

**GOVERNANCE AND ANTI-CORRUPTION**

**PROJECT PREPARATION:  
GOOD PRACTICES FOR  
FINANCIAL MANAGEMENT SPECIALISTS**

Financial Management Sector Board

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## GOVERNANCE AND ANTI-CORRUPTION

### PROJECT PREPARATION: GOOD PRACTICES FOR FINANCIAL MANAGEMENT SPECIALISTS

#### Background

1. The primary objective of governance and anti-corruption work at the project level is to improve the development impact of Bank financed projects. While it is not feasible to protect projects completely against risks of fraud and corruption, task teams are expected to identify and mitigate risks that are likely to have a material impact on the project outcomes and to act in response to indicators of corruption. The particular responsibility of Financial Management specialists is to help ensure that project funds are used for the intended purposes, with economy and efficiency. Given their knowledge of local financial management systems, project funding and accountability arrangements and the capacity of local institutions, FM specialists can provide useful advice to borrowers and to task teams on Governance and Anti-Corruption (GAC) related risks and mitigation measures.

2. This purpose of this note is to share good practices on how to tailor FM work during the design and preparation of investment projects, and help mitigate risks of fraud and corruption, especially in higher risk environments. Since standard FM work is already concerned with ensuring that Bank funds are used for intended purposes, this note identifies what is incremental in respect of:

- financial management assessment work
- fiduciary risk mitigation measures, including capacity building
- enhancing the effectiveness of external audit and assurance
- project readiness and supervision planning

3. This note provides access to additional resources, including project examples and other related good practices and guidance via embedded web links. These links will be updated periodically as new material becomes available.

#### Principles of the FM Approach

4. FM specialists should be guided by the following principles in approaching governance and anti-corruption work at the project level:

- a) Strengthening country systems is the preferred approach.** Bank financed projects generally operate in the context of financial management processes and controls that are determined at national level. Weaknesses in these systems will often influence the corruption risks in project implementation to a greater extent than project specific FM arrangements. For this reason FM gives priority to strengthening national systems such as government accounting and

internal controls, financial reporting systems, internal audit, and external oversight institutions such as supreme audit institutions and anti-corruption agencies. At the project level there may also be opportunities to work in support of better country systems to mitigate corruption risks: piloting improvements that have the potential to be scaled up, or helping the client to implement government-led initiatives to improve transparency, accountability and integrity that have been inadequately resourced.

**b) Staying engaged in high risk situations.** The Bank remains committed to helping the poor, even in countries with weak governance environments and high corruption risks, for example in conflict-affected states and in emergency situations. Governance deficits can be bridged through a combination of capacity building to strengthen governance over the medium term, outsourcing to fiduciary agents, and third-party assurance, to ensure that GAC risks are adequately managed and monitored by the client in the short term. The reasons for not using country systems should be clearly explained in the project document, consistent with the commitments made as part of the Accra Agenda for Action.

**c) Mainstreaming monitoring and supervision of GAC risks.** Primary responsibility for managing fraud and corruption risks rests with the implementing agency. The Anti-corruption Guidelines that now form part of the standard loan agreement clarify the clients' responsibilities for monitoring and reporting all instances of suspected corruption. Good practice projects often incorporate governance and capacity building components designed to strengthen clients' own ability to manage and monitor risks, for example through improved internal controls, automation of transaction processing and internal audit. More effective client monitoring systems also enable Bank staff to spend less time checking transactions and more time dealing with substantive project implementation issues.

**d) Teamwork** A pre-requisite for effective management of fraud and corruption risks is that FM specialists work closely with other team members, especially the team leader, sector specialists and procurement specialists, to develop an integrated understanding of vulnerabilities and agree on actions to mitigate the risks. In countries and sectors where there are known to be corruption risks FM staff should be involved from the concept stage. Although the initiative rests with the task team leader to request FM inputs, FM staff should be proactive, drawing potential risks to the attention of the country management and the regional FM manager as necessary.

