

**FINANCIAL MANAGEMENT SECTOR:
APPROACH TO GOVERNANCE AND ANTICORRUPTION**

FINANCIAL MANAGEMENT SECTOR BOARD

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ABBREVIATIONS AND ACRONYMS

AAA	Analytic and Advisory Activity
A&A ROSC	Report on Observance of Standards and Codes – Accounting and Auditing Module
ACCA	Association of Chartered Certified Accountants
BP	Bank Procedure
CA	Chartered Accountant
CAS	Country Assistance Strategy
CDD	Community-driven development
CFAA	Country Financial Accountability Assessment
CFE	Certified Fraud Examiner
CFMS	Country Financial Management Strategy
CIA	Certified Internal Auditor
CIFPA	The Chartered Institute of Public Finance and Accountancy
CMU	Country Management Unit
CPFA	Certified Public Finance Accountant
CPA	Certified Public Accountant
CPAR	Country Procurement Assessment Report
CPIA	Country Policy and Institutional Assessment
CSR	Controller’s, Strategy and Resource Management Vice Presidency
CWA	Cost and Works Accountant
DGF	Development Grant Facility
DPO	Development Policy Operation
EITI	Extractive Industry Transparency Initiative
FM	Financial Management
FMIS	Financial Management Information System
FMSB	Financial Management Sector Board
GAC	Governance and Anticorruption
HIPC-AAP	Heavily Indebted Poor Countries: Assessment and Action Plan
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDF	Institutional Development Fund
IEG	Independent Evaluation Group
IFA	Integrated Fiduciary Assessment
IIA	Institute of Internal Auditors
INT	Department of Institutional Integrity
ISA	International Standards on Auditing
ISR	Implementation Status Report
MTEF	Medium-term Expenditure Framework
OECD	Organisation for Economic Co-operation and Development
OP	Operational Policy
OPCS	Operations Policy and Country Services Vice Presidency
PEFA	Public Expenditure and Financial Accountability Partnership Program
PEMFAR	Public Expenditure Management and Financial Accountability Review
PER	Public Expenditure Review
PFM	Public Financial Management
PREM	Poverty Reduction and Economic Management Network
PRSC	Poverty Reduction Support Credit (a type of DPO)
SAI	Supreme Audit Institution
ToR	Terms of Reference

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CONTENTS

I.	Introduction.....	1
II.	Helping Countries to Improve Governance and Reduce Corruption.....	2
	A. Public Financial Management	2
	B. Corporate Financial Reporting.....	5
	C. Country Assistance Strategies.....	6
III.	Strengthening Fiduciary Practices in Bank-Financed Projects	7
IV.	Global Partnerships.....	12
V.	Implementation	13

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I. INTRODUCTION

1. The Board of Directors of the World Bank has approved a paper articulating its strategy for strengthening its engagement on governance and anticorruption (GAC).¹ It states that the Bank's GAC work aims to help develop capable and accountable states and institutions that can devise and implement sound policies, provide public services, set the rules governing markets, and control corruption, thereby helping to reduce poverty. The strategy takes a comprehensive approach that involves working at the country, operational, and global levels. It seeks to build on lessons of experience, to systematically scale up programs that have a track record of success.
2. ***Purpose of this Note.*** This note, prepared by the Financial Management Sector Board (FMSB), outlines the sector's overall approach to implement the Bank's GAC strategy in FM operational work. This note will serve as the basis for developing necessary guidance and tools for staff, and assist the FMSB's discussions on the sector's human resources strategy and resource requirements.
3. ***FM Sector's Role.*** The FM sector has a major role to play in implementing the GAC agenda. Sound public financial management (PFM) ensures accountability and efficiency in the management of public resources, and is an essential underpinning to improving governance and fighting corruption. Good corporate financial reporting standards and practices are essential for the functioning of a market economy. Maintaining strong fiduciary practices in Bank-financed operations is needed to provide acceptable assurance on the use of funds provided by the Bank, to sustain the confidence of its shareholders, other stakeholders and the public at large.
4. ***FM Sector Strategy.*** The FM sector's strategy in implementing the GAC agenda is to (a) assist partner countries in improving governance and reducing corruption by strengthening their PFM systems, improving their corporate financial reporting standards and practices, and increasing the number of qualified FM professionals to work in the public and private sectors; (b) strengthen fiduciary practices in Bank-financed projects; and (c) work with global partners to support partner countries in this area, harmonize practices, and support development of international standards. In these activities, the sector would work in close collaboration with various internal partners including PREM, CSR, Procurement, Legal, sectors (e.g., Sustainable Development, Human Development) and country management units (CMUs).
5. ***Structure of this Note.*** Following this introduction, Sections II, III and IV set out the FM sector's approach at the country, project and global levels respectively. Section V outlines next steps for implementation and further issues that would be considered by the FMSB.

