Using Country Public Financial Management Systems

A Practitioner's Guide

부산 세계개발원조총회
4th High Level Forum on Aid Effectiveness
29 Nov – 1 Dec 2011, Busan, Korea

Acknowledgements

Using Country Public Financial Management Systems: A Practitioner's Guide was commissioned by the Task Force on Public Financial Management, co-chaired by Anthony Hegarty (World Bank) and Peter Simbani (Malawi) and Kennedy Musonda (Zambia), under the auspices of the Working Party on Aid Effectiveness (an international partnership hosted by the OECD-DAC). The Practitioner's Guide was prepared jointly by the Inter-American Development Bank (Deborah Sprietzer) and the World Bank (Manuel Vargas), based on evidence and analytic frameworks provided by Hernan Pflucker and Mokoro (Alta Folscher), and using as reference the work undertaken by the Collaborative African Budget Reform Initiative (CABRI) and others. The document was edited by Patricia Rogers (World Bank). Peer reviewers from the Task Force on PFM Advisory Panel included the United States Agency for International Development, the U.S. Department of the Treasury's Office of International Affairs, the U.S. Millennium Challenge Corporation, the European Commission, CABRI, Better Aid, the Swedish International Development Cooperation Agency (SIDA), and the Canadian International Development Agency (CIDA). In addition, the PEFA Secretariat and other PFM Task Force members provided valuable contributions and comments. The Task Force on PFM held consultative meetings with partner countries during its meetings in Malawi (April 2010) and India (December 2010). Both meetings provided an opportunity for participants to share experiences in the use of country systems across aid modalities and country circumstances (Middle Income Countries, Low Income Countries, and Fragile States).

The Task Team would like to thank the Chairs of the Task Force on PFM, the hands-on support of the OECD-DAC Secretariat (Sara Fyson), the Advisory Panel, and the organizations who assisted the Task Team by sharing information, supporting the design and responding to the report's supporting survey, providing useful supporting documentation and examples of good practices, and commenting on this document. While this Guide is intended for donor agencies, the Task Team hopes that it will be useful for PFM practitioners within and outside of the donor community.

IDB

OECD
BETTER POLICIES FOR BETTER LIVES

Contents

Abbreviations and Acronyms

Executive Summary 1
- **Methodology** 1
- **Current donor practices** 2
- **A framework for the use of country systems** 4
- **Donor policies and procedures** 4
- **Options for using country systems** 6
- **Conclusions** 9

Introduction 11
- **Objectives** 13
- **Overview of the Practitioner's Guide** 14
- **Contextualizing Good Practice** 15

SECTION I Determining the Use of Country Systems: Status of Current Approaches 17
- **Donor policies: Coverage and compatibility** 17
  - *General review of assistance policies* 17
  - *Compatibility of policies and regulations with use of country systems* 18
- **Donor decision-making processes in the use of country systems** 19
  - *Main approach to decision-making on use of country systems* 19
  - *Who is involved in the decision?* 20
  - *On what factors is the decision based?* 21
  - *Are risks and benefits taken into account?* 21
  - *What risks are taken into account?* 22
- **Aid modalities and use of country systems: Donor preferences** 22
  - *Choice of aid modalities* 23
  - *Choice of funding mechanisms/channels* 23
- **Analytical and diagnostic tools** 24
  - *Commonly assessed PFM sub-systems* 25
  - *Other issues assessed* 26
- **Developing internal capacity to use country systems** 26
  - *Training and development of guidance* 27
  - *Providing incentives to use country systems* 27
- **Disincentives to using country systems** 27
- **Conclusion** 28

SECTION II A Framework for the Use of Country Systems 29
- **Key principles for using country PFM systems** 29
- **Donor policies and procedures** 31

Existence and coverage of donor policies *31*
Core approach to using country systems *31*
Decision-making processes for the use of country systems *32*
The basis for decision-making: Balancing risks and benefits *33*
Risk management *38*
Donor skills for the use of country systems *40*
Country context *41*
Monitoring the use of country systems *44*
Supporting mechanisms *44*
Options for using country systems in practice **45**
Components of country PFM systems *46*
Using country systems: External financing “on plan” and “on budget” *48*
Using country systems: External financing “on parliament” *54*
Using country systems: External financing “on treasury” *56*
Using country systems: Aid “on procurement” *61*
Using country systems: External financing “on account” *61*
Using country systems: Aid “on audit” *66*
Use of country systems: External assistance “on report” *70*
Conclusion **71**
ANNEXES **73**
Annex 1. Survey scope and methodology **73**
Annex 2. Statistical Summary of Donors’ Answers – Survey, Part 1 .... **76**
Annex 3. Good Practice Examples of Donor-financed Programs – Survey, Part 2 .... **81**
Annex 4. Bibliography **85**