## **Risk Assessment**

5. At the **project concept stage** task teams make use of the [Risk Identification Worksheet](#) (link) to identify the key risks and vulnerabilities facing the project, propose measures to mitigate those risks and determine the level of management review required. The RIW includes a section on corruption risk and FM is one of several sources of

information contributing to this assessment. At the concept stage the responsibility of the FMS is to advise the task team leader (TTL) on the initial corruption risk assessment, based on known weaknesses in financial management and controls, and the potential corruption risk that may result from these.

6. The FM assessment of GAC risks should factor in a) the risk environment at the country and sector level, as well as b) risk factors that are specific to the project concept, for example implementation through decentralized local bodies, or NGOs, that have weak capacity or lack of accountability. Sources of information that may help FM specialists to form a judgment on country level risks include:

- PEFA Indicators, country financial accountability assessments (CFAA) and other fiduciary diagnostics (e.g. CIFA, PEMFAR etc.)
- Country and/or sector assessments of governance and political economy
- The Country Policy and Institutional Assessment (CPIA) especially Qs 16 and 13,
- WBI Control of Corruption Index
- Country and sector portfolio performance reviews
- IMF Reports

Additional guidance on [country corruption risk analysis](#) is available on the OPCFM website.

7. Since patterns of corruption vary from sector to sector it is important to understand the sector specific nature of the risks. Corruption vulnerability matrices have been developed for a number of sectors and others are being developed. The “value chain” analysis is a systematic approach to identifying corruption risks in the various processes and transactions involved in project implementation and service delivery. Click [here](#) to access those that are currently available. Others are under development by sector anchors. In addition sector specialists and procurement specialists can provide guidance on the nature of risks, based on their knowledge and experience. FM staff should also make use of guidance on indicators of possible corruption (“[red flags](#)”). The FM risks should be integrated into the overall risk assessment in the RIW.

8. Risks identified at the country and sector level will often play out differently at the project level. Therefore the analysis needs to include project specific information about the risks, including:

- entity audit reports and management letters,
- previous FM assessments of the implementing agencies, project supervision and completion reports (ISR and ICR) and any reports available from INT.

9. The FMS should identify gaps or weaknesses in internal controls that create opportunities for corruption. In making this assessment FM specialists should ensure they have information not just about the design of internal controls but also how they operate in practice. Where necessary an independent review of internal controls should be commissioned as part of project preparation. Sample terms of reference are included in the [GAC Audit and Assurance Toolkit](#).

10. A simple but effective technique for identifying governance weaknesses and corruption risks is to organize consultation meetings, both with the client staff and with external stakeholders. The Committee of Sponsoring Organization ([COSO](#)) has proved a useful tool for task teams, working with the borrower, to identify and evaluate project risks. Anonymous voting is a key feature of COSO that results in more candid assessment. Client participation in the process of risk identification and evaluation is critical in securing ownership and implementation of risk mitigation and oversight measures.

11. FM staff should document their assessment of corruption risk as part of the FM risks assessment and communicate this to both the task team leader and the regional FM manager. The main tool for doing this is the RIW. In addition the PRIMA system provides a systematic means for staff in ECA to record and follow up on identified corruption risks. The risks should be reviewed and updated, during project appraisal and implementation as additional information becomes available.

### **Risk Mitigation: “Smart project design”**

12. Projects with high or significant corruption risks require more intensive design and preparation work. When planning project preparation FM staff should consider whether they need to incorporate additional types of work as follows:

- further assessment of client capacity and systems, to ensure that the main GAC related risks are identified and assessed
- design of capacity building components to address governance weaknesses,
- design of independent assurance and third party monitoring arrangements

13. To support this, the FM Regional Manager will normally nominate an experienced senior FMS to lead preparation of high risk operations, or provide additional support to less experienced staff. The FMS should discuss and agree with the TTL and the client the preparation work required and the costs and timing of this work.

