

DECEMBER 2009

Managing fiduciary risk when providing Financial Aid

Introduction

1. This How to Note provides **operational guidance** on how to manage fiduciary risk in DFID's financial aid projects. It updates and replaces previous guidance focused on managing fiduciary risk when providing Financial Aid¹ (Annex 1 highlights matters of special relevance to PRBS from the earlier guidance).
2. A standardised FRA evaluating the national PFMA system is **mandatory** in country planning where Financial Aid is being provided or considered.
3. This note is targeted towards country office staff involved in Fiduciary Risk Assessments (FRAs), PEFA Framework assessments and Public Financial Management and Accountability (PFMA) reform programmes. It aims to provide a consistent and holistic approach to fiduciary risk management in DFID country programmes.
4. The guidance has been strengthened to reflect White Paper IV commitments. In particular it provides a strengthened approach to the use of safeguards and quantifying risks, and reviews commitments to anti-corruption standards and anti-money laundering systems.
5. The How to Note includes clarification on completing FRAs and ASPs at country, sector or sub-national level, including the requirement to send ASPs annually to FCPD (FRA-ASP Central Scrutiny)
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 manage fiduciary risk to DFID programme expenditure is to work with partner countries to improve the overall fiduciary control environment. This note focuses on assessing, mitigating and monitoring risks associated with national PFMA systems.
7. This note does not address the management of risks outside the fiduciary/corruption field in depth, although these may be closely connected – for example, political and governance factors². Nor does it provide advice on

¹ This note updates and replaces the most recent consolidated How to Notes: 'Managing fiduciary risk when providing financial aid' (March 2009); 'Managing Fiduciary Risk in DFID's bilateral aid programmes' (Jan 2008).

² Further guidance on assessing governance can be found in the Country Governance Analysis HTN, July 2008

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 here³. It does not provide detailed advice on managing risks to aid delivered through mechanisms such as International Financial Institutions, other donors, international or national Non-Governmental Organisations.

8. For further information on issues relating to DFID processes and the management of fiduciary risk to DFID funds when using financial aid, please contact Finance and Corporate Performance Division (FCPD) using the e-mail address FRA-ASP Central Scrutiny. For advice on issues relating to PFMA performance and reform at the partner country level, please contact the Public Financial Management workstream in AEAD.

Structure of this note

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

Overall approach (p.8)

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

Understanding the risk environment (p.13)

This section provides guidance on how to evaluate PFMA systems and associated risks at the national level. It explains the relationship between Fiduciary Risk Assessments and PEFA Framework assessments and provides guidance on how to make both as robust as possible. It also suggests approaches to evaluating risk at the sub-national and sectoral levels for individual aid instruments.

Mitigating risk (p.28)

This section outlines basic design principles which should underpin support to long-term PFMA reform programmes. It also provides guidance on the use of short term risk mitigation measures.

Monitoring progress (p.33)

This section sets out the arrangements which should be put in place to monitor fiduciary risk on an on-going basis. It provides a template for the Annual Statement of Progress on fiduciary risk.

³ Further guidance will be available from the Aid Effectiveness team in AEAD

Table of Contents

- Section 1: DFID’s approach to managing fiduciary risk 5
 - Principles 5
 - Processes 5
 - Understanding the fiduciary risk environment 6
 - Mitigating fiduciary risk 7
 - Monitoring performance on an ongoing basis 7
 - Non-routine reassessment 8
 - Central review and support 8
- Section 2: Understanding fiduciary risk 10
 - The standardised FRA to assess national PFMA systems 10
 - FRAs and PEFA Framework evaluations 11
 - Other information 12
 - Consultation 12
 - Assessments in the FRA 13
 - Historical, governance and institutional context 13
 - Performance of the PFMA system 13
 - What are the key risks? 14
 - Assessing the financial impact of risk in the use of country PFM systems 16
 - What is the overall level of fiduciary risk? 16
 - What is the risk of corruption? 17
 - Are existing reform programmes credible? 19
 - Trajectory of change 20
 - Are there key risks which are not adequately mitigated by existing measures? 20
 - Assessment of fiduciary risk at the aid instrument level 22
 - Risk assessment at the Sub-National level 22
 - Risk assessment at the sectoral level 23
- Section 3: Mitigating risks 25
 - Support to partner government PFM reform programmes 25
 - The Platform Approach to PFMA reform 27
 - Use of short-term safeguards 27
 - Types of safeguard 28
 - Design of Safeguards 29
 - Documenting decisions about short-term safeguards 30
- Section 4: Monitoring performance on an ongoing basis 32
 - Performance monitoring indicators 32
 - Audit by the NAO 33

Annexes

- Annex 1: Key points to note in relation to PRBS 35
- Annex 2: DFID work processes related to fiduciary risk 37
- Annex 3: Central review and scrutiny process for the FRA 39

Annex 4: Generic Terms of Reference for an FRA consultancy	41
Annex 5: The PEFA framework indicators	44
Annex 6: Relationship between FRAs and PEFA	46
Annex 7: Lessons for carrying out a PEFA Framework evaluation	47
Annex 8: Anti-corruption and Procurement	51
Annex 9: Other sources of information	54
Annex 10: Questions to assess reform credibility	59
Annex 11: Issues to consider in assessing sector performance	62
Annex 12: Examples of safeguards.....	66
Annex 13: ASP template	69
Annex 14: Recommended Scope of DFID 8 Good Practice Principles and 15 Benchmarks	71
Annex 15: Fiduciary Risk Matrix.....	76
Annex 16: FRA summary table	77
Annex 17: Assessing the financial impact of risk in the use of country Public Financial Management Systems.....	79

Definitions

Public Financial Management (PFM) is the system by which the financial aspects of the public services' business are directed, controlled and influenced, to support the delivery of the sector's goals.⁴ 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 countries⁵. 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.

⁴ Definition from the Chartered Institute of Public Finance and Accountancy (CIPFA)

⁵ 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. A shared commitment to strengthening financial management and accountability, and reducing the risk of funds being misused through weak administration or corruption, is one of three key objectives on which an effective aid partnership should be based⁶. Our approach to managing fiduciary risk is designed to allow us to work effectively with partner governments to support them in strengthening their public financial management systems.
11. 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** performance on an on-going basis.
12. This approach underpins the management of **all DFID funds** 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 also allows remedial action to be taken quickly if problems arise. The three elements of fiduciary risk management should be undertaken on a **continuous and continuing** basis.
13. This approach to managing fiduciary risk applies to all countries, including fragile states. The level of work needed to understand risk in different countries; the detailed activities required to mitigate it; and the type of monitoring arrangements put in place to review performance will vary depending on the individual country situation and its capacity and commitment to undertaking reform.

Processes

14. 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 best practice and will vary according to country circumstances. Annex 2 summarises the work processes involved and notes where further guidance can be found.

⁶ See policy paper 'Partnerships for poverty reduction: rethinking conditionality' (March 2005)

Understanding the fiduciary risk environment

15. Country offices need to develop an understanding of fiduciary risk at two levels, in relation to:
- The national PFMA system; and
 - Any different, additional or specific risks associated with individual aid instruments.
16. A standardised FRA evaluating the national PFMA system is **mandatory** in country planning where Financial Aid is being provided or considered, and is a mandatory annex to the issues and choices submission. (Financial Aid comprises both PRBS and non-PRBS Financial Aid as per the definition in Section B10 of the Blue Book).
17. The standardised FRA focused on the national PFMA system will:
- Feed into DFID's country planning process and help determine the options for aid instruments;
 - Act as an assessment for general PRBS (if provided); and
 - 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 we use in a particular country and provide information on a country's progress towards the three partnership commitments, including its commitment to improve public financial management. 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 occurring and the credibility of reform programmes. Likewise, the detailed analysis in the FRA will generate information the CGA can draw on in areas such as revenue mobilisation and public financial management, and corruption. Country offices should take advantage of these synergies to streamline, rather than duplicate analytical work.
19. It is **mandatory** for all projects over £1 million to have an assessment of risk and should include a statement drawn from the country level FRA,, where appropriate (Blue Book, Section B5). The content of a risk assessment for individual aid instruments will normally be less standardised than that of the FRA to assess national PFMA systems. The approach adopted will depend on factors such as the general PFMA environment, and the nature of risks associated with a particular sector. The nature of additional analysis to support the design of individual aid instruments will vary from country to country but typically will involve looking at fiduciary risks in particular sectors or levels of sub-national government where country offices anticipate providing support.

20. Country offices are free to carry out this analysis in conjunction with the standardised FRA evaluating national PFMA systems or as a separate exercise, to suit country circumstances. Country Offices may exceptionally undertake standardised FRAs in particular sectors or levels of sub-national government if this is thought to provide a more robust assessment, and should submit these for central scrutiny. Where FRAs are undertaken at these levels and outside the country planning process the standard DFID template assessing 8 Good Practice Principles and 15 benchmarks should be used in the absence of a sector or sub-national PEFA.

Mitigating fiduciary risk

21. It is not sufficient to simply identify areas of weakness and fiduciary risk. Country offices must consider how such risks can best be mitigated and balance this against the potential development benefits of different options. Risk can be mitigated through the choice of aid instrument, for instance, choices can be made to spend funds in sectors where PFM systems are relatively stronger or to spend funds outside government systems. Decisions about the shape of the overall aid portfolio necessarily need to consider a broader range of issues than fiduciary risk; the Country Planning process sets out the rationale for programme choices.
22. Over time, risk can be mitigated by providing support to partner governments' PFMA and anti-corruption reform programmes to improve how well national systems function. However, the time horizon for changes bedding in and reducing 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 for any high risk areas.

