



# Chapter 19

## Financial Management

### 1. Why financial management is important?

- To facilitate the delivery of large volumes of funding rapidly and transparently through the MAP;
- To satisfy fiduciary requirements that project resources are being used economically, effectively and efficiently for the purpose intended;
- To build stakeholders' trust in the MAP approach and its ways of doing business;
- To assist with the control of misappropriation and other corrupt practices;
- If finance is misused, accessing further funding will be difficult or unavailable.

### 2. What is needed for an effective financial management system?

#### Introduction.

Money makes projects happen and financial management and control is all about ensuring that money and other resources are used economically, effectively and transparently and are available where needed, on time, to meet project needs. Financial management comprises five basic elements, see Box 19.1.

Because of the nature of the MAP program and structure, MAP financial management and control, especially internal financial systems which are essential to good implementation, is more complex than in traditional investment projects. This is because of the different levels and financial channels involved in the successful implementation of a MAP. These levels are: first, the primary organization (NAC/NAS) which is responsible for overall project coordination, financial management, and administration; second, secondary organizations which implement and supervise programs on behalf of NAC/NAS; and third, tertiary organizations, or local communities, which implement subprojects at the local level. The cascading of funds down to these different levels also means that financial management and control must extend from the national NAC/NAS level to the community. Similarly, financial reporting must cascade back up from the community level, through district and other intermediate levels, to the national organization or the NAC/NAS.

#### Box 19.1: Financial Management

- Planning and budgeting
- Disbursement (see Chapter 20)
- Recording financial transactions
- Reporting financial transactions and physical progress
- Ensuring the integrity of internal systems and controls and financial reports. Providing an effective value adding internal audit mechanism and independent and effective external audit.

Many people consider compliance with financial management requirements a difficult and daunting task. These people also often believe that financial management, internal control systems, and audit rules make compliance issue worse. In fact, the opposite is true, particularly when the main financial management tasks are assigned to a trained and experienced specialist. World Bank financial management rules and requirements are specifically designed to provide projects with flexibility while providing sound financial control and maintaining the integrity of the program's objectives. MAP projects provide greater flexibility than most other Bank financed projects, particularly at the community or district level. While rules do obviously apply, they are relatively simple, few in number, very flexible, and can be easily accommodated, particularly with competent and trained people.

## Requirements for suggested financial management system

MAP programs are designed to follow the financial management rules of borrower / recipient governments and in consultation with donor institutions. The financial management system must ensure that: (i) record of project assets, liabilities, receipts, and expenditures are maintained in compliance with statutory and other requirements; and (ii) financial information is provided to facilitate project management and to improve project performance continuously. Table 1 at the end of this chapter provides a matrix of requirements for a suggested financial management system for a MAP at different levels of implementation . It is subdivided into three implementing categories or levels and key financial management elements. The number and type of implementing organizations in different MAPs will vary considerably but the three generic categories noted here should cover most possibilities. They are:

- Category A** Primary organizations such as NAC/NAS which are responsible for: (i) the maintenance and management of the Special Account(s) and other overall MAP fiduciary responsibilities; (ii) coordination of the MAP program; (iii) disbursing funds to secondary or intermediary organizations (Category B); and (iv) disbursing funds to communities (Category C).
- Category B** Secondary or intermediary organizations such as NGOs, private sector service providers, line ministries, or other decentralized service providers. These organizations are responsible for: (i) the maintenance of a MAP program bank account; (ii) the delivery of services; (iii) the disbursement of funds to communities (Category C); and (iv) supervision of the implementation of the MAP programs;
- Category C** Tertiary organizations- mainly communities which may not necessarily operate a bank account and which implement subprojects.

The attached matrix (Table 19.1) provides summary guidelines by category (A, B, and C) for:

- Accounting methods
- Books of account such as the cash book and general ledger
- Financial statements and reports such as the sources and uses of funds, balance sheet and income and expense statement, and statement of expenditures
- Reporting cascade
- Internal audit
- External annual audit, including the management letter

These guidelines are not exhaustive but they do provide a framework around which a project accounting manual or the financial management manual may be prepared.

## Other key considerations

Specific information of relevance to the financial management of MAPs which is not included in Table 19.1 is noted below. The Disbursement subject is addressed in Chapter 20.

## Financial reporting

MAP finances are administered by the finance and administration units of the National AIDS Council (NAC) or the National AIDS Council Secretariat (NAS). The NAC/NAS itself is responsible, or more commonly through sub-contracting to a special public agency such as the Ministry of Finance or a private firm, for project coordination, the management of bank accounts, the consolidation of all project reports<sup>36</sup>, and liaison among the government, the Bank, and other donors.