Abbreviations and Acronyms

AAA	Accra Agenda for Action
CABRI	Collaborative Africa Budget Reform Initiative
CFAA	Country Financial Accountability Assessment
CIDA	Canadian International Development Agency
CPAR	Country Procurement Assessment Report
DAC	Development Assistance Committee
DFID	UK Department for International Development
GBS	General Budget Support
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
IPSAS	International Public Sector Accounting Standards
NGO	Non-governmental Organization
OECD	Organisation for Economic Co-operation and Development
PBA	Program-based Approach
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PRSC	Poverty Reduction Support Credit
SAI	Supreme Audit Institution
SBS	Sector Budget Support
SIDA	Swedish International Development Cooperation Agency
SWAp	Sector Wide Approach
TOR	Terms of Reference
TSA	Treasury Single Account
UCS	Use of Country Systems
UN	United Nations

Executive Summary

In the 2005 Paris Declaration, as part of a global effort to make development aid more effective, partner countries committed to strengthening their national systems, while donors committed to using these systems to the maximum extent possible. At the Third High Level Forum on Aid Effectiveness, held in Accra, Ghana in 2008, both partner countries and donors agreed to accelerate and deepen their commitments, given the evidence that, although some progress had been achieved in strengthening country systems, less progress had been made toward advancing the use of country public financial management (PFM) systems by donors, with only 45% of external financing (disbursements) being channeled through country PFM systems in the countries surveyed in 2008.

The 2011 Survey showed a marginal increase to 48% of disbursements using country PFM systems in the countries surveyed in 2010. In addition, the survey results showed a weak correlation between the quality of a country PFM system and its use by donors.

The objectives of this document are to:

i. Present the different approaches through which donor organizations (bilateral and multilateral development agencies) determine whether they will use country PFM systems for donor-financed programs (Section I), and

ii. Propose a framework for guiding the use of country PFM systems, in a manner that strengthens countries' sustainable development (Section II).

In doing so, this report identifies good practices in relation to the various elements or subcomponents of an integrated PFM system in varied country environments and for different aid modalities, such as general budget support (GBS), sector budget support (SBS), and program-based approach or project support. For the purposes of this document, using country systems is seen as a continuum of practices, with the ideal being the delivery of aid using all of the components of the core budget process, regardless of the aid modality. However, it is recognized that depending on their ability to take on risk, donors may use country systems to a greater or lesser degree.

This report therefore identifies good practices in relation to the various elements or components of an integrated PFM system in varied country environments and for different aid modalities. It also offers for donors' consideration a number of procedures that can help to improve the harmonization of donor and government procedures.

Methodology

This document presents the current donor approaches and practices to determining the use of country PFM systems, based on the 17 responses received to a survey conducted in May 2010. The survey was comprised of a set of specific questions about the donors' policies on and approaches to the use of country systems, their preferences, and their experiences in using country PFM systems. It also asked respondents to submit examples of good practice cases, in which country systems were used.

Based on the survey responses and analytical frameworks developed by the Task Team and others, such as the Collaborative Africa Budget Reform Initiative (CABRI), the Task Team proposed a framework for guiding the use of country systems –exemplified by a number of good practices.

Current donor practices

Almost all donors already have, or are in the process of preparing, an operational policy that encourages the use of country PFM systems. Of the donors who responded to the survey, most multilateral institutions and one-third of the bilateral donors have also reviewed their overall assistance policies and procedures to promote the use of country systems.

Donors have made efforts to overcome specific legal constraints to using country systems, but some donors reported that they still face such constraints. Only one bilateral donor (out of the 12 that provided answers to those specific questions) reported that its policies do not allow country agencies to maintain control of the financial and non-financial aspects of assistance programs. However, according to earlier work by the Finnish Ministry of Foreign Affairs, most donor policies foster the use of country systems for general and sector budget support programs, but not for project support.

For some components of the PFM system (i.e., budget, treasury, accounting, financial reporting, audit), the use of country systems is allowed; however, some donors seek to identify how countries' systems can be modified to accommodate donor-specific requirements.

In general, most donors use a two-phased process to determine the use of country PFM systems. A decision is first made at the country level on the feasibility of using country systems. For almost all donors, this decision is taken by headquarters staff or, in the case of bilateral donors, the relevant political authority. For half of the donors, acceptance by the political authority is required. Subsequent decisions are then taken for each program and/or project. For half of the survey respondents, headquarters staff are still involved at this level.