Monitoring performance on an ongoing basis

23. It is essential to monitor performance on an ongoing basis to:
- Check that identified fiduciary risks are being adequately managed and planned reforms or safeguards are being implemented; and
 - Identify any new fiduciary or corruption risks or changes in circumstance.
24. Monitoring risk at the individual aid instrument level is **mandatory** under the arrangements described in Section B11 of the Blue Book. It is also important to maintain an up to date perspective of fiduciary risk at the wider country level, in order to ensure the overall country strategy remains appropriate. **It is mandatory to complete an Annual Statement of Progress (ASP) on fiduciary risk for each FRA.** An ASP is therefore required for the standardised FRA assessing national systems and aligned with country planning as well as any sector or sub-national FRAs that country offices decide to undertake. The ASP will be the primary way in which we track a partner country's continuing commitment to strengthening financial management and accountability and reducing the risk of funds being misused through weak administration or corruption. Unless there is evidence of significant problems emerging, this 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.

Non-routine reassessment

25. In normal circumstances, where the aid relationship between DFID and a partner government is proceeding smoothly, a full FRA only needs to be completed in line with the Country Planning timetable, that is, normally every three years.

26. However, where we are faced with a potential breach in the commitment to strengthen financial management and accountability, we may need to carry out a full and immediate reassessment of fiduciary and corruption risk to clarify the latest position and feed into the process of deciding whether the existing aid relationship remains appropriate. Any potential breach should be considered in the light of DFID's conditionality policy⁷. Triggers which could lead to a full reassessment of fiduciary risk include major changes in circumstance or events with the actual or perceived potential to undermine the commitment, such as:

- Significant changes in the partner government's PFMA reform programme, including any related anti-corruption reforms (such as could happen with a change in government);
- Significant changes in partner government's PFMA systems relied upon for the use of funds (such as a major increase in funds allocated to sub-national government);
- Availability of new diagnostic work, for example a new PEFA evaluation, which provides significantly different perceptions of fiduciary risk or the risk of corruption;
- A serious corruption scandal challenging the overall credibility of partner government's PFMA systems and related reforms; or
- Decisions by DFID or other international partners to suspend, discontinue or change how they deliver aid because of PFM or corruption issues.

27. This is not intended to be a comprehensive list and there is no precise definition of a significant event. Country offices should consult with FCPD and AEAD on PFM-related issues⁸ on whether a full reassessment of fiduciary risk is needed, where any unusual event or circumstance gives cause for concern.

Central review and support

28. **All FRAs are subject to central scrutiny and review**, including those exceptionally undertaken at a sector or sub-national level. The review provides assurance to the Accounting Officer and Ministers and strengthens consistency and lesson learning across DFID. The process is led by Finance and Corporate Performance Division (FRA-ASP Central Scrutiny@dfid.gov.uk) and supported by a panel of independent PFM technical 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;

⁷ See the HTN on Conditionality for general guidance on how to deal with potential breaches of partnership commitments.

⁸ The Aid Effectiveness team in AEAD can advise on DFID's conditionality policy; the PFM team can advise on PFM related issues.

- There is consistency across countries and FRAs in the application of this HTN
- The process is producing useable information in the expected format, and to inform/prompt revisions required to the assessment process.
- Judgements are explicitly presented and consistent with reasonable evidence.

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

29. 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.
30. At the aid instrument level, additional fiduciary risk analysis and risk mitigation plans must be detailed in project documentation and reviewed and approved through line management channels according to the delegated authority limits set out in the Blue Book (Sections B5 and B7). The Blue Book requires country offices to consult with appropriate central teams (Section B6). FCPD welcome 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.
31. 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.
32. In monitoring FRAs and ASPs FCPD will request information annually from country offices regarding the number and timing of returns.

Section 2: Understanding fiduciary risk

33. This section provides guidance on preparing the standardised FRA to assess national PFMA systems and on how to approach additional assessments of fiduciary risk at the aid instrument level.

The standardised FRA to assess national PFMA systems

34. The FRA is intended to assess the level of fiduciary risk associated with the national PFMA system in a standardised way. There are 4 specific assessments highlighted below in Table 1 setting 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 30 to 40 pages long, with an Executive Summary of up to 5 pages. It is essential that the Executive Summary explicitly sets out the country office's assessment of the key issues detailed in Table 1 below.

Table 1: Content of the standardised FRA

	Content	Detail
1	Table of Contents Abbreviations Executive Summary	Overall assessment of fiduciary risk (L/M/S/H), including a specific assessment of corruption risk (L/M/S/H). Summary of PFMA weaknesses and key risks identified, highlighting risks not fully addressed by existing reform programmes. Statement on whether there is credible programme to improve. Statement on whether the PEFA assessment (if applicable) has been quality assured by the PEFA Secretariat.
2	Historical, governance and institutional context	Description and analysis of the wider context in which national PFMA systems operate.
3	Performance of PFMA systems	Description of PFMA performance based on either : <ul style="list-style-type: none"> • PEFA Framework indicators and performance report; or • DFID's 15 benchmarks and related narrative where no PEFA available.
4	Identification of key fiduciary and corruption risks	An assessment of corruption risks corresponding to the risk rating L/M/S/H.
5	Credible programme to improve	Summary of current PFMA reform initiatives and other related reforms, where relevant. An assessment of the credibility of the programme to improve.
6	Financial impact	An assessment of the possible financial impact of weaknesses in PFMA systems with a view to quantifying the impact and risks to DFID's funds and identifying additional safeguards..
7	Safeguards and residual risks	A summary of safeguards designed to mitigate short-term risks; their contribution to strengthening PFM capacity and the exit strategy from safeguards. Summary of residual risks not mitigated by credible reform programmes and safeguards in the life of the FRA.

8	Monitoring fiduciary risk	Outline of how fiduciary risk / PFMA improvement will be monitored over the next period
9	Summary Table	Summary table of scores to include a trajectory of change
10	Bibliography	Note of information sources used.

35. 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 or study was performed and by whom. A summary of this information should be included as a bibliography in the FRA.
36. Country offices often contract consultants to help in the preparation of FRAs. Annex 4 provides generic Terms of Reference for contracting consultants to assist in developing a FRA.
37. 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 PFMA 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 a 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 will develop shared understanding and help build a partnership between the government and international partners. It will provide a high-level overview of the main weaknesses in the system, including in many cases gaps in information which will need to be filled by further detailed analysis.

FRAs and PEFA Framework evaluations

38. As far as possible, the FRA should draw on information from a country's most recent PEFA Framework evaluation. One of PEFA's key objectives is to strengthen partner government and donor ability to measure and monitor the condition of partner country revenue, expenditure, procurement and financial accountability systems. DFID strongly supports using PEFA Framework evaluations to inform our fiduciary risk assessments. Where a PEFA process has yet to be established, Country Offices should explore the scope for adopting one with the government and other partners.
39. FRAs and PEFA Framework assessments both examine PFM systems but have different objectives. A PEFA Framework evaluation cannot replace the FRA. A FRA remains necessary 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 PFMA system; the FRA uses this information, amongst others, to inform **judgements** about the levels of risk in national PFM systems and 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 Framework information feeds into the assessments which need to be included in a FRA.

40. As PEFA Framework evaluations are a key source of information for our FRAs, it is important they are of a **high quality with sufficient evidence to justify the indicator ratings**. This note does not include detailed guidance on carrying out PEFA Framework evaluations and assessing individual indicators. Guidance is available on the PEFA website www.pefa.org, in the PEFA Framework handbook (hard copies available from the PFM workstream in AEAD) and the PEFA note 'Good Practices in Applying the PFM Performance Measurement Framework'. The PEFA Secretariat provides direct advice on queries relating to individual evaluations and can be contacted through its website. **DFID recommends that all draft PEFA Framework evaluations are shared with the PEFA Secretariat** who have the best understanding of how the indicators should be applied and the evidence needed to support the ratings. Country offices should work with partners involved in PEFA Framework reports to ensure a quality assurance role for the PEFA Secretariat is planned into the evaluation exercise. Details should be provided in the Executive Summary of the FRA (see Table 1).
41. Annex 7 summarises key issues which country stakeholders should address to produce a robust PEFA Framework report⁹. DFID's central review process will look for assurance from country offices about the quality of underlying PEFA evaluations.

Other information

42. Not all the information needed for an in-depth assessment of fiduciary risk will be available from the PEFA Framework evaluation, which is a high level assessment tool measuring performance of technical aspects of the PFMA system. On its own, it does not drill down into specific areas of the PFM system, nor provide a diagnosis of the reasons for strong or weak performance. Understanding the historical, governance and institutional context of partner governments' PFMA systems and processes is also critical for an effective assessment of risk. Use of information outside the PEFA Framework is particularly necessary for assessing the risk of corruption.
43. 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 sorts of partner government analysis as well as international diagnostics on PFMA and corruption issues, which may be available.

Consultation

44. The PEFA Framework, as an internationally agreed, joint assessment tool, should be the main mechanism for gathering data about how PFMA systems are functioning, and can provide one 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 Framework

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

evaluation. 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 Framework and other sources and allow us to understand their views. Given that the FRA is likely to be developed in parallel with the Country Plan and related analysis such as the Country Governance Analysis, there is scope for harmonising consultation processes between the DFID country office and government and other counterparts. Country offices are also encouraged to share the conclusions of their Annual Statements of Progress with others, although as this will normally be a light touch exercise, major consultation processes are unlikely to be needed.

45. In the absence of a PEFA Framework assessment, the FRA should follow the format of the DFID template, including the 8 Good Practice Principles and 15 benchmarks (see Annex 14). When using the DFID template the 4 point risk rating as set out in box 2 should be used. Internally, consultation with FCPD is welcomed on developing the FRA.

Assessments in the FRA

46. 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 present all the key data from the PEFA, or summaries thereof, which are used to support the PEFA conclusions. If this is not done reviewers cannot form an opinion on the risk levels proposed and the trajectory of change. This section sets out advice on things to consider in reaching a judgement on the issues involved.

