MOVING FORWARD

ANALYZING THE STRENGTH OF A PARTNER COUNTRY'S FINANCIAL SYSTEMS

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"Sound public financial management paves the way for economic growth and development by ensuring that host country governments manage public resources and service delivery transparently, accountably, and efficiently."

In light of the pro-democratic movements sweeping the Middle East and North Africa, the demand for government accountability is more critical than ever. Effective public financial management (PFM) is at the heart of that demand. PFM is the process in which a country manages its monetary resources. It involves all components of the government's budget process, from strategic planning and revenue management to auditing and oversight. To foster transparency and accountability in a country's financial management, USAID's development efforts must work through their public financial systems –not around them or we risk undermining the country's ability to deliver essential services themselves. Before we begin that process, we perform a thorough risk assessment to determine if and how we can proceed. Not every country can participate and not all their systems can be used to implement our programs. As part of USAID Forward's Implementation and Procurement Reform initiative that focuses on government to government support, USAID has developed a Public Financial Management Risk Assessment Framework (PFMRAF) to help us determine whether we can work with a country in this capacity.

ABOUT THE FRAMEWORK

The Public Financial Management Risk Assessment Framework (PFMRAF) was created to help USAID Missions identify and mitigate the fiduciary risk encountered when aligning donor assistance with a partner country's public financial management (PFM) system. The PFMRAF is based on modern risk management principles that allow us to identify weaknesses; analyze risk associated with weaknesses; and determine ways to eliminate or control weaknesses. The PFMRAF, taking a new and developmentally sound approach, recognizes that the PFM system along with its weaknesses and strengths - belongs to the partner country. In partnership, not patronage, the partner country is involved in risk identification and together we mitigate risks through improvements to the PFM system. This framework is comprised of five stages outlined below.

STAGE 1 RAPID APPRAISAL: The rapid appraisal covers issues affecting country-level fiduciary risk, such as country commitment to development, transparency, and accountability of public funds. It also examines political or security factors that impact fiduciary risk such as the existence and quality of policies, legal and institutional framework and systems. This appraisal provides USAID with a high-level snapshot of fiduciary risks associated with use of the country's PFM systems and helps inform the decision as to whether USAID should move forward to undertake a more rigorous, formal Stage 2 Risk Assessment.

STAGE 2 RISK ANALYSIS, ASSESSMENT, MANAGEMENT AND MITIGATION: During this stage, USAID identifies and where appropriate proposes measures to mitigate fiduciary risks at the country, sector, or subnational government level. Requirements USAID may use to treat risk are the imposition of specific operational standards before the government receives fund advances or close program monitoring for viability and realistic planning. Operational measures can include the development of an agreed upon standard financial reporting template/model, regular or concurrent financial audits, special oversight mechanisms for procurement or financial transactions, periodic re-assessment using the PFMRAF and other proven risk treatment measures.

STAGE 3 PROJECT DESIGN: This stage requires joint design, between the local USAID Mission and the partner country, where the parties mutually agree on the development objectives, the implementing mechanisms, the uses of country systems, additional financial controls that might be required, and capacity building for sustainability. At times, USAID will confront limited areas in which fiduciary risk cannot be treated but the larger partnership is still conducive to achieve US development goals. In these cases, other risk management mechanisms are used such as transfer to a third party (such as insurance) or termination of the risk by bypassing the unacceptable elements of the partner country's PFM system. For example, when risk remains unacceptable, USAID will achieve its development objectives through classic contracts or grants. Ultimately, USAID will employ the best risk management practices from the public and private sectors in its use of partner country systems to protect US taxpayer dollars.

STAGE 4 BILATERAL PROJECT AGREEMENT: At this stage, the project design and all other legal and regulatory provisions are documented in a formal agreement called "Approval of Use of Partner Country Systems" between the partner government and USAID. This agreement is binding and requires a monitoring plan, periodic progress reports, progress meetings, completion dates or milestones, and provisions to ensure partner country compliance with risk mitigation measures stated in the Approval document and other project design documents. Compliance with Section 110 of the Foreign Assistance Act of 1961 is mandated in USAID's operating procedures whereby the partner government is required to make at least a 25 percent contribution to projects using their country systems. This provision ensures that the partner country subjects its own resources to the same risks as the donor and thereby provides an important incentive for compliance with risk mitigation measures and capacity building to permanently remove or further reduce such risks.

STAGE 5 IMPLEMENTATION, MONITORING, AND EVALUATION: The implementation process is driven by project design and the provisions in the bilateral project agreement that provide for strong monitoring processes subject to (1) periodic financial audit; (2) re-assessment using the PFMRAF; and (3) other reports as agreed. Projects implemented through partner country systems are covered by USAID's new Evaluation Policy and those requirements are included in the bilateral project agreement. Final completion reports for the project will address fiduciary risks and mitigating measures highlighting the strengths and weaknesses of government performance, recommendations for further PFM reform, and suggestions to improve the risk mitigation process.

PROGRESS

As of October 2011, USAID's Chief Financial Officer's office, in broad collaboration with USAID Washington-based bureaus and offices and overseas missions, had completed Stage 1 Rapid Appraisals in Liberia, Peru, Rwanda, Nepal, Ghana, Tanzania, El Salvador, Malawi, Senegal, South Africa and Moldova. USAID will not proceed with further PFMRAF stages in Malawi and Nepal due to governance and accountability concerns in those countries. USAID Senegal may proceed after the results of the February 2012 elections are known and formation of the next government is complete. Rwanda successfully completed Stages 2 and 3 and is finalizing a bilateral project agreement (stage 4). Tanzania is in Stage 3 for its Feed the Future activity and Stage 2 for the health and education sectors. All other countries that completed Stage 1 are in Stage 2. The ability of the PFMRAF to discern between cases where consideration of use of partner country systems should proceed, such as Peru, and cases where it should not, such as Malawi, is an important validation of its effectiveness.

This story is an example of how USAID is working with host country systems as part of the USAID Forward reform agenda. Forward aims to change the way the Agency does business with new partnerships, an emphasis on innovation and focus on results.