support existing government systems, or do they impose an additional administrative burden? Are there plans to ensure increasing reliance on government systems?

- Are timely and frequent **bank reconciliations** performed at the sector level? Is there an effective process to investigate discrepancies with subsequent follow up by senior management?
- Are **suspense accounts** and advance accounts routinely reconciled and cleared?
- Do budgeted resources reach front-line **service delivery units** in a timely and transparent manner? (Evidence of this may be obtained through Public Expenditure Tracking Surveys, which may also identify areas of corruption risk and of leakage)
- Is there a regular and timely **two-way flow** of information between the sector and the Ministry of Finance? Do **sector budget reports** provide accurate, comprehensive and understandable information to allow progress against the budget to be monitored?
- What is the system for preparing **annual financial statements** for the sector? Do line ministries and other agencies meet their obligations in a timely and comprehensive manner?

External Scrutiny and Audit

- Is the Supreme Audit Institution (SAI) adequately **resourced** and empowered to audit the sector effectively? What proportion of sector expenditure is audited each year?
- Has the SAI recently performed any sector-specific investigations / audits? If so, what were the key findings and how will they be followed up?
- Does sector management have an effective **working relationship** with the SAI (e.g., through a sector liaison officer)? Are adequate procedures in place to enable the external auditor to readily access information?
- Where sector specific / additional **SWAp** external audit arrangements are in place, to what extent do these arrangements strengthen / undermine capacity development of national systems and institutions?
- Is there effective **follow-up** of external audit findings by the executive (line ministry and/or Ministry of Finance)? Is there **evidence of changes** in systems / processes at the sector level in response to audit findings? Are incentives in place at the sector level to promote effective follow up on audit findings?
- Has the legislative committee (e.g. **Public Accounts Committee**) followed up on any sector-specific issues?

Additional Guidance

Additional guidance on managing fiduciary risks in key sectors will be developed, drawing on lessons from experience.

Annex 12: Examples of Safeguards

This annex is not presented as a list of safeguards to be used in all cases. It identifies short-term safeguards, at national or aid instrument level, that can protect resources in the short term and contribute to long term strengthening of PFM systems. These safeguards focus on enhancing transparency, accountability and participation in PFM systems. The selection and design of safeguards should be appropriate to country circumstances, taking into account risks, dependencies within the PFM cycle, the interaction of safeguards with the underlying PFM system and on-going reforms, and the wider governance and institutional environment.

Transparency

- Enacting right to information laws and media freedom laws.
- Publication of consumers' rights, service delivery standards and official price schedules at the point of service delivery.
- Publication of appropriate financial and management information, e.g. sector plans, budgets, performance measures, results, in-year financial monitoring reports against the budget, end of year financial reports, audit reports, reviews of service delivery standards.
- Publication of Public Procurement information (on-line and through use of local newspapers etc). Information might typically include notification of upcoming bidding opportunities but may also relate to financial and non-financial performance status of procurement projects.
- Presenting information in a way that is appropriate for the target audience, e.g. appropriate presentation format, graphical and narrative information, translated into local languages.
- Using appropriate communication tools, e.g. newspapers, radio, community theatre, notices and posters in appropriate places as well as modern communication tools such as web-based technologies and mobile phones.
- Community level disclosure of budgets, fund transfers and actual expenditure, e.g. on community notice boards and web-based where appropriate.
- Simplifying fund flow arrangements, towards the most direct routes possible with fewer intermediaries.
- Transparent arrangements for determining funding from national to sub-national government and to service delivery units, e.g. block-based funding, per capita funding.
- Transparent processes for allocating national revenues both horizontally and vertically, e.g. revenue sharing arrangements, fiscal transfer systems.

Internal Accountability

Strengthen corporate governance, risk management and internal control within implementing agencies, through:

- ensuring appropriate organisational structures and reporting lines;
- clarification of organisations' and individuals' roles and responsibilities;
- introduction of financial regulations and operating manuals;
- a proportionate approach to identifying and dealing with key risks;

- effective segregation of duties;
- maintenance of financial records, including control logs, payrolls and asset registers that meet information management standards e.g. for accuracy, timeliness and data security;
- effective management of physical assets e.g. using asset registers, spot-checks and physical security controls;
- automation of controls in order to limit personal discretion and to provide an audit trail;
- introduce asset disclosure requirements for key decision makers and due diligence of those overseeing the management of public funds;
- introduce internal mechanisms for reporting and investigating suspected cases of fraud and corruption, and enforce sanctions where breaches occur;
- introduce bank reconciliations and reconciliations of accounting records and systems to identify unexplained discrepancies; and
- remove control risks such as unduly complex approval processes and cash transactions.
- Appoint qualified staff to carry out and supervise key control functions.
- Strengthen (or set up) financial inspection units to ensure compliance with government financial regulations.
- Strengthen (or set up) units to verify the validity of payments before they are made.
- Strengthen (or set up) internal audit functions within public sector bodies, in order to support management to review and strengthen internal controls.
- Strengthen the role and operation of management boards and committees, (e.g. audit, finance, and advisory committees).
- Codes of Conduct setting out clear guidance and behaviour expected of staff including those for Conflicts of Interest and receipt of Gifts and Gratuities.

External Accountability

Strengthen the role, scope and independence of external audit through:

- enhancing the legal and operational independence of the Supreme Audit Institutions;
- improving the relationship between the Supreme Audit Institutions and the appropriate Parliamentary Committees;
- introducing a risk based approach to selection of audits and conduct of individual audits;
- developing the skills for the conduct of specialised audits, such as procurement and contract auditing;
- improving supervision and quality control of audit work and introducing a quality assurance function to review a sample of audit assignments each year;
- promoting the publication of external audit reports and communication of key findings in an accessible format;
- ensuring the Supreme Audit Institution is adequately resourced to fulfil its audit mandate; and

- establishing peer review or twinning arrangements with other more developed Supreme Audit Institutions.
- Introduce joint-audit arrangements, between the partner country Supreme Audit Institution and other independent external auditors, e.g. from other Supreme Audit Institutions, the public or private sector.
- Support national and sub-national Parliamentary Committees, such as the Public Accounts Committee (PAC), to undertake meaningful review of the budget, the government's annual financial report and audit reports, and to hold accounting officers to account for their performance at PAC hearings.
- Strengthen the role of external inspectors and standard setting agencies in reviewing and reporting on the delivery of public services.