Historical, governance and institutional context

47. A thorough analysis of how PFMA systems actually work requires an evaluation of both formal and informal structures. This information will enable a more informed assessment of the credibility of PFMA reform programmes and whether there is a positive trajectory of change and a genuine commitment to strengthening national systems. Understanding the dynamics of power underpinning PFMA processes can inform more effective support by reinforcing incentives for accountability and transparency. More information on these issues can be found in the DFID Briefing, 'Understanding the Politics of the Budget'. Guidance on undertaking Country Governance Analysis (CGA) is also directly relevant: lessons about the general governance situation in a country should feed into, and be informed by, the FRA.

Performance of the PFMA system

48. This section is largely descriptive and information can be taken directly from the PEFA Framework assessment. The PEFA Framework is designed to provide a snapshot of how PFM systems are performing. It consists of a set of 28 indicators, broken into six thematic groups, which measure the performance of national PFMA systems and 3 indicators which measure donor performance (Annex 5). The 3 indicators relating to donor performance are not generally used

in the FRA. The indicators are supplemented by a narrative performance report which provides country context; more detailed information about key systems, processes and institutions; and a description of PFM reform processes. A summary of the PEFA indicator scores and the relevant narrative detail should be included in the body of the FRA.

What are the key risks?

49. Each PEFA indicator is assessed on a four-point scale, where A is the strongest performance and D the weakest and some indicators have several dimensions, each of which is scored individually on an A to D basis. Using the information provided in the PEFA Framework to identify key risks should not be done mechanistically; rather the PEFA results should be interpreted based on an understanding of the country context. However, some general rules of thumb can be identified.

Box 1: Rules of thumb for interpreting PEFA scores

A scores	Represent performance that meets good international practice. The risk to funds within the national PFM system should be low.
B scores	Depending on the indicator, B scores represent a level of performance ranging from good to fair by international standards. The risk is therefore likely to be low to moderate.
C scores	Depending on the indicator, C scores represent a level of performance ranging from fair to poor, and a potential level of risk ranging from moderate to substantial.
D scores	D scores indicate either that a process or procedure does not exist at all, or that it is not functioning effectively. The risk is likely to be high.

50. These rules of thumb should be used with caution: the extent to which a low PEFA rating translates into a risk to funds passing through the PFM system can vary according to the nature of the indicator. For instance, a low rating on an indicator such as PI-5, Classification of the Budget indicates poor performance, but is unlikely to translate as directly into financial risk as a low rating on an indicator related to budget execution such as PI-18 Effectiveness of Payroll Controls. Both C and D scores may represent key risks. The extent to which the PEFA Framework report explicitly identifies key PFMA risks is likely to vary. Country offices will probably need to interpret the PEFA information in order to reach a view. Whilst there is no mechanistic link between PEFA indicators and risk levels, the central scrutiny reviewers consider it good practice to provide an explanation where either (i) an indicator is graded as C or D but is not considered by the FRA as a key risk or (ii) an indicator is graded A or B but is listed as a key risk. A helpful starting point can be to identify key weaknesses and associated risks in each of the six PEFA indicator groups. The FRA should provide risk levels and a trajectory of change for each PEFA indicator or at the overall category level as indicated in Annex 16. Table 2 sets out the significance of each group of indicators and the risks related to poor scores.

Table 2: Significance of PEFA indicator groups

<p>Indicator Group 1: Credibility of the budget (PEFA Indicators 1-4)</p>	<p>This group 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.</p> <p>Poor scores point to the possibility that resources may not in practice reach the policy priorities reflected in the budget to the extent intended.</p>
<p>Indicator Group 2: Comprehensiveness and Transparency (PIs 5-10)</p>	<p>This group 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.</p> <p>Poor scores indicate fiduciary risks due to the non-availability or fragmentation of information about public finances, the absence of opportunity for Government to be held accountable by its own population and a lack of external checks and balances that transparency otherwise makes possible.</p>
<p>Indicator Group 3: Policy-Based Budgeting (PIs 11-12)</p>	<p>These indicators reflect the extent to which budget allocations are made in a strategic context reflecting agreed policies and priorities and with due consideration to the longer term impact of decisions.</p> <p>Low scores would indicate risk of fiscal instability, weak prioritisation and linkage to policy objectives. They would also suggest vulnerability to imbalances between types of expenditure and inefficient use of resources due to 'stopping and starting' of projects and lack of complementarity between different categories of expenditure.</p>
<p>Indicator Group 4: Predictability and Control in Budget Execution (PIs 13-21)</p>	<p>These indicators consider the extent to which managers and service providers inside the public service can deploy resources provided in the budget with certainty and timeliness and within a control framework that is effective in enforcing discipline without being so cumbersome that service delivery is compromised.</p> <p>A low score here indicates 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.</p>
<p>Indicator Group 5: Accounting, Recording and Reporting (PIs 22-25)</p>	<p>These indicators reflect the adequacy of information about what happens to resources in practice as a means of both informing managers at all levels about their own progress and that of other levels in implementing the budget; and as a means of exerting control and transparency.</p> <p>Weak performance here implies vulnerability to sub-optimal usage of resources, slippage in performance and weak accountability. It would also have implications for the effectiveness of controls dealt with by the previous group of indicators since many of those controls are dependent on the flow of appropriate data.</p>
<p>Indicator Group 6: External Scrutiny and Audit (PIs 26-28)</p>	<p>These indicators seek to show the extent and effectiveness of independent scrutiny of what the administration does.</p> <p>Low scores would tend to indicate the lack of an independent view and of a back stop deterrent to wrong doing or inefficiency.</p>

Assessing the financial impact of risk in the use of country PFM systems

51. Country offices should carefully consider **the possible financial impact of weaknesses** in PFMA 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 PFMA systems could translate into leakage or inefficiency in the use of funds. While it will not always be possible to predict actual waste or losses reliably, a first important step in managing fiduciary risk is to outline the value of funds exposed to significant levels of risk. Matching the results of PFMA diagnostics to an understanding of the flow of funds through partner country financial systems provides a starting point to assess the risk of leakage or inefficiency.
52. DFID does not recommend attempts to predict losses or inefficiencies from PFMA systems based on subjective risk assessments. Instead, the results of any 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 PFMA 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.
53. The findings of such studies should be used to 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 also be considered in light of the expected benefits of using country systems.
54. The central review and scrutiny process will consider the extent to which FRAs assess the possible financial impact of weaknesses in PFMA systems. Annex 17 provides further guidance on assessing the financial impact of risk in the use of country PFMA systems. An illustrative table to record the different assessments relating to the risk of leakage and inefficiency from country PFMA systems described in Annex 17 is provided at Table 7.

What is the overall level of fiduciary risk?

55. The FRA must set out the country office's assessment of the overall level of fiduciary risk, including the risk of corruption. This assessment should be made on an absolute rather than a relative basis, that is, focusing on the level of risk within the PFMA system of the country involved, not how well or poorly its system compares with those in other countries.
56. The FRA should explicitly include the country office's opinion as to whether fiduciary risk is low, moderate, substantial or high, and a similar specific assessment of the risk of corruption. **These ratings reflect a change in DFID's previous practice** of assessing risk as low, medium or high. They provide a more finely nuanced assessment of the situation and bring our approach into line with

that used by other donors including the World Bank. For DFID FRA purposes, the rating levels mean:

Box 2: Explanation of risk ratings

Risk level	Detail
Low	Represents a situation where the structure of the PFMA system broadly reflects good international practice and there is routine compliance with the majority of controls within the system. Any remaining weaknesses are being addressed.
Moderate	Represents a situation where the structure of the PFMA system broadly reflects good international practice, although there may be some gaps or inefficiencies. There is basic compliance with controls within the system but regular exceptions occur. There is a credible commitment to addressing key weaknesses.
Substantial	Represents a situation where the structure of the PFMA 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. Reform plans may need to be strengthened and prioritised.
High	Represents a situation where the structure of the PFMA 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. Commitment to a credible reform programme may be weak.

57. The judgement on the overall level of fiduciary risk is closely linked to the assessment of how the PFMA system is performing and the identification of key risks. However, there is no mechanistic formula for the number of PEFA scores in a particular grade which equates to a particular level of risk. Neither is there a key subset of indicators where poor ratings would automatically lead to a specific risk assessment. Clearly, the more indicators which score poorly, or where insufficient information is available to derive a score, the higher the fiduciary risk is likely to be.

What is the risk of corruption?

58. An assessment of the strength of PFM systems should be situated within 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 PFMA systems, but also the wider political economy of the country and how this affects levels of corruption. Moreover global trends (such as the spread of organised crime, religious extremism, the race for natural resources, etc) are increasingly driving and facilitating corruption and need to be assessed.

59. 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 corruption risk and also of the credibility of anti-corruption reform processes (see Paras. 60-62). The principal elements of this framework are set out in Table 3.

Table 3: Framework for assessing corruption risks

<p>Country Governance Context</p>	<p>What is the level of state capability, accountability and responsiveness?</p> <p>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)?</p>
<p>Preventive measures</p>	<p>What is the strength of the package of preventive measures currently in place?</p> <p>This will include: public sector ethics and procedures; public procurement; public sector finance; 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?).</p>
<p>Criminalisation and enforcement</p>	<p>Are provisions in place to criminalise the key corruption offences and take enforcement action?</p> <p>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?</p>
<p>International Drivers and International Co-operation</p>	<p>How significant are international factors in driving in country corruption?</p> <p>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?</p>
<p>Technical Assistance and Information Exchange</p>	<p>What is the extent and nature of external support on anti-corruption?</p> <p>Who provides it (does it come through UNCAC, IFIs, regional bodies or bilateral donors)??</p> <p>Does it match key areas of need?</p>

60. 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 academic or 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 Anti-Corruption team in AEAD can also provide guidance on where to source specialist advice on international corruption issues.