For over 80% of bilateral donors and about 65% of multilateral donors, fiduciary risk is a key factor at the country level. Slightly greater than 40% of bilateral donors see such risk as important at the program level, compared to half of the multilateral donors.

Non-PFM factors featured more heavily in bilateral donors' assessments. Two-thirds of the bilateral donors reported that partner country-specific circumstances play a role, including, for some, adherence to underlying principles such as human rights, good governance, and democratic principles. Only two bilateral donors out of all respondents indicated that country negotiations influenced their decisions.

Across factors, donors tend to give more weight to risk factors than to the potential benefits of using country systems. This resonates with the 2008 study undertaken by the Task Force on PFM on donor approaches to managing risk, which found that most donors focused their assessments on fiduciary and reputational risks, as well as corruption, and very few donors analysed the risk of not achieving the poverty reduction objectives or not using country systems. Subsequent studies highlighted the tendency to give more weight to the short-term risks that affect donors directly than to the longer-term benefits that accrue to both the partner country and donors when country systems are used.

Just over half of the respondents indicated that they do not have a preference for a specific modality. Most bilateral donors indicated that they prefer to use a suitable mix of modalities at the country level, including budget support and project support.

Donors generally disburse development assistance either as goods and services or as cash. Six responding donors indicated that they require proper justification, if assistance is delivered as goods and services only (in other words, the donor manages the project or disburses to a third party). Cash assistance can be disbursed to a project-specific account and be managed using donor procedures (almost 40% of donors required justification when this is the chosen disbursement method), or it can be disbursed to a project-specific account but managed using the country's own procedures (almost one-third of donors indicated that this needs to be justified). Although 43% of responding donors indicated that they provide cash assistance directly to country treasuries and that the government has control over the use of funds, 19% of donors indicated that they do not use this procedure.

For all responding donors, assessing country PFM systems is a priority when deciding to use country systems. Most donors use harmonised tools like the Public Expenditure and Financial Accountability (PEFA) assessment methodology, but in combination with their own tools. Four of five multilateral donors use their own tools, while 72% of the bilateral donors who answered the survey either already have or are developing their own tools to implement. Two-thirds of donors expressed an awareness of gaps in existing tools, indicating the need to: 1) develop additional tools, 2) extend the scope of the PEFA methodology to cover specific sectors or sub-national governments *(the PEFA Program has already issued guidance for application of the tool at the sub-national level)*, 3) extend the PEFA methodology to provide a more thorough analysis of the causes of weak systems, or 4) "fine-tune" the PEFA methodology and framework.

Whereas all responding donors assess budget preparation and classification systems, not all confirmed that they assess the treasury, budget execution, and accounting systems. The systems that are assessed by the fewest donors are external oversight by parliament, the integrated financial management information system, and treasury procedures to manage local and foreign currencies.

More than 80% of responding donors provide training on PFM to build capacity for the use of country systems. Fewer donors provide training on the different modalities and the use of country systems (54%), and less than half trained staff specifically on the use of country systems. All donors either have or are developing specific guidance on the use of country systems.

Many donors (56%) were discouraged from using country systems by the operational and fiduciary risks associated with it. For fewer donors (25%), their own lack of know-how, tools, manuals, and procedures were also factors in making a decision not to use country systems. A small percentage of donors (12.5%) indicated that operational capacity is a constraint. Some donors (19%) also said that they are constrained by partner countries' own preferences for the use of parallel systems.

Overall, the survey provided evidence that all responding donors support the use of country systems in their programs and have, or are developing, an institutional base for using country systems. However, their responses suggest that understanding and harmonizing donor and government procedures and requirements in the initial years is a big challenge for both donors and partner countries and requires a transition process. In this respect, the survey also shows important limitations in donors' preparedness for the use of country systems.

For most donors, delegating to partner countries control over development assistance programs is possible only for budget support modalities. Few donors provide their country teams with guidance on using only some components of a PFM system, or on maximizing use within any one component; nor do they identify options for safeguards for which transaction costs are low, so that country teams could use country systems in more cases. Moreover, few donors have in place systems to monitor the use of country systems internally, with a view to learning lessons, although some are undertaking knowledge management efforts around the use of country systems.

A framework for the use of country systems

The framework provided in this document draws on donor experience to provide key principles for using country systems (see Box), details the important donor arrangements to maximise the use of country systems, and sets out options for using country systems at the country and program level to inform the development of donor policies and procedures.

