



***Fiduciary Safeguards and Budget Support
How to Ensure that Resources are Put to
the Best Possible Use***

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General Budget Support – Introduction



- **General Budget Support (GBS) operations - Development Policy Loans (DPLs) at the World Bank: rapidly disbursing policy-based financing (in the form of loans or grants) to help address partner countries actual or anticipated development financing requirements of domestic or external origins to support a program of policy or institutional actions**
- **GBS may take place at the national or sub-national level**
- **GBS may follow a programmatic approach consistent with a country's economic and sectoral policies**
 - i.e., a series of individual DPLs (e.g., annually)
- **GBS may be disbursed as a single-tranche operation or multiple-tranche operation or multiple operations**

General Budget Support–Fiduciary Risk



- **GBS is intended to be managed through the recipient country's own systems for Public Financial Management (PFM), including Public Procurement**
- **The best fiduciary assurance that funds are well managed is sound, well-functioning PFM systems in partner countries. Therefore, the key issue in analyzing fiduciary risk is the quality of a country's PFM systems**
- **Sound PFM is crucial for poverty reduction, permitting a partner country to develop, implement and report on a budget that is comprehensive, realistic, well prioritized and has a medium-term focus**
- **As a result, PFM issues have become a key aspect of the policy dialogue, which also emphasizes the need for government ownership of a commitment to PFM reforms**
- **However, Donors should be realistic about how quickly the level of fiduciary risk can be lowered by improved PFM, since experience suggests that institutional/system reforms only produce results in the MLT. Also, potential risks need to be compared with prospective benefits in development assistance**

Fiduciary/Developmental Objectives



- PFM development and fiduciary issues are two sides of the same coin and cannot be usefully separated
- In extending GBS, the challenge is therefore to develop commonality of interest into a country-led concern with sound PFM that is supported by Donors and includes dialogue on mutual objectives and trust

- In fact: is the end-use of funds in GBS tracked?
 - Funds are disbursed into and are commingled with country's foreign exchange reserves
 - Funds immediately become available to the country to be used for its public expenditures, and are commingled with the country's other budget resources
 - End-use of funds cannot be tracked (fungibility argument)

- What are the “project expenditures” in GBS? What is accounted, audited and reported for?

Conceptual Framework for Fiduciary in GBS



What do the Bank/Donors do in GBS regarding Fiduciary issues?

- **Understand the environment into which funds flow**
 - I. the country's foreign exchange control environment (normally central bank)
 - II. the country's system for management of its budget resources i.e., its PFM systems
- **Examine whether there is satisfactory commitment to address weaknesses**
- **Obtain reasonable assurance that funds reach the country's foreign exchange reserves and the budget**
- **Bank/Donors review of the above inform decisions on program amounts, tranching, content, conditionality and risk mitigation measures**



GBS at the World Bank

- **Fiduciary Staff are an integral part of the task team**
 - ❖ Involved from concept note to implementation completion report (ICR)
 - ❖ work in close coordination with other internal partner (particularly PREM)
 - ❖ help to carry out the PFM dialogue as part of a broader fiscal adjustment dialogue or governance improvement dialog

- **Aim is to move to *integrated country PFM teams***
 - ❖ FM, PREM and Procurement staff to jointly carry out all country PFM work including on DPLs
 - ❖ single input on PFM issues in DPLs from this *integrated country PFM team*

- **Fiduciary Staff usually work on two aspects**
 - ❖ on fiduciary aspects
 - ❖ on the DPL program content relating to PFM issues

- **Experience has been that DPLs are often an important catalyst for PFM improvements, building PFM awareness, and starting PFM reform dialogue**

Public Financial Management Issues



- **Adequate knowledge of the country's PFM system is a necessary analytical underpinning for GBS**
 - ✦ covers the entire budget cycle (budget formulation, execution and reporting, internal controls and external audit, including procurement)