61. Where hard evidence is limited and the assessment of corruption risk relies on anecdotal evidence, this should be **explicitly stated**. Similarly, where weaknesses in PFMA systems indicate that a risk of corruption would be expected in many circumstances, but evidence exists to contradict this

assumption or evidence in this area is limited, this should be made clear in the risk assessment. This helps to ensure consistency in treatment of corruption risk across DFID. In these circumstances, it is important to monitor the emergence of new corruption diagnostic material which may provide an improved evidence base.

Are existing reform programmes credible?

62. PFM and anti-corruption reform activities are likely to be under way in every country where DFID works. It is important to know how credible they are in order to:

- Assess the extent to which they are likely to mitigate key fiduciary and corruption risks and over what timescale; and
- Identify risks that are not adequately mitigated by existing programmes where other safeguards need to be considered.

The FRA should provide an explicit judgement as to whether the government has a credible programme to improve.

63. Box 3 highlights seven general features of a credible programme of improvement. 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 approach across country offices. It is unlikely that partner country reform programmes will fully 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.

Box 3: General features of a credible programme to improve

The programme to improve should:

- | | |
|----|---|
| 1. | Be government led: enabling full political ownership and leading to effective harmonisation of donor intervention. |
| 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. |

64. The FRA should provide an overall summary (or a ‘map’) of PFMA and anti-corruption reform initiatives including, where relevant, connections to programmes such as Public Sector Reform and Local Government reform.

Trajectory of change

65. In considering the credibility of a reform programme, it is helpful to look at the direction of travel achieved to date. The FRA should record progress made to date using an arrow system.

Positive progress	↑
No change	↔
Negative progress	↓

66. This can be done at either the level of each PEFA indicator of DFID benchmark, or for each of the six groups of indicators, or both. **The arrows should not anticipate future patterns** of progress, which may or may not emerge in reality. The assessment of what past performance means for the future, should be made in the narrative of the FRA as part of the wider assessment of credibility of the reform programme and understanding of the political and institutional context.

67. While what has been achieved to date can be a useful indication of what may happen in the future, a positive past trajectory does not automatically guarantee future progress. Conversely, the lack of previous progress does not mean that future reforms cannot be credible.

68. Country offices should also be alert to the issue of **‘reform stagnation’**, that is, constant promises of improvement being just around the corner, which never actually produce tangible results. Where such a situation continues for a long period, for example, over five years, it should raise questions about the credibility of partner government’s commitment to reform and/or the design of reform programmes, and therefore how DFID works in country.

Are there key risks which are not adequately mitigated by existing measures?

69. The FRA should identify residual fiduciary and corruption risks to inform decisions on how DFID support is delivered. These are significant risks which are either not covered by existing reform programmes, or will only be addressed in the long term (that is, beyond the Country Planning timeframe). This information should feed into broad decisions on the types of aid instrument to use and the design of short term safeguards. For example, while we do not require governments to reach a minimum standard of PFM performance before we can provide PRBS, our policy is only to use this aid instrument (or provide financial aid) where the partner government is actively committed to strengthening PFM systems. A good understanding of the credibility of reform programmes and any gaps in them also enables additional support for PFMA systems to be designed into country programmes where necessary.

70. Where residual risks are identified, additional safeguards may need to be implemented at the national and / or the individual aid instrument level (see Para. 93).

Procurement

71. 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 corruption 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 not be familiar with the subject. Application of best practice procurement principles can help reduce corruption by increasing transparency and accountability but provide no guarantee.

72. Evidence shows that country procurement systems are often fundamentally sound in terms of their basic systems and procedures. However weaknesses in execution, compliance, monitoring/oversight and enforcement are commonplace. This and the traditionally high levels of corruption associated with the procurement function contribute to a lack of donor confidence.
73. The renewed commitments made at the 3rd HLF forum in Accra to accelerate and deepen implementation of the Paris Declaration (PD) on Aid Effectiveness will require increased donor collaboration behind country lead reform programmes. Joint donor groups which focus on Procurement may already exist in some countries. Whether DFID have previously engaged or not, commitments to scale up our use of country systems mean that DFID will need to take a more active interest in all our PSA countries. 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 short term risk mitigation measures which may be necessary.
74. Many developing countries now undertake a self assessment of their procurement systems using the recently developed **OECD/DAC assessment tool**. The assessment tool incorporates two types of indicators which look at key aspects of public procurement systems. Baseline Indicators deal with the formal and functional features of the existing system; Compliance/Performance Indicators monitor performance data to determine the level of compliance with the formal system. Use of this assessment tool and implementation of a capacity development programme based on the findings, will provide a useful indication of how committed the government is to reform in this area. The methodology is designed for self or joint assessment. The baseline and compliance indicators are based around four pillars of:
 - Legislative Framework
 - Integrity & transparency
 - Institutional capacity
 - Operations and Markets
75. The outcome of the review should be used to produce an agreed joint procurement strategy aimed at increasing partner government capacity and controlling the fiduciary risk of procurement within the country. The credibility of the assessment and subsequent reform process will be further enhanced if conducted in partnership with members of the donor community and some form of independent verification of assessment results is undertaken. Ongoing monitoring at operational level will also be essential to ensure systems adherence and maintain desired levels of integrity and propriety.
76. Assessments have already been conducted or are planned in most of the PSA countries. The report should be freely available from the partner government or

can be found on Procurement Department page of the OECD website (www.oecd.org).

77. Assessment results will reveal where risks are more likely to occur in the systems. If these are being addressed then the level of overall risk should decrease. Ongoing monitoring will however be essential. Where some form of mutual accountability agreement has been signed by the donors and the Partner Government the reform programme is also more likely to stay on track. Where none exists DFID should encourage one to be put in place as a pre-requisite to donor engagement in the reform /capacity development process as this will significantly enhance the donor groups ability to deal with risks in the system.
78. Annex 8 presents the main sources of additional guidance on assessment, including: a DFID Guidance note, and an OECD 'Checklist for enhancing Integrity in Public Procurement' (a recently developed OECD/DAC assessment tool) and the Nordic + Joint Procurement Policy document.

Assessment of fiduciary risk at the aid instrument level

79. Risk assessment requirements are set out in Section B5 of the Blue Book. The level of analysis required 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.
80. The most significant additional analysis – in addition to the Country Planning level FRA – is likely to be needed for Financial Aid projects directed towards either sub-national government or a specific sector or sectors. Such aid may be in the form of Sector Budget Support or Non-PRBS Financial Aid¹⁰. As explained in Para. 17, country offices may exceptionally undertake a FRA in particular sectors or levels of sub-national government.

Risk assessment at the Sub-National level

81. Sub-national government can take many forms, from large regional administrations to tiny village level entities, and funds often flow down an administrative hierarchy. In terms of assessing risk, the main focus should be on the top level of government DFID is dealing with.
82. 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 sub-national government in terms of how it implements its own PFMA systems

¹⁰ See Section B10 of the Blue Book for basic definitions; and Aid Instruments paper for more detailed information.

and interacts with the entities below it. In addition, it includes an additional indicator and narrative assessment covering the relationship with central government.

83. 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 PFMA at a sample of lower tier bodies.
84. 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.
85. Any assessment of a lower tier sub-national government should be proportionate to its PFMA 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 these obligations. In addition, local political and institutional factors, which may support or limit the scope for PFMA strengthening, should be assessed.

Risk assessment at the sectoral level

86. The fiduciary risks at a sectoral level may differ from those relating to general central government PFMA systems. Every sectoral aid instrument needs to provide an adequate assessment of fiduciary risk and, if necessary, a risk mitigation plan. The detailed approach used to assess performance and risk should be tailored to the specific sector in the particular country concerned, and may vary from sector to sector, and country to country. This section sets out a recommended approach rather than a definite list of sectoral PFMA indicators.

Table 4: approach to assessing fiduciary risk at the sectoral level

1.	Assemble a team	This will normally involve a range of partners in country, including government officials. The team should have enough PFMA and sectoral expertise to identify and assess relevant fiduciary risks.
2.	Review available documentary information	The Country Planning level FRA and related PEFA Framework evaluation should be key sources of information, plus available diagnostic and programmatic documentation about the sector.
3.	Identify relevant sectoral PFMA performance indicators and risk areas*	These can be derived in a range of ways: <ul style="list-style-type: none"> • Some can be drawn directly from the PEFA Framework, in areas where sector entities have a substantial role and responsibility. For example, many of the indicators on control in budget execution and accounting and reporting deal with tasks which are normally carried out by sector level entities. • PEFA indicators can be adapted to the sectoral context, for example

		<p>comparisons of budget and actual income and expenditure at the sectoral level.</p> <ul style="list-style-type: none"> • Add sector specific analysis if necessary. The nature of operations in particular sectors may carry inherent fiduciary risks not addressed in detail in the PEFA Framework, for example, drug procurement in the health sector. These may need to be assessed in more depth.
4.	Assess performance against the identified indicators and risk areas.	<p>The PEFA Framework and the Country Planning level FRA will provide generic information and highlight areas of potential weakness.</p> <p>Assess actual performance in the sector against the basket of indicators and risk areas identified in Step 3.</p> <p>Ensure institutional and governance factors in the sector are taken into account.</p>
5.	Record findings	Use a suitable format as set out in Section B5 of the Blue Book.

87. Note that 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 PFMA 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 spontaneously from a central government PEFA Framework evaluation. Where this is done, the sectoral basis used for the PEFA assessment should be stated in the PEFA performance report.

88. Annex 11 highlights issues it may be relevant to consider when carrying out a sectoral risk assessment. This is not intended to be a comprehensive checklist to be followed automatically for every sectoral assessment. Rather it is a resource intended to stimulate thinking about what are the relevant indicators and risk areas.