Participation

- Citizen engagement in decisions about resource allocation, e.g. through participatory budgeting.
- Involvement of consumers and community groups in the design and delivery of public services.
- Introduction of effective complaints mechanisms to improve service delivery and reduce corruption.
- Legal and practical protection for whistle blowers.
- Consumer satisfaction surveys and citizen report cards to strengthen the responsiveness and accountability of public services.
- Engaging NGOs and community groups in the oversight of public policy, public services, and projects.
- NGOs undertaking social audits.
- Civil society involvement in tracking the flow and use of public funds, e.g. through Public Expenditure Tracking Surveys (PETS).
- Citizen representation on formal boards of public sector bodies, e.g. parents' representation on school boards.
- Use of open public meetings and hearings giving citizens the chance to bring issues to the attention of government officials and ministers.
- Engaging civil society groups in monitoring the delivery of goods and services, (e.g. monitoring delivery of school text books in rural communities).
- Civil society monitoring of payment of wages and salaries (e.g. ensuring that wages and salaries are only paid to teachers and nurses who are employed and turn up to work).

A wide range of safeguards and mitigation strategies have been developed in the area of Procurement, see for example the U4 webpage on mitigation measures in procurement at http://www.u4.no/themes/procurement/mitigating-strategies.cfm and the OECD 'Checklist for enhancing Integrity in Public Procurement' at http://www.oecd.org/document/46/0,3343,en_2649_34135_41072238_1_1_1_37447,00.html

Annex 13: ASP Template

(Download from Word templates)

ASP for [Insert Country / Sector / Aid Instrument for other FRA]

Date ASP due		**Date ASP completed**		**Date ASP submitted to FCPD**	

Does the FRA relating to this ASP draw on a PEFA assessment? (Yes/No)	
If No, was the FRA based on the 8 Good Practice Principles and 15 Benchmarks? (Yes/No)	

Overall Situation

Current level of fiduciary risk (L, M, S, H)		Comparison to previous FRA/ASP (Improving, Stable or Worsening)	
Overall assessment of corruption risk (L, M, S, H)		Comparison to previous FRA/ASP (Improving, Stable or Worsening)	
Is a full FRA update required? [Likely to be needed where there has been a potential breach in the partnership commitments related to PFM, domestic financial accountability and fighting corruption]. Para. 34. provides further guidance.			

Progress against short term safeguards, PFM conditions and reform recommendations proposed or agreed with government

List all safeguards, PFM conditions and reform recommendations identified previously in the FRA or in the ASP previous to this one, if later. Include: a brief description of the risk; planned measures to address it during the period of the ASP; and progress achieved. Where progress is off-track, outline remedial measures which have been/will be taken. Where formal PFM conditions have been agreed with partner governments, identify progress against agreed conditions. Where the implementation date for PFM conditions has been reached, state whether these conditions have been met or whether there has been a breach of the partnership commitments.	
Measure 1	
Measure 2	
Measure 3	
Etc.	
Have any new risks been identified? [Yes/No] If Yes, include a brief description of the risk and planned measures to address it.	
New Risk 1	
Etc.	
What is our updated assessment of partner government commitment to improving PFM, strengthening domestic financial accountability and fighting corruption? [Credible / Partly Credible / Not Credible]. Whatever the answer, give brief details below to justify that opinion.	
Can you cite examples of positive progress to report which could feed into DFID external publications? Useful examples could include successful delivery of key reform programmes or activities, quantified fiduciary or anti-corruption achievements (e.g., increased tax collection rates, reductions in the number of ghost workers, or savings made in procurement programmes)	
Example 1, etc.	

Sources used in Preparing this ASP

[Tick / add date as appropriate]

Regular Govt/donor monitoring processes		**Govt-produced reports**	
PAF indicators		Quarterly Budget Reports	
Budget Support Group/PFM Group meetings / Sector Group meetings		Annual Financial Statements	
Other		Annual audit reports Insert date of most recent audit report	
		Other	
DFID bilateral meetings		**DFID project documents**	
Meetings with government officials		Data from annual programme and project performance reviews	
Meetings with CSO contacts			
Meetings with other donors / others			
PFM diagnostics produced in the ASP period		**Corruption diagnostics**	
PEFA /PER, etc. [state relevant sources]		TI CPI / Public Integrity Index, etc. [state relevant sources]	

Submitted by:

Date:

Annex 14: Recommended Scope of DFID 8 Good Practice Principles and 15 Benchmarks

These principles and benchmarks should be used where a PEFA framework assessment is not available. The suggested questions are intended to help in making an assessment but are **not necessarily exhaustive**, nor intended as a checklist. Where an assessment is based on the good practice principles and benchmarks, the 4 point rating scale set out in Box 1 should be used.

8 Good Practice Principles (GPPs) and 15 Benchmarks	Suggested Questions to Consider
GPP 1: A clear set of rules governs the budget process	
1. A budget law specifying fiscal management responsibilities is in operation.	Is the budget law of **adequate quality** to satisfy requirements on government to be fully accountable for the use of public funds? (This should *inter alia* provide for an effective macroeconomic framework, budget process and independent scrutiny process, with clearly defined roles and responsibilities.) Is there an effective **budget circular** with related **budget guidelines** and procedures on budget preparation and execution? Are the budget law, guidelines and procedures actually understood and **implemented**? Is there an effective **legislative committee** (e.g., Budget Committee) that examines the annual budget law and related budget appropriations? Does the scope of legislative review cover **fiscal policies** and the medium term fiscal framework in advance of revenue and expenditure details? Does the legislative committee have **adequate capacity** to effectively perform its role (for example does it receive timely, prioritised, user-friendly budget reports and have adequate resources for in-depth review)? Is the budget law passed before the financial year commences?
2. Accounting policies and account code classifications are published and applied.	Is there **effective classification** of the budget in relation to administrative / economic / functional / programmatic classifications? Are standard **international classification practices** applied, such as the UN-supported Classification of Functions of Government COFOG)? Is the classification system understood throughout government and actually implemented on a consistent basis? (Inconsistent classification distorts allocations and reduces transparency).
GPP 2: The budget is comprehensive	
3. All general government activities are included in the budget. 4. Extra budgetary expenditure is not material.	To what extent does the budget include **all significant expenditures** on government activities, including sub-national governments, state-owned enterprises and activities funded by donors? Is adequate financial information provided by **donors** on all significant funding / assistance in a timely manner? How close are the actual funds provided to forecasts (predictability of donor funding)? Is there effective coordination of budgeting for **recurrent and investment** expenditures? Is key fiscal information (including annual budget reports, procurement information and audit reports) **officially published and readily accessible** to the public, in a user-friendly format?