- **Such knowledge may come from a variety of sources**
 - ✦ analytic work e.g., Country Financial Accountability Assessments (CFAA), CPAR (Country Procurement Assessment Reports), PER (Public Expenditure Reviews), integrated analytic work (combination of some or all of the above), HIPC-AAP, and increasingly the PEFA PFM Performance Indicators- Integrated PFM Performance Report (the latter provides a robust high level framework to measure progress in the medium-term)
 - ✦ analytic work done by other donors e.g., IMF's Fiscal Transparency ROSC, DFID's Fiduciary Risk Assessment
 - ✦ analytic work by country institutions



PFM Issues – Key Points

- **There is no established minimum PFM performance level as a precondition for GBS**

- **Main issue is Government's commitment to PFM improvement/reform, and reasonable evidence that improvements are occurring over time (being mindful that this is a medium to long- term agenda)**

- **Improved PFM performance may therefore be an outcome, rather than a precondition for GBS**

- **PFM improvements may be supported by other operations, rather than by the GBS program itself**
 - ❖ **PFM reforms may be supported by other donors or by the country itself**
 - ❖ **In practice, many GBS programs support PFM improvements, but these are also complemented by other operations**

Design of PFM Program Content and Conditionality – Good Practices



- **Link PFM conditions and triggers to analytic work**
- **Appropriately sequence PFM conditions and triggers**
- **Ensure continuity of actions – process as important as desired outcomes, including Donor collaboration and harmonization**
- **As far as practicable, focus PFM conditions and triggers on results**
 - **specific, observable, measurable**
- **Ensure that appropriate implementation arrangements are in place**
- **Most importantly, country ownership is crucial**
 - **construct program content around the country's reform agenda**
 - **The Declaration from the Paris High Level Forum on Harmonization, Alignment , Results and Mutual Accountability includes a commitment by partner countries to take the lead in the reform of PFM and Procurement systems**



Foreign Exchange (FX) Control Environment in DPLs – Key Points

- **Principal analytic work is the IMF's Safeguards Assessment of Central Banks**
- **IMF Article IV Consultation Reports (usually done annually) provide an updated status of implementation of recommendations**
- **The Bank may also review audit reports and financial statements of the central bank**
- **Control weaknesses are addressed through an IMF-monitored improvement plan.**



DPL Funds Flow : Normal arrangements

- **GBS is disbursed into an account that forms part of the country's official FX reserves (normally held with the central bank)**
- **Equivalent amount is credited to an account of the government that is available to finance budgeted expenditures (e.g., Consolidated Fund, Single Treasury Account)**
 - the second step could be an accounting transaction.
 - in some cases money may also be transferred from the FX bank account to a local currency bank account
- **Bank/Donors perform appropriate due diligence role to ensure that these steps are properly done**
- **At the World Bank the simplest and recommended approach is to obtain a confirmation (or "representation") from the borrower with details on the above aspects**

Managing Reputational Risk in DPLs:

“Negative List”



- **Bank/Donors do not require tracking the ultimate use of DPL funds (in both FX and local currency)**
- **No fiduciary reporting requirements regarding the country's budget expenditures**
 - **government financial reporting may be part of the PFM improvement program and conditionality**
- **Items for which loan proceeds may not be used (often called “negative list”) is included in the loan agreement**
 - **includes items such as military expenditures, environmentally hazardous goods, jewelry, tobacco, alcoholic beverages**
 - **local currency expenditures are no longer part of the “negative list”**
- **The Borrower's undertaking that loan proceeds will not be used for “negative list” is a “self-implementing code of conduct” for borrowers**
 - **Bank has right to exercise remedies if this is breached**
 - **however, Bank will not monitor end-use of funds**



Additional Fiduciary Arrangements

When?

- Inadequate knowledge of central bank's FX control environment, and audit reports of the central bank indicate weaknesses
- Inadequate knowledge of the country's PFM system
- Acceptable plan to deal with identified weaknesses is not in place
- Bank management considers significant possibility of 'reputational risk' that Bank loan proceeds could be identified as being used for ineligible expenditures (the "negative" list)

How?