¹ See [Strengthening Bank Group Engagement on Governance and Anticorruption](#), (R2007-0036/2), March 21, 2007.

II. HELPING COUNTRIES TO IMPROVE GOVERNANCE AND REDUCE CORRUPTION

A. Public Financial Management (PFM)

6. Sound PFM systems are critical for achievement of public policy objectives, and an essential pre-requisite for reducing corruption. Transparent public finance information and effective demand-side institutions enable legislature and civil society to hold the government to account. Effective supreme audit institutions serve as a watchdog over public finances. Sound internal controls and internal audit help deter fraud and waste. Good information and accounting systems enable timely and reliable budget and financial information across government and help strengthen financial control and management of public funds. Computerized systems enable faster transaction processing, enable tighter tracking, better analysis, and easier sharing of information. Adequate controls over revenues help to minimize leakages. Comprehensive budgets help ensure that off-budget accounts (which often operate outside of established rules and regulations, have limited transparency or scrutiny and are susceptible to misuse) are minimized. Credible budgets and good cash management enable predictability of funds to spending agencies and facilitate service delivery.

7. ***Support to Country PFM Improvements.*** Over the past few years, the Bank has engaged significantly on PFM issues and is supporting country PFM improvement programs using a range of Bank instruments:

- a) analytic work. The Bank has obtained and provided partner countries with indepth analysis of country PFM systems. PFM analytic work has been completed in most active partner countries (more than 100) through reports such as CFAAs, PERs, HIPC-AAP, PEMFAR, Integrated Fiduciary Assessments, and PFM Performance Reports. This analytic work assists countries in designing PFM improvements and provides knowledge for the Bank's fiduciary purposes;
- b) financial and technical support to country PFM improvement programs through a range of instruments: Institutional Development Fund (IDF) grants, investment projects (standalone projects focusing on PFM improvements, or PFM-related components of other investment projects), training, policy dialogue, and non-lending technical assistance;
- c) PFM policy reforms actions are prominent in Development Policy Operations (DPOs). 72 percent of recent DPOs included PFM as part of the policy actions supported by the program.

Bank support to PFM improvements covers a range of activities across the PFM cycle including financial management information systems, accounting, budget classification systems, supreme audit institutions, and budget planning. PFM work is also being done at the subnational level as needed by country circumstances (e.g., states in India, Pakistan, Mexico, Nigeria). Box 1 provides country examples.

Box 1. Country PFM Improvements with Bank Support

Egypt. Support to improve budget formulation, execution and transparency, establishment of a Treasury Single Account system, development of a unified chart of accounts consistent with international standards and the development of Internal Audit function.

Ghana. Support for reforms in several areas: (i) legal framework – new Financial Administration Act and updated Financial Regulations, the Internal Audit Agency Act, and the Public Procurement Act; (ii) timeliness of budget approval (prior to the beginning of the fiscal year); (iii) improved transparency of the budget documentation; (iv) strengthened commitment controls to improve overall monitoring of expenditures; (v) a new computerized budget management system.; and (vi) clearing the backlog of audit reports, thereby also improving external oversight by Parliament.

Honduras. Support in the following areas: (i) the new comprehensive Organic Budget Law and its regulations, (ii) implementation of IMF *GFS Manual 2001* budget classification and new government Chart of Accounts, (iii) implementation of upgraded IFMIS with full coverage across the central government, (iv) improved treasury operations, including successful implementation of single treasury account, (v) support to the Audit Court, including implementation of the HR strategy and new external audit regulations, and (vi) new internal audit standards and regulations.

Moldova. Support to improve budget formulation and execution, establish a financial management information system, and enhance internal control and audit capability.

Mongolia. Support for installation of a Government FMIS, establishment of a Treasury Single Account system, development of a unified chart of accounts consistent with international standards, asset valuation, updating of the debt management information system, training, and change management.

Nepal. Support for improving the external audit function: revising audit guidelines to international standards, improving audit procedures and reporting formats, and developing human resources capacity.

Pakistan. Support to establish an integrated government-wide accounting systems, improved auditing, and human resource development through an Improvement to Financial Reporting and Auditing Project.

8. ***Going Forward -- Step-up Engagement in and Enhance Effectiveness of PFM Work.*** Helping countries to establish sound PFM systems would continue to be high priority. The enhanced focus on governance and anticorruption calls for further stepping-up engagement and enhancing the effectiveness of the Bank's PFM work. The goal is to help countries to establish and operate an open and orderly PFM system (see Box 2). Key PFM aspects that are particularly relevant to the anticorruption agenda would be emphasized. These include:

- Transparency of financial and budget information.
- Developing demand-side institutions such as the legislature (e.g., Public Accounts Committees, Budget Committees).
- Strengthening supreme audit institutions (including capacity in forensic and investigative audits).
- Internal controls and internal audit in government.
- Financial management information systems, accounting and reporting systems.
- Ensuring the integrity of the budget through comprehensive and credible budgets.

