

Health Systems Funding Platform

Harmonization and simplification of Financial Management

EXPOSURE DRAFT

November 23, 2010 *(revised October 2011)*

Executive Summary

This report is jointly produced by financial management focal points from the World Bank, the Global Fund (GFATM) and the GAVI Alliance. The objective of the work is to develop financial management processes acceptable to the different agencies that can be applied to funded operations. The recommendations outlined in this report can be commonly applied to future HSS funding, and, to some extent, to existing operations funded by the three agencies. They would allow the harmonization of Financial Management (FM) framework, requirements, processes, and practices to a large extent, whether or not pooling of funds is involved.

The discussions on Procurement are at an early stage with a different group of participants from the three institutions. The group will submit a separate report when sufficient progress is made and as appropriate. Also, the subject of harmonization of monitoring and supervision during implementation of financed operations requires more discussions and guidance from the management.

Following this executive summary, a short report provides the salient features and relevant details of the issues and provides the recommendations. Both the executive summary and the main report were revised in March and October 2011, taking into consideration the comments received to date. A more detailed and technical report is in annex to provide background and describe the process and methodology used for the work. It describes similarities and differences in approach and processes and goes on into discussions regarding the salient features of Public Financial Management (PFM) and the areas for harmonization of FM practices and processes by the three agencies. The detailed technical annex then concludes by offering details of the recommendations for harmonization of requirements and approaches, ranging from, for example, a single FM assessment and a process of quality assurance prior to financing through to single financial reporting and single external audit arrangement, among the three agencies. These would also be applicable to, and should be discussed with, other Development Partners (DPs) at both global and country level. The report finally raises a few questions regarding remaining challenges and seeks guidance from Management of the three organizations.

The overall conclusion of the FM group is that the same principles for accountability and financial management apply for financing of operations by the three agencies. As a matter of policy, they require that, by the time funds are released, capable systems and adequate arrangements are in place by the recipients in order to: manage and account for funds received, produce periodic financial reports and statements, and have external audits carried out annually by acceptable external auditors. The three agencies, by and large embrace internationally recognized Standards, guidelines, and good practices related to financial management (i.e. planning and budgeting, internal control, management,

accounting, financial reporting, and auditing. The recipients are expected to have adopted similar standards and to practice them. When this is not the case, the agencies expect that, at least for their funds, the Partner Countries (PC) quickly build capacity to be able to adequately comply with the agreed requirements before funds can be released. Alternatively, or as an interim measure, the agencies accept safeguard measures in order to mitigate and manage the fiduciary risk. These include parallel systems and arrangements and increased scrutiny of financial transactions. They are designed and agreed upon, and implemented before funds can be released.

In order to ensure the above requirement, now the three agencies require that a Financial Management Assessment (FMA) be carried out in order to detect any shortcomings and gaps and to provide action plans to overcome them. In general, the team noted some important differences in the current FM practices of the three agencies. These are partly due to the differences in timing, enforcement, and approach to quality assurance (QA) of the FMAs and partly due to risk assessment and management and application of mitigating measures and follow-ups.

The FM group's recommendations do not constitute any major change in the FM policies or principles of the agencies, but rather to practices. For example:

- FMAs are required (policy) by each of the three, but in practice they vary in scope, timing and degree of QA. GAVI and GF policies are to start these after a grant is approved but before funds are released while the World Bank completes the assessment before the board consideration.
- The three agencies have very different approaches to ongoing monitoring: the World Bank does this mostly through its in-country presence; the Global Fund mostly through a combination of its Local Fund Agents and Secretariat resources; and GAVI through a combination of in-country partners and Secretariat resources.
- The three agencies also require periodic financial reports which fairly represent the state of the progress, the expenditures, assets and balances, etc.
- Finally, agencies require at the minimum an annual external financial audit of the funded operations' accounts and financial statements.

The differences, lack of harmonization and the fact that currently each organization imposes its own requirements, drive the recipient to establish dedicated capacity and systems for each DP, produce separate reports and make separate institutional arrangements. In case the same unit is managing operations funded by different DPs, the staff faces multiple audit teams regularly chasing the same files and requesting time of the same staff.

The fact that each agency acts separately and at a different time in the grant/loan approval cycle, the variations in the requirements, and varied follow-up actions create duplication of efforts and costly burden on PCs, and further amplifies the fragmentation and contributes, sometimes, to additional risks. The FMA is critical to most of the other requirements and arrangements; a jointly carried robust FMA under a common quality assurance will provide a solid foundation for coordination and harmonization.

This report offers recommendations in terms of joint FMA, common quality assurance process, and the minimum required content for a complete FMA report which could be acceptable to the three agencies, and perhaps many other DPs.

Harmonization among the three agencies, and perhaps many other participating development partners, could take place in the following 4 areas:

- A single and Joint FM Assessment of the implementing entity(ies) - harmonization of the process, timing, scope, and quality of the FMA which is required prior to financing approval (may be post approval for the challenge funds but has to be prior to board presentation for the WB), with the aim to have a single FMA acceptable to all three agencies. A joint quality assurance approach is proposed and the process is described in some detail;
- A common Financial Management and Accountability framework - harmonization of the 3 agencies' requirements for good financial management during the implementation period as well as accepted common good practices for financial accountability in terms of execution, internal controls, and Reporting. With the aim to streamline the requirements and accept a single set of financial policies and procedures, and reports for each financed operation that satisfy all financiers, a single accounting system capable of directly generating reports needs to exist or to be designed. With a joint comprehensive and good quality FMA, the harmonized accountability framework, common requirements and mitigating measures, and a single accounting system and chart of accounts would be a natural output;
- Streamlined and flexible Flow of Funds and robust assets management - harmonization of fund flow arrangements and cash as well as other assets management aspects with the aim to have efficient, secure, and transparent channels for proper safeguarding of assets (including non cash but valuable assets) and for the resources to reach all intended levels of service. Although pooling of fund is an ideal approach and should be pursued whenever feasible, at this stage of the Platform's development the flow of funds arrangements should remain flexible enough to include as many development partners as possible (both pooling and non-pooling). The best option should remain the full pooling but it should not be a must. Not all participating DPs can pool their funds but they can accept all other FM arrangements, thus a great deal of harmonization; and,
- Harmonized External Scrutiny¹ and Audits – harmonization of scope, type, and frequency of audits and acceptability of the auditors, as well as harmonization of approaches to the follow-up and treatment of audit findings, for example by an audit committee or parliamentary committee with the aim to create a single annual integrated external scrutiny and audit for all participating DPs and uniformity of approach to the resolution of audit issues. The ToRs for audits of the funded operation, description of the audit arrangements, criteria for eligibility and qualification

¹External scrutiny refers to controls and demand for accountability by external auditors, parliaments of recipients, civil society, etc. The DPs' monitoring and supervision of operations during implementation, as explained elsewhere, requires more discussion and guidance from management. It is largely excluded in this report.

of the auditors, and selection process are other outputs of a full FMA. In particular the capacity and qualification of the SAI should be considered in order to privilege, whenever acceptable, the harmonization around the country systems and national institutions.

It is suggested that the output from a complete and robust FMA would provide the necessary design, action plans for capacity building, and mitigating measures to manage risk and to address the above areas and produce a draft common financing arrangement for each operation/country. In order to test and refine the recommendations and to develop detailed procedures, these recommendations need to be piloted in few select countries (suggested four to five countries).

A framework agreement (Memorandum of Understanding -MOU) would be needed to document the arrangements and to operationalize the harmonization among the three agencies. The document would include all aspects mentioned above with some level of detail in order to clearly spell-out the interactions and roles and responsibilities of each party: in summary, the way the organizations will work together. It would also describe an arrangement for coordination, information sharing and quality assurance processes for FM in order to eliminate overlaps and gaps.

The conclusions and recommendations regarding each of the above are detailed in the report and its annexes. While essentially aiming to improve coordination and reduce duplication and transaction costs, when fully implemented as a package, the recommendations would also enhance fiduciary oversight, accountability, and transparency by bridging some gaps and addressing the fragmentation that currently exists.

Finally, some areas where further guidance and decision from management of the 3 organizations is required are related to: **a)** harmonization of the applications for funding; **b)** consideration for alignment of funding with the budget cycle of the PCs; **c)** how to coordinate the response regarding fraud and corruption in dealing with the recipient of funds; and **d)** the subject of harmonization of monitoring and supervision during implementation of financed operations. These are beyond the scope of the FM group's work but have practical implications for the above suggested approach. Agreement in these areas could further enhance coordination and harmonization and reduce transaction costs beyond the proposed recommendations of this report.