	To what extent are different revenue streams actually captured on budget? This is a key area of **corruption risk**, for example through unrecorded tax collection, or natural resource concessions.
GPP 3: The budget supports pro-poor strategies	
5. Budget allocations are broadly consistent with any medium term expenditure plans for the sector or for the overall budget.	Is there a consistent **multi-year perspective** in fiscal planning, expenditure policy-making and budgeting? Are there costed statements of **national and major sector strategies** to guide the development of forward estimates? To what extent are **forward estimates** integrated in the annual budget formulation process? Is there strong direction in the budget circular regarding multi-year forecasts to be adhered to in budget submissions? To what extent can **poverty-related expenditure** be identified in the budget (for example, through a comprehensive classification system or specific appropriations)? Is there evidence available to demonstrate that government expenditure is in accordance with agreed plans and supports the **Poverty Reduction Strategy** and Medium Term Expenditure Framework? Is there effective **participation** in the budget process by spending ministries? Are budget allocations and related strategy documents available as **public documents**?
GPP 4: The budget is a reliable guide to actual expenditure	
6. Budget outturn shows a high level of consistency with the budget.	To what extent does the actual **fiscal deficit** deviate from budget? What has been the trend over the last three years? Is there a **mid-year review process** to update the revenue forecast and adjust related expenditure to maintain fiscal balance? To what extent does actual **expenditure** deviate from budget? What has been the trend over the last three years? Are there any notable trends across administrative (e.g. line ministry / spending agency) or functional (e.g. health / education) classifications? Are there any significant **expenditure arrears**? To what extent does actual **revenue** deviate from budget? What has been the trend over the last three years? Are line ministries and spending agencies able to **plan and commit expenditures** in accordance with the budget? (This requires funds to be made available by the Ministry of Finance in a predictable and transparent manner.) Do budgeted resources reach front-line **service delivery units** in a timely and transparent manner? (Evidence of this may be obtained through Public Expenditure Tracking Surveys, which may also identify areas of leakage and hence **corruption risk**).
GPP 5: Expenditure within the year is controlled	
7. In-year reporting of actual expenditure.	Is there a relevant **internal control** system, which is cost effective, well-understood and complied with, for which senior management takes full responsibility? Is there regular and adequate review of the internal control system through an effective **internal audit** function? Is there reporting of error rates in procurement and expenditure transactions? Are findings used by the Supreme Audit Institution (external audit) and follow up action taken by management? Are there effective **payroll controls**? Are payroll records reconciled to human resource records (“the nominal roll”)? Is there a strong system of payroll audit to identify control weaknesses and/or ghost workers?
8. Systems operating to	Are **virements** (‘re-allocations within the budget’) performed in an open and transparent manner in line with agreed procedures?

control virement, commitments and arrears.	Do virements reduce the effectiveness of the budget as a tool for effective planning and predictable funding? What are the political and economic interests influencing virements? Is there effective **cash flow** planning, management and monitoring? Is there a daily calculation and consolidation of cash balances? Is borrowing planned on the basis of reliable cash forecasts? Is there a single treasury account? Is there proper recording and reporting of government **debt and guarantees**? Are all guarantees approved by the Ministry of Finance against transparent criteria? Is there regular and sustainable analysis of debt sustainability?
GPP 6: Government carries out procurement in line with principles of value for money and transparency	
9. Appropriate use of competitive tendering rules and decision-making is recorded and auditable. 10. Effective action taken to identify and eliminate corruption.	**Note**: The **risk of corruption** associated with procurement is potentially high. This should be taken into account when considering the following questions. Is the procurement system defined by a clear **regulatory framework** which is consistently implemented under the oversight of both internal and external control systems? Are **regulatory institutions** and procedures adequately resourced (e.g. tender board)? Are contracts awarded on the basis of **competition** and value for money in accordance with the regulatory framework? Are controls in place to prevent conflict of interest in the award of contracts? Is there regular **advertisement** of procurement opportunities and publication of data on public contracts and awards? Are contracts awarded and payments made on a **timely and transparent** basis? Are records maintained and accessible? Is there a functioning independent appeals process? Do bidders have recourse to an independent judiciary? **Note**: Where procurement risk is judged to be significant, more in-depth analysis may be necessary.
GPP 7: Reporting of expenditure is timely and accurate	
11. Reconciliation of fiscal and bank records is carried out on a routine basis.	Are timely and frequent bank **reconciliations** performed (reconciling government accounting records with bank statements held by central and commercial banks)? Are there any large differences left unexplained? Is there an effective process to **investigate differences** with subsequent follow up by senior management? Are **suspense accounts** and advance accounts routinely reconciled and cleared? Regular and effective bank reconciliations are a key internal control to minimise the **risk of corruption** or misuse of funds. Even where formal internal controls are in place, corruption remains a risk if they are not applied in practice.
12. Audited annual accounts are submitted to Parliament within the statutory period	Are budget reports disseminated within government on a **timely and regular** basis? Do these reports provide adequate classification that allows direct comparison of actual performance to budget, and which incorporates expenditure, revenue and debt information? Is there an effective **two-way flow** of information between the Ministry of Finance and spending units (e.g., line ministries and sub-national governments)? Are the financial statements **comprehensive and understandable**, and prepared in a timely manner in line with the legislative framework? Are the financial statements prepared in line with recognised national / international **accounting standards**? Are the financial statements presented to the **Supreme Audit Institution** (external auditor) / **legislature** on a timely basis? (The more time elapses before accounts are compiled and audited the more difficult it becomes to investigate and identify cases of corruption.)
GPP 8: There is effective independent scrutiny of government expenditure	