Box 2. Critical dimensions of an open and orderly PFM system

- The process for translating public policies into budgets is satisfactory.
- The budget and the fiscal risk oversight are comprehensive.
- The budget is realistic and implemented as planned.
- Fiscal and budget information is accessible to the public.
- The budget is implemented in an orderly and predictable manner. There are satisfactory arrangements for the exercise of control and stewardship in the use of public funds (e.g., management/internal control, internal audit, payroll and procurement systems).
- Adequate records and accounts are maintained, and information is produced and disseminated to meet decision-making, control, management and reporting purposes.
- Audit systems are effective, and there is adequate scrutiny of budgets and accounts (e.g., by parliament).

Based on: *PEFA PFM Performance Measurement Framework*

9. ***The “Strengthened Approach” to PFM Work.*** The Bank’s PFM work would be based on the “strengthened approach” – a common framework to increase the effectiveness of PFM work that has been widely agreed among the Bank and development partners.² Assisting partner countries to implement PFM reform and achieve concrete improvements will be the principal focus of the Bank’s PFM work (as contrasted with analytic work). The “strengthened approach” emphasizes: (a) aligning the Bank’s PFM work with the country’s capacity and priorities, and ensuring strong country ownership of PFM reforms; (b) appropriate prioritization and sequencing of reforms within a multiyear framework; (c) close coordination among development partners in supporting PFM reforms. (d) using the internationally agreed PEFA PFM indicators for an integrated and harmonized approach to measuring and monitoring performance and progress; and (e) greater integration of the Bank’s work at the country level by bringing together in a single team the three Bank sectors involved (FM, PREM, and Procurement). Implementation of this approach has commenced and going forward would be deepened.

10. ***Sector-level and Local Government PFM.*** PFM work would also focus on the sector and decentralized levels as required by individual country circumstances. This is in line with the Bank’s GAC strategy of scaling up and paying increased attention to governance and corruption issues in the sectors and in local governments.

- Sector-level PFM work will be carried out to drill down and identify strengths and weaknesses of the PFM system, to assist in the design and implementation of sectoral reforms, and to provide information for the Bank’s fiduciary work e.g., in SWAps. This would be carried out in collaboration with the concerned sector teams e.g., sector-level PFM analysis is being carried out as part of Sector AAA work in Brazil (Infrastructure sector) and Mexico (sectoral PERs). In resource rich countries that generate revenues from extractive industries, where transparency and ensuring appropriate management of revenues are important issues, PFM work would be done in close collaboration with the Extractive Industry Transparency Initiative (EITI). Box 3 provides examples of recent sectoral PFM work.

² See *Strengthening the Bank's Public Financial Management Work*, July 25, 2005, Joint Memorandum of the Vice Presidents of the OPCS and PREM networks.

- **Local Government Financial Management.** Financial management is one of the core institutional building blocks for local governments. PFM work in this area is particularly relevant in strengthening capacity, processes and FM performance; and offers room for innovative approaches (e.g., social audits, local level transparency and accountability mechanisms). Work on supporting improvement of local government PFM systems has commenced in some countries (e.g., India, Bangladesh, Indonesia).

Box 3. Sector-level PFM work

Croatia. An Education Sector Fiduciary Assessment provided the basis for developing an improvement program supported under the Bank-financed Education Sector Support Program, while also providing the Bank's fiduciary assessment of the Program.

Egypt. Institutional Financial Management Capacity Assessments (IFMCA) in 4 priority sectors (education, health, water, and transport) examined the working of the PFM system and identified sector-specific capacity gaps and appropriate mitigating measures, including on corruption risk. The IFMCA was conducted as part of the Egypt PER and in coordination with procurement colleagues.

India. Given the importance of the power sector to the fiscal situation, analytic work was done on public financial accountability issues in the sector. Analytic work was also done on PFM issues on centrally sponsored schemes (large government programs).

11. **Human Resources Development.** Increasing the number of qualified FM professionals in partner countries to work in the private and public sectors is another priority area. Shortage of qualified FM professionals is a critical impediment which affects both PFM and corporate financial reporting in partner countries. Some countries have fewer than 100 qualified accountants in the public sector, including Angola, Eritrea, Ethiopia, Mali, Mauritania, Mozambique, and Sierra Leone.³ Possible measures include: (a) training through local and regional institutions; (b) supporting staff in partner country institutions to acquire technician-level accreditation and professional FM/accounting qualifications (e.g., ACCA, CIA, CPA, CA, CWA, CFE, CPFA); (c) the development of professional bodies/associations to train and certify FM professionals and hold them to professional standards (e.g., accounting, auditing, internal audit, control, fraud examination); (d) the development of local or regional training institutions (e.g., Eastern Central and Southern African Federation of Accountants based in Kenya, Accountancy Association Bodies of West Africa based in Nigeria, Institute of Finance in Lebanon) and strengthening universities in providing accounting education; and (e) highlighting civil service issues that impact on the PFM performance e.g., pay scales, performance culture.