Suggested next steps:

- 1- The three agencies to carry out as many pilot FMAs as possible, by June 2012;
- 2- The FM team to develop model interim financial reports relevant to the FM information needs of the 3 agencies and sample terms of reference for external audits;
- 3- Management of the three agencies to decide on the items (b) and (c) above: alignment with country budget cycles and coordinating the response regarding fraud and corruption;
- 4- FM team to develop proposals for harmonization of monitoring and supervision during implementation of financed operations;
- 5- After completion of steps 1-4, the FM team to report back on the lessons learned and outcomes.

Introduction

The Health Systems Funding Platform (the Platform) was established in 2009 on the recommendation of the “High Level Taskforce on Innovative International Financing for Health Systems”. It is intended as a mechanism to accelerate progress towards the MDGs, and specifically to: “...coordinate, mobilize, streamline and channel the flow of existing and new international resources to support national health strategies.” The Platform is being developed initially by the GAVI Alliance, the Global Fund and the World Bank, and facilitated by the World Health Organization (WHO), in consultation with countries and other key stakeholders, including civil society. It is based on the principles of the International Health Partnership Plus (IHP+), in line with the Paris Declaration on Aid Effectiveness, to promote: national ownership; alignment with national systems; harmonization between agencies; managing for results; and mutual accountability among partners, donors and countries.

This is the progress report from the working group focusing exclusively on harmonizing the Financial Management (FM) frameworks and processes between the GAVI Alliance, Global Fund, and the World Bank. The objective of the work is to develop financial management processes acceptable to the different agencies that can be jointly applied to new and, where possible, existing funding. The recommendations outlined below would allow maximum harmonization of FM processes and practices that can be jointly applied to HSS funding, and, to some extent, to existing operations funded by the three agencies.

Key Areas of FM Harmonization

Good Financial Management (FM) is critical for aid effectiveness. One simple way to describe the FM functions is that they ensure that the public funds are used for the approved/intended purpose, economically and efficiently. All development partners (DPs) attach great importance to appropriate FM and fiduciary work. International Standards, guidelines, and good practices², including in the area of governance, are well recognized by DPs and increasingly adopted by Partner Countries (PCs) as the basis for good FM. However, in dealing with the recipients of funds, practices of the DPs vary and each imposes its own requirements. As a result of this, there is fragmentation, duplication and potentially gaps in FM frameworks, increasing transaction costs and adding burden for PCs. The Platform aims to harmonize FM procedures across participating development partners and better align those procedures with those of the partner countries.

With this in mind, the FM group reviewed the policies and practices of the three agencies using the standards, guidelines, and good practices referred to above as a benchmark in order to determine:

- those areas where already there is consistency, similarity, and harmonization (and where joint working is **more a matter of will, good coordination, and information sharing**);
- where differences exist and some changes are needed in approaches of the three agencies; and

² Including the International Public Sector Accounting Standards (IPSAS) and guidelines on good practices, IMF and World bank Guidelines and publications on Budgeting and Expenditure Management, Guidelines issued by PEFA secretariat, COSO, INTOSAI etc.

- where gaps exist and new jointly-developed processes are needed.

The FM group also aimed to propose **common processes** and arrangements that would both minimize the burden on PCs and the agencies themselves, while also ensuring that:

- a) minimum requisite capacity exists or is quickly built-up in the implementing agencies before funds are disbursed;
- b) capacity and agreed practices remain adequate during implementation to provide timely and reliable financial information to allow uninterrupted flow of funds and disbursements; and
- c) errors, mismanagement, or deviations from agreements are primarily prevented or otherwise detected as early as possible.

The overall conclusion of the FM group is that all three agencies already embrace the aforementioned Standards, guidelines, and good practices. They also expect the recipients of their funds to have adopted similar standards and to practice them. When this is not the case, the agencies expect that, at least for their funds, the PCs quickly build capacity to be able to adequately comply with the agreed requirements before funds can be released; otherwise alternative safeguard measures are put in place to mitigate and manage fiduciary risk. Furthermore, the three agencies either have the needed capacity and staffing within the organization or choose to outsource the pre-financing approval due diligence work as well as fiduciary oversight and monitoring during the implementation period. However, such delegation still requires adequate capacity within the agency for oversight and monitoring of the quality of work done by the others.

There are also several important differences in the current FM practices of the three agencies. They are primarily the result of differences in the practical approach to the initial assessment as well as to the ongoing monitoring and supervision³: the World Bank does this mostly through its in-country presence; the Global Fund mostly through a combination of its Local Fund Agents and Secretariat resources; and GAVI through a combination of in-country partners and Secretariat resources. Moreover, the fact that each agency acts separately and at a different time following its own grant/loan approval cycle creates duplication of efforts, fragmentation and, potentially, higher risk. The variations in practices are largely in the level, depth, and timing for fulfilling the critical FM analysis, accountability, and other aspects such as type and format of required financial information, and internal control procedures as well as external audits. From a fiduciary perspective, there is also variation in the approaches adopted and, as a result, the composition and focus of the capacity of the three agencies (balance between verification of capacity prior to approval of financing, scrutiny and implementation monitoring thereafter, delegation of some critical tasks to outside firms with variable quality assurance, etc.). At present, this results in differences in the way that capacity is deployed and used, where the focus lies for fiduciary work, and in the level of detail, timing, and depth of the analysis of financial reports and scrutiny of expenditures

³ These differences are highlighted in the technical annex that supports this report. Subsequent to the development of the technical document, both GAVI and the Global Fund have made and are continuing to make changes to their policies and procedures in some of the areas outlined in this report.

exercised by each agency. All three agencies have a risk-based approach but the measurement and mitigation of risk, and monitoring and treatment of risk seems to vary.

The FM group's recommendations do not constitute any major change in the FM policies of the agencies but in operationalization, practices and, first and foremost, cooperation. Harmonization among the three agencies, and any other participating DPs, could take place in the following 4 areas:

- A single and Joint FM Assessment of the implementing entity (ies) - harmonization of the process, timing, scope, and quality of the FMA which is required prior to financing approval (may be post approval for the challenge funds but has to be prior to the board presentation for the WB), with the aim to have a single FMA acceptable to all three agencies. A joint quality assurance approach is proposed and the process is described in some detail;
- Financial Management and Accountability framework - harmonization of requirements for good financial management during the implementation period as well as good practices for financial accountability in terms of **a)** budget execution and internal controls for the financed operation, and **b)** content, frequency, format, etc. of the financial reporting with the aim to streamline the requirements and accept a single set of financial policies and procedures, single accounting and reporting system capable of directly generating reports, that satisfy all financiers. With a complete and good quality FMA, the harmonized accountability framework and common mitigating measures and requirements would be a natural output;
- Flow of Funds and assets management - harmonization of fund flow arrangements and cash as well as other assets management aspects with the aim to have efficient, secure, and transparent channels for proper safeguarding of assets (including non cash but valuable assets) and for the resources to reach all intended levels of service. Although pooling of fund is the ideal approach at this stage of the Platform's development and should be pursued whenever feasible, the flow of funds arrangements should remain flexible enough to include as many development partners as possible (both pooling and non-pooling). The best option should remain the full pooling but it should not be a must. Not all participating DPs can pool their funds but they can accept all other FM arrangements, thus a great deal of harmonization; and,
- External Scrutiny⁴ and Audits – harmonization of scope, type, and frequency of audits and acceptability of the auditors, as well as harmonization of approaches to the follow-up and treatment of audit findings, for example by an audit committee or parliamentary committee with the aim to create a single annual integrated external scrutiny and audit for all participating DPs and uniformity of approach to the resolution of audit issues. The ToRs for audits of the funded operation, description of the audit arrangements, criteria for eligibility and qualification of the auditors, and selection process are other outputs of a full FMA. In particular the capacity

⁴ In this paper, external scrutiny refers to controls and demand for accountability by external auditors, parliaments of recipients, civil society, etc. The DPs' monitoring and supervision of operations during implementation, as explained elsewhere, requires more discussion and guidance from management. It is largely excluded in this report.

and qualification of the SAI should be considered in order to privilege, whenever acceptable, the harmonization around the country systems and national institutions.

The conclusions and recommendations regarding each of the above are summarized below and further detailed in the technical report and its annexes⁵ (*to be added*). While essentially aiming to improve coordination and reduce duplication and transaction costs, when fully implemented as a package, the recommendations would also enhance fiduciary oversight, accountability, and transparency by bridging the gaps and addressing the fragmentation that currently exists.