13. Government accounts are independently audited	Is the Supreme Audit Institution (external auditor) adequately **resourced** and empowered to perform its role effectively? Is the Supreme Audit Institution **independent** from the executive? This includes consideration of independence in relation to resource allocations and the scope and nature of audit work performed, in addition to the independence of individuals within the institution (e.g. Auditor General). Does the **scope** of external audit include all major entities in the public sector? Does the **nature** of the external audit work cover the full range of financial audit, including reliability of financial statements, regularity of transactions and functioning of internal control and procurement systems? Does the Supreme Audit Institution (external auditor) adhere to appropriate **auditing standards** (e.g. INTOSAI, IFAC) and focus on significant and systemic issues in its reports? **Note**: An independent audit is an important means to prevent and detect **corruption**. A 'systems-based' audit can be more useful than a 'transactions-based' approach in identifying weaknesses in the internal control system, which may facilitate corruption.
14. Government agencies are held to account for mismanagement 15. Criticisms and recommendations made by the auditors are followed up	Is there effective **follow-up** of external audit findings by the executive (e.g. Ministry of Finance and/or individual audited entity)? This may be evidenced by a formal response on how the audit findings are being addressed and the timely reduction in un-cleared findings. Is there an effective **legislative committee** (e.g., Public Accounts Committee) that examines the external audit reports and questions responsible parties about the findings and subsequent actions for follow up? Does the legislative committee have **adequate capacity** to effectively perform its role (for example does it receive timely, prioritised, user-friendly audit reports and have adequate resources, including technical skills, for in-depth review)? Is the legislative scrutiny conducted in a **transparent** manner open to the public and media? Is there freedom of information legislation and media freedom to facilitate access? Are controls in place to prevent conflicts of interest (e.g., asset declarations, whistleblower protection)? Do conflicts of interest undermine the **independence** of legislative scrutiny? Effective and transparent legislative scrutiny and follow-up are important to identify and manage the **risk of corruption**. Several other institutions may have responsibility for the investigation of and prosecution for **corruption**; for example civil service internal disciplinary procedures, separate anti-corruption entities and the police / judiciary.

Annex 15: Fiduciary Risk Matrix

Note: Illustration of format for reporting when the assessment is based on the 8 good practice principles and 15 benchmarks. (may be easier in landscape format).

Good Practice Principle	**Benchmarks for assessment**	**Current Risk Rating (L, M, S, H)**	**Previous Risk Rating (L, M, S, H)**	**Trajectory of Change**	**Overall Assessment** (Including major PFM weaknesses, key fiduciary risks, planned reforms and recent progress, wider governance context)
1. A clear set of rules governs the budget process.	1. A budget law specifying fiscal management responsibilities is in operation.	**Sub**	**High**	↑	
	2. Accounting policies and account code classifications are published and applied.	**Mod**	**Mod**	→	
2. The budget is comprehensive.	3. All general government activities are included in the budget.	**Mod**	**Low**	↓	
	4. Extra budgetary expenditure is not material.	**Low**	**Low**	→	
3. The budget supports pro-poor strategies	5. Budget allocations are broadly consistent with any medium term expenditure plans for the sector or for the overall budget.				
4. The budget is a reliable guide to expenditure	6. Budget outturn shows a high level of consistency with the budget.				
5. Expenditure within the year is controlled	7. In-year reporting of actual expenditure. 8. Systems operating to control virement, commitments and arrears.				
6. Government carries out procurement in line with principles of value for money and transparency	9. Appropriate use of competitive tendering rules and decision making is recorded and auditable. 10. Effective action taken to identify and eliminate corruption.				
7. Reporting of expenditure is timely and accurate	11. Reconciliation of fiscal and bank records is carried out on a routine basis. 12. Audited annual accounts are submitted to parliament within the statutory period.				
8. There is effective independent scrutiny of government expenditure	13. Government accounts are independently audited. 14. Government agencies are held to account for mismanagement. 15. Criticisms and recommendations made by the auditors are followed up.				