Section 3: Mitigating risks

89. The three main ways to mitigate fiduciary risk are through:

- The selection and design of aid instruments and use of a mixed aid programme to spread risk;
- Ongoing support to partner government reform programmes to strengthen national PFMA systems, and to related institutional reforms (e.g., Public Sector Reform); and
- The use of short term safeguards at the national level and / or around specific aid instruments, if necessary.

90. This section deals only with the second and third aspects. The selection and design of aid instruments is influenced by many factors in addition to fiduciary risk which are beyond the scope of this Note. Separate guidance on aid instruments is available in the Aid Instruments paper, July 2006.

Support to partner government PFM reform programmes

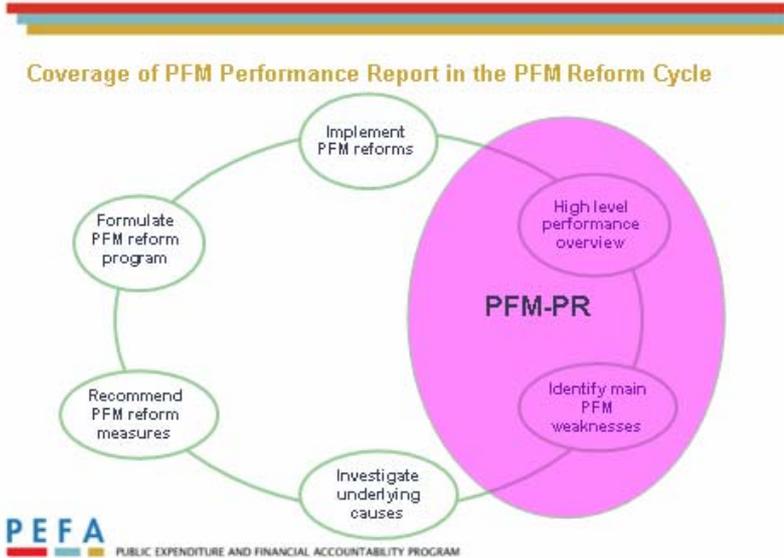
91. In the medium to long term, the most sustainable way to manage fiduciary and corruption risk is to work with partner countries to improve their overall control environment. The PEFA Strengthened Approach is DFID's preferred way of supporting PFMA reform. The PEFA Strengthened Approach has three elements:

- 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 Report).

92. PEFA assessments (the third element of the strengthened approach) 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, supported by the use of specific drill-down tools (e.g. for procurement systems), will be required to diagnose the underlying causes of strong or weak performance. Technical linkages also 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. PFM assessments are only a part of the PFM reform cycle, as illustrated below¹¹.

¹¹ Diagram from www.pefa.org

Figure 1: The Role of PEFA Performance Reports in PFM Reform



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

94. It is critical to ensure the reform programmes we support are designed on a credible basis and are realistically achievable. Programme design should take into account the factors in Box 3 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 within the system.
Capacity development	To build up the knowledge, competency and skills of people within the system.
Motivational issues	To encourage real implementation of reforms.

95. The number and experience of staff within the existing PFMA system, and the leadership the partner government is able to exert, will greatly affect the complexity and number of reforms and the speed at which they can be delivered. Countries with more and better qualified staff, and capable leaders, are more able to deliver complex reform programmes across a number of budget sub-systems or institutions. Integrated SWAp-style programmes for PFM reform can be useful in these cases, for example, Ghana and Tanzania. An alternative which offers good potential for successful PFMA reform, particularly in partner countries with very limited capacity or starting from a very low level of PFMA performance, is the Platform Approach.

The Platform Approach to PFMA reform

96. A Platform Approach is a sustainable package of measures, tailored to the country situation which is designed to achieve increasing levels (platforms) of PFM competence over the long term. It places a strong emphasis on the importance of sequencing and 'getting the basics right'. An initial platform may focus on building effective **dialogue, trust and integrity of basic data** and should be defined in terms of improved outcomes, rather than individual short-term measures. The measures selected to achieve the defined outcomes will be dependent on specific country context. For example, to reduce the scope for leakage, it may be more appropriate to improve basic internal controls for systems that already exist (e.g. improve existing payroll system) rather than implementing a new technical solution. Where possible, the three elements of the PEFA Strengthened Approach should be followed 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.

Use of short-term safeguards

97. Supporting partner government PFM reform programmes is the most effective way of managing fiduciary risk in the medium to long term. However, PFM reform measures may provide little protection to government and donor funds until they are implemented effectively. In the short term, where there is high fiduciary risk, safeguards may be necessary at either the national level or around individual aid instruments.

98. **Short-term safeguards need to be used intelligently**, not in a simplistic 'problem-solution' way. Research indicates that individual short-term safeguards can be fragmented and ineffective in providing protection¹², particularly where numerous donors each impose their own requirements. In considering the appropriateness of short-term safeguards, care should be taken to avoid potential negative impacts on the PFMA system as a whole. The promotion of parallel systems should only be used where state accountability and responsiveness to citizens needs is weak. Parallel systems can undermine long term systemic improvement, attract skilled staff away from essential government posts or create over-reliance on short-term external technical assistance. Instead, safeguards should focus on strengthening and enforcing the checks and balances within and outside partner government PFMA systems which provide assurance that resources are used effectively and for the intended purposes.

99. **Short-term safeguards should mitigate fiduciary risk and strengthen PFMA 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 PFMA systems.

¹² 'Study of measures used to address weaknesses in PFM systems in the context of policy based support', PEFA website <http://www.pefa.org>

Types of safeguard

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

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

Table 5: 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.

101. Short term 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

102. To be effective safeguards need to be designed in a balanced and proportionate way, not only in themselves, 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.

103. 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



104. 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.

105. **Short-term safeguards should take into account the need to strengthen weak links in the PFM cycle.** Safeguards which promote the 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.

106. How short term safeguards are designed and implemented, as well as the selection of safeguards, is important in contributing to strengthening PFMA

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 PFMA 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. 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 short-term safeguards

107. 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.

108. 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 safeguard** agreed with the partner government and the donor group, either at the national level or as part of individual aid instruments.

109. In some environments, short-term 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 short term safeguards, or the risk that safeguards pose to government led PFM reforms may be deemed too great.

110. In these cases, country offices should consider the residual risks against the long-term benefits of providing financial aid with no short term safeguards. Where country offices decide to accept the residual risk, programme documentation should provide **a reasoned narrative of why additional short-term safeguards are not deemed appropriate**. In these cases, the FRA process should focus

even more attention on monitoring long term PFM reform as a means of managing fiduciary risk.

111. 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.

Section 4: Monitoring performance on an ongoing basis

112. A Fiduciary Risk Assessment is **not a one-off static exercise**: maintaining a good understanding of fiduciary risk is a continual and continuous process. It is essential to monitor performance on an ongoing basis to:
- Check that identified fiduciary risks are being adequately managed and planned reforms or safeguards are being implemented; and
 - Identify any new fiduciary or corruption risks or changes in circumstance.
113. Most monitoring of fiduciary risk can be done as an inherent part of good project management. Other information should flow naturally from developing close relationships with partner governments, civil society organisations and other donors in country.
114. Monitoring risk at the individual aid instrument level is **mandatory** under the arrangements described in Blue Book Section B11. It is also important to keep the wider, country perspective of fiduciary risk up to date and to systematically monitor progress against all the key 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-ASP Central Scrutiny email address. The ASP will be the primary way in which we track a partner country's continuing commitment to strengthening financial management and accountability and reducing the risk of funds being misused through weak administration or 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.
115. The ASP should also highlight positive examples of PFMA 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.

Performance monitoring indicators

116. The indicators chosen to monitor PFMA performance and fiduciary risk are important, although they do not need to be reported on in detail in the ASP. Across a country programme, PFMA indicators will be built into individual aid instruments, and aspects of PFMA may also be monitored through indicators connected to broader mechanisms such as the Poverty Reduction Strategy.
117. Where possible, targets and milestones should be defined and agreed with reference to the key aspects of the partner government's own PFM reform programme, ideally drawing on indicators established as part of that programme. Where the partner government has no PFM reform programme, or reviews have identified weaknesses in the programme, indicators should focus on establishing

or strengthening the reform programme. Guidance for assessing the credibility of PFM reform programmes is provided at Annex 10. Monitoring of fiduciary risk should complement wider monitoring of progress against agreed poverty reduction targets. Where there are existing mechanisms for monitoring progress in PFMA reform (such as through a PRSP review process), these can be utilised for the monitoring of fiduciary risk. Wherever possible, the main monitoring tools should be the partner country's own reports, especially those of the Supreme Audit Institution. Our approach should help to strengthen national systems for collection, analysis and use of data. The overall aim should be for the partner government to be able to demonstrate a clear track record of improvement over an agreed timeframe.

118. At the country level, teams should seek to influence PFM reform programmes to ensure that they have a spread of indicators to monitor PFMA and fiduciary risk, and draw on these for their monitoring. This should include indicators which address:

Process issues, that is, how well the PFMA system is functioning	The PEFA Framework is valuable in this respect. Over time, PEFA Framework reiterations will provide important information on trends in a particular country. However, most PEFA indicator can not easily be updated on an annual basis. COs may want to identify shorter term actions to monitor as well (e.g., are planned reform activities being implemented on time?)
Output issues, that is, what is being delivered through the PFMA system	Reviews of partner country financial information such as Quarterly Budget Reports and Annual Financial Statements are important to verify how funds are actually being used. PEFA provides some relevant information (Indicators 1 to 4, which are relatively easy to assess on an annual basis), but particularly at the sector level, a more detailed analysis is useful.
Outcome issues, that is, what results are being achieved	Strengthened PFMA systems are more a means to an end than an end in themselves; that is, an improved system should enable more resources to flow more quickly and efficiently to policy priorities. These effects will largely be measured by other indicators (such as those relating to the MDGs). However, indicators which measure PFMA efficiency changes can be useful, for example, the number of audit recommendations being acted on or savings achieved by anti-corruption initiatives.