Joint FM Assessment by the DPs – Financial management assessments are undertaken to ensure that the capacity of the partner country is adequate to manage and account for funds provided by the Development Partners. This FM-specific capacity assessment is therefore to be carried out prior to financing approval and normally covers the following areas to a degree of detail that is commensurate with the level of risk and complexity of the proposed program to be financed:

- assesses the institutional and legal framework and the FM systems, procedures, practices, and capacity at the relevant levels, and assesses the inherent as well as specific operational fiduciary risks;
- assesses the proposed financial management arrangements against common requirements, including areas such as disbursements, flow of funds with possible variations, fiduciary oversight/supervision arrangements, and the accountability and reporting requirements for the whole implementation period. When weaknesses exist, the FMA recommends enhancements to the systems, capacity, and controls and, when necessary, provides an action plan and advice on TA needs. It also recommends measures for management of the remaining risks.
- in light of the outcome of the assessment and where possible, it recommends the level of reliance on the country systems, the mitigating measures to manage financial risks, the funds and other resources management and flow arrangements, type and frequency of financial reports, and supervision and type and scope of external audits. In principle, a Joint Financing Arrangement (JFA) document, focusing on implementation and FM arrangements would be produced as a result of a complete FMA.

Conclusion/recommendation: **The harmonization of the FMA exercise and output along with mutual acceptance of the work and products are feasible and highly recommended.** It would substantially reduce duplication and transaction cost, **provided that a coordination and joint quality assurance process (CQA) are in place.** An FM questionnaire is provided in Annex 2 of the main report for use on an FMA and a model JFA is included in Annex 3 (*to be produced*) to illustrate the type of information needed. The JFA needs to be tailored to each country situation, be program-specific and reflect DPs harmonized requirements and agreements.

⁵ The planning and budgeting is not included in the executive summary but in the main report as they are important, particularly when a sector wide approach is contemplated. The JANS exercise for example includes a full assessment of those areas.

Financial Management and Accountability Framework

a) Budget execution and internal controls –an orderly budget appropriation process and quick and efficient availability of approved budgets at the beginning of each year, and the funds as and when needed during the financial year, is critical to successful implementation of plans. Furthermore, robust internal controls should be used to ensure that the expenditures are appropriate and value for money is achieved. At present, due to weaknesses, the use of PC’s budgetary systems and practices and internal controls is ad-hoc, or uneven at best (except for budget support by some DPs).

Conclusion/Recommendation: Strengthening the country system and, whenever acceptable, alignment of the DPs procedures with those of the country system is feasible and desirable. Where an FMA notes weaknesses in these (or during a transition period when systems are being strengthened) **a harmonized set of implementation and internal control procedures could be developed in the form of an FM manual for the sector.** FMAs and technical assessments should diligently assess and contrast the execution capacity against the size and complexity of plans and budgets; they should look at the capacity and efficiency for the budget execution as well as internal controls and make recommendations, case by case, for their use or the development of interim arrangements. During the implementation period, the three agencies should join forces and enhance the monitoring and review of the implementation and use of funds. In this regard, the coordination established for the FMA phase should continue.

b) Financial Reporting – The main tool for accountability and collection of financial information for review of financial status and an aide to decision making on subsequent release of funds⁶ by the DPs is the periodic financial report. Financial reports are also useful for monitoring the progress and evaluating the financial efficiency of the financed operations. Periodic Financial Reports should therefore be **timely, reliable, and useful**, and preferably linked to the M&E and outputs. In order to produce such reports, the Partner Country should have sufficient capacity and a reliable accounting system and a chart of accounts (CoA) that allows a useful classification of information contained in the reports. This is further discussed in the technical annex⁷ and some recommendations for alignment are presented.

Harmonization of the DPs’ requirements would facilitate and reduce the burden on the countries’ capacity and promote use of a single accounting system. This can be achieved by either accepting the country’s own reporting when sufficient or, in the situation that this is deemed insufficient, designing a single set of financial reports (format and content) for periodic reporting that satisfies the need of all participating DPs.

Conclusion/recommendation: The harmonization of reporting requirements among the three agencies seems feasible and is highly desirable. A single periodic financial report (in content and format) to satisfy all participating DPs should be immediately adopted and few models should be carefully crafted at the design stage for the first pilot countries in case their standard reporting is deemed

⁶ This is mainly relevant to traditional investment operations. For Policy or results-based financing other criteria may be used for disbursements.

⁷ The alignment would be complex to achieve from a sector ministry as entry point, as it has to deal with the country’s central PFM system, normally under the responsibility of MoF- Accountant Generals of the government.

insufficient⁸. The recommendation is to move to a single reporting requirement for interim and end of year financial reports. In order to achieve this objective, we recommend that the FM working group produces models for this purpose from the very first joint FMA exercises. Alternatively, the FMA teams could produce the first few reports to develop such models. The cost of this additional investment will be absorbed later by the time saved during implementation. The FM group has discussed the adequacy of the format and content of the single reports and each FMA would agree on format, content and frequency of the financial reports appropriate for each situation with each PC (*Annex 4 with some examples of acceptable reports to be produced*).

Flow of funds – the design of fund flow mechanisms is important in that it can facilitate or make harmonization of other FM aspects, such as reporting, easier or more difficult. For example, while pooling of funds with the Government’s own funds raises the level of fiduciary risk (in use of funds for purposes other than intended), it would substantially facilitate the production of a single set of financial statements and reports for the sector, as well as reducing the volume of work. Some definitions and clarifications regarding the alternative options would allow good progress towards full harmonization. A specific note on this subject is attached in Annex ## [to be developed]. Parallel co-financing (as opposed to Joint/pooled co-financing) may be less efficient from the PCs point of view. It is however still feasible to agree on other common FM arrangements (eg. single financial reporting and single audit, single expenditure and asset management framework,...), even when some development partners choose not to pool funds. Signing of an inclusive agreement should be done so as to encourage and include as many financiers for the health programs as possible in order to increase the transparency and comprehensiveness of financial reports. This is the case in Nepal where a group of pooling and non-pooling DPs signed a Joint Financing Agreement (JFA) which is drafted in such a way that provides for the co-existence of both groups on the same platform and subject to the same FM rules and arrangements, with the exception of the bank accounts. As a result of this association, all related transactions and resources and expenses of all participating DPs (a total of seven so far) will be transparently reported on the same financial statements. Those common financial statements would also be audited by the same auditors (the National Audit Office), thus achieving alignment and a great deal of harmonization and cost savings.

Conclusion/Recommendation: Flexibility in the flow of funds for Platform participants is feasible and highly desirable, as it increases transparency and can lead to better and less costly reporting and audits. The issue of pooling or not pooling of funds has been a distraction and deterrence for DPs to join forces. As the Nepal case can demonstrate, there are many advantages in allowing the two arrangements to co-exist. A well crafted MOU/JFA and open dialogue among DPs can allow such a dual arrangement for funding flow while all other aspects are harmonized (e.g., single financial reports, single audit, joint supervision, Single M&E, etc.). **We therefore recommend keeping the fund flow arrangements flexible, accepting both pooling and non-pooling side-by-side in order to incorporate all resources into the same financial statements and to finance “one plan and one budget”.** The proposed draft MOU/JFA model (*annex # to be added*) or a similar document can be used to draft the necessary agreements and to design the flow of funds mechanisms for each operation.

⁸ Participation of the countries in the development of the model single financial reports is critical for the feasibility and ownership.

External Audits – a robust and comprehensive audit by independent auditors (Auditor General, Cour des Comptes, qualified private auditors, or equivalent) is absolutely necessary for obtaining reasonable assurance that the financial statements produced by the implementing entities are reliable and that they fairly present the underlying financial transactions and the use of funds, as well as “Value for Money”. The individual project financing, funding separate operations, or using different arrangements by DPs has thus far created a fragmentation of financial operations and audits which can result in a risk that potential double counting or misrepresentation goes undetected. Fragmentation of audits (different auditors looking at different pieces of financial operations) in the same sector is a problem in and of itself, as several auditors working in isolation are less able to ‘connect the dots’ and the resulting reports do not always provide the full financial picture nor a sense of “value for Money”. Furthermore, as observed in Ethiopia⁹, the PCs routinely have to deal with a multitude of audit teams in relatively short periods of time while carrying out their daily work and, at the same time, producing different financial reports for each of the DPs.

Conclusion/Recommendation: Accepting single annual integrated audits from qualified auditors which satisfy all participating DPs is feasible, desirable and necessary. A methodology for assessment of the auditors’ capacity, competency, and independence has been shared among the three agencies for selection of acceptable auditors. **Recommendations are: a) ToRs for integrated Audits (financial, procurement, and performance) should be drafted and negotiated jointly and single annual audits undertaken by one team of auditors should be adopted by the three agencies; and b) Qualification, Independence, and Capacity of auditors should be assessed by DPs prior to acceptance of an auditor.** For better alignment with government systems, when the independence, capacity, approach and competency of the Office of the Auditor General or equivalent (e.g., National Audit Office, Cour des Comptes, etc.) permit, the latter should be requested by the PC to provide the audit services. These areas will be reviewed and assessed as part of the FMA exercise and reflected in the FMA report.