Annex 16: PEFA and FRA Summary

PEFA Performance Measurement Framework Indicator Set and FRA Ratings

PFM Performance Indicator		Scoring Method	Dimension Ratings i.	ii.	iii.	iv.	Overall Rating	Previous Rating	Trajectory of Change
A. PFM-OUT-TURNS: Credibility of the budget		**Fiduciary Risk Assessment:**					**Sub**	**Mod**	↓
PI-1	Aggregate expenditure out-turn compared to original approved budget	M1	C				**C**	**B**	↓
PI-2	Composition of expenditure out-turn compared to original approved budget	M1	C				**C**	**D**	↑
PI-3	Aggregate revenue out-turn compared to original approved budget	M1	B				**B**	**A**	↓
PI-4	Stock and monitoring of expenditure payment arrears	M1	NS	D			**D**	**B+**	↓
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency		**Fiduciary Risk Assessment:**					**Sub**	**Mod**	↓
PI-5	Classification of the budget	M1	C				**C**	**B**	↓
PI-6	Comprehensiveness of information included in budget documentation	M1	B				**B**	**C**	↑
PI-7	Extent of unreported government operations	M1	C	A			**C+**	**A**	↓
PI-8	Transparency of inter-governmental fiscal relations	M2	C	D	D		**D+**	**C**	↓
PI-9	Oversight of aggregate fiscal risk from other public sector entities	M1	C	D			**D+**	**C**	↓
PI-10	Public access to key fiscal information	M1	A				**A**	**B**	↑
C. BUDGET CYCLE									
C(i) Policy-Based Budgeting		**Fiduciary Risk Assessment:**					**Mod**	**Sub**	↑
PI-11	Orderliness and participation in the annual budget process	M2	A	A	B		**A**	**B**	↑
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	M2	D	A	B	C	**C+**	**C**	↑
C(ii) Predictability and Control in Budget Execution		**Fiduciary Risk Assessment:**					**High**	**Sub**	↓
PI-13	Transparency of taxpayer obligations and liabilities	M2	D	A	C		**C+**	**B**	↓
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	M2	C	C	C		**C**	**C**	→
PI-15	Effectiveness in collection of tax payments	M1	B	A	C		**C+**	**C**	↑
PI-16	Predictability in the availability of funds for commitment of expenditures	M1	C	D	D		**D+**	**C**	↓
PI-17	Recording and management of cash balances, debt and guarantees	M2	B	C	C		**C+**	**B**	↓
PI-18	Effectiveness of payroll controls	M1	A	C	B	B	**C+**	**C+**	→
PI-19	Competition, value for money and controls in procurement	M2	A	B	B		**B+**	-	**N/A**
PI-20	Effectiveness of internal controls for non-salary expenditure	M1	D	B	C		**D+**	**C**	↓
PI-21	Effectiveness of internal audit	M1	C	B	D		**D+**	**D+**	→
C(iii) Accounting, Recording and Reporting		**Fiduciary Risk Assessment:**					**Sub**	**Sub**	→
PI-22	Timeliness and regularity of accounts reconciliation	M2	C	C			**C**	**C**	→
PI-23	Availability of information on resources received by service delivery units	M1	B				**B**	**D**	↑
PI-24	Quality and timeliness of in-year budget reports	M1	C	B	C		**C+**	**C+**	→
PI-25	Quality and timeliness of annual financial statements	M1	C	A	C		**C+**	**C+**	→
C(iv) External Scrutiny and Audit		**Fiduciary Risk Assessment:**					**High**	**Sub**	↓
PI-26	Scope, nature and follow-up of external audit	M1	B	B	C		**C+**	**C+**	→
PI-27	Legislative scrutiny of the annual budget law	M1	C	B	B	D	**D+**	**C+**	↓
PI-28	Legislative scrutiny of external audit reports	M1	D	C	B		**D+**	**C+**	↓
D. DONOR PRACTICES		**Fiduciary Risk Assessment:**					**Mod**	**Sub**	↑
D-1	Predictability of Direct Budget Support	M1	A	A			**A**	**C+**	↑
D-2	Financial info provided by donors for budgeting/reporting on project/program aid	M1	B	C			**C+**	**C**	↑
D-3	Proportion of aid that is managed by use of national procedures	M1	D				**D**	**D**	→
(FOR SUB-NATIONAL GOVERNMENT ASSESSMENTS ONLY)		**Fiduciary Risk Assessment:**					**N/A**	**N/A**	-
HLG-1	Predictability of Transfers from Higher Level of Government	M1	-	-	-		-	-	-

Annex 17: Assessing the Financial Impact of Risk in the Use of Country Public Financial Management Systems

Country offices should carefully consider the possible financial impact of weaknesses in PFM systems with a view to quantifying the impact and risks to DFID's funds. This annex provides a step by step approach to help country offices assess the financial impact of risks. This approach should be used to help identify and manage fiduciary risk including identifying suitable safeguards. A five stage approach is suggested:

- Understanding the likelihood and impact of risks
- Identifying significant PFM systems by "following the flow of funds"
- Considering the PFM diagnostic information
- Quantifying the financial impact of risk, and
- Identifying additional safeguards.

Understanding the Likelihood and Impact of Risks

An understanding of risk requires analysis of the likelihood of the risk materialising and the impact if it does. Weaknesses in PFM systems increase the likelihood of occurance. The value of funds flowing through the system determines the potential impact. Both factors should be considered in assessing and managing risk.

The likelihood of leakage or inefficiency from individual PFM systems depends on factors including the type of system, the nature of assets safeguarded by the system, the effectiveness of specific system controls, and the effectiveness of the overall internal control environment, including organisational culture. While the likelihood is difficult to quantify precisely, estimates can sometimes be inferred from specific studies into actual leakage or inefficiency from PFM systems. These may include reports of the Supreme Audit Institution, the results of Public Expenditure Tracking Surveys, measurements of the efficiency of tax collection, and investigations into ghost workers on the payroll.

However, a broad indication of the likelihood of leakage or inefficiency from individual PFM systems may be gleaned from analysis of selected PFM indicators, such as appropriate PEFA indicators or DFID's 15 PFM benchmarks[23]. Translating indicator scores into risk assessments should not be mechanistic and should consider country context and compensating controls such as cultural factors, the short term impact of reforms and any additional safeguards. However, some general rules of thumb are given in Box 1[24].

The impact of leakage or inefficiency from individual PFM systems depends on the value of funds or resources processed or safeguarded by each system. Individual PFM systems include:

[23] See Annex 14
[24] See Box 1, after Para. 69, main text

- Revenue collection systems, e.g., income tax, VAT, natural resource revenues, fees and charges
- Expenditure management systems, e.g., payroll, procurement of goods and services, procurement of capital, and transfers to autonomous agencies and sub-national governments
- Systems for safeguarding assets, e.g., stock and stores control.

The identification of individual PFM systems will depend on the country context, particularly the structure of government, the significance of sub-national government activities, and whether core financial systems are centralised in the finance ministry or decentralised to line ministries. However, even centralised financial systems rely on information provided, transactions processed, and internal controls implemented across different ministries, departments and agencies, with differing degrees of diligence. Some sectors, particularly defence, may be subject to their own financial procedures and controls with significantly different risk implications.

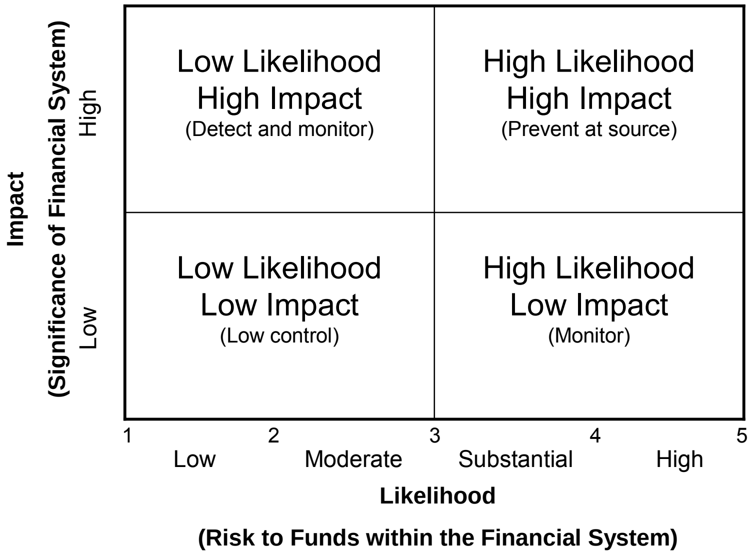
Identifying Significant PFM Systems

While countries are likely to have numerous separate PFM systems across central government, sectors and sub-national government, the principle of “following the flow of funds” should be used to identify the most significant systems. The starting point should be the Government’s own financial statements (if available) or budget, which is often summarised in the PEFA PFM Performance report.