Audit by the NAO

119. DFID is accountable to the UK Parliament for how it uses public funds and active management of fiduciary risk is critical to underpin this accountability. 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.

120. 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.

121. DFID systems need to provide evidence that funds have been properly accounted for, used for the purposes intended by Parliament and provide value for money. The overall approach to managing fiduciary risk set out in this note

supports these objectives. Detailed evidence about how funds have been used is recorded at the individual aid instrument level and is governed by the various rules and regulations set out in the Blue Book (notably Sections B10 and C4). The Best Practice Guide also provides guidance (under Programme management cycle > Audit Arrangements) on the type of information the NAO will be looking in its audit work.

Annex 1: Key points to note in relation to PRBS

On PRBS policy

1. As before, **DFID does not require partner countries to meet a minimum standard of public financial management performance** for the provision of PRBS. However, there must be evidence of a credible programme to improve PFMA performance.

On understanding the risk environment

2. Where Financial Aid is being provided or considered during the life of a Country Plan, a standardised Fiduciary Risk Assessment exercise must be carried out as part of the Country Planning process to inform the design of the entire country programme. The Country Planning FRA will always cover central government PFMA systems and provides an adequate risk assessment for General PRBS. Where Sector PRBS is to be provided, Country offices must ensure they have an adequate understanding of any additional, different or specific risks related to the sector or sub-national PFMA system. 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 Planning level FRA or as a separate exercise.

On mitigating risks

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

On monitoring performance

4. Once funds are granted to a partner government as PRBS, DFID is not directly responsible for the use of those funds: 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) PRBS, will be its own annual financial statements and related Supreme Audit Institution (SAI) reports. DFID's standard Memorandum of Understanding for PRBS requires partner governments to provide us with copies of these documents
6. Country offices should review partner government documents and consider the information they provide about:
 - The **ongoing performance of national PFM systems**, for example, the timeliness and completeness of financial statements and audit reports and the extent to which they comply with relevant accounting and audit standards, can provide assurance about the continuing validity of judgments in the original FRA;

- **How budget resources have actually been spent:** a comparison of actual expenditure to that budgeted can provide useful information, on PFM capacity, and whether the government is resourcing its poverty reduction priorities as intended.
 - **Whether DFID's PRBS contributions are correctly recorded** in the national accounts.
7. This type of monitoring should normally be carried out through established PRBS performance monitoring mechanisms, with DFID acting as part of a wider donor group. Additional DFID requirements on partner governments should be avoided.
 8. Country offices should draw on the PRBS Health Check List available on the FCPD Insight pages to help ensure that the budget support programme is being managed in accordance with good practice.

Annex 2: DFID work processes related to fiduciary risk

Understanding the fiduciary risk environment				
Process/Document	When needed?	Mandatory?	Responsibilities	Further guidance
Fiduciary Risk Assessment (FRA)	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 prior to the Country Planning Review Committee meeting	Section 2 of this HTN Country Planning guidance 2008
Risk assessments for individual aid instruments	All projects over £1 million	Yes	Country office responsible for preparation If the country office opts for a full FRA, this must be sent to FCPD for central scrutiny	Section 2 of this HTN Blue Book B4
Mitigating risks to DFID funds				
Selection of aid instruments	In design of country programme	Yes	Country office sets out strategy in the Country Planning Issues & Choices Submission	Country Planning guidance 2008 Guidance on Aid Instruments 2006
	In response to breach of conditionality policy	Depends on circumstances	Country office responsible for preparation	Conditionality policy 2007
Long-term support to PFMA and anti-corruption reform programmes	Dependent on country circumstances	No	Country office / line management	Section 3 of this HTN Understanding and reforming public expenditure management (2001) Platform Approach to Improving PFM (July 2005)
Risk mitigation measures for individual aid instruments	Dependent on country circumstances	Yes	Country office / line management	Section 4 of this HTN

Process/Document	When needed?	Mandatory?	Responsibilities	Further guidance
Monitoring progress				
Annual Statement of Progress (ASP)	Annually for each FRA (both country level and any sector or sub-national level FRAs)	Yes	Country office responsible for preparation FCPD responsible for collating results	Section 4 of this HTN
Annual monitoring at project (aid instrument) level	Annually, via PRISM/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 fiduciary risk?
 - Is there an explicit judgement on the **risk of corruption**?
 - Are weaknesses in PFM systems and **key fiduciary risks** identified?
 - Has the **possible financial impact** of weaknesses in PFMA systems been considered?
 - Is there an explicit statement on whether there is a **credible programme to improve** PFMA (is there a positive trajectory of change)?
 - Do the detailed narrative and related risk ratings provide reasonable and consistent **evidence** for judgements made?
 - Does the FRA consider how **safeguards** are responding to short-term risks; how they contribute to PFM capacity and ensure that safeguards are designed with an exit strategy in mind
 - Does the assessment of the **risk of corruption** consider overall trends of corruption in 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?
 - Does the FRA set out how risks will be **monitored**?
 - 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 minor 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 / xx sector programme]. The primary objective of the FRA is to understand the fiduciary risk environment in [relevant country or sector]. 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 sectoral FRAs, background information about the sector and on-going programmes and reform efforts;
- Description of the Government's PFMA 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

Guidance

The consultants will follow the guidance set out in DFID's How to Note on Managing Fiduciary Risk of March 2009. (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 / sub-national assessments of fiduciary risk only

As the first stage of the assessment, the consultants will identify relevant sectoral PFMA 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 SWAp programmes. (Guidance on sectoral issues is available in Annex 10 of this HTN)

Sources of information

The consultants should draw on existing sources of information as far as possible, particularly the PEFA Framework evaluation. Other key sources of information

include **[add list of material available at country level]** (See Annex 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 sectoral 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 January 2009 and be approximately 30 to 40 pages long, 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).

Consultants

Skills and expertise required

The consultant team should have the following competencies:

- Significant expertise and experience of Public Financial Management and Accountability issues;
- A good working knowledge of DFID's policy on Fiduciary Risk and its methodology for carrying out Fiduciary Risk Assessments and of the PEFA Framework approach;
- A sound understanding of the technical and institutional aspects of PFMA in **[insert country]**; and
- A sound understanding of the **[XX sector]** 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 Planning level /xx sector 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 PFMA system in **[insert country or sector]** 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 reform programmes and set out pros and cons of using them.
- Outline the options for monitoring future performance.

Note: This is not intended to be a comprehensive list, and you should add any other relevant tasks.

Annex 5: The 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 institutional context	The PEFA Framework should provide some background information on PFMA reform but may not be very detailed. DFID assessment likely to be needed (Para. 42).
How well is the PFM system currently performing?	This information should be taken directly from the PEFA Framework, and include a summary of the 28+3 PEFA indicator scores and relevant narrative detail in the FRA. Where available, the 28+3 PEFA indicators should replace DFID's old 15 FRA benchmarks, there is no need for both (Para. 43).
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. 44-52).
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. 53-55).
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. 56-58).
Is there a credible programme to reform?	The PEFA Performance Report should describe the reforms and 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. 59-64). Additional relevant information may be available from work related to the other 2 parts of the strengthened approach: the country-led strategy and donor programme of support.
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. 65-66).

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’¹³ 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

Parties involved typically 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 strongly 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

Typical costs of a PEFA Framework evaluation for a medium-sized country, covering only central government systems, range from £50,000 to £75,000. Between 2 and 4 person-months are typically required for a full assessment of central government.

¹³ www.pefa.org

This does not include donor and government staff time for planning and administration, head office management and report reviews.

Personnel

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 diverse¹⁴ 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;

¹⁴ 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.

- 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.

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 (e.g., the PFM work stream in AEAD); and
- 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 draft reports are shared with the PEFA Secretariat who have the best understanding of how the indicators should be applied and the evidence needed to support ratings.

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 the website of the partner country 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, consistent with the spirit of the strengthened approach.

DFID supports full disclosure as a means of promoting transparency and accountability about how public finances are used. As a minimum, PEFA Framework reports should be available to all donors in a 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 other two elements of the Strengthened Approach. 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

The following anti-corruption measures are expected under UNCAC¹⁵

Prevention

Public sector ethics and procedures

- Recruitment and promotion based on efficiency, transparency and objective criteria such as merit, equity and aptitude (Art. 7)
- Codes or standards of conduct for the correct, honourable and proper performance of public functions (Art. 8)

Public procurement

- Systems based on transparency, competition and objective criteria

Public sector finance

- Appropriate measures to promote transparency and accountability with respect to, *inter alia*, procedures for the adoption of the national budget,
- Timely reporting on revenue and expenditure, accounting and auditing standards and related oversight, effective and efficient systems of risk management and internal control (Art. 9)

Public reporting, access to information, whistleblower protection

- Members of the public be allowed to obtain information on the organisation,
- Functioning and decision-making processes of its public administration (Art. 10)
- The public has effective access to information (Art. 13)
- Protection of witnesses, reporting persons and victims of corruption (Arts. 32 and 33)

Public education

- Public information activities and public education programmes, including school and university curricula (Art. 13)
- Private sector standards, including accounting and auditing standards
- Prohibition of off-the books accounts and transactions, of recording non-existent expenditure, of incorrect identification of liabilities, of use of false documents and intentional destruction of bookkeeping documents earlier than foreseen by law (Art. 12)

¹⁵ Source: Transparency International (2006) Anti-corruption Conventions in Africa.

Money laundering

- A comprehensive domestic regulatory and supervisory regime for banks and non-bank financial institutions (Art. 14)
- Authorities dedicated to combating money laundering have the ability to cooperate and exchange information at the national and international levels (Art. 14)
- Governments consider establishing a financial intelligence unit

Criminalisation

- Bribery (domestic or foreign), embezzlement, trading in influence, abuse of functions, illicit enrichment, laundering of proceeds, and obstruction of justice.
- Optional provisions relating to bribery and embezzlement in the private sector i.e. private to private corruption.