Operationalization of the proposed Joint FMAs

An up-front FM assessment is a useful tool that would provide the designs and elements of the above items. However, for such an assessment to be acceptable to the participating DPs and comprehensive enough, mutually agreed scope and methodology and other processes to ensure the quality of the assessment is a necessity. The working group agreed that, in addition to the principles and good practices that need to be pursued, the following three stipulations should also be met:

1. Agreement among the participating DPs, on the scope of the FM Assessment and fiduciary requirements, to be commensurate with the complexity of each operation. Each case would be reviewed by a Coordination and Scoping Meeting (CSM) among FM professionals of the participating agencies (and preferably including a country-based representative of an active donor);

⁹ In Ethiopia, the Ministry of Health’s Finance and Administration Unit received 5 teams of auditors during the first half of 2010 while at the same time, in addition to the routine work, it had to produce some 28 reports for different DPs.

2. Agreement on the terms of reference for the FMA, including qualifications of the team carrying out the assessment, time allowed for the reviews, expected output of each FMA (the format of the report, minimum required content of the report-- normal fiduciary requirements, proposed action plans, suggested next steps and recommended supervision plans). The FM group could produce generic TORs to be easily tailored for each case – TORs to be clear about the use of existing relevant diagnostic work as part of the assessment, and;
3. Other quality assurance process - Opportunity for the three agencies (and other funding development partners) to provide comments to the draft FMA report; Verification of the final report to ensure that all material comments have been properly addressed.

The principles of this stipulation should be pre-agreed ahead of each FMA. We suggest that three or four joint FMA ‘pilots’ be conducted in order to learn lessons and to review and refine the approach. After the testing a framework agreement (Memorandum of Understanding - MOU) would be needed to document the arrangements and operationalize the harmonization among the three agencies. The document would include all aspects mentioned above with some level of detail in order to clearly spell-out the interactions and roles and responsibilities of each party. It would also describe an arrangement for coordination, information sharing and quality assurance processes for FM in order to eliminate overlaps and gaps.

Seeking guidance from Management

Areas that require guidance from Management of the three institutions are related to **a)** harmonization of the applications for funding; **b)** important milestones such as the Board approval of respective agencies for financing and commitment from each agency; and **c)** how to coordinate the response regarding fraud and corruption in dealing with the recipient of funds. These are beyond the scope of the FM group’s work but have practical implications for the above suggested approach. Agreement on these areas could further enhance harmonization and reduce transaction costs even beyond the above proposed recommendations of this report.

On the subject of harmonization of monitoring and supervision during implementation of financed operations, we are offering the following comments. Joint supervision would be complicated, yet is potentially an effective way to substantially reduce the burden and transaction costs associated with implementation. Supervision and monitoring is critical for accountability and fiduciary assurance and the three agencies deploy important resources (GF-LFAs, World Bank field and HQ staff, GAVI’s monitoring by in-country partners and Secretariat staff) for this purpose. However, due to the current approaches, differences in timing of interventions and various requirements, PCs are often confronted with multiple missions and demands at differing times. As an extension of the proposals in this report, it is important to coordinate among the three agencies for joint missions and information sharing. This needs careful consideration to avoid (the perception that) one agency is taking over or becoming the fiduciary agent of the others. There could be substantial gains in this effort but the approach will likely vary from country to country. Complementarities in task and cost sharing, to bridge gaps and reduce duplication for better results, should be the objective. On a case by case basis, the FMA (or JANS) could be the right

instrument to define the arrangements and a JFA or a framework agreement (an MOU) could document the modalities. Following an overall agreement among the three agencies, guidelines and tools can be produced to facilitate the implementation and pilots can produce demonstrative examples for dissemination.

Conclusion/recommendation: A gradual harmonization of FM supervision is feasible and highly desirable. Recommendations are: **a) The World Bank supervision efforts and the work of Global Fund LFAs and others should be synchronized and made complementary. GAVI's monitoring efforts should be assessed and its potential contributions be inventoried and incorporated;** and **b) monitoring and quality assurance of the work of the teams and consultants should become systematic.** In a manner similar to the quality assurance processes in place at the World Bank for staff and consultants, the qualification, experience, and capacity of staff and consultants needs to be carefully reviewed at the selection/appointment stage and the quality of their work monitored routinely. These issues need to be discussed and decided, case by case, at the outset (FM assessment stage) and documented in an MOU or JFA but an overall framework agreement should guide the case-by-case discussions. This is why the FM team felt that management's discussion and guidance on this subject would be necessary. After the first few pilot cases, the practice would be reviewed and internalized to potentially become standard procedure. Important issues for all three agencies and Partner Countries are predictability as well as alignment with the country budget cycle which is an issue that is particularly problematic for the first and last year of the financing period. In addition to the right timing, it is often essential that, in order to help the ministries of health, the DPs supporting the sector engage with the central ministries (Ministries of Finance, Planning, etc.) to ensure good communications and understanding of the health sector by these ministries and to maximize the potential for increased financial and technical support for the sector.

On the subject of harmonizing budgeting and planning, the ideal approach would be to use the country planning and budgetary systems and timetable and to incorporate DPs financing into the country processes. However, until such time that those systems are reliable and well functioning, the harmonization among DPs is the second best alternative to reduce the transaction cost while maintaining full accountability and discharge of fiduciary responsibility. This said, and despite the weaknesses in the PCs systems and practices, in addition to using the National Health Strategy and Plans as the basis for financing, the alignment with the country's budgetary calendar and use of the national Medium Term Expenditure Framework (MTEF) process is very helpful to the PCs and would reduce the burden for all concerned parties.

ANNEX TO THE FINANCIAL MANAGEMENT PROGRESS REPORT

WORKING GROUP

TECHNICAL REPORT

Purpose

This Technical Report was a working document prepared by Finance professionals from the three agencies in 2010 and is a relevant source of information for interested readers who would like further information on some of the recommendations made in the Financial Management Report. It provides additional details that are helpful for implementation of the main report's recommendations.

As the Financial Management Report has evolved during 2011 along with certain policies and procedures of GAVI and the Global Fund, there may be some inconsistencies between this Technical Report and the Financial Management Report.

Background

The 2010 work plan prepared by the Health Systems Funding Platform inter-agency working group identified priority area of work, one of which was relates to Financial Management and Procurement. Subsequently, in April 2010 a Financial Management group was formed to develop Financial Management and Procurement processes acceptable to the different agencies that can be jointly applied to new and existing funding. The group led by Ms. Nicole Klingen (World Bank) and assisted by Mr. Iraj Talai (PFM consultant), had the following members from each agency:

GAVI Alliance – Mr. Joe Martin (Head of Transparency and Accountability Program Delivery);

Global Fund – Mr. Pdraig Power (Senior Finance Officer – Finance Unit); and

World Bank -- Ms. Nicole Klingen (HDNHE, lead person) and Mr. Hisham Waly (Sr. FMS and Secretary of the Quality and Results Committee of the FM sector board, OPCFM).

In line with its Terms of Reference, the group reports on the progress made until September 30, 2010, its findings, conclusions and offers recommendations for processes and harmonization of FM practices that can be jointly applied to HSS funding and, to some extent, to existing operations funded by the three agencies. The discussions on Procurement started recently and are at an early stage with a different group of participants from the three institutions. The group will submit a separate report when sufficient progress is made and as appropriate.

After an initial period of uncertainty as to the representation of each agency, the process went smoothly and collaboratively with adequate information sharing and positive attitude towards the achievement of the objectives. The FM group used interviews, study of background documents, brainstorming, and consultation with management and other FM professionals, and working sessions as methodology while

the international standards, guidelines, and recognized good practices¹⁰ were kept in mind as the reference for its work. The group reviewed and compared the policies, procedures and processes of the three agencies in order to determine the areas where there is consistency, where some changes are needed, or where gaps exist and new processes are needed.

The group discussed the issues related to the assignment and particularly similarities and differences between the FM policies and procedures and requirements of the three institutions were considered. Each member of the group ensured that the management of the respective agencies was regularly briefed and feedback was received for this report. The overall conclusions are that the capacity and systems for Financial Management and procurement that are needed for timely and smooth implementation and for fiduciary discharge and accountability by the recipients of funds should be assessed before funds are disbursed, by qualified people, and with a quality assurance process. These assessments are to be carried out during preparation and appraisal of operations (or about the same time as JANS exercises), prior to the negotiations and signing of the financing agreements (here-in-after called “up-front” assessments or FMAs)¹¹. We also concluded that after the start of implementation and when the funds are made available, a robust monitoring and supervision by all financiers will be necessary. The financial situation and operations during implementation phase, from effectiveness, disbursement, reporting, auditing, and supervision of implementation should be reviewed systematically. What follows relates to these two phases of prior assessment and monitoring of activities from FM perspective.