Principles for using country systems

The Framework draws on the Paris Declaration and Accra Agenda for Action to establish key principles for the use of country systems.

Principles for donors' approach to the use of country systems. While recognizing that the use of country systems is not an "all-or-nothing" approach, donors should develop policies and practices to ensure the use of country systems to the maximum extent possible. This means that, besides using modalities that use country systems more fully more often, donors should seek out opportunities in all other modalities to use some country systems at least to some degree.

Principles for maximising the development benefit of using country systems. Partner countries also face risk, both when country systems are used and when they are not. Donors should therefore respect country leadership in the use of country systems and ensure that it is agreed to as part of partnership dialogue. When donors do not use country systems (or do not use them fully), they should seek to minimize any harm that choice might cause partner countries. This means that, at a minimum, they must provide timely, comprehensive, and reliable information on all aid, in formats that country systems can use to integrate aid into country processes. When donors use country systems but institute special arrangements to manage risk, they should design these arrangements in a manner that would strengthen—and not undermine—country systems. To realize maximum benefits from the use of country systems, donors should emphasise capacity building in their assistance strategies to improve the country's PFM performance and human resource base.

Principles for implementing the use of country systems. In implementing approaches to the use of country systems, donors should seek to harmonise their tools for assessing country systems and should monitor implementation to keep track of progress and enable lesson learning and sharing on what works.

Donor policies and procedures

A donor's decision to use country PFM systems in the operations it funds should be based on clear policies applicable to different assistance modalities; clear procedures and institutional capacity for deciding on, managing, and monitoring the use of country systems; the use of analytical tools at the country level and, when necessary, at the sector, ministry, and sub-national levels, to influence operational design and manage PFM risks; and supporting mechanisms that promote the use of country systems.

Existence and coverage of donor policies. Donors should provide clear guidance to field offices and country teams on the use of country systems. This requires that they develop a specific use-of-country-systems policy to frame practices, and that they review all policies and guidance documentation to integrate the use of country systems and remove blockages.

Core approach to using country systems. Donors should develop a clear rule governing decision-making on the use of country systems. This could be either a "must use except when" or a "can use as long as"' approach. In either case, however, the development of the approach must (i) limit the exceptions to using country systems, and (ii) provide options for still using country systems even when the limits apply.

Decision-making processes for the use of country systems. Donor policies should ensure that the programming of all assistance—at both the country level and aid activity level, whatever the aid type and flow type—include a decision point on the extent to which country systems will be used. This applies to both country level and aid activity level. Donor processes to make decisions at each of these levels should be integrated, so that (i) for some countries using country systems can be a first option once the decision is made at the country level; and (ii) when this is not possible, authority to decide on the use of country systems for each program is fully delegated to the country level. If a donor is not able to delegate to the country level full authority for the use of country systems in individual assistance programs and projects, it can delegate it to the maximum extent possible: in other words, either up to a monetary threshold or only for some components of a PFM system beyond a certain degree. Partner country authorities should be included in the discussion at both country and program levels.

The basis for decision-making. Donors should make clear what the conditions are under which they will and will not use country systems, and how systems will be assessed against those conditions. This means that the donor must specify (i) the factors that it will take into account, (ii) the standards that it will apply to these factors, and (iii) the tools that it will use to assess the factors.

- Donor policies and procedures should take into account both the risks and benefits that affect the donor directly in the short term and the risks and benefits that affect the donor through its effect on partner countries in the long term. This includes, with examples in brackets, fiduciary risk (risk of funds being misused or poor value for money), reputational risk (from poor country governance and fiduciary breaches) and developmental risk (when used implementation of programs can be affected in the short term, but when not used, parallel systems affect country capacity to manage own funds and reduce sustainability), as well as developmental benefits (crowding in resources for development of country systems, better integration with country resources, policy coherence and transparency when used) and reputational benefits (recognition for implementation of donor commitments when used, strategic control and high visibility when not used).

- Donors also have to take into account the costs and savings associated with the use of country systems and consider them against potential benefits. Costs are typically the transitional cost of adjusting systems, developing policies and retraining staff and the recurrent cost of increased PFM and strategic capacity at country level. Savings include the administrative cost of third-party implementing agents and donors' own parallel systems if they manage the funds themselves.

- Donor policies have to be explicit about the thresholds that they apply to the criteria for using country systems, underscoring that benefits can accrue and risks can be managed as long as countries demonstrate progress towards recognized standards.

- Donors should be explicit about the analytical tools that country teams need to apply in order to use country systems, and should develop a set of tools that are harmonised as far as possible.