B. Corporate Financial Reporting

12. Timely, transparent and reliable corporate financial reporting contributes to the governance and anticorruption agenda by promoting growth of a competitive and responsible private sector, facilitating monitoring of companies thus influencing their behavior, strengthening financial discipline of government business enterprises, and improving the assessment and collection of taxes on corporate profits. For example, opacity in corporate financial reporting make it easier to conceal illegal transactions; audits carried out with standards that are less stringent than the International Standards on Auditing (ISA) are less likely to detect fraudulent operations. The Bank's GAC strategy notes the importance of a thriving, open and competitive private sector as a strong source of demand for good governance.

³ See [Capacity Development in Africa: Management Action Plan](#), (Sec M2006-0323), July 14, 2006.

13. ***Report on Observance of Standards and Codes – Accounting and Auditing Module (A&A ROSC)***. The Bank supports corporate financial reporting improvement through the A&A ROSC. These reports provide information on the state of corporate financial reporting, accounting and auditing practices in partner countries, and have been completed for 62 countries (as of June 30, 2006). They examine standards and practices vis-à-vis international financial reporting and auditing standards; and issues of institutional capacity, legal framework, accounting profession, accounting education and training, standard setting process, regulation and enforcement.

14. ***Going Forward - From Diagnosis to Implementation***. The emphasis going forward will be on assisting countries to implement improvement measures relating to institutional and regulatory frameworks, accounting and auditing standards and practices, and professional skills. Some recent efforts have been made in this direction: Bank-financed operations, technical assistance, and learning events are supporting the implementation of the A&A ROSC recommendations and capacity building in partner countries e.g., Bangladesh (drafting of a Financial Reporting Act and design of a Financial Reporting Council), 10 countries in the ECA Region (drafting and phasing-in of legal and regulatory instruments to comply with the EU standards, institutional design and operating procedures, and design of education and training programs, twinning arrangements with leading foreign institutions, and start-up support for a network of regulators, standard-setters, and officials from participating countries), Nigeria (implementation of A&A ROSC recommendations through a Bank-financed project), and Egypt (implementation of ROSC-AA recommendations through the Financial Sector DPL).

C. Country Assistance Strategies (CASs)

15. ***FM-related Issues in CASs***. The Bank's GAC strategy provides a prominent role for CASs: instituting a systematic and disciplined approach that fine-tunes the CAS to the challenges that governance and corruption may pose for poverty reduction and to the fiduciary risks for the Bank is noted as a key priority. Bank teams preparing CASs will be required to give explicit consideration, underpinned by improved diagnostic work, to governance shortcomings and corruption in the country, the potential risks that they may pose for development and Bank-funded operations, the adequacy of the government's program for addressing these problems, and the way in which private sector engagement and domestic accountability mechanisms can be used to support and strengthen the program's implementation and governance outcomes. Given the centrality of the CAS, FM-related issues would continue to be discussed in CASs covering: (a) the Bank's proposed program of work to assist countries—in improving their PFM systems and corporate financial reporting—using the range of Bank instruments; and (b) the fiduciary risk management strategy for the Bank-financed portfolio, based on an analysis of fiduciary issues and risks. Mainstreaming the use of the Country Financial Management Strategy (or alternative planning tool) would significantly help in this regard.

16. ***Improved Assessment of Country PFM Reform Programs to Support Development Policy Operations (DPOs)***. Assessments of the country's commitment to PFM improvements and progress over time are currently carried out as required by the Bank's DPO policy and to support CAS decisions in this regard. Going forward, quality would be further enhanced as recommended by the [recent review of DPO implementation](#): the main area for improvement is providing a more clear and candid assessment of the government's PFM reform program to

ensure that key identified weaknesses are being addressed, proposed policy measures are clearly stated and met, and over time concrete results are being achieved.

III. STRENGTHENING FIDUCIARY PRACTICES IN BANK-FINANCED PROJECTS

17. Financial management is a core element of the Bank’s fiduciary framework, in conjunction with procurement and disbursement. Together these arrangements are intended to provide assurance that the funds provided by the Bank are used appropriately and only for the purposes intended. The Bank has a robust FM policy framework and risk-based operating model outlined in *OP/BP 10.02, Financial Management* and a *FM Practices Manual* (see Box 4). The aim is to ensure that each investment project (including those financed by trust funds) has satisfactory arrangements for budgeting, funds flow, internal controls, accounting, financial reporting, and auditing. The use of country FM systems—use of the country’s institutions and applicable laws, regulations, rules and procedures for the operation being supported by the Bank—is actively encouraged, where the Bank has assessed these systems to be adequate.