During project preparation the donors and the government or NAC/NAS should decide on the minimum financial data needs and agree to collect only these. It is highly desirable to avoid reporting the same data in different formats to satisfy different stakeholders. Report designers should consider either: (i) adopting the existing or government reporting formats and requirements; or (ii) adapting the government format to conform to standards for a program with MAP's complexity. Each transaction will be initiated on a source document such as a bill, receipt, or invoice. These documents will be evaluated before payments are made and filed for future audit.

## Financial Monitoring Reports

Recently the Bank simplified reporting requirements for its clientele. Financial Monitoring Reports (FMRs) are simply put, a comprehensive report of project expenditures and other financial data matched to the physical progress of the project and the status of implementing the procurement plan at a given date, which is usually end of a quarter and in some rare cases end of a six month period. Preparation of FMRs (previously PMRs – Project Management Reports) is mandatory for Bank financed projects approved after July 1, 1998. Some projects also use FMRs as the basis of disbursement (report based). FMRs are in that case playing a dual role i.e. a monitoring tool and a trigger for subsequent disbursement of Credit/ Loan/Grant proceeds to the implementing entity. FMRs are generally due within 45 days following end of the reporting period. NAC/NAS is responsible for putting the FMR in place before project implementation begins and the Bank's role is to monitor and review their use throughout the MAP's life.

FMRs need to provide sufficient information to establish: (i) whether funds disbursed are being used for their intended purpose; (ii) project implementation is on track; and (iii) budgeted costs are not exceeded. Financial information should be linked with information on physical progress and status of implementing the procurement plan and matched with the results of program monitoring and evaluation.

The format and content of FMRs should be determined during project preparation and agreed at negotiations. Adequate financial management arrangements, including the ability to produce timely FMRs, should be in place by project effectiveness. Examples of report requirements for MAP projects are included in Reference 13.2 (FMR Guidelines Reference A Sample 3) and they include: (i) Discussion of Project Progress; (ii) Sources and Uses of Funds Statement; (iii) Uses of Funds by Expenditure Type; (iv) Output Monitoring Report; and (v) Procurement report.

<sup>36</sup> Report formats must be clearly specified in the operations manual which should be agreed during project preparation. The timing for the submission of reports should also be specified.

## Auditing procedures and arrangements

### External Audit

**Scope of Audit:** All MAP projects are subject to annual external audits and these must comply with government regulations and the Bank's Operational Policies (OP/BP 10.02).

Examples of unqualified audit reports for an organization, for a project financial statement including a statement of expenditure, and for a special account are attached in references.

Audits of the Statement of Expenditures (SOE) – [where applicable] should be considered a part of the overall audit of the specific project financial statements but a greater effort of compliance checking is usually necessary. This is because withdrawal requests to the World Bank to transfer funds (from the Bank) to the Special Account may not be supported by documentation. The primary objective of this part of the audit is to ascertain that there is adequate audit trail behind each individual transaction that comprise the SOE based expenditures.

**Selection and appointment of auditor.** In principle, the use of independent audit firms should be encouraged where possible. Every effort should be made to appoint auditors who fulfill the criteria required by the International Standards on Auditing. Government auditors may provide an alternative to private auditors but their level of independence needs to be carefully assessed, as does their capacity to conduct a MAP audit given their other tasks. However, where available, reference should be made to the Country Financial Accountability Assessment (CFAA), which will have addressed this matter and provided recommendations for action. Where the government auditor is considered unlikely to have the required capacity to audit complex MAPs, effort should be made by government to contract the audit to an independent private auditing firm following Bank Guidelines for the Selection of Consultants.

Auditors should preferably be appointed early during the first year of project implementation to allow them an early opportunity to provide advise to the borrower on financial management systems and other implementation arrangements which involve financial transactions. During this period the auditor should also advise the borrower on the adequacy of the internal control procedures planned for the administration of the project.

NAC/NAS must advise the donors of the proposed auditors even when the government auditor is to be used and agreed at negotiation. The donor will review NAC/NAS nominee and issue its no objection if it believes the nominated auditor meets the project's requirements.

#### Box 19.2: Audit reports need to include:

- An assessment of the adequacy of the accounting and internal control systems to monitor expenditures and other financial transactions and ensure safe custody of project-financed assets;
- A determination as to whether NAC/NAS and other project implementation entities, communities or individuals have maintained adequate documentation on all relevant MAP transactions;
- Verification that expenditures documented to the Bank are eligible for financing, and identification of any ineligible expenditures;
- A separate opinion as to whether the financial statements of the Special Account(s) give a true and fair view of the financial position of the Special Account(s); and
- A management letter from the auditor which evaluates overall management performance within the NAC/NAS

### Internal control and internal auditing

World Bank guidelines do not require the establishment of an internal audit unit. But, because of the wide geographic spread and nature of implementation arrangements of the MAP, the establishment of a competent internal audit unit within the NAC/NAS or, perhaps more appropriately, the appointment of an external firm to fulfill the function is highly recommended but taking the cost of the service into consideration. An internal auditor should work within a well-defined framework of programs and reporting requirements.