Risk management. Donors can apply various risk mitigation strategies, including using a mix of modalities and a mix of PFM systems, and arranging additional safeguards in any one system that is used. While such mechanisms allow country systems to be used, the risk is that they again deflect focus from developing better systems for domestic budget expenditure and increase transaction costs. Thus, when introducing such mechanisms, donors should ensure that they effectively lower the risk level and build upon and improve, rather than circumvent, the government PFM systems.

Donor skills. Donors' specific policies on the use of country systems should incorporate strategies to build skills for the use of country systems—for example, awareness raising on the use of country systems; updating training and capacity-building programs to include the use of country PFM systems; reorienting donor systems to facilitate the use of country systems; and building up-to-date knowledge bases on PFM systems in the countries where they operate and ensuring that all relevant staff have access to the knowledge base (these activities can be harmonized with other donors).

Country context. While maintaining core approaches and policies and procedures to decide on and manage risks related to using country systems, donors should understand the political economy, change management and technical factors that can enable the use of systems in a particular country context. Donors should encourage the use of this knowledge to develop innovative, country-specific strategies to support the strengthening and increase the use of country PFM systems.

Monitoring the use of country systems. Donors should monitor their use of country systems at the program, country, and donor levels, regularly reviewing their policies, decision-making rules, decisions, and practices to improve the degree to which, and how, country systems are used.

Supporting mechanisms. Donors face domestic and country-level resistance to the use of country systems. To address this resistance, they can work at the country level to build support from a broader array of national stakeholders; use communication and outreach strategies within donor structures and to domestic audiences; and use international partnerships to foster change.

Options for using country systems

Donors can opt to use country systems to various degrees across aid flows or for any one program or project. Donors can (i) use only some of the components of the country PFM system, (ii) limit the degree to which each component is used, and (iii) use a mix of modalities across their programs, each of which uses country systems to a greater or lesser degree.

Aid can be integrated with different phases of the national budget process, each of which is associated with a PFM system component: planning, budget preparation, approval by parliament, budget execution through treasury, procurement, accounting, auditing, and reporting. Aid can therefore be managed through any one of these components, or any combination (for example, it can be "on plan," "on budget," and so forth). However, depending on the characteristics of the donor-financed operation and the level of development and operation of PFM systems, a donor's risk management strategy for all modalities can call for the selective use of certain PFM elements, with a gradual and sequenced process to expand to full use and to the other components of a PFM system.

Different modalities are traditionally associated with different degrees of use country systems. However, if aid modalities are differentiated primarily by the degree to which donors earmark the funds (for example by sector objective, geographic use, and allowed inputs), modalities that are traditionally associated with parallel systems can equally well be delivered through country systems.

All donor assistance programs and projects should, at the minimum, be "on plan," "on budget," and "on report," whatever the modality and whatever a donor's willingness to take on risk. From an aid effectiveness perspective, this transparency is essential for partner country ownership of donor assistance, alignment of aid, donor harmonization, managing for results, and mutual accountability. From a partner country system perspective, when aid is not reflected “on plan” and “on budget,” planning for the use of domestic resources cannot take adequate account of donor-financed activities—a situation that results in overlap and duplication, and that contributes to weak local accountability. Full reflection of donor assistance “on plan” and “on budget” enables countries to improve their macroeconomic management, improves transparency within the budget process, and contributes to improved policy coherence and efficiency in allocation.

Options for aid “on plan” and “on budget”. Full use of planning systems means that donor assistance is programmed—that is, decisions about objectives and activities within the parameters of the assistance are made—using country planning institutions. Full use of country budgeting systems means that the allocation of available resources for the assistance to objectives and activities is done using partner country budgeting procedures, ideally within the formal budget process. When programming is driven by donors, at a minimum reliable information should be made available to the partner country in time to be considered in its planning and budgeting processes and reflected in its planning and budget documentation.

SWAps and basket funds for which the government is the lead or is a significant partner in the management of the activity can be important instruments for increasing the use of country systems for planning for donor resources. However, the use of these instruments alone is not in itself equal to the use of country systems: these instruments contribute fully to progress in the use of country systems only where the joint planning, budgeting, budget execution, accounting, reporting, and auditing of pooled funds are done through country systems.

For donors to bring aid “on plan” and “on budget,” it is necessary to take into account country planning and budgeting processes, their instruments, timeline, and mechanisms for coordination between institutions and formats, particularly budget classifications. Benefits from including aid “on plan” and “on budget” will only materialize if quality information (completeness, reliability, predictability, level of disaggregation) is provided in a timely manner, and if government systems of sufficient quality incorporate information on aid flows.