Similarities and Differences in practice and processes

The analysis of similarities and differences in policies and procedures, guidelines and practices of the three institutions is helpful in providing insight into the areas where harmonization in FM is necessary and how it could be achieved. In this respect the group carried out the analysis and a summary of important issues is presented below:

- The most critical similarity from the Financial Management perspective among the 3 agencies is that they all embrace the same principles, the internationally recognized and generally accepted accounting and auditing standards and practices for fiduciary, transparency, and accountability of their funds. Many DPs, including the three agencies, require that systems and capacity of the recipients be adequate before funds are transferred to the latter. The differences arise mainly from variations in practice and processes which at times reflect the difference in nature of the agencies and the allocation method and mechanisms. Some differences are about the timing and area of focus for fiduciary and accountability some others have to do with approving the amounts and

¹⁰ Including the International Public Sector Accounting Standards (IPSAS) and guidelines on good practices, IMF and World bank Guidelines and publications on Budgeting and Expenditure Management, Guidelines issued by PEFA secretariat, COSO, INTOSAI etc.

¹¹ The term “Up-front” or “Up-stream” as opposed to “Ex-post”, or “Down-stream” are used to show the timeline of events in connection with a specific milestone. In case of the “up-front” FMAs, it generally takes place before negotiations and signing of financing agreement and before funds are disbursed. Depending on the institution, the FMAs are carried out either prior to the presentation of projects to the board (world Bank) or after the board approval but prior to the negotiations and signing of grant agreements (GAVI and GF).

- disbursing the funds, and the subsequent monitoring of (or lack thereof) eligibility of expenses for which funds were provided.
- The Bank and more recently GAVI have similar and well articulated policies for an “up-front” assessment of recipients’ financial management and fiduciary systems and capacity (the FMA) while the GF has procedures to assess implementer capacity through the Principal Recipient Assessment carried out by its Local Fund Agents (LFA). There are some issues with the latter such as objectivity, scope, and quality assurance of the LFA work.
 - The GF and the Bank have detailed policies and well developed practices for the downstream implementation monitoring and supervision of operations (the GF via its LFA, and the Bank via the presence of its local and international staff in countries/hubs, as well as well developed guidelines, quality assurance mechanisms and audit procedures). GAVI has only recently developed a policy which suggests the mix use of internal and external resources to conduct FMAs but yet has to have a well developed downstream monitoring policy or practice. While these are done by multi-disciplinary teams for the Bank, for the GF its LFAs carryout this function. Each DP will need to be assured that the LFA qualification, independence, quality of past work and performance, and capacity have been appropriately assessed, should all agencies intend to rely on the work of the LFAs. At present, a gap in the practices for quality assurance also seems to exist.
 - The World Bank has extensive guidelines and procedures issued by its FM Sector Board which is regularly updated, compliance with which is monitored. A strong staff capacity at local, regional, and global levels exists and work of its staff and consultants is subject to a systematic quality assurance review. The Staff systematically carries out the up-front FMAs, supports the PCs to build their FM capacity, and carries out periodic monitoring and implementation support missions.
 - The Bank’s detailed and extensive assessment requirements are developed for large and higher risk operations. Simplified guidelines have been developed and are in application for projects below US\$5 million. Furthermore, the Bank uses a risk-based approach to decide on the scope and level of scrutiny and process.
 - The GF has very detailed procedures and specific requirements for “upstream” presentation (in format and content) of applications and very detailed budget; its up-front scrutiny of proposals at such detail, which intends to reduce “budget padding” and to identify efficiencies at an early stage, appear cumbersome and perhaps difficult to prepare and to adhere to during a long period of time (5-6 years). GAVI has a similarly detailed application process wherein an application for a cash grant is approved on the basis of a detailed and costed work plan for the duration of the period for which support is sought. Both agencies are about to revise their proposal forms and guidelines. The JANS exercise, wherever it is fully carried out, might reduce the need for this type of exercise or limit it to the annual reviews.

- GF, GAVI, and the Bank require interim financial statements with details of plans and actual with analysis of variances between budget and actual. This good practice should be generalized for platform partners and content and timing of reports streamlined.
- The GF and GAVI operate on the basis of individual Applications/proposals for specific project funding. For GF, the discussions with the applicants and detailed implementation planning and other arrangements begin only after its board approves the proposal for funding. As to GAVI, once the Independent Review Committee (IRC) makes a recommendation to the GAVI Board to approve an application, GAVI management does not normally extensively modify a successful application but does now conduct a limited Financial Management Assessment (FMA) which only tests the financial management arrangements proposed in the application.
- Based on the Country Assistance Strategies, and at the request of partner countries, the Bank supports PCs in the design and development of the projects/program. Bank staff appraises the final version of the designed project and proposed arrangements (including the FM and procurement arrangements) and identifies the risks and necessary mitigating measures; approval by the Bank's Board takes place after all assessments have been carried out, and once the terms and conditions are negotiated and the operation is ready for implementation. Frequently, FM and or Procurement capacity enhancement action plans are set in motion prior to Board approval in order to develop/enhance the systems and capacities of the partner country and or the recipients.
- All three institutions have the similar approach to pooling of funds and separation of earmarked funds for which attributions are to be made (see more details under the flow of funds paragraphs).
- WB fiduciary work starts as part of preparation work and ends a year after the close of financial year in which the financed operation is completed and final audit report is received and accepted. The fiduciary (both FM and Procurement) work is performed by the staff (or consultants but under close monitoring of staff) and with robust quality assurance.
- GF hires LFAs to provide services but there seems to be little upfront assessment of their capacity and practices other than an initial review at the tendering stage, with the GF relying on the LFAs' own internal quality control processes combined with its Performance Evaluation Tool which allows GF staff to provide feedback and rate the quality of LFA products¹². In the past, due to the nature of some of its financing and mechanisms for funding, GAVI has not required major fiduciary scrutiny once the grant was disbursed ("reward" money disbursed or drugs purchased and delivered) although FMAs now conducted by GAVI do cover all GAVI cash grants. It does not seem to have specific policy on systematic ex-post monitoring.
- Global Fund does not require a FMA prior to approval of its grants. Like GAVI, it requires a specific application for funds with detail information regarding the cost. It carries out a detailed

¹² The methodology and effectiveness of this performance evaluation is not clear.

review of the work plan and costing and budget for the proposals after approval of financing (by the board following a TRP recommendation) but prior to funding agreements and funds flow. It receives and scrutinizes a very detailed work plan and budget for 2/3 years. It hires a Local Fund Agent (LFA) to perform a due diligence work and subsequent monitoring of spending and reporting. This dual responsibility is a conflict of interest and reduces objectivity of the agent.

- Since about a year ago GAVI's policy has been to carry out a systematic FMA after the board approval for financing but before disbursements commence. A program is in place to also carry out the FMA for those countries in the portfolio which have received funds prior to this policy change. Equally, the external audit has become a requirement. However, the institution has limited staff and outsources a large part of the work. Given the present financing policies, either drugs are procured by UNICEF and delivered to the countries or funds are released based on reported performance. GAVI's new policy in this area has also seen an increase in the weight applied to financial monitoring and reporting from eligible countries.
- The WB has developed detailed (perhaps somewhat stringent) sets of policies and procedures and guidelines for staff, has the largest capacity and presence in the field and at HQ, and monitors the quality of work done by staff at every step of the way. It regularly accompanies the PCs to design and develop the operations. But, with some exceptions, it does not do an up-front scrutiny of the very detailed plans and budgets for the entire life of the operations. Once the assessment of the country partner's systems and capacity is satisfactory, it relies on those systems and capacity for annual and more realistic estimates and plans and on the regular supervision carried out by the Bank staff.
- While the WB has four different disbursement methods (for expenditures actually incurred and for advances) which allow flexibility and risk management, the GF and GAVI normally release periodic tranches at fixed intervals. GAVI releases further disbursements if performance to date is deemed satisfactory. They do not seem to require documentation regarding expenditures and mainly rely on reports and external audits. However, For GF its LFAs are expected to scrutinize the expenditures.
- Other non-FM assessments such as Safeguards assessment (environmental, social, indigenous and minority,...) are not required by GAVI or GF.
- The Global Fund has core principals related to performance-based funding and therefore the ability to track GF finances and link them to the programmatic results is key and would be a factor that needs to be addressed in any pooled funding arrangement. Alternatively, the Nepal approach and flexibility should be envisaged to create an "inclusive" platform in other countries.