### Implementing project financial management requirements

Two basic options are available: first, undertaking all financial recording and reporting functions under the project umbrella in the NAS using its own staff; and second, contracting these functions to a suitably qualified firm of relevant professionals, (Financial Management Agent – FMA) which may also provide procurement services. In view of the emergency response nature MAPs are meant to support there is an even greater need to ensure integrity and competence in the financial management. To this end, use of FMA is highly desirable. So far there is a correlation because successful MAPs and use of FMAs.

#### Box 19.3: Role of the Internal Auditor

Typical matters which the internal auditor should appraise and report to top management include:

- The effectiveness of accounting, financial and operational controls, and any need for revisions;
- The extent of compliance with prescribed policies, plans and procedures;
- The reliability of accounting systems, data and financial reports;
- Methods of remedying weak controls or creating them where there are none; and
- Verification of assets and liabilities

## 3. Lessons learned and recommendations

Since the first MAP project commenced a number of key lessons have been learned:

- **Contracting financial management services** has been found to be the most effective way of managing project funds and complying with government and donor fiduciary requirements. However, there is a need for NAC/NAS to provide clear information about MAP and provide guidelines and information on the operations, flow of funds, and reporting requirements to both civil society and other stakeholders in the public sector;
- **Action plans for both financial management and monitoring and evaluation should be agreed from the outset.** Given the type of expenditures, multi-sector nature and geographic spread of the program, the accountability and discharge of fiduciary functions dictates different means of ex-post control. Accountability must be complemented by an effective monitoring and evaluation system. Accordingly it is important that the financial management and monitoring and evaluation are integrated and in place at the outset;
- **Capacity building within the financial management agency and the implementation of financial management concepts** and action plans has taken considerable time. This should be reduced and minimized in future through knowledge management and the reuse of systems and documents. Reuse of developed material, designed systems, and designed hardware and software specifications can save time and money;
- **Delay in the return of required documentation** and accounting for advances has reduced disbursements. Forms and other procedures need to be simplified further but a strong finance team headed by a well qualified professional with strong leadership capacity is necessary to ensure timely and complete accountability;

- **Implementation of FM systems** have largely been achieved at NACs but more attention is required at lower levels of the public sector and civil society where capacity varies.
- **Disbursement of funds** for the MAP has commenced but there is evidence that disbursements are slow. There is a clear need for the financial management system to include a timely monitoring system to detect actual and potential problems and bottlenecks;
- **Government financial and internal control systems** may be inconsistent and may not always be effective. Additionally, the concept of internal audit is not well understood and the design and capacity for the internal audit function is less than adequate. Early local advice and close liaison with government is essential to ensure satisfactory internal control and internal audit procedures;
- **Workshops in capital cities address generalities and will not detect and address crucial details which hinder day to day operations.** Financial management and procurement specialists must visit all ministries and regional entities to discuss and review financial management and procurement arrangements and issues;
- **Public sector accountability for MAP funds has been found to be inadequate in some countries.** Adequate training, strict procedures, follow-up and audit must be in place from the day the project becomes effective and ideally even before during project preparation;
- **Government budget ceilings on levels of expenditure may be problematic.** Project preparation teams should review this issue and resolve any possible conflicts with project objectives prior to project effectiveness.