Options for aid “on parliament”. While country legal frameworks determine which aid should be approved by country parliaments and the formats within which the aid is approved, some flow types and some categories of aid should be on parliament in principle and others less so, to support local accountability and the rule of law in resource management. For example, all loan-financed programs should be on parliament, while there is less of an argument that aid disbursed to NGOs should be “on parliament,” even if it is subject to an agreement with government. Donors can support increased use of country systems in this phase of the budget process by (i) supporting countries in improving the transparency of aid “on parliament,” and (ii) providing reliable, comprehensive, and timely information in partner country budget formats for inclusion on parliament or on budget.

Options for aid “on treasury”. Using country treasury systems fully means that development assistance flows are disbursed using the same treasury systems and banking arrangements as are used for disbursing the government’s domestic resources. By definition, general and sector budget support modalities use country treasury systems fully. A supplemental version of using country systems—one that provides more assurance to donors—is using special accounts that manage donor funds separately from a country’s own resources, even if disbursement processes are managed by country institutions through common treasury systems. Special accounts can be kept with the central bank or in other banking institutions. They can be controlled by the central treasury, or by implementing agencies –

depending on the country's own treasury model. They can operate on a fixed disbursement basis to the implementing agency account against a work or cash flow requirement plan, subject to report, or on a reimbursement basis; or the implementing agency can request payment directly from the central treasury account to suppliers.

The degree to which benefits from using country systems are realized depends on a range of factors: the level of derogations from core treasury systems, the degree to which the systems are used across donors, the predictability of disbursements, and the additional support provided to strengthen country treasury systems.

A good understanding of country banking, cash management, and budget execution procedures and capacity is necessary to properly define the terms in which the program resources will be provided, managed, and recorded in the PFM system.

Options for aid "on account". External financing is on account when government accounting systems are used to manage, classify, and record transactions for aid programs and projects and produce financial reports. Programs and projects are fully "on account" when the government system is used as is and government financial reports are accepted, without any additional safeguards or reporting. A supplemental form of "on account" occurs when programs are executed using government accounting systems, but donors require government systems to be modified to allow tracking of program expenditure or additional reporting—perhaps by adding codes to the country chart of accounts to track expenditures, using a conversion matrix in an integrated financial management system to align and convert country classifications to donor-oriented classifications, or producing donor-specific reports.

In practice, "on treasury" usually is coupled with using government procedures to commit and control funds and government systems to account for and report on aid funds. Donors often use country accounting systems for projects when countries have a functional integrated financial management system that allows donors to track project expenditures and receive additional reports.

Options for aid "on audit". External financing is "on (external) audit" when development assistance programs and projects are audited by country auditing institutions in accordance with country legal frameworks and audit frameworks and procedures. Full use of country audit systems means that donors are satisfied with the audit coverage, approach, and frameworks of the country's supreme audit institution (SAI) and do not require any additional audits to be done. Supplemental use of country audit systems occurs when donors use the country SAI, but require specific audits of donor programs, usually in terms of donor-specified terms of reference. The staff who conduct such supplemental audits can be the SAI's own staff, or a private firm approved and quality-assured by the SAI. Using country audit systems benefits donors and partner countries through the development of audit capacity and the additional encouragement for performance.

Options for aid "on report". Aid is "on report" when donors accept country reporting systems and formats for their own financial and performance reporting purposes. Full use of aid on report means that donors are satisfied with the content, format, and timing of country reports for their own purposes. Supplemental use occurs when donors require only minimal additional reporting, imposing fairly insignificant recurring costs on the country system.

In principle donors should ensure that all aid is reflected on country financial and performance reporting, even if they are not using country reporting systems for their own purposes. Together with putting aid "on plan" and "on budget," ensuring that comprehensive, accurate, timely, and useful information on all aid flows is available at country level for inclusion in government reports is a minimum level of use of country systems that should apply for all donors.

Conclusions

The use of country systems to deliver development assistance requires that donors reorient their policies, procedures, and capacity. Key factors in this process are the rules donors apply when deciding on the use of country systems. These guidelines provide options for donors to use country systems, even when they are highly risk-averse or are constrained by legal or procedural limits.