14. In the event that INT has carried out investigation work in-country that may be relevant to the project, a good practice is to consult with INT Preventive Services Unit (PSU) about possible risks affecting the project. The PSU may also be able to provide advice on risk mitigation and project design.

### **Typical FM GAC related risks and mitigation measures**

15. Tools and techniques for addressing GAC risks follow three main principles: transparency, accountability and participation.

*Transparency* implies openness and visibility. It is the foundation upon which both accountability and participation are built. Information in the public domain is the “currency” of transparency and, together with open and visible decision-making processes, signals that there is really nothing to hide. Transparency facilitates good governance; its absence provides cover for conflicts of interest, self-serving deals, bribery, and other forms of corruption.

*Accountability* has many dimensions, including internal and external. 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 revenue, in the creation of public goods and in the delivery of basic services. External accountability refers to the responsiveness of public officials to the citizens including accountability for delivery and quality of basic services, such as health care, education, water and sanitation, and for stewardship of public funds and other public assets.

*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. The benefits of participation in public governance are well documented. In the context of projects participation is important in decisions on the type of investment projects to be done, their design and implementation, and their operation and maintenance. The involvement of civil society organizations, consumer groups, project beneficiaries and affected communities in all stages of Bank-financed projects can simultaneously improve development outcomes and reduce the scope for fraud and corruption.

Table 1 below describes various FM tools and techniques that have been used in high risk projects to mitigate corruption risks.

**Table 1: Typical FM Risk Mitigation Measures**

<i>FM capacity building</i>	<i>Third party monitoring and assurance</i>	<i>Modified funds flow</i>	<i>Use of Remedies</i>
Strengthened internal controls <ul style="list-style-type: none"> <li>• Finance Manuals</li> <li>• Systems automation</li> <li>• Staffing and training</li> </ul>	Expanded scope of external financial audit: <ul style="list-style-type: none"> <li>• Geographical coverage</li> <li>• Internal controls testing</li> <li>• Verification of existence</li> </ul>	Elimination of cash transactions	Pre-determined, graduated Bank responses to fraud and corruption including partial suspension of disbursements and reimbursement.
Strengthened internal audit <ul style="list-style-type: none"> <li>• Independence</li> <li>• Procedures</li> <li>• Staffing and training</li> </ul>	Special purpose audit and assurance engagements	Direct transfers to implementing units and project beneficiaries	Client initiated remedies.
Assistance to NGOs, CBOs etc. to meet FM benchmarks for handling project funds.	Use of fiduciary agents to compensate for weak client capacity and high corruption risk	Selection of implementing agencies tied to FM capacity and qualification criteria.	
Support for community oversight of project finances.	Community level disclosure of project budgets, funds release and utilization (community notice boards and web-based disclosure).		

In addition, a selection of good practice projects, incorporating examples of FM innovations in World Bank financed projects can be accessed via the [FM Website](#). Annex 1 sets out in more detail the commonly occurring risks of fraud, corruption and misuse of project funds, together with interventions that can enhance project design and help mitigate the risks.

16. In a number of regions and countries Governance and Accountability Action Plans have been standardized as a tool to agree and monitor risk mitigation activities with the client (see [India guidance note](#) on the development of GAAPs).

### **Project readiness**

17. A common problem in implementation is that key risk mitigation measures, such as appointment of key staff and establishment of effective internal controls, are not completed until well into project implementation, and sometimes not at all. In higher risk projects FM specialists need to clearly flag those risk mitigation measures that should be conditions of either appraisal or effectiveness, and ensure that the other members of the task team and management are aware of these. This depends in part on early involvement of FM specialists in project preparation, so that there is time to implement whatever mitigation measures are required, thus minimizing possible delays to the project while appraisal requirements and conditions for negotiations and effectiveness are met.