In identifying the most significant PFM systems, it may be useful to map the flow of funds between central, sector and sub-national government, as well as the major financial systems operated at each level. As a guide, identifying the 20 most significant financial systems, or the systems which account for 80% of the country’s revenue and expenditure, should provide sufficient information to assess the financial impact of risk.

The likelihood and impact of leakage and inefficiency from PFM systems can be brought together in a risk assessment map (below). This can help to inform the management of risk and prioritisation of reform measures and additional safeguards. Key risks to prevent and proactively manage are high likelihood, high impact risks. Systems should also be designed to detect low likelihood, high impact risks. Other risks should be monitored.

Risk Assessment Map



PFM Systems and PFM Diagnostics

Mapping PFM indicator scores to different financial systems requires careful consideration of the country PFM systems and available diagnostic information. Table 10 below is intended as a guide. The list of common PFM systems presented here is not intended to be exhaustive.

Table 10: Performance Indicators Related to Core PFM Systems

PFM System	PEFA Performance Indicators	DFID PFM Benchmarks
Tax Collection Systems	3 – Aggregate revenue out-turn compared to original approved budget 13 – Transparency of taxpayer obligations and liabilities 14 – Effectiveness of measures for taxpayer registration and tax assessment 15 – Effectiveness in collection of tax payments	3 – All general government activities are included in the budget 4 – Extra budgetary expenditure is not material 6 – Budget outturn shows a high level of consistency with the budget
Natural Resource Revenues	3 – Aggregate revenue out-turn compared to original approved budget *Additional analysis may be required (e.g. EITI reports)*	3 – All general government activities are included in the budget 4 – Extra budgetary expenditure is not material
Other Fees and Charges	3 – Aggregate revenue outturn *Additional analysis may be required*	3 – All general government activities are included in the budget 4 – Extra budgetary expenditure is not material
Payroll	18 – Effectiveness of payroll controls	7 – In year control of actual expenditure
Procurement (Minor)	20 – Effectiveness of internal controls for non-salary expenditure	7 – In year control of actual expenditure

PFM System	PEFA Performance Indicators	DFID PFM Benchmarks
Procurement (Major)	19 – Competition, value for money and controls in procurement *Where available, results from the OECD DAC MAPS Tool should also be used*	9 – Appropriate use of competitive tendering rules and decision-making is recorded and auditable 10 – Effective action taken to identify and eliminate corruption
Debt Management and Interest Payments	17 – Recording and management of cash balances, debts and guarantees *Where available, results from the World Bank's Debt Management Performance Assessment tool should also be used*	8 – Systems operating to control virement, commitments and arrears
Transfers to Sub-National Government	8 – Transparency of inter-governmental fiscal relations 23 – Availability of information on resources received by service delivery units	6 – Budget outturn shows a high level of consistency with the budget
Oversight of Fiscal Risk from Agencies and SOEs	9 – Oversight of aggregate fiscal risk from other public sector entities	8 – Systems operating to control virement, commitments and arrears
Control of Stock and Stores	*Additional analysis may be required*	*Additional analysis may be required*

Note: A separate risk assessment for the specific system may be required.

In addition to the above indicators which are directly linked to the risk of leakage and inefficiency from specific financial systems, the following cross-cutting indicators are likely to impact on the risk associated with all financial systems. Weaknesses in these indicators are likely to increase the risk of leakage and inefficiency from all financial systems.

Table 11: Performance Indicators Related to Cross-Cutting Checks and Balances

PEFA Performance Indicators	DFID PFM Benchmarks
10: Public access to key fiscal information	3: All general government activities are included in the budget
21: Effectiveness of internal audit	7: In-year control of actual expenditure
22: Timeliness and regularity of accounts reconciliation	11: Reconciliation of fiscal and bank records is carried out in a routine basis
26: Scope, nature and follow up of external audit 28: Legislative scrutiny of external audit reports	13: Government accounts are independently audited 14: Government agencies are held to account for mismanagement 15: Criticisms and recommendations made by auditors are followed up

To assign a risk rating to a specific financial system may require consideration of a number of directly and indirectly related indicators. This should be done through judgement, based on an understanding of the country context and PFM systems, rather than through a specific aggregation methodology. The rationale for such judgements should be recorded.

In some countries, significant financial systems may include sectoral and sub-national financial systems. In these cases, risk assessments should draw on evidence from sectoral and sub-national assessments where available, such as the PEFA Performance Measurement Framework at Sub National Government Level. While there is no similar PEFA tool for sectoral PFM assessments, it should be noted that general PEFA assessments are usually based on review of evidence from key sectors, and the sector basis for the indicator scores should be stated in the PEFA performance report. **In addition**, a general PEFA assessment may be designed to assess and record separate indicator scores for key sectors, as well as an overall score for each indicator. These may provide useful information on the performance on PFM systems within key sectors.

Quantifying the Financial Impact of Risk in the Use of Country Systems

The methodology above is designed to bring together assessments of the likelihood and impact of leakage and inefficiency from PFM systems onto a risk assessment map. DFID does not recommend the translation of risk assessments into probabilities in order to produce an estimate of the expected value of leakage and inefficiency. Instead, country offices should initially draw on available evidence to produce estimates of leakage and inefficiency in financial systems. Table 8 summarises some of the evidence sources which may be useful for this purpose.