Under the Accra Agenda for Action, donors have committed to using country systems as a first option, particularly to support services provided by the public sector, to make progress on the Paris Declaration commitment to use country systems to the maximum extent possible. These guidelines encourage donors to

- Ensure that their assessments related to the use of country systems take all risk and all benefits into account.
- As a minimum, ensure that complete, quality information on aid is available on a timely basis for integration into country planning and budgeting systems and for reflection in country financial and performance reports.
- Go beyond the minimum, utilizing a combination of (i) core approaches and policies and procedures to decide on and manage risks related to using country systems and (ii) understanding the political economy, change management and technical factors that can enable the use of systems in a particular country context, to develop country-level strategies to support the strengthening and increase the use of national PFM systems.
- If not able to implement a “must use except when” approach for all countries, identify the countries where this approach can apply to all programs and projects, even if with negotiated safeguards.
- If not able to implement a “must use except when” approach for a country, reduce the burden for country offices to make the decision to use country systems as far as possible.
- Using country-level strategies as point of departure, maximize the use on a modality-by-modality or program-by-program basis using the options identified in the Guide.
- Harmonize country-level work around the use of country systems, respect partner country leadership in the decision, and support country capacity building and policy actions to improve PFM performance and human resource skills base.
- Build the necessary institutional capacity in terms of systems and human resource capacity to maximize the use of country systems, using communication and outreach, quantitative targets, reporting requirements, and international partnerships to strengthen incentives for action.

Introduction

In the 2005 Paris Declaration, as part of a global effort to make development aid more effective, partner countries committed to strengthening their national systems, while donors committed to using these systems to the maximum extent possible. At the Third High Level Forum on Aid Effectiveness, held in Accra, Ghana in 2008, both partner countries and donors agreed to accelerate and deepen their commitments, given the preliminary results presented during the forum. Strong evidence was presented that, although some progress had been achieved in strengthening country systems, less progress had been made toward advancing the use of country public financial management (PFM) systems by donors, with only 45% of external financing (disbursements) being channeled through country PFM systems in the countries surveyed in 2008.

The 2011 Survey showed a marginal increase to 48% of disbursements using country PFM systems in the countries surveyed in 2010. In addition, the survey results showed a weak correlation between the quality of a country PFM system and its use by donors.

As a result, in §15 of the Accra Agenda for Action (AAA) both developing countries and donors recommitted to "strengthen and use developing country systems to the maximum extent possible," including to use country systems as a first option for aid programs in support of activities managed by the public sector (Box 1 provides useful definitions).[1]

[1] To facilitate the implementation of these commitments, the OECD/DAC Working Party on Aid Effectiveness created a Global Partnership on Strengthening and Using Country Systems to (a) accelerate progress in donors' use of country systems; (b) facilitate the strengthening of country systems and effective locally-rooted capacity to reform systems where deemed necessary; and (c) better communicate the benefits of using country systems and the involvement of a greater number of stakeholders (parliaments, civil society organizations) in overseeing the strengthening and use of country systems. Two task forces were created under the Global Partnership to produce guidance and good practice notes on strengthening PFM and procurement systems. As part of the work program of the Task Force on PFM, the Inter-American Development Bank and the World Bank were asked to prepare this *Using Country Public Financial Management Systems: A Practitioner's Guide*.

Box 1. What does "use of country systems" mean?

The use of country systems poses two definitional questions: (i) what do we mean by *country systems*, and (ii) what do we mean by *using* them?

According to the Paris Declaration, "Country systems and procedures typically include, but are not restricted to, national arrangements and procedures for public financial management, accounting, auditing, procurement, results frameworks and monitoring (OECD/DAC, *Paris Declaration*, p. 4). Indicator 5 of the Paris Declaration measures the use of partner country PFM systems by the use of budget execution, auditing, financial reporting, and procurement systems, while indicator 3—which is related to alignment with partner country strategies—measures how much aid is reported on budget.

The 2009 OECD/DAC report on using country systems defined it as the use of systems in "the entire budget cycle from strategic planning to oversight. Accordingly, use of country FM systems means using components of the PFM system in donor-financed activities" (OECD/DAC, 2009, *Managing Development Resources. The Use of Country Systems in Public Financial Management*, p13).

The Collaborative African Budget Reform Initiative (CABRI) also interprets the use of country systems to refer to all elements of the expenditure budget cycle, from planning to audit (CABRI, 2009: *Putting Aid on Budget: Good Practice Note*). It defines the use of country systems as referring to aid being
On plan: aid is integrated into spending agencies' strategic planning and supporting documentation for policy intentions behind the budget submissions.
On budget: aid is integrated in the budgeting processes and reflected in the documentation submitted with the budget to the legislature.
On parliament: aid is included in the revenue and appropriations approved by parliament.
On treasury: aid is disbursed into the government's main revenue funds and managed through the government's systems.
On procurement: procurement using aid funds follows the government's standard procurement procedures.
On account: aid is recorded and accounted for in the government's accounting system, in line with the government's classification system.
On audit: aid is audited by the government's auditing system.
On report: aid is included in the government's ex-post reports.