### **Ensuring effective project oversight and supervision**

18. Well designed projects integrate corruption monitoring and oversight arrangements, such as social audit, complaints handling and additional assurance, into the project design. Nevertheless, high risk projects generally require more intensive and targeted implementation support and oversight by Bank staff during implementation. The overall approach and resources should be discussed and agreed with the client and with the Bank's management during project preparation. The FMS should prepare a supervision plan that ensures adequate review of high risk areas and anti-corruption components of the project. This should be agreed with the TTL and the Regional FM Manager and documented in the FM supervision plan. Elements of a smart supervision plan may include:

- Combined supervision by FM, Procurement and technical staff
- Target risk areas
- Random selection of sites to visit, without advance notice
- Confirm existence and end use
- Support client management of GAC risks
- Vigilance for indicators of possible fraud and corruption (red flags)
- Systematic response to red flags and consistent follow up

(More information about implementation support and oversight is provided in a separate note FM Good Practice Note)

The Bank's management is responsible for ensuring that sufficient time and resources are allocated to carry out adequate project supervision.

### **Roles and responsibilities**

19. The responsibility of the FM specialist during project preparation is to provide professional advice to the client, the task team and Bank management on potential implementation risks related to weaknesses in internal controls, funds flow, financial reporting and audit arrangements, based on a thorough understanding of the performance of those systems. The FMS is also responsible for providing advice on measures to mitigate significant risks, and the expected residual risks. These may be contained within the project or dealt with as part of another activity, such as a development policy loan or analytical and advisory activities (AAA).

20. The FM Manager is responsible for providing FM specialists with sufficient guidance and support to enable them to discharge their responsibilities fully, including selecting suitably qualified and experienced staff to work on high risk projects. The Manager is also responsible for reviewing the quality of the project preparation work carried out by the FM specialist and for bringing to the attention of senior management significant risks that, in their view, have been inadequately addressed by the task team leader or more senior managers.

## ANNEX 1 : FM GAC RISKS AND GOOD PRACTICE RESPONSES

<i>FM Risk Area</i>	<i>Typical GAC risks</i>	<i>Good practices in project design</i>
<b>Resource allocation and budgeting</b>	<ul style="list-style-type: none"> <li>• Allocation of resources is influenced to benefit specific interest groups or communities.</li> <li>• Budget resources are reallocated or diverted for improper use.</li> <li>• Budgets that are not properly analyzed, supported and monitored are susceptible to fraudulent procurement schemes that may appear to be “within budget”.</li> </ul>	<ul style="list-style-type: none"> <li>• Promote stakeholder involvement in decisions about resource allocation, selection of beneficiaries and use of project funds.</li> <li>• Strengthen budget processes that control project costing, allocation and viring of funds.</li> <li>• Disclosure of budget information to beneficiaries and other stakeholders.</li> </ul>
<b>Funds flow</b>	<ul style="list-style-type: none"> <li>• Complex financing arrangements and handling by multiple officials create opportunities for rent seeking behavior and for frauds to remain undetected.</li> <li>• Payments to beneficiaries and suppliers are withheld or delayed to extract bribes.</li> <li>• Payments are made to secure release of budgeted funds from central or local government.</li> </ul>	<ul style="list-style-type: none"> <li>• Simplify funds flow arrangements. Ensure that funds flow by the most direct route possible to the beneficiaries, minimize the involvement of intermediaries, and</li> <li>• reduce the number of bank accounts.</li> <li>• Automation of transaction processing.</li> <li>• Complaints handling mechanisms.</li> </ul>
<b>Internal controls</b>	<ul style="list-style-type: none"> <li>• Weak internal controls allow officials divert project funds to other purposes, carry out fraud or otherwise misuse project funds.</li> <li>• Client staffing is inadequate to ensure effective fiduciary oversight of complex project transactions.</li> <li>• Lack of monitoring of internal controls creates opportunities for fraud and corruption and allows actual frauds to remain undetected.</li> <li>• Failure to regularly monitor the existence and quality of assets presents a risk of fraudulent delivery, misuse and theft.</li> </ul>	<ul style="list-style-type: none"> <li>• Strengthen internal controls to ensure effective segregation of duties, maintenance of financial records, including control logs, payrolls and asset registers and removal of control risks such as unduly complex approval processes and cash transactions.</li> <li>• Appointment of qualified staff to carry out and supervise key control functions..</li> <li>• Outsource fiduciary functions to an expert agency under client control.</li> <li>• Automation of controls in order to limits personal discretion and provide an audit trail..</li> <li>• Strengthen (or set up) internal audit functions within project implementing entities, in order to monitor and strengthen internal controls</li> <li>• Expand the scope of external audit <b>to cover identified</b> risks. Aspects to consider include the frequency of audit, geographical coverage, the level of substantive testing, verification of existence and end use, and the nature of the audit opinion.</li> </ul>