International co-operation

- The existence and use of mechanisms for extradition, gathering and transferring evidence, assisting investigations and prosecutions.
- States Parties are committed by UNCAC to consider joint investigation, the transfer of criminal proceedings and special investigative techniques.
- States may also not refuse assistance on the basis of bank secrecy and can involve dual criminality requirements only in limited cases.

Technical Assistance and Information Exchange

- “Enhance financial and material assistance” are seen as key to the successful implementation of UNCAC, but there are not explicit provisions in this regard.

Procurement

See Procurement Guidance Notes > PGN 17: ‘Checklist for reviewing procurement procedures and processes’ from the Procurement Group homepage.

See paragraph 72 on the OECD/DAC assessment methodology and tool. More information on the assessment 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, a group of like-minded donors pursuing a harmonized work plan on aid effectiveness in the area of procurement. The JPP builds on work done by the Joint OECD/DAC-World Bank Procurement Round Table Initiative, outlines the commitments made by members of this 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 program managers and field staff for managing risk associated with transferring the responsibility for procurement to recipient governments. The intention behind developing the guide was to support donor alignment with recipient country systems in the context of implementing the Paris Declaration.

The JPP Policy document and Guide can be 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.

Previous FRAs have relied too heavily on the information in the World Bank CPAR reports, which are often dated. The World Bank are increasingly incorporating the OECD methodology into their own assessment exercises and this is becoming the methodology of first choice. Where they exist they are likely to be more up to date than the WB CPAR findings. PEFA are also looking into developing closer links with the OECD assessment methodology as it provides more detailed information on system performance.

It is anticipated that validation of the OECD assessment exercises and subsequent implementation of reform measures will be conducted by donors and civil society organisation. Ongoing discussions with these groups will be essential to keep informed of any risks associated with the procurement process.

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 your 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 PFM workstream within AEAD or Procurement Group.

Annex 9: Other sources of information

Partner country analysis

Information generated by PFMA 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 PFMA 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 and Institutional Reviews or Public Expenditure Tracking Surveys.

A useful resource for further information is the International Budget Project of the Center on Budget and Policy Priorities at www.internationalbudget.org.

International diagnostic tools on PFMA

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 CFAAs, 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 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 28 PEFA Framework indicators, 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 latest survey, 2008, covers 85 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)

More than 140 countries have signed up to UNCAC, (including virtually all DFID PSA countries). 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 with provisions in UNCAC. 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 the individual citizens and the 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.

This 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, taking the form of a survey of surveys reflecting the perceptions of a range of international organisations. It is not useful for providing 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 new Transparency International survey that assesses general public attitudes towards and experience of corruption in dozens of countries

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. This will act as a deterrent to corruption and facilitate detection but will not necessarily indicate the prevalent levels of corruption. Available at: www.fatf-gafi.org

FATF-Style Regional Bodies (FSRBs)

Virtually all DFID PSA countries are members of FATF style regional bodies (FSRBs). FRSBs support many country jurisdictions to put national AML strategies in place and to conduct technical assistance needs assessments. The FATF is also developing guidance to assist Low Capacity Countries (LCCs) 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 (CFT). The findings of both can help indicate the overall risk of corruption: the development of an AML regime rarely happens in the absence or in advance of other anti-corruption reforms.

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, household and bribery surveys.

The **U4 anti-corruption resource centre helpdesk** (<http://partner.u4.no>) can assist in sourcing material. The Anti-Corruption work stream in AEAD can also 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: Questions to assess reform credibility

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 PFMA?
- Is there demonstrable political commitment to PFMA improvement? Is there engagement of parliament / cabinet in PFMA reform and related monitoring of progress?
- Is PFMA reform a priority in the Poverty Reduction Strategy and any related Performance Assessment Framework?
- Does government take the lead in developing and monitoring the PFMA reform programme? Is there an active steering group?
- Is there ownership of PFMA 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 PFMA improvement with effective incentives to push change through?
- Is the government investing its own funds to support PFMA 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 PFMA 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 PFMA 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 PFMA 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?
- 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 PFMA 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 PFMA reform design process (such as historical, governance and institutional factors)?
- Does the PFMA reform programme address the key risks identified in the fiduciary risk evaluation (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 PFMA work?

5. Includes capacity development strategies

- Does the reform programme enable 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 PFMA 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: Issues to consider in assessing sector performance

This is not intended as a checklist. Its relevance is dependent on the country context.

Sector context

- Are there any issues raised in the PEFA / Country Planning level FRA which are likely to affect PFMA performance in the sector?
- 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?¹⁶
- Is the sector financial management capacity adequate (at national and sub national levels) in terms of staffing, skills, infrastructure and overall institutional arrangements?
- What PFMA reforms are under way in the sector and how credible are they?
- What are the main corruption risks at sector level in this country

1. Credibility of the sector budget

- 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? (This requires funds to be made available by the Ministry of Finance in a predictable and transparent manner).

2. 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?

¹⁶ 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 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?

3. 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?

4. Predictability and control in budget execution

- Is there an **internal control** system at the sector level, 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?
- Does 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** at the sector level? 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 **procurement** system is in place? Does the sector comply with the national procurement system or follow separate procedures? What is the estimated percentage of sector expenditure spent on procurement? Do regulatory institutions (e.g., tender board) provide effective oversight at the sector level?
- Where sector specific / additional **SWAp procurement arrangements** are in place, 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 in place?
- 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)?

5. Accounting, recording and reporting

- Are **accounting policies** at the sector level consistent with 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 additional administrative burden? Are plans in place 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 leakage and hence corruption risk)
- 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?

6. 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** / audit reports? If so, what were the key findings and how will these points 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 (e.g. autonomy of budget resources / recruitment / performance management)?
- Has the legislative committee (e.g. **Public Accounts Committee**) followed up on sector specific issues?

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) pre-audit 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 Institute;
 - improving the relationship between the Supreme Audit Institute 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 Institute 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 Institute and other independent external auditors, e.g. from other SAIs, 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 that 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 or project 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? (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)
Specific assessment of corruption risk (L, M, S, H)	Comparison to previous FRA/ASP (Improving, Stable or Worsening)
Is a full FRA update required? [Yes: likely to be needed where risk levels have worsened / No: where the situation is stable or improving]	

Progress against key fiduciary risks identified previously

List all key fiduciary risks identified previously in the FRA or in the previous ASP 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.

Risk 1	
Risk 2	
Risk 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.	
Is the PFMA reform programme still credible? [Yes/No].	
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			
PFMA 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

This guidance draws on the set of 28 PFM Performance Indicators within the PEFA Framework. This is **not necessarily exhaustive**, nor intended as a checklist. Where the DFID template is used as an alternative to a PEFA Framework the 4 point rating scale set out in Box 2 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	
<p>1. A budget law specifying fiscal management responsibilities is in operation.</p>	<p>Is the budget law of adequate quality to satisfy requirements on government to be fully accountable for the use of public funds? (This should <i>inter alia</i> provide for an effective macroeconomic framework, budget process and independent scrutiny process, with clearly defined roles and responsibilities.)</p> <p>Is there an effective budget circular with related budget guidelines and procedures on budget preparation and execution?</p> <p>Are the budget law, guidelines and procedures actually understood and implemented?</p> <p>Is there an effective legislative committee (e.g., Budget Committee) that examines the annual budget law and related budget appropriations?</p> <p>Does the scope of legislative review cover fiscal policies and the medium term fiscal framework in advance of revenue and expenditure details?</p> <p>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)?</p> <p>Is the budget law passed before the financial year commences?</p>
<p>1. Accounting policies and account code classifications are published and applied.</p>	<p>Is there effective classification of the budget in relation to administrative / economic / functional / programmatic classifications?</p> <p>Are standard international classification practices applied, such as the UN-supported Classification of Functions of Government COFOG)?</p> <p>Is the classification system understood throughout government and actually implemented on a consistent basis? (Inconsistent classification distorts allocations and reduces transparency).</p>
GPP 2: The budget is comprehensive	
<p>1. All general government activities are included in the budget.</p> <p>2. Extra budgetary expenditure is not material.</p>	<p>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?</p> <p>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)?</p> <p>Is there effective coordination of budgeting for recurrent and</p>

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

1. 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

1. 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

1. 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

	<p>findings used by the Supreme Audit Institution (external audit) and follow up action taken by management?</p> <p>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?</p>
--	--

<p>1. Systems operating to control virement, commitments and arrears.</p>	<p>Are virements (‘re-allocations within the budget’) performed in an open and transparent manner in line with agreed procedures? 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?</p> <p>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?</p> <p>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?</p>
---	--

GPP 6: Government carries out procurement in line with principles of value for money and transparency

<p>1. Appropriate use of competitive tendering rules and decision-making is recorded and auditable.</p> <p>2. Effective action taken to identify and eliminate corruption.</p>	<p>Note: The risk of corruption associated with procurement is potentially high. This should be taken into account when considering the following questions.</p> <p>Is the procurement system defined by a clear regulatory framework which is consistently implemented under the oversight of both internal and external control systems?</p> <p>Are regulatory institutions and procedures adequately resourced (e.g. tender board)?</p> <p>Are contracts awarded on the basis of competition and value for money in accordance with the regulatory framework?</p> <p>Are controls in place to prevent conflict of interest in the award of contracts?</p> <p>Is there regular advertisement of procurement opportunities and publication of data on public contracts and awards?</p> <p>Are contracts awarded and payments made on a timely and transparent basis? Are records maintained and accessible?</p> <p>Is there a functioning independent appeals process? Do bidders have recourse to independent judiciary?</p> <p>Note: Where procurement risk is judged to be significant, more in-depth analysis may be necessary (DFID is currently working with the Joint OECD-DAC / World Bank Roundtable on Strengthening Procurement Capacities to further develop work in this area, including the development of a specific set of procurement benchmarks to underpin the related PFM Performance Indicator. Contact the PFMA team for more information).</p>
--	--