18. **Clarification of Responsibilities.** The primary responsibility for the prevention and detection of fraud and corruption rests with the borrower, which is required to establish and maintain a control environment adequate to provide reasonable assurance that Bank loan proceeds will be used only for the intended purposes. Consistent with international assurance industry standards, FM staff review that the control environment established by the borrower continues to provide such assurance.⁴

Box 4. FM Framework for Investment Lending

- A qualified Financial Management Specialist (FMS) is a task team member of every operation throughout the life of the project commencing with the FM capacity assessment at entry.
- FM staff obtain an understanding of country environments through country-level diagnostic reviews such as CFAA, PER, PEFA PFM Performance Measurement framework and A&A ROSC.
- Using structured risk based approaches (including consideration of inherent risks from the country and project-entity environment, and project-specific risks), FM staff assess the proposed FM arrangements for each project at appraisal.
- During project preparation, FM staff also work with project agencies to identify measures to mitigate FM risks, strengthen controls, and develop borrower capacity.
- Throughout project implementation FM staff review the continuing adequacy of FM arrangements, review and follow-up on findings contained in interim and audited financial statements, and –depending on assessed risks – test check of individual transactions. They record the ongoing status of FM progress in ISRs. FM staff make recommendations to Management on appropriate application of remedies including increasing documentation requirements for disbursements, suspending disbursements, and delaying or withholding further loans to defaulting entities.
- Bank-wide FM quality assurance arrangements, including managerial inputs at key points, have been adopted to provide ongoing assurance that the FM framework remains adequate and continues to operate as intended. Substantive ex-post quality assurance and learning feedback activities are expected to be jointly conducted by CSR and the FM sector.

⁴ The International Framework for Assurance Engagements issued by the International Auditing and Assurance Standards Board (IAASB) recognizes that reasonable assurance is less than absolute assurance, and states that reducing assurance risk to zero is very rarely attainable or cost beneficial as a result of factors such as the use of selective testing, the inherent limitations of internal control, that fact that much of the evidence available is persuasive rather than conclusive, the use of judgments in gathering and evaluating evidence and forming conclusions, and in some cases, the characteristics of the subject matter.

19. ***Going Forward: Enhancing FM Practices and Improving Quality.*** Practice enhancements, all within the existing FM framework (*FM Practices Manual*), would be made to improve quality and enhance impact of FM fiduciary work. Ongoing implementation experience has highlighted the need for fully implementing the *FM Practices Manual*. A range of possible practice enhancements, in the context of the enhanced anticorruption focus, is outlined below. Specific measures in individual projects would be determined based on the country and/or project circumstances.

- ***Internal Controls.*** INT’s investigations indicate that fraud and corruption are often related to breakdown or weaknesses in the internal control environment (see Box 5). More rigorous attention will be paid during project preparation to the design of project internal control systems, including documentation and audit trails. Systems audits would be increasingly emphasized, and as appropriate, detailed internal control reviews by independent auditors/reviewers will be built into project FM design to review the appropriateness and actual functioning of internal control systems. Such review teams would typically include both traditional auditing skills and technical/function specialist skills relevant to the nature of the project. In some cases, these could be designed as part of project external audits. Increased attention will also be given to project internal audit arrangements. Some examples of emerging practices on enhanced attention to internal controls are highlighted in Box 6 below.
- ***Technical and Physical Audits.*** Where needed, project FM designs would include independent checks to verify quality and quantity of output and appropriateness of unit costs. Such arrangements would be designed working jointly with the sectors concerned and the Procurement sector.
- ***Increasing Effectiveness of Project Audits.*** More rigorous attention would be paid to the design and functioning of audit arrangements. Particular attention would be paid to ensuring that the audit scope/terms of reference are appropriate (the “normal” audit scope would be expanded, in some cases, to go beyond merely certification of financial statements to focus more on internal controls and detection of fraud and corruption); and that requirements/expectations are clearly spelt out, including the auditors responsibilities to consider fraud in the audit of financial statements in accordance with ISA 240. Quality of the quality and audit work (including the audit report and management letter) and audit timeliness would be monitored more closely. More rigorous follow of audit reports and management letters by the borrower and the Bank, including audit committees with external stakeholders (such as civil society, professional organizations, and government representatives from outside the project entity) would be emphasized.
- ***Readiness for Implementation of Project FM Arrangements.*** More attention would be paid to ensuring that various aspects of the FM system – manuals/procedures, staffing, internal controls and audit, external audit, etc – are well in place before project start.
- ***Appropriate Project Budgets.*** Increased attention would be paid to ensure that project cost estimates/budgets are correctly estimated (jointly with sector specialists).