- Bank loan proceeds are deposited into a dedicated account(s) used exclusively for the DPL funds
- Dedicated account may be established for FX or local currency or both (depending on whether the identified risks are)
- Purposes for which loan proceeds may not be used (negative list) are agreed
 - In exceptional cases a "positive list" of expenditures may be used
- Receipts and payments in the dedicated accounts are tracked and accounted
- The dedicated account(s) may also be audited

Additional Fiduciary Arrangements

– Key points to note



- **These additional arrangements principally reduce reputational risk**
 - part of broader risk mitigation
- **Dedicated accounts and tracking of flows should not be seen as a satisfactory response to weak PFM or central bank control environments**
 - the real solution is a credible improvement program
- **Earmarking of GBS funds for specific expenditures also does not add to fiduciary assurance**

Fraud and Corruption



- **Fraud and corruption affect the functioning of the PFM and Procurement systems, whether through diversion of funds or in some other way, and affect the level of fiduciary risk**
- **Need to use governance anticorruption diagnostic information in decisions on GBS operations**
- **Focus on those aspects of the PFM system that may be most likely to facilitate fraud and corruption**
 - non-transparent off-budget accounts
 - failure to observe internal controls
- **Procurement addresses fraud and corruption issues by requiring a review of transparency and accountability in the country procurement systems**
 - codes of ethics for government employees
 - adequacy of procedures for reporting bribes
 - adequacy of access to administrative review and appeal
 - other measures and initiative to curb or control fraud and corruption, including legislation

DPLs - Documentation in the Program

Document



● On PFM system

- status of analytic work and summary results
- summary of PFM improvement plans and actions taken/committed (all actions being taken – both within and outside the GBS operation)
- conditions, triggers, benchmarks, expected outcomes, indicators

● On funds flow arrangements

- central bank control environment drawing from IMF's Safeguards Assessment. Bank reports should only record information contained in the summaries of safeguards assessments that are submitted to the Fund's Board
- brief description of funds flow arrangements
- any additional fiduciary arrangements



DPLs - Supervision

- **Monitor whether agreed fund flow arrangements have been complied with**
 - Bank loan proceeds have reached country's FX reserves and budget
 - any additional fiduciary arrangements were complied with

- **Monitor whether agreed PFM improvement actions are being implemented**



Conclusions

- Focus on **country-owned policies, strong analytic backing, participation and results** – with inclusion of results framework, clear assignment of M&E responsibilities to borrower, with validation of results by the Bank/Donors
- Bank/Donors consider the country's **commitment to and ownership** of the program as demonstrated by track record; and the **institutional ability** to implement the program, opportunely supporting **capacity building** efforts
- Assessment of **program risks**, including **fiduciary safeguards** with **upstream analytical work** at country/sector levels



Conclusions (cont.'d)

- **Early participation of fiduciary experts** in preparation and supervision is important to assess measures and identify any additional analytic work
- **Conceptual treatment of potential negative impact and risks** (including fiduciary) through relevant analysis of country systems and, if necessary, program actions and conditionality
- **Fiduciary risk mitigation** (front-end flow of funds, controls, external oversight mechanisms, etc. but also loan amounts, tranching, conditionalities, etc.) are **informed by these fiduciary reviews**
- Where **knowledge of the control environment or budget management system** are **inadequate**, **further fiduciary arrangements** may need to be applied
- Need for **Donor collaboration** to reduce the number of separate PFM diagnostics, both to improve the quality of due diligence work and to **reduce transaction costs** to Donors and partners countries



Select Reference Material

- OP and BP 8.60: *Development Policy Lending*
- Good Practice Note (#3): *Financial Management Issues in DPLs*
- World Bank CFAA Guidelines
- World Bank CPAR Procedures
- PEFA PFM Performance Measurement Framework
- IMF Safeguards Assessment of Central Banks
- High Level Forum 2005
- Budget Support as More Effective Aid? Recent Experiences and Emerging Lessons