GPP 7: Reporting of expenditure is timely and accurate

<p>1. Reconciliation of fiscal and bank records is carried out on a routine basis.</p>	<p>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?</p> <p>Is there an effective process to investigate discrepancies with subsequent follow up by senior management?</p> <p>Are suspense accounts and advance accounts routinely</p>
--	---

	<p>reconciled and cleared?</p> <p>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.</p>
<p>1. Audited annual accounts are submitted to parliament within the statutory period</p>	<p>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?</p> <p>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)?</p> <p>Are the financial statements comprehensive and understandable, and prepared in a timely manner in line with the legislative framework?</p> <p>Are the financial statements prepared in line with recognised national / international accounting standards?</p> <p>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.)</p>
<p>GPP 8: There is effective independent scrutiny of government expenditure</p>	
<p>1. Government accounts are independently audited</p>	<p>Is the Supreme Audit Institution (external auditor) adequately resourced and empowered to perform its role effectively?</p> <p>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).</p> <p>Does the scope of external audit include all major entities in the public sector?</p> <p>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?</p> <p>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?</p> <p>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.</p>
<p>1. Government agencies are held to account for mismanagement</p> <p>2. Criticisms and recommendations made by the auditors are followed up</p>	<p>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 to how the audit findings are being addressed and the timely reduction in un-cleared findings.</p> <p>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?</p> <p>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</p>

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: To be used when a PEFA does not exist. When constructing this matrix, a landscape format may be more user-friendly.

Good Practice Principle	Benchmarks for assessment	Rating (L, M, S, H)	Trajectory of Change	Overall Assessment (including key risks, measures / reform to mitigate risks, progress to date and expected progress, which may also include further detail on credible programme to improve, risk of corruption, and governance and institutional context)
1. A clear set of rules governs the budget process.	1. A budget law specifying fiscal management responsibilities is in operation.	S	↑	
	2. Accounting policies and account code classifications are published and applied.	M	↔	
2. The budget is comprehensive.	3. All general government activities are included in the budget.	M	↓	
	4. Extra budgetary expenditure is not material.	L	→	
Etc.	Etc.			

Annex 16: FRA summary table

Note: To be completed when a PEFA exists.

PFM Performance Indicator		Current PEFA Score	Change since previous PEFA	Current FRA Risk Level
A	Credibility of the Budget			M
1	Aggregate expenditure out-turn compared to original approved budget	B	(↑)	M
2	Composition of expenditure out-turn compared to original approved budget	D	(↔)	H
3	Aggregate revenue out-turn compared to original approved budget	A	(↔)	L
4	Stock and monitoring of expenditure payment arrears	B+	(↑)	M
B	Comprehensiveness and Transparency			M
5	Classification of the budget	A	(↑)	L
6	Comprehensiveness of information included in budget documentation	B	(↔)	M
7	Extent of unreported government operations	B+	(↑)	L
8	Transparency of Inter-Governmental Fiscal Relations	D+	(↔)	H
9	Oversight of aggregate fiscal risk from other public sector entities	C	(↔)	S
10	Public Access to key fiscal information	B	(↔)	M
C	Policy-Based Budgeting			S
11	Orderliness and participation in the annual budget process	C+	(↓)	S
12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	B	(↑)	M
C	Predictability and Control in Budget Execution			S
13	Transparency of tax payer obligations and liabilities	B	(↔)	M
14	Effectiveness of measures for taxpayer registration and tax assessment	C+	(↔)	M
15	Effectiveness in collection of tax payments	NS		H
16	Predictability in the availability of funds for commitment of expenditures	D+	(↔)	H
17	Recording and management of cash balances, debt and guarantees	B	(↑)	M
18	Effectiveness of payroll controls	D+	(↔)	H
19	Competition, value for money and controls in procurement	C+	(↑)	S
20	Effectiveness of internal controls for non-salary expenditure	C+	(↑)	S
21	Effectiveness of internal audit	C+	(↑)	M
C	Accounting, Recording and Reporting			S
22	Timeliness and regularity of accounts reconciliation	B	(↑)	M
23	Availability of information on resources received by service delivery units	B	(↑)	M
24	Quality and timeliness of in-year budget reports	D+	(↓)	H

25	Quality and timeliness of annual financial statements	C+	(↔)	S
C	External Scrutiny and Audit			M
26	Scope, nature and follow-up of external audit	B+	(↔)	M
27	Legislative scrutiny of the annual budget law	B+	(↑)	M
28	Legislative scrutiny of external audit reports	C+	(↔)	S
	OVERALL RATING			M

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 PFMA 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 PFMA systems by "following the flow of funds"
- Consideration of the PFMA 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 both the likelihood and impact of potential risks. The risk of leakage or inefficiencies from country PFMA systems is driven by weaknesses in those systems (likelihood) and the value of funds flowing through them (impact). Both factors should be considered when assessing and managing risk.

The likelihood of leakage or inefficiency from individual PFMA 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 PFMA 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 PFMA systems may be taken from analysis of selected PFMA indicators, such as appropriate PEFA indicators or DFID's 15 PFMA benchmarks¹⁷. Translating indicator scores into risk assessments should not be done mechanically and should consider country context and compensating controls such as cultural factors, planned short term reforms and additional safeguards. However, some general rules of thumb are given in Box 1¹⁸.

¹⁷ See Annex 14

¹⁸ See Box 1, after Para. 46, main text

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

- 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 government
- Systems for safeguarding assets, e.g., stock and stores control.

The identification of individual PFMA systems will be dependent 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.

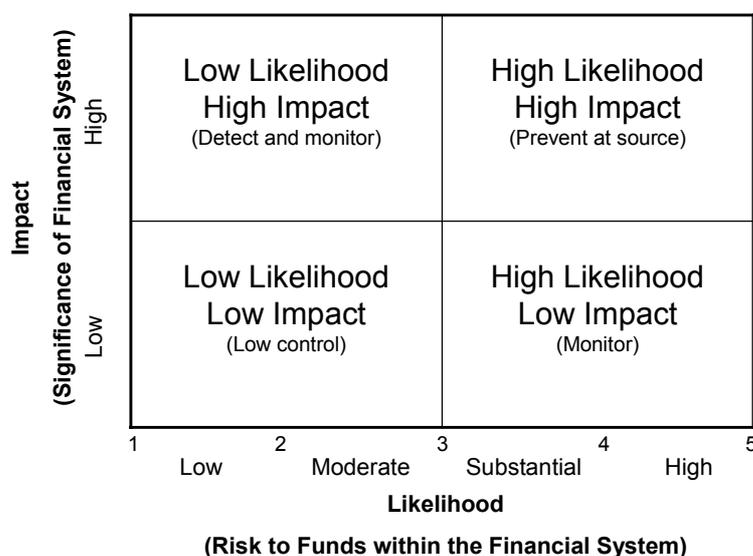
Identifying significant PFMA systems

While countries are likely to have numerous separate PFMA 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 PFMA 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 PFMA 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



PFMA systems and PFMA diagnostics

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

PFMA System	PEFA Performance Indicators	DFID PFMA 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 <i>Additional analysis may be required (e.g. EITI reports)</i>	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 <i>Additional analysis may be required</i>	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

Procurement (Major)	19 – Competition, value for money and controls in procurement <i>Where available, results from the OECD Procurement Assessment Tool should also be used</i>	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 <i>Where available, results from the World Bank's Debt Management Performance Assessment tool should also be used</i>	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	<i>Additional analysis may be required</i>	<i>Additional analysis may be required</i>

Note: In the table above, DFID PFMA Benchmarks include other factors. 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.

PEFA Performance Indicators	DFID PFMA 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 PFMA 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 PFMA 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 PFMA 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. The following table summarises some of the evidence sources which may be useful for this purpose.

PFMA System	Examples of Sources of Evidence	Issues
Tax Collection Systems	Comparison of amounts due for collection under each tax against amounts recorded as collected	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.
Natural Resource Revenues	EITI reports: comparison of amounts recorded as paid by companies against amounts recorded as received in Government accounts	
Other Fees and Charges	Comparison of amounts recorded by collection units against amounts reported as paid in household surveys	
Payroll	Quantification of ghost worker payments as a percentage of total payroll payments	
Procurement (major)	Comparison of actual price paid to standard price list or international market prices	Need to know what a competitive market price for the goods or services would be in that country
Procurement (minor)	Sample audit of payments to produce estimate of percentage of improper expenditure	Relies on the Supreme Audit Institution maintaining adequate records and utilising statistical sampling
Transfers to Sub-National Government	Comparison of amounts transferred to sub-national government (and onwards to service delivery units) against amounts recorded as received	Public Expenditure Tracking Surveys
Control of Stock and Stores	Comparison of the quantities of stock purchased against quantities issued and approved as written off. Comparison of the quantities of stock issued from central stores against the quantities received at service delivery units.	Relies on complete and accurate stock records.

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 PFMA 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 PFMA systems overall.

Recording the benefits of using country systems

Consideration of the risks of leakage and inefficiency in country PFMA systems should be weighed against the expected benefits of using country systems, which may include¹⁹:

- Improved resource allocation through increased coherence of Government planning
- Increased operational efficiency through improved balance between recurrent and capital expenditure
- Increased scrutiny of Government PFMA systems and the funds they manage
- Reduced burden imposed on Government staff through the use of parallel PFMA systems

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 PFMA systems is provided in Table 7.

¹⁹ For further guidance, see the How to Note: Assessing the Potential Benefits of Poverty Reduction Budget Support, DFID, January 2008

Table 7: Assessing the risk of leakage and inefficiency from country PFMA systems

PFMA 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.