Box 5. Weaknesses in Internal Controls: Findings from INT investigations

INT investigations provide examples of fraud and corruption arising from weaknesses in internal controls such as weak accounting evidence—forged and fictitious documents (invoices, training attendance sheets, travel expenses, altered quantities and amounts), poor documentary trail (“informal” receipts), diversion of funds (project funds disbursed by treasury to wrong accounts and diverted), and excessive amounts paid out (e.g., manipulation of quantities).

Lessons learnt include: (a) need for early warning measures (awareness of fiduciary risk flags during supervision, attention to proper payment validation, segregation of financial functions in project organization, need for seamless link between different audit levels); (b) supervision is critical (internal audits within the project, Bank supervisions and SOE reviews, ex-post reviews to focus on internal controls, analysis of audit management letters for patterns of control lapses, linking frequency of supervision to fiduciary risks); (c) the nature of vulnerability varies by type of expenditure. “Soft” expenditures are very vulnerable to forgery and financial fraud (workshops, training, travel, operating expenditures). Goods and works expenditures are more vulnerable to collusion in procurement. In consultancies, reimbursable expenditure are vulnerable to mark ups and fictitious claims; (d) there is need for audit beyond the documentation (in projects where fraud and corruption were substantiated, financial statements were prepared in time and obtained clean audit opinions). Increased sampling for audit may help; (e) preventive mechanisms are important e.g., transparency and disclosure of outputs and audit reports; easy complaints mechanisms and complaint handling systems; improve quality of accounting evidence; and improved internal controls and internal audits.

Source: *Lessons from Fraud and Corruption in Indonesian Projects* (Presentation), May 26, 2006.

Box 6. Examples of Emerging Practices on Strengthened Internal Controls

Kyrgyz Avian Flu Project (detailed upfront focus on Internal Controls). Recognizing the high risk involved in the Compensation Fund—involving cash payments to large number of beneficiaries—detailed work was done in establishing internal controls. Procedures for checking and recordkeeping relating to poultry culling, compensation claims and payments were clearly spelt out. An annual operational review by external reviewers will review the operation of the internal control framework.

Bangladesh Road Sector Reform Project (detailed upfront assessment). A Fiduciary Assessment of the Roads Department is being done at appraisal to identify control and risk management weaknesses in management of projects, assets and other resources; existence and efficacy of mechanisms for external review of decisions; measures to minimize fiduciary risks; and to monitor fiduciary status. The assessment team has multi-disciplinary skills: professional accounting and controls, roads project management, information systems, transport planning and communications.

Nigeria Portfolio (improving internal audit effectiveness). Measures were instituted to strengthen internal audit effectiveness by bundling together internal audit functions across projects. This has made increased the independence of the internal audit function, and enabled better identification of common issues and learning across projects.

West Bank and Gaza (enhanced Statements of Expenditure - SOE review). An indepth SOE review by independent auditors has been instituted. This includes a detailed review of the control procedures e.g., review and approval procedures, documentation of roles and responsibilities, segregation of duties, reconciliation procedures, verification of delivery of goods and services, invoice verification procedures, and payroll controls. It also includes verification of assets, price comparability and verification of bidders on a sample basis; and a detailed transaction-level review for a selected sample including supporting documentation and eligibility of expenditures.

20. ***Transparency of Project FM Information.*** Disclosure of project FM information by the borrower/project entity would be strongly encouraged as part of project FM design. Examples include: project financial statements (interim and annual), audit reports and Management letters, follow-up actions taken on audit reports and management letters, contract information, unit costs, adherence to service standards (e.g., timeliness of financial reporting, the extent of audit reports followed-up on and satisfactory actions taken, adherence to payment schedules and payment sequencing procedures), remuneration to project staff and consultants, project expenditures linked to physical/project progress. Further, project FM design would incorporate measures such as civil society monitoring / oversight to enhance the demand for accountability, training of NGOs on FM and procurement processes so that they can follow these in a more “informed” manner, furthering links with universities to promote the use of development data in studies, and establishing links with local professional associations who can provide useful feedback and highlight red-flags.

21. ***More Emphasis on Integrated Design of Project Arrangements.*** To enhance impact, efforts would be made to better integrate FM arrangements with overall project design, and procurement, disbursement and project monitoring arrangements.

- A more holistic approach to controls in the “contract management cycle” jointly by FM, Procurement and sector specialists, and similarly to the “grant cycle” in cash transfer schemes would be pursued, to ensure that responsibilities among Bank teams for control and monitoring during all stages of the cycle are well defined and that Bank supervision effectively covers the entire cycle (particularly at the post contract-award stage).
- Better coordination of financial transparency measures with community participation and monitoring measures such as social audits, and of project FM design with overall project monitoring and evaluation (M&E) arrangements would be pursued.
- FM staff would play a significant role in country anticorruption teams and in developing project-specific anticorruption action plans envisaged in risky settings. Standard FM controls and monitoring measures would be an important element in such plans.