Table 12: Evidence Sources to Quantify the Financial Impact of Risk

<table>
<tr><th>PFM System</th><th>Examples of Sources of Evidence</th><th>Issues</th></tr>
<tr><td>Tax Collection Systems</td><td>Comparison of amounts due for collection under each tax against amounts recorded as collected</td><td rowspan="3">As completeness is the key risk for revenue systems, it is not appropriate to use the amounts recorded as collected in Government accounts as the basis for quantification of leakage or inefficiency. Another evidence source should be used to compare amounts expected to be collected against amounts recorded as collected.</td></tr>
<tr><td>Natural Resource Revenues</td><td>EITI reports: comparison of amounts recorded as paid by companies against amounts recorded as received in Government accounts</td></tr>
<tr><td>Other Fees and Charges</td><td>Comparison of amounts recorded by collection units against amounts reported as paid in household surveys</td></tr>
<tr><td>Payroll</td><td>Quantification of ghost worker payments as a percentage of total payroll payments</td><td></td></tr>
<tr><td>Procurement (major)</td><td>Comparison of actual price paid to standard price list or international market prices</td><td>Need to know what a competitive market price for the goods or services would be in that country</td></tr>
<tr><td>Procurement (minor)</td><td>Sample audit of payments to produce estimate of percentage of improper expenditure</td><td>Relies on the Supreme Audit Institution maintaining adequate records and utilising statistical sampling</td></tr>
<tr><td>Transfers to Sub-National Government</td><td>Comparison of amounts transferred to sub-national government (and onwards to service delivery units) against amounts recorded as received</td><td>Use Public Expenditure Tracking Surveys</td></tr>
<tr><td>Control of Stock and Stores</td><td>Reconciliation of stock purchases, issues and write-offs to changes in stock levels. Reconciliation of stock issues to quantities received at service delivery units.</td><td>Relies on complete and accurate stock records.</td></tr>
</table>

It is unlikely that sufficient evidence will be available to quantify the financial impact of risk from each significant financial system. As it can be time consuming and expensive to conduct the research needed to collect the evidence cited above, a considered approach to balancing the costs and benefits of data collection should be used. Proposals for additional studies to quantify the risk of leakage and inefficiency in country PFM systems should focus on high likelihood, high impact risks. Where possible, risk analysis should be shared with the partner Government and other donors, and further studies led by the Government, or used to develop Government capacity for such studies in the future. The results of such studies can be used to gradually build up an understanding of the levels of leakage and inefficiency in individual financial systems and country PFM systems overall.

Recording the Benefits of Using Country Systems

Consideration of the risks of leakage and inefficiency in country PFM systems should be weighed against the expected benefits of using country systems, which may include[25]:

- Improved resource allocation through increased coherence of Government planning
- Increased operational efficiency through improved balance between recurrent and capital expenditure
- Increased scrutiny of Government PFM systems and the funds they manage
- Burden on Government through the use of parallel PFM systems avoided.

Additional Safeguards

The risk assessment map and quantified estimates of leakage and inefficiency from individual financial systems should be used to inform the management of risk. This is likely to include agreeing priority actions with the partner Government, designing additional short term safeguards, selecting appropriate aid instruments and prioritising the monitoring of risks.

An illustrative table to record the different assessments relating to the risk of leakage and inefficiency from country PFM systems is provided in Table 13.

[25] For further guidance, see the How to Note: Assessing the Potential Benefits of Poverty Reduction Budget Support, DFID, January 2008

Table 13: Assessing the Risk of Leakage and Inefficiency from Country PFM Systems

PFM System (e.g.)	Entity (Include Central, Line Ministry and Sub-National Bodies)	Relevant PEFA/FRA Indicators and Scores	Compensating Controls Already in Place	Risk of Leakage or inefficiency (L, M, S, H)	Value of Funds processed by system	Quantified Estimate of Leakage or Inefficiency		Additional Quantitative Studies Proposed	Expected Benefits of Using Country Systems	Additional Safeguards Proposed
						%	Value			
Income Tax									N/A	
Corporate Tax									N/A	
VAT									N/A	
Import Taxes									N/A	
Natural Resource Revenues									N/A	
Other Fees and Charges									N/A	
Payroll										
Procurement (minor)										
Procurement (major)										
Interest Payments									N/A	
Transfers to Sub-National Government										
Oversight of Fiscal Risk from Agencies & State Owned Enterprises									N/A	
Control of Stocks and Stores										

This table is available in landscape format as Quest No. 2075031.

Annex 18: Good Practice Approaches to Reform

The PEFA Strengthened Approach

The PEFA strengthened approach comprises three elements:

- A country-led PFM reform strategy and action plan
- A co-ordinated IFI-donor, multi-year programme of work that supports and is aligned with the Government's PFM reform strategy
- A shared information pool (provided through the PEFA Performance Report).

PEFA assessments (the third element) can be useful to identify strengths and weaknesses of PFM systems as a starting point for discussion of reform. However, a PEFA assessment alone is insufficient for the development of a PFM reform programme. Additional analysis (which may involve use of specific drill-down tools) will be required to diagnose the underlying causes of strong or weak performance. Technical linkages exist between various elements of the PFM system, so that successful reform of some elements depends on the performance of others. Countries also face political, cultural, legal, administrative, resource and capacity constraints. Any plan for PFM reform should be prioritised and reform actions sequenced, taking those factors into consideration.

The PEFA strengthened approach embodies the Paris Declaration principles of ownership, alignment, harmonisation, managing for results and mutual accountability, for the PFM sector. In practice, countries may be following this type of approach without necessarily calling it a PEFA Strengthened Approach.

Reform programmes should be credible and achievable. Programme design should take into account the following factors and seek to build in the features set out in Annex 10. Effective reform is not just about finding the optimal technical solution: it needs to take account of the political, social and economic realities as well. Technically best solutions need to be tempered with political realism. Successful reform programmes need to address:

- **Process issues**: Technical changes or additions to existing systems.
- **Institutional issues**: Changes to the organisational and governance arrangements or management culture.
- **Capacity issues**: Building the knowledge, competence and skills of people.
- **Motivational issues**: To encourage implementation of reforms.

The number and experience of staff within the PFM system, and the leadership which government is able to exert, will be significant in determining how ambitious a reform programme can be, in terms of scope, complexity and speed. Many reform programmes continue to be overloaded and based on unrealistic timeframes.