Table 19.1- Matrix of Suggested Financial Management Requirements

Category C Fund <sup>37</sup>		Category B Fund <sup>38</sup>		Category A Fund <sup>39</sup>	
Accounting method	<ul style="list-style-type: none"> <li>i. Use local language</li> <li>ii. Transactions recorded in simple formats</li> </ul>	<ul style="list-style-type: none"> <li>i. Use English/French language</li> <li>ii. Double entry bookkeeping system</li> <li>iii. Historical cost accounting</li> <li>iv. Computer or manual system</li> </ul>	<ul style="list-style-type: none"> <li>i. Complies with Bank Procedures BP 10.02</li> <li>ii. Complies with detailed procedures located in agreed individual project accounting manual</li> <li>iii. Use English/French language</li> <li>iv. Double entry bookkeeping system</li> <li>v. Historical cost accounting</li> <li>vi. Computerized system is essential</li> </ul>		
Books of account	<ul style="list-style-type: none"> <li>i. Cash issued register</li> <li>ii. Supporting documents retained</li> <li>iii. As few forms as possible to be used</li> <li>iv. Register of in-kind contributions maintained</li> </ul>	<ul style="list-style-type: none"> <li>i. Cash payment &amp; receipt book</li> <li>ii. Petty cash book</li> <li>iii. Stores records</li> <li>iv. Fixed asset register</li> <li>v. Cheques issued register</li> <li>vi. Cash issued register</li> <li>vii. Journal for non cash transactions</li> <li>viii. Fund replenishment register and register of expenses</li> <li>ix. general ledger</li> </ul>	<ul style="list-style-type: none"> <li>i. Cash payment &amp; receipt book</li> <li>ii. Petty cash book</li> <li>iii. Stores records</li> <li>iv. Fixed asset register</li> <li>v. Cheques issued register</li> <li>vi. Cash issued register</li> <li>vii. Journal for non cash transactions</li> <li>viii. Credit drawdown register</li> <li>ix. Register of SOEs</li> <li>x. general ledger</li> </ul>		
Financial statements and reports	<ul style="list-style-type: none"> <li>i. Monthly cash fund reconciliation statement</li> <li>ii. Fund Replenishment Request as required</li> <li>iii. Annual Cash Fund Reconciliation statement in predetermined cost categories</li> <li>iv. Annual Statement of In-kind Contributions in predetermined categories (see sample)</li> <li>v. Milestone report</li> </ul>	<ul style="list-style-type: none"> <li>i. Fortnightly and annual bank reconciliation statement</li> <li>ii. Fund Replenishment Request as required</li> <li>iii. Physical progress report</li> <li>iv. Fiscal year Balance Sheet if assets purchased or liabilities incurred within 1 month of year end</li> <li>v. Fiscal year Income and Expenditure statement in predetermined categories within 1 month of year end</li> <li>vi. Summary of Sources and Uses of Funds by agreed categories- including individual category C funds where practicable</li> <li>vii. Budget for next fiscal year 3 months before year end</li> </ul>	<ul style="list-style-type: none"> <li>i. Fortnightly and annual bank reconciliation statements for all bank accounts</li> <li>ii. Financial Monitoring Reports including:                             <ul style="list-style-type: none"> <li>a. Discussion of Project Progress</li> <li>b. Sources and Uses of Funds Statement</li> <li>c. Uses of Funds by Expenditure Type</li> <li>d. Output Monitoring Reports</li> <li>e. Procurement Report</li> </ul> </li> <li>iii. Disbursement documentation for replenishment (see Chapter 14 for specific details)</li> <li>iii. Special Account(s) Statement plus Annual Statement of Expenditure Withdrawal by agreed categories</li> <li>iv. Annual summary of Sources and Uses of Funds by agreed categories and individual funds where practicable</li> <li>v. Annual Balance Sheet for assets and liabilities within 3 months of year end</li> <li>vi. Annual Income and Expenditure Statement in predetermined categories within 3 months of year end</li> <li>vii. Annual External Audit Report and audit of the Special Account(s)- 6 months after year end</li> <li>viii. Annual Internal Audit Report within 2 months of year end</li> <li>ix. Budget for next 12 months by fund, 2 months before year end</li> </ul>		
Reporting cascade	<ul style="list-style-type: none"> <li>i. All fund activities</li> </ul>	<ul style="list-style-type: none"> <li>i. All Category B Fund activities financed directly by Category B Fund, plus</li> <li>ii. Sum of all Category C Fund activities funded by Category B fund</li> </ul>	<ul style="list-style-type: none"> <li>i. All Category A Fund activities financed directly by Category A Fund, plus</li> <li>ii. Sum of all Category B &amp; C Fund activities funded directly by Category A Fund</li> </ul>		
Internal audit	<ul style="list-style-type: none"> <li>i. Random review of financial management procedures</li> </ul>	<ul style="list-style-type: none"> <li>i. Annual review of financial management procedures</li> </ul>	<ul style="list-style-type: none"> <li>i. On-going process</li> </ul>		
External annual audit	<ul style="list-style-type: none"> <li>i. Random selection</li> </ul>	<ul style="list-style-type: none"> <li>i. Random selection for accounts with less than USD20,000 annual expenditure</li> <li>ii. Full annual audit for accounts with USD20,000 or more annual expenditure</li> </ul>	<ul style="list-style-type: none"> <li>i. Full annual audit</li> </ul>		

<sup>37</sup> Tertiary organizations- mainly communities which may not necessarily operate a bank account and which implement subprojects.

<sup>38</sup> Secondary or intermediary organizations such as NGOs, private sector service providers, line ministries, or other decentralised service providers. These organizations are responsible for: (i) the maintenance of a MAP program bank account; (ii) the delivery of services; (iii) the disbursement of funds to communities (Category C); and (iv) supervision of the implementation of the MAP programs;

<sup>39</sup> Primary organizations such as NAC/NAS which are responsible for: (i) the maintenance and management of the Special Account(s) and other overall MAP fiduciary responsibilities; (ii) coordination of the MAP program; (iii) disbursing funds to secondary or intermediary organisations (Category B); and (iv) disbursing funds to communities (Category C)