22. ***Indepth Fiduciary Reviews.*** In selected countries e.g., where the inherent FM country or sector risks are assessed to be high and there is need for a cross-cutting view across projects, portfolio fiduciary reviews would be carried out to look at control issues in more depth, obtain a systemic view, and combine elements of preventive and investigative approaches. This would help to identify areas of vulnerability, provide more specifics on particular areas of attention in the given country context, and identify areas/ sectors/ types of projects for focused attention. (see Box 7 below on the Cambodia and Lao PDR Fiduciary Reviews).

Box 7. Indepth Fiduciary Reviews in Cambodia (completed) and Lao PDR (ongoing)

Review teams were led by the CMU/INT, and included INT forensic investigators, and FM and Procurement specialists. The objective was to identify and assess the key risk points for fraud and corruption, and to identify mitigation measures. The reviews included a step-by-step examination of the procurement process, FM, disbursement, contract administration and supervision, and the quality and effectiveness of project outputs, as well as project preparation and design with regard to corruption risks (e.g., vested interest in land acquisition, whether least cost designs were adopted). The reviews also examined the effectiveness of existing systems and controls (including audits). The Cambodia Review (completed) indicated that traditional approaches to managing fiduciary risks were not working. Weaknesses identified included: projects FM arrangements and audit requirements did not give enough attention to management control issues and consequently could not be expected to reveal significant breakdowns or irregularities e.g., procurement procedures were not adhered to; and the quality of completed sub-projects exhibited poor quality or below-specification workmanship. Improvement measures identified included strong internal controls and monitoring, expanding TOR of project audits to include in-depth audit of financial internal controls and systems, and bundling most project audits under a single contract. A Fiduciary Action plan is now being implemented for the ongoing portfolio.

23. ***Collaboration with the Department of Institutional Integrity (INT).*** To further the linkages between the preventive and investigative dimensions of project-level efforts, we would seek to work more closely with INT. Potential areas of increased collaboration include: (a) joint work on Detailed Implementation Reviews or Fiduciary Reviews; (b) flag potential corruption issues highlighted in internal control reviews, audit reports and management letters to INT; (c) follow-up on INT findings e.g., informing proven cases of fraud and corruption in Bank-financed project to the relevant partner country authorities such as supreme audit institution and anti-corruption institutions, and to relevant authorities in the source country; (d) seek and incorporate lessons from INT's Detailed Implementation Reviews and other work into FM arrangements in new and ongoing projects; and (e) joint training to staff and clients with INT.

24. ***No Changes to Use of Country FM Systems Approach.*** The Bank's strategy paper states that the Bank will strive to strengthen, rather than bypass, country systems—better national institutions are the more effective and long term solution to governance and corruption challenges and to mitigating fiduciary risk for all public money, including that from the Bank. The use of country FM systems will be continued to be encouraged, where assessed to be adequate. Within a given country context, country systems could be used for all or for selected aspects of project FM arrangements, or in specific sectors or institutions, as appropriate. Where ringfencing or special arrangements are instituted as demanded by country or project circumstances, these would be designed in a manner that would strengthen (rather than undermine) country FM systems e.g., supplementing rather than bypassing the country's regular systems and institutions, with such supplemental measures phased out as country performance increases. Simultaneously, developing FM performance, country capacity and human resources would continue to be strongly emphasized, thus facilitating the greater use of country systems over time.

25. ***Inputs into Project Risk Rating.*** The Bank's GAC strategy proposes an upstream risk rating of projects to identify the subset of projects that are most at risk, more senior level review of riskier projects, and a regular risk review of the project portfolio and pipeline to focus resources and managerial attention in areas of higher risk, particularly during supervision.

Clusters of projects that share common features and risks—for example, projects incorporating block grants, cash transfers, compensation payments, or subnational components—will also receive further in-depth review. FM staff will provide inputs into the institutional risk management exercise, which includes FM risk. The established project FM risk model would continue to be used.

26. **Resource Allocations.** FM supervision plans and resources would be better linked with FM and project risk ratings. More senior FM staff would be deployed to work on project design and supervision of riskier projects. Peer review inputs by senior FM sector staff from a different region would also be used as appropriate in high-risk operations.