<i>FM Risk Area</i>	<i>Typical GAC risks</i>	<i>Good practices in project design</i>
<b>Financial reporting</b>	<ul style="list-style-type: none"> <li>• Financial reports that are not prepared on time, in agreement with underlying records and supporting evidence may be fraudulent</li> <li>• Lack of timely and accurate reporting allows misuse of funds to remain undetected.</li> </ul>	<ul style="list-style-type: none"> <li>• Strengthen the financial reporting function.</li> <li>• Ensure scope of internal and external audit work is sufficient to verify consistency with underlying transactions and records</li> <li>• Ensure access to financial reports, and ease of understanding by stakeholders through attention to the presentation format, inclusion of graphical and narrative explanations, translation into local languages and public dissemination via the web, community notice-boards, local newspapers etc.</li> </ul>
<b>Disclosure of financial information</b>	<ul style="list-style-type: none"> <li>• Lack of accessibility of financial information undermines accountability to beneficiaries for delivery of resources and services.</li> </ul>	<ul style="list-style-type: none"> <li>• Promote transparency and disclosure of project financial information to stakeholders. Details of budget allocations, transfers of funds, utilization, accounts and audit reports, management letters, contract information, adherence to service standards, and remuneration to project staff and consultants may be shared with stakeholders, subject to negotiation with the client and limitations in the Bank's legal agreements.</li> </ul>
<b>External audit</b>	<ul style="list-style-type: none"> <li>• External auditors fail to identify material risks or report control failures.</li> <li>• Scope of the financial audit is insufficient to address identified high risk areas.</li> <li>• Failure to address audit findings in a timely manner represents a significant deficiency in accountability and control.</li> </ul>	<ul style="list-style-type: none"> <li>• External auditors need to be assessed on their quality, capacity and independence.</li> <li>• The scope of the routine financial audit can be expanded to cover specific monitoring of anti-corruption measures, such as the availability of financial information to beneficiaries or handling of complaints.</li> <li>• Special purpose audit and assurance engagements to verify end use, project effectiveness, contract implementation etc. Further guidance is available in the Audit and Assurance Toolkit.</li> </ul>
<b>Contract non-performance and procurement fraud.</b>	<ul style="list-style-type: none"> <li>• Corrupt payments by contractors result in non-performance</li> <li>• Asymmetric information provision favoring some providers</li> <li>• Collusion between suppliers to inflate costs</li> </ul>	<ul style="list-style-type: none"> <li>• A standard contract audit clause in Bank funded projects allows for contractors books and records to be audited.</li> <li>• Specialized audit type reviews can be required as part of client supervision of the project in addition to the financial audit. These include performance audits, procurement audits and technical audits of infrastructure, see GAC Audit and Assurance Toolkit.</li> <li>• Note that the team leader, rather than the FMS, has overall responsibility for determining the scope of assurance work where this extends beyond the financial statement audit.</li> </ul>