The working group noted the ongoing discussions between GF and GAVI regarding the potential discontinuation of separate financing proposals under the International Health Partnership (IHP+) and the Platform.

Financial Management Standards, guidelines, and Practices

The participants at the Working group agreed that the Internationally recognized accounting and auditing and reporting standards, the IPSAS standards and guidelines, and international good practices are applicable for Financial Management. They should serve as basis for establishing FM requirements for financed operations of the three agencies -- for carrying out FMAs prior to financing, and for financial reporting, accountability, and monitoring of operations during the implementation period. Those National Standards that are consistent and substantially comparable with the International Accounting and Auditing Standards are equivalent to the international standards.

Areas for harmonization and alignment

The function of Financial Management (FM) and Procurement (PC) in financing public sector activities can be described as “ensuring that the public funds are used for the approved/intended purpose, economically and efficiently”. Public Financial Management (PFM) arrangements use the budgetary and other tools and mechanisms to fulfill this function and protect public interest by credible planning and budgeting, orderly execution of approved budget, timely recording and financial reporting, smooth and efficient flow of funds, well functioning and proactive internal controls, and independent audits and scrutiny – these are the 6 pillars of PFM. Whether a project with well defined boundaries and activities is considered for financing, a program with defined objectives and outputs, or a sector or system as a whole, the above PFM pillars are important for success and relevant to the stakeholders interest; they are tools to maximize the impact and support the Platform’s goal of “more health for money” in the health sector.

Not only the plans and budgets should be realistic and credible, adequate capacity and experience should exist to carry out the related activities within the required timeframe. Transactions should be executed within legal and regulatory boundaries, funds should be available and monies be paid in exchange for goods and services that were needed and received by /for the public, at reasonable prices. The Management needs information to make appropriate decisions and monitor progress in achieving objectives and goals and, when necessary take corrective measures. Additionally, the internal and external financing partners and other stakeholders need information and reasonable assurance. The internal controls (including Internal Audit), financial reporting, and external audit provide these to the management, stakeholders including the parliament and Development Partners.

As a matter of policy, the three agencies do accept the internationally recognized standards and practices as the reference and expect the recipients of funds to have adopted such standards and practice them or to quickly build capacity in order to adequately comply with the international standards and practices before funds are released to them. While the three institutions, and in fact many other Development Partners (DP), have adopted these, there are differences in practice that contribute to duplication and high cost of transaction due to lack of a harmonized approach in the application of the recognized standards.

Achieving a harmonized approach (for the three institutions and other DPs) and, wherever possible, alignment with the Country Systems of Public Financial Management (PFM), would require a review of

the following pillars of PFM in light of the fundamentals and principles imbedded in the international standards and practices and agreement on a common approach, wherever differences exist:

Planning and budgeting – The planning and budgeting is the foundation for management, including financial management, and the fundamental tool for translating the strategy into actionable documents. Planning is necessary to ensure that actions are taken in an orderly and predictable manner. A credible, realistic, and comprehensive budget which takes into account all operations that are to be undertaken, financed and be covered and accounted for is critical to appropriate accountability and financial performance measurement.

The three agencies do practice this when relevant to their funding arrangements, albeit with some variations which can be harmonized [for discussion: (need agreement on the level of detail required (GF) at the outset and in the applications for funds. When dealing with Health Systems and the platform, then maybe GF and GAVI don't need as much details as now they require for their challenge funds for vertical programs)]. Even for ring-fenced and projectized operations, many cases require that the World Bank carry out an overall assessment of the planning and budgeting capacity and practices of the implementing agencies but it does not scrutinize minute details of each expense, leaving that kind of scrutiny to the periodic supervision and implementation support provided to the PCs by its staff. In other words, PCs' own systems and capacity is privileged at the outset [(as opposed to a well crafted document prepared by consultants that might not be very realistic)]. Given the method of allocation (a challenge fund), the GF does a comprehensive review (line by line /item by item scrutiny) of the expenses for the full 3-year period in order to ensure that no "budget padding" takes place and funds are not unnecessarily set aside when not required¹³.

Whether a project with narrow scope is under consideration, a program with wider scope is contemplated, or a full sector-wide approach is undertaken for financing by the DPs, plans and budgets must be prepared and scrutinized at the outset in order to agree on the amount of financing required and the timing of the implementation¹⁴. This however does not mean that the detailed budgets are necessary for the outer years (beyond the first and, to lesser extent, second years, more indicative numbers for the remaining years); an overall costing and envelopes would be sufficient at the assessment point, leaving the detail scrutiny to annual discussions and agreements among partners supported by performance and audit reports.

In countries where JANS are undertaken, this exercise and scrutiny of the plans and budgets and assessment of the costing would be an essential part of the JANS exercise.

Recommendation1: Wherever the JANS is carried out, it should adequately cover the assessment of the planning and budgeting capacity of the sector actors at national as well as decentralized/sub-national level. It should also assess the quality and feasibility of the proposed plan and its costing. When the JANS exercise is not carried out, then the funding partners must include such exercise as part of their joint FMA and annual discussions. As to the first year of financing, detailed information should be

¹³ This exercise is however carried out after the Board has approved the financing of winning proposals.

¹⁴ Counterpart funding from the government and availability of funds has historically been an issue in many IDA countries.

required but for the outer years envelopes, calculated based on reasonable assumptions and costing methods, could be accepted; leaving the details and item by item transaction costs for annual discussions and budget exercises.

Recommendation 2: In order to mitigate any risk of wastage and overestimates due to reduction in ex-ante scrutiny of all expenses, more in-depth verification should be exercised on the annual budget estimates, on actual expenditures, and interim and annual financial reports.

Budget execution – having an orderly budget appropriation and a speedy and efficient distribution of budgetary credits further down the chain is critical to successful implementation of plans and operations. On the other hand, an efficient and transparent execution by the recipients of funds is critical to success and results. Execution capacity and competency of the intermediaries (logistics, stores, etc.) and recipients of funds should be commensurate with the size and complexity of the plans that are to be implemented. The capacity and systems should therefore be assessed at the outset from these two angles.

While assessment of the FM capacity and systems supporting the financial transactions is part of the FMA, the up-stream budgeting and allocation, as well as assessment of the staffing and technical capacity and competency of medical staff, would be part of a separate exercise. A sector strategy, planning, and costing assessment such as the “Joint Assessment of National Strategy” (JANS), developed under the IHP+ would cover these areas. Specific reference is included in the JANS guidelines regarding this and other aspects. Therefore, wherever JANS is carried out, the appropriation practices, the costing and financing, and technical capacity should be covered. In the absence of a JANS exercise in a country, either the FMA scope should be expanded or the planning and budgeting practices as well as the budget appropriation practices should be carried out separately.

Given the different nature and work of the three agencies, and the way they release funds, the practice in this area is quite different and will require some alignment at the FMA stage (should be already agreed at the FMA scoping). The Bank, and more recently the GAVI do assess the capacity and robustness of the budget execution as does the GF. However the GF assessment focuses only on the key implementers financial management systems, including the reliability and robustness of their budgeting procedures. The GF’s LFAs verify expenditures and balances during implementation and report to the GF on significant variances between budget and actual.

Recommendation 3: In future operations, the capacity for budget execution from two perspectives should also be covered under the JANS and FMAs and routinely monitored as DPs rely to a large extent on the government systems for all transactions. A complete JANS, whenever carried out, should adequately cover this area for the national and sub-national levels (including the sector ministry’s relation with the central ministries and with sectoral sub-national levels).

Internal Controls and resource/expenditure management – which ensures that transactions are carried out in conformity with the formal rules, recorded, and reported appropriately and timely and prevents and detects errors and mismanagement. For an FMA to be adequate and for subsequent financial management monitoring and accountability on the use of funds, this is one of the main accountability

items to be dealt with by the DPs. Unless the nature of funding is different (eg. the ISS from GAVI), the internal controls of a recipient of funds is at the heart of financial management. Even for reward grants, poor internal control exposes the grantor to reputational risk because of potential for financing inefficiency or fraud and corruption. For the purpose of HSFP, the 3 agencies are fully harmonized in this area and agree that the scope of FMA, and the subsequent monitoring and supervision, should cover the internal controls comprehensively. The issue remains one of coordination to minimize the duplications and also to bridge the gaps that exist in the practices by joint monitoring.

Recommendation 4: The cost sharing and joint monitoring of the expenditures should be discussed and agreements documented in a Memorandum of Understanding. The eligible expenditures should be clearly defined at the outset so as to allow proper monitoring and identification of ineligible expenses (part of the Financing agreements). There is potential for creating complementarity between the WB staff's work, the work of the GAVI Secretariat, and the GF's LFAs. This is an operational issue which falls outside the present scope of the FM group's work.