IV. GLOBAL PARTNERSHIPS

27. **Multilateral and Bilateral Development Agencies.** The FM sector has been a leader in the Bank's harmonization efforts. Key partnership arrangements include an MDB Financial Management Harmonization Technical Working Group, a Joint Venture on Public Financial Management under the auspices of the OECD-DAC which covering several bilateral and multilateral partners; and the Public Expenditure Financial Accountability (PEFA) partnership program. There have been significant progress e.g., the PEFA PFM Performance Measurement Framework, several joint PFM diagnostics, increasing coordinated support for country PFM reform programs, sharing of good practices, common FM assessments and arrangements in projects. Going forward, the Bank will continue and enhance collaboration with development partners to advance both: (a) common objective-setting and support to partner countries—in improving PFM and corporate financial reporting; and (b) harmonization of practices in projects including enhanced anticorruption-related measures. The major focus will be deepening implementation in individual country programs.

28. **Professional and Standard-Setting Bodies.** The Bank also engages with global accounting and auditing professional and standard-setting bodies dealing with both the public and private sectors. Major partnerships include the International Organization of Supreme Audit Institutions (INTOSAI), the International Federation of Accountants (IFAC) and its International Assurance and Auditing Standards Board (IAASB), and the International Accounting Standards Board (IASB). The Bank also engages with regional and country professional bodies. Through these engagements, the Bank seeks: to ensure that development issues of partner countries are addressed in the activities of the organization concerned; to support standards, codes and practices that can be used in Bank operations; and more broadly to contribute to improved financial accountability globally. In the context of the enhanced anticorruption focus, the Bank would continue to engage with these professional and standard-setting bodies, including to ensure that professional standards and codes adequately reflect concerns relating to fraud and corruption.

V. IMPLEMENTATION

29. ***Tools and Guidance for Staff.*** No changes to FM operational policies or procedures appear necessary. Tools and guidance for staff needed to facilitate understanding and implementation of the GAC agenda will need to be developed. A detailed work program outlining specifics would be prepared.

- ***Staff Guidelines.*** The approach to the GAC agenda outlined in this note would need to be incorporated into existing/planned FM guidelines, including: (a) FM issues in DPOs; (ii) fiduciary issues in CASSs; (c) FM Practices Manual (if needed); (d) PFM, including on risk rating; (e) corporate financial reporting. This can be done as part of already planned updates (e.g., guidelines on FM issues in DPLs, guidelines on PFM). Additional guidance material would be developed as needed e.g., how to calibrate FM approaches to country and project circumstances and identified risks, and circumstances/triggers under which portfolio reviews would be appropriate.
- ***Tools.*** Ready-to-use reference material would be collected from existing practice or developed and made accessible to staff e.g., templates/model of terms of reference; sector-specific fiduciary issues in selected sectors, project-level “red flags” / typologies of vulnerable transactions, examples of fraud and corruption, checklist of PFM issues that have bearing on anticorruption, methodology/TOR for detailed internal control review, and modalities of fiduciary reviews.
- Efficacy of the working of regional fiduciary quality assurance processes in the Regions (including fiduciary sign-offs) may need to be reviewed, to identify improvements.

30. ***Dissemination, Sensitization and Training.*** Dissemination and training for FM and other staff would be carried out as part of the overall FM knowledge and learning activities. FMSs would also be encouraged to obtain training in broader related issues such as business ethics, corruption indicators, understanding of broader country political and economic environment, forensic audits and non-formal accountability mechanisms (as in CDD projects).

31. ***Results Framework.*** The Sector will develop performance measures and tools to monitor performance and results. At the country level, the PEFA PFM performance indicators would be used to measure and monitor country PFM performance over time. For Bank portfolio fiduciary work, tools are being developed to help enable more structured results measurement e.g., in the South Asia region, on performance indicators to monitor the impact of FM fiduciary work and the status of FM issues in projects and portfolios. An FM Status Report is being developed to capture key FM *supervision* performance indicators. A FM risk and portfolio management system is being developed to provide real-time management reports relating to regular FM work.

32. ***Issues Requiring Further Consideration.***

Amongst the issues requiring further consideration are the following:

- ***Resources and Skills Implications.*** Resources and skill implications need to be discussed further, and considered in the context of Bank-wide discussions on this subject and the FM sector’s overall human resources strategy. Implementation of these measures will likely require additional resources: particularly in country FM teams, and also

initially at the central level (to develop guidance and tools, training and to support initial implementation). The enhanced work under the GAC agenda also reinforces the need for the FM sector to work “smarter” (particularly to leverage country-level work across projects, and make use of the various modernization/simplification measures effected), and to make tradeoffs in determining relative priorities and allocating resources. Some retooling of staff and upgrading of staff skills will also likely be needed.

- ***Ethics Framework for the FM Sector.*** A further issue for consideration by the FMSB is possible introduction of an "Ethics Framework" for FM staff (in addition to the Bank's [*Code of Professional Ethics*](#)). The objective is to provide leadership by example to both clients and staff. This could be modeled on or reiterate the ethics framework already issued by IFAC/other accounting professional institutes (to which most FMSs are affiliated), and include appropriate disclosures including close relationships with government officials in the concerned partner country.