The Platform Approach to PFM reform

A Platform Approach is designed to achieve increasing levels (platforms) of PFM competence over the long term. It places a strong emphasis on dependencies and the importance of sequencing. A critical feature of the approach is that each platform is defined in terms of improved outcomes, rather than the completion of specified activities. The platforms and the measures required to achieve them depend on the country context. The three elements of the PEFA Strengthened Approach should be followed as far as possible when applying the Platform Approach. More detailed information on the Platform Approach, including a case study based on the Cambodian experience, is available in the DFID Briefing Note, ‘A Platform Approach to Improving Public Financial Management’, July 2005.

Experience of applying the platform approach has also yielded some important lessons which are worth restating.

(i) There is no universal set or sequence of platforms. Platforms need to be defined for each country, taking into account country context and initial state of PFM.

(ii) The platform approach was intended to help make reform programmes more manageable for partner governments, by offering a reasoned explanation for delaying some well intentioned and important reforms. In practice in too many countries, the early platforms have been overloaded and overwhelmed the government’s capacity to implement and coordinate the reform programme.

(iii) Implementation plans for the early platforms have suffered from pressure from both donors and partner governments to work to unmanageable time frames, particularly in relation to rolling out major reforms.

The PEFA Strengthened Approach and the Platform Approach emphasise different aspects of the reform process. They are not alternatives and they should complement one another. The first element in the PEFA Strengthened Approach is a country led PFM reform strategy and action plan. The Platform Approach could be used to determine what should be in the strategy and action plan.

Annex 19: Assessing the Quality of SAI's Strategic and Development Plans

Types of Plan

An SAI *strategic development plan* sets out the strategy for developing the SAI over the longer term. A *development action plan* is about how the strategic development plan will be implemented (who will do what, when and the resources required). It will have a shorter time horizon and should be subject to regular review and if necessary change.

Both these plans should be distinguished from the SAI's *operational audit plan*, which is about carrying out its operational responsibilities (e.g. audits to be conducted over the coming year).

Assessing the quality of strategic development plans and development action plans

The quality of plans can be assessed by considering the extent to which they comply with good practice. Good practice encompasses the content of the plans and the process by which they are prepared. The process may not be apparent from the plan, although it would be good practice to include a brief summary of the process in the introduction to the plan. In the absence of this, evaluating the plan may involve asking the SAI about the process by which it was prepared.

Features of good practice for strategic development plans and development action plans are set out below.

Strategic Development Plans

The process by which the plan is developed should involve/ensure:

- High level ownership within the SAI (i.e. active involvement in the process by the Auditor General)
- Wide involvement in development of the plan within the SAI (e.g. involvement of working groups representing different departments in the SAI)
- High level political ownership (e.g. Public Accounts Committee or equivalent has been involved in the process and approves the plan)
- Consultation with other relevant bodies (e.g. Ministry of Finance, government internal audit function, financial inspectorate etc)
- Awareness of ongoing developments in public financial management

The content of the plan should cover:

- The process by which it was developed (in summary)
- The legal framework within which the SAI operates (including any detailed regulations)
- The organisational structure of the SAI (including location of offices)
- Human resource issues (including staffing levels, recruitment, training and professionalisation)

- Facilities (including office accommodation, equipment, transport and Information and communications technology infrastructure)
- External relations (e.g. relations with Parliament and with other auditors and/or financial inspectorates)
- Communications strategy (including on dissemination of audit findings)
- International relations (including where applicable, arrangements for co-ordinating development assistance – received or delivered)
- For federal states, the relationship with audit offices at the sub-national (e.g. state) level
- Audit approach to be applied (including process for planning audit work; financial, compliance and value for money audit; sampling; audit manuals; policy for contracting out audit work; quality assurance policies etc.)
- Use of IT in conducting audit work

Each section should include a clear statement of the constraints under which the SAI operates, which may impact on its ability to deliver the desired changes and a clear recognition of the risks which will need to be managed during implementation.

The plan should:

- Where possible be costed (and costs should be reasonable in relation to funding available or likely to become available (including aid funds)). At the very least an estimate of the overall resources required to implement the plan should be included
- include targets and indicators by which progress can be measured (which will include policy actions and measures of improved performance)
- be consistent with any overall government plan to improve public financial management (i.e. if such a plan involves decentralisation or increased use of information and communications technology, the audit strategic development plan should indicate how the SAI will adapt to this)

Development Action Plan

The development action plan should:

- be updated regularly (perhaps annually)
- include actions which are clearly sequenced with timescales specified
- allocate responsibility for the actions
- be consistent within itself (i.e. actions should contribute towards consistent ends)
- be consistent with the strategic development plan
- include arrangements for regular reporting of progress
- be structured in such a way that it helps build the demand for change (i.e. early actions prepare the way for and help stimulate demand for later actions).

Annex 20: Reviewing Partner Government's Financial Reports

Reviews of a government's in-year budget monitoring reports and year end consolidated financial statements, should focus on two issues, Firstly, whether the government is staying on track with respect to aggregate fiscal discipline; and secondly, revenue and expenditure performance against the budget.

Fiscal discipline targets

- Are deficit and debt targets consistent with maintaining aggregate fiscal discipline over the medium term?
- Did they run a primary surplus (surplus before interest charges?)
- If deficit exceeds deficit target, is appropriate action taken promptly to get back on track?
- Does the data exclude key fiscal risks which might change our view on fiscal discipline (e.g. failure to capture arrears and other unrecorded liabilities)?
- Is the Government in a position to continue refinancing its debt and avoid a debt crisis? If not, what actions are necessary (from Government and International Financial Institutions/donors)

Review revenue and expenditure performance

- Were revenue and expenditure forecasts reasonable, or was there deliberate under or over budgeting?
- What are the major revenue and expenditure variances? Are the reasons for them adequately explained? Are the reasons for them acceptable/reasonable? This analysis should be carried out both across government departments and across spending heads within government departments, in order to understand if virement between budget heads is systematically undermining the budget process, and if there are certain departments which are worse performers than others in this area.
- Where variances are within Government control, are remedial actions being taken promptly?
- Where variances are outside Government control, is appropriate action being taken to reprioritise public spending or to seek approval for additional borrowing?