Flow of funds and treasury/banking arrangements – is also critical for appropriate and timely implementation and payment of suppliers and for safeguarding funds. This area is also critical to all operations whether projectized or part of a sector program. However, the pooling of funds is not the main issue - the efficiency in flows (ensuring that funds are available when needed) and full transparency on the usage is. As the Nepal case demonstrates, it is to the advantage of the PCs and the DPs alike to have majority of DPs on the same platform financing the same plan, and using the same procedures and set of information. One big advantage from the fiduciary perspective is the risk reduction by elimination of fragmented approaches.

The technical aspect of pooling of funds has, in the past, distracted the discussions from more pertinent issues around planning, appropriate FM and reporting arrangements, and other implementation issues. In the Nepal case a Joint Financing Arrangements (JFA) document including both pooled and non-pooled funders is an innovative solution to enhance the partnership, harmonize among participants, and improve transparency in FM. Furthermore, the experience in Nepal demonstrates, that the options of: a) using discrete designated accounts, and b) pooling funds should be available to funding agencies so as to allow for maximum participation and support for the national strategy and budget (bring everyone on plan and on budget).

Some definitions and clarification seems appropriate:

Co-financing of an Investment project, a program, or parts of a national health strategy by the DPs is normally either done as **joint** co-financing or **parallel** co-financing¹⁵. Under **joint co-financing** the DPs agree to indivisibly pay for the expenditures that they have collectively agreed to finance¹⁶. In such cases there is no good reason to keeping their funds in separate bank accounts -- **pooling of funds** in the same

¹⁵ Co-financing is used as a generic term when two or more financiers provide funding for the same investment or activity such as a "project" or "program". Co-financiers may agree to split the cost of each item (a portion of each invoice) in which case we refer to joint co-financing, or they may agree to each finance different items or parts of the "project/Program" alone (or with the project owner- eg. government). In the latter case where only one of the financiers pays for each expense item, we refer to parallel co-financing. See annex ##

¹⁶ Expenditures agreed to be financed by the DPs are normally defined in the financing agreement documents. A negative list (expenses unacceptable for financing – eg. taxes) instead of an exhaustive "positive" list can be used.

bank account, with or without government funds, is an ideal option (variations for pooling exist though— e.g., in-country or outside the country; see annex ## for details). **Parallel co-financing**, on the other hand, is when some or all co-financiers select specific expenditure items (or group of items) and finance them in parallel and separately¹⁷. In such cases, funds of those donors are kept in separate “designated” bank accounts to pay the pre-identified expense items. This allows tracking specific use of funds and provides a good audit trail (and attribution when needed). A hybrid system is a combination of the two which was adopted in Nepal.

The issues here are more related to the fact that GAVI and GF currently approve cash grants on the basis of fairly detailed applications made by countries. In case a pool fund arrangement is to be used, in which attribution will not be possible¹⁸, how will GF and GAVI (given existing application and approval mechanisms) handle this? Therefore, **the question is that in case of financing HSS, is there still need for attributing those funds?** GAVI is clear in that they can accept the pooling of funds and the common fund disbursement, financial reporting and oversight arrangements that occur with a pool funding operation as long as an FMA has been completed and fiduciary risk is managed. For GF also the pooling is feasible, provided all activities financed from the pool are agreed upon up front. However, in case some financiers wish to also fund other activities in addition to those agreed for the pool, a virtual separation of pooled funds will at least be necessary. In case the systems are not robust enough or the environment is risky, then a full separation of funds into a separate bank accounts (eg. Nepal) will be necessary. The FMA would need to consider this as well as the capacity requirements for adequate reporting.

Recommendation 5: The 3 agencies should be willing to accept pooling and non-pooling partners to join the platform and put the emphasis on the other aspects for harmonization and fiduciary risk management. The FMA should develop the Country specific fund flow case by case and propose a draft JFA for each case to that effect (*model in annex #*).

Financial reporting – is primarily necessary for management decision making. Complete and timely reporting of useful information is also the primary source of information for accountability and continued flow of funds from DPs to the recipients. The harmonization among the agencies would result from the DPs developing and accepting a single but complete set of financial reports. However, this can't be done easily in countries where there is fragmentation of plans and budgets and various arrangements. Furthermore, an alignment with the PC would only come from the use of the country's own chart of accounts and its accounting system, once they are adequate and able to produce such reports on time and directly from the system and without additional manipulation.

The financial reporting and external audit arrangements are the two areas that require most harmonization and work among the three agencies and other DPs. As the FMA is assessing the capacity of the main implementing entities, a single reporting system (we might include schedules with details for those DPs who need attribution and separate audit opinion) should be considered and the FM design

¹⁷ It could also be that some DPs aren't allowed to pool funds without any restrictions to fund specific expenditure item.

¹⁸ Virtual separation of pooled funds in the accounting system of the recipient is possible but dependent on the robustness of the “in-house” accounting system and the ability to keep accurate records and produce reports.

should attempt to accomplish this, primarily using the PC's own system and, if not feasible, from a dedicated system.

From PC side there are two aspects to the financial reporting: a) how the financial information is classified to be useful – the Chart of Accounts related issue; and b) what system is used to record transactions and produce reports – information treatment and compilation of information issue. In well advanced PFM environments, the PFM system is able to directly produce the needed reports, provided that the Chart of Accounts (CoA) is carefully reviewed and efforts are made at the outset to align the reporting requirements of the DPs with the CoA (which in turn should preferably be aligned with the National Health Accounts classifications). It is however, well known that many CoAs are providing aggregate information which might not allow the needed level of clarity and transparency and sub-systems or re-classification of information may become necessary. Often delegation of budgets and virments are also important and distort the picture given by the financial reports. These aspects are important from the harmonization perspective. In a situation where the PC's system and Chart of Accounts (CoA) are capable of providing on time and reliable information with the right classifications and in adequate details, financial reports should be directly produced from the PCs' own system. As the FMA is assessing the capacity of the main implementing entities, a careful review of the country's CoA (or other sub-systems) in place and dialogue between the FM and the health systems experts should allow to determine whether the CoA provides sufficient details for both fiduciary and technical monitoring purposes and whether the PC's own reporting system could be used.

The alignment of PC systems to suit DPs, for example, would be impractical from a sector ministry's entry point, as it has to deal with the country's central PFM system, normally under the responsibility of MoF- Accountant General of the government. We recommend a pro-active approach and interaction with the officials responsible for PFM reforms in the country and the DPs involved in the reforms to ensure that the health ministries are chosen among the first ministries for the deployment of any new FM information system. Following such deployment, the DPs supporting health sector should actively support MOHs for successful use of the systems (provided CoA is satisfactory). The FM group believes however that the discussions should continue in order to produce a standard sector-specific CoA (management accounting sub-set) for health sector which is also consistent with the SHA classifications. Such a development will have substantial benefit for health sector as a whole and facilitates the production of the National Health Accounts.

Recommendation 6: The FMA should assess the reporting needs and the capacity to satisfy those needs. The FMA report should contain the content, frequency, and format of the financial reports for all financiers rather than some agencies. We suggest that the FM group be tasked to develop some models for facilitating this work and in coordination with the SHA experts develop standard CoAs .

Recommendation 7: Since the budgets are prepared on cash basis and most PCs accounting systems and practices are on cash-basis, for consistency and simplification, we recommend that all financial statements and reports be on cash (or modified cash) basis of accounting, with the exception of countries that already have reliable accrual budgeting and accounting. A full schedule of all investments should also be part of the financial reports.

External audits and oversight – external scrutiny enhances the accountability and provides confidence to stakeholders; the external audit providing reasonable assurance, the parliamentary scrutiny demanding accountability in connection with the previously approved budget and success of the sector strategy.

The Harmonization will come from DPs accepting and using the same ToRs and same auditors for all audits under the same operation, single integrated audit report (financial, procurement, performance) for all co-financiers. Alignment will also be possible wherever the Country's Supreme Audit Institution (such as National Audit office, cour des comptes, etc. – SAI) has the required attributes (independence, capacity, use of appropriate standards) and is able and willing to ensure the annual financial audits. The preferred option is to use the SAIs. The INTOSAI peer review and the World Bank methodology can be used to assess the acceptability of the auditors, private or public.

Recommendation 8: with respect to financial audit, carefully select the auditors for the full scope integrated audits. Unless readily available for a country, make an assessment of the SAI for acceptability. If SAI is not acceptable, then carry out similar assessment of private auditors. Use the same ToRs (see model in annex#) for the audits. Modalities of this and financing arrangements of it would be included in the JFA proposed by each FMA team.

Recommendation 9: for other types of audits (performance audit/value for money, procurement audit), the FMA should be clear about the needs and propose the type and frequency and, as much as possible, to incorporate all audits into one single audit (the mentioned integrated annual audit).

Need for a JFA for each country and an MOU among the 3 agencies – It is recommended that an MOU between the 3 Development Partners (DPs) be developed and signed which would commit the partners to sharing relevant information from assessments and verification, including information such as annual work plans and budgets of similar projects. The MOU should set out the code of conduct and a framework for joint FMAs and the principles in terms of relying on work performed or contracted by each DP provided sufficient quality assurance mechanisms are in place. The aim will be to reduce the burden and costs on Partner Countries (PCs) and DPs. This overarching agreement will help set the tone and scope for more in-depth cooperation and agreement on a country by country basis on some of the specific issues which are dealt with below. The decision to jointly co-finance or harmonize reporting and verification at a Country level should be the subject of a JFA for each situation.

Harmonization through a joint FM Assessment An up-front FM (and procurement) assessment is a necessary and useful tool. However, we recognize that separate assessments by each institution and for separate applications (and fragmented plans), is not in line with the IHP+ idea and does not support the one strategy and one plan, the cost of doing business for both the Partner Countries and the DPs are much higher than if the 3 institutions, and maybe other DPs, harmonized and agreed on one set of rules and requirements and accepted a common FM work. The working group agreed on the applicable principles for adequate financial management and accountability. We also jointly developed a questionnaire to guide FM assessments in future. Based on these principles, it was agreed that an FMA

prepared jointly, by one of the three agencies, and in future perhaps by other DPs, would be acceptable to the others so long as the following three stipulations are also met:

1. Agreement, on a case by case basis, on the scope of the FM Assessment and fiduciary requirements. Each case would be reviewed by a Coordination and Scoping Meeting among FM professionals of all participating agencies (and preferably including a country-based representative of an active donor), and including other development partners who intend to finance the program;
2. Agreement on the terms of reference for the FMA, to be commensurate with the complexity of each operation, including qualifications of the team carrying out the assessment, time allowed for the reviews, expected output of each FMA (in terms of some discussion on the format of the report, as well as the report's minimum required content - normal fiduciary requirements, proposed action plans, suggested next steps and recommended supervision plans). The FM group can produce generic TORs to be easily tailored for each case – TORs to be clear about use of existing diagnostic work done by other donors, and;
3. A quality assurance process - Opportunity for the three agencies (and other funding development partners) to provide comments to the draft FMA report; Verification of the final report to ensure that all material comments have been properly addressed.

These and other proposed arrangements should be documented in a framework agreement (an MOU) signed by the 3 institutions. The above 3 stipulation should take place ahead of each FMA.

Learning process and Other Implications

We suggest that at least three or four 'pilots' are conducted and follow this approach in order to learn lessons and to review and refine the approach. The implementation and supervision could provide invaluable input into revision of the proposed approach.

These have resource and budget implications that needs guidance from the management.

Summary of areas that need changes for better harmonization:

There is uncertainty as to the necessity of up-front requirement (by GF and to an extent by GAVI) for very detailed budget proposals at the time of application (GF does not carry out an FMA, as such, but relies on LFA for monitoring and FM supervision downstream. Instead, it scrutinizes the 5 year proposals and 2-3 first year budgets and requires a very detailed budget, and estimates for subsequent years, up-front). With the advent of JANS and annual reviews, this seems unnecessary and less effective. [discuss further – an effective expenditure framework and Internal control is critical and more effective]

The issue of timing at which the Principle Recipient (PR) and Sub-recipient (SRs) Implementing agencies should be assessed remains an area for further discussion. One view is that if JANS is used as the main tool for assessment of the national strategy and related budget and plans, all main actors in the health

sector are known and can be assessed in the context of the JANS exercise. [discuss and agree on the appropriate timing and extent]

It is arguable that, unless financing of the national strategy materializes shortly after the JANS exercise, the FMA should and can be deferred to a later date and the FM and procurement assessment for the JANS exercise can be limited to the country and sector (including the MOH). This is not a very strong argument, however, because the National Strategy and Sector Budget feasibility and credibility is dependent on the capacity of all main actors in a sector (NHS feasibility assessment). The planning/budgeting cycle of a particular CP is important so that all preparatory work, on the JANS and in subsequent FMAs, is completed in time to ensure DP support is on plan and on budget.

There is a need to harmonize and align the Chart of Accounts (classifications of revenues and expenditures in the accounting and reporting system) with the SHA classifications, and to harmonize the format and content of financial reports to the later, as closely as possible. Linking indicators to expenditures also is useful so as to be able to link the results and output and outcomes to the financial progress. [discuss auxiliary accounting for health sector] (examples of Ethiopia and Uganda manual sets of books for classification)

The three agencies need to develop a common dictionary and common practice. For this, it is suggested that the first few assessments and discussions for development of financial reporting requirements be jointly carried out.

Areas which need clarification and guidance from IHP+ coordination team or the Management of GF/GAVI/WB:

1. Harmonizing approval processes: While GF and GAVI Board approval precedes the preparation, FM assessment and negotiations, the Bank Board approval comes after everything is completed and the operation is negotiated. In addition to the fact that such an approval is before readiness for implementation in the case of GAVI and the GF, once the financing is approved, there is less incentive for changes and improvements of arrangements and building capacity and ownership of any action plan from the recipients maybe less than desirable.
2. Alignment with government planning and budgeting cycles: There is a major and reoccurring issue of harmonization of the application, approval, reporting and disbursement timetables with those of the Government budget calendar to allow inclusion of the financing in the government budgets.

Unless harmonization in the sequence of events and board presentation /approval materializes and the alignment with the CPs' budget cycle takes place, the FM and procurement harmonization would not have the maximum impact and some redundancies and duplication may remain.

The requirement for detailed multi-year program budgets: As indicated, both GF and GAVI approve grants based on the preparation and review of a detailed activity and financial plan which includes multi-year costing of programs by activity and economic classifications. In those countries where PFM

(in particular costing) capacity is limited, it is a challenge to produce reliable detailed line-item budgets beyond the coming financial year. In this context, further thought is needed on the requirement for detailed multi-year line item budgets as the basis for giving approvals for programs. At the minimum, where a functioning MTEF process does exist (most HSFP countries struggle in this area), it could be accepted that the line ministries provide detailed line item budgets for the 1st year (coming FY) (in line with their annual budget calendars) and broad policy costing estimates into the medium term i.e. years 2 and 3, with each year refining and providing details 4 months before the beginning of the following year (to allow smooth continuation of disbursements).

The Implementation arrangements (part of work area #4 of JANS), which are closely related to FM, have been separated from work area # 3, which poses a problem for FM. The issue of implementation is fully relevant and related to FM and cannot be developed in isolation. These two groups need close coordination. Additional resources (budget and expert time) for all three agencies are needed to take this work forward.

List of **Annexes to the FM harmonization report**

Annex 1 – Step by step operational table for full financing cycle

Annex 2 - Questionnaire for FMA (to be attached)

Annex 3 – note on flow of funds options (to be attached)

Annex 4 – sample agenda for FMA Coordination and Scoping Meetings (to be developed)

Annex 5 -- Content of FMA report including format and content of Financial Statements (tbd)

Annex 6 --Governance and Anti-Corruption (tbd)

Annex 7 -- Audit ToRs (tbd)

Annex 8 -- Model JFA (and Nepal case) (to be attached)

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Step by step operational table for full cycle (from GF and GAVI perspective)**Operational aspects of the recommendation and challenges ahead**

The Progress and agreements on how to organize and operationalize the above could be as follows:

1. The milestone for fiduciary work is reached. This can be a request from the Government for funding, JANS, an agreement between one of the agencies and the MOH to proceed with the preparation work,... (to be discussed as to what constitute the trigger).
2. An FM Scoping and Coordination (FMSC) Meeting will be organized as soon as possible to agree on stipulations 1 and 2 above (under 'conclusion and recommendation ... Harmonization of the FMA') and to decide on next steps and provide guidance to the team carrying out the assessment.
3. Terms of Reference, timing of the FMA process, composition of the FMA team (including consultants, if any, to be used) and a desk review of secondary sources on country PFM will be agreed by the FMSC.
4. After the draft FMA is prepared, the same members (or designates) of the FMSC will receive copies of the draft FMA for comment. The comments are expected within 10 working days of the receipt of the draft report.
5. The FMSC approved draft report would be distributed to all relevant parties including the MoH and its development partners within 10 days of the receipt of the draft report.
6. The same FMSC would be responsible for monitoring and assessing the progress on any FM action plan and capacity building activities required prior to commencement of the programme.

Full cycle table (to be attached)