Many stakeholders have adopted this typology as a useful way to describe existing practice comprehensively, while at the same time offering a framework to target progress toward improved use of country systems.

The CABRI framework for bringing aid on budget also starts to answer the question of what it means to *use* country systems. Following earlier work by the Danish Ministry of Foreign Affairs (Danish Ministry of Foreign Affairs, 2005: *Including aid funds in the partner country budget*), it distinguishes between merely *reflecting* external financing in country documentation for planning, budgeting, and reporting purposes and *integrating* aid in the processes. For example, the full use of country systems implies that aid is not only reflected in planning documentation, but integrated in it so that aid is programmed using partner country planning systems.

The Paris Declaration monitoring framework assesses the percentage of funds that are managed using partner country PFM systems. In particular, it considers whether aid is managed in compliance with the country's established legislation/regulations and implemented by the government entities that use it. In some countries, legislation makes specific provisions for the systems and procedures used to implement aid-funded activities, which may differ from those used to manage funds from, for instance, domestic revenue. An example of this is the use of special funds in the "on treasury" dimension. The Paris Declaration Monitoring Surveys report such cases as using country systems.

For the purposes of this document, the "use of country systems" is therefore seen as a continuum of practices, with the ideal being the delivery of aid using all of the components of the core budget process fully, whatever the aid modality. Donors can therefore use country systems to a greater or lesser degree: they can use some or all of the PFM component systems for any or all of the aid modalities they use, and they can use each system entirely or partly.

Objectives

The objectives of this document are to:

i. Present the different approaches through which donor organizations (bilateral and multilateral development agencies) determine whether they will use country PFM systems for donor-financed programs (Section I), and

ii. Propose a framework for guiding the use of country PFM systems, in a manner that strengthens countries' sustainable development (Section II).

In doing so, this report identifies good practices in relation to the various elements or subcomponents of an integrated PFM system in varied country environments, following the typology set out in Box 1,[2] in varied country environments (fragile states, low-income countries, and middle-income countries), and for different aid modalities: general budget support (GBS), sector budget support (SBS), and program-based and project support (see Box 2).

[2] Procurement matters are addressed by the Task Force on Procurement. Revenue management is not considered in this document because, while it represents a critical PFM area, it has a relatively small impact on the use of country systems for donor-financed operations.

Box 2. Aid modalities and the use of country systems

For most stakeholders the term "aid modalities" refers to approaches to delivering development assistance or to channelling donor support to the activities to be funded. Development practitioners distinguish different aid modalities because different ways of delivering aid have different scopes and structure development assistance differently in terms of governance, leadership, and implementation responsibilities.

However, stakeholders can differ significantly on where they draw the lines of distinction between different modalities, and on what basis. Some emphasise the "scope" aspect of the term when they name different aid modalities: for example, GBS, SBS, and project support have different scopes. Others emphasise how and where the funding is converted into activities, and under whose leadership and facilitation, making distinctions between budget support, parallel support, and in-kind support. Others conflate the concepts of aid modalities and of specific aid instruments and forms, namely Sector Wide Approaches (SWAps), basket or pooled funding, technical assistance, scholarships, training, contestable funds, funding through nongovernmental organizations (NGOs), and so forth as different types of aid modalities, whereas for others these instruments commonly coincide with higher-order modalities (for example, SWAps as a program-based approach, scholarships as a project).

These Guidelines distinguish between GBS, SBS, program-based approaches (PBAs, which include pooled/basket funds), project support, and technical assistance (delivered outside of projects), following the types of aid distinctions used in the OECD/DAC Creditor Reporting System.

For our purposes, the "scope" differences between these modalities are less important than differences with regard to (i) the funding channel they are commonly associated with, and (ii) where the responsibility lies for programming, managing, reporting, and auditing the assistance. These are important aspects of using country systems in line with different parts of the PFM system, and these Guidelines provide a framework for approaching different modalities so as to maximize the use of country systems.

Overview of the Practitioner's Guide

This Guide is structured in two main parts: a discussion of donor approaches to and good practices in using country PFM systems, and the drawing of a generic framework based on experience, with references to good practice examples.

The Guide is based on existing guidance on the use of country systems and a May 2010 survey of 6 multilateral organizations and 37 bilateral organizations, in 24 countries. Part I of the survey was designed to obtain relevant information on the donor's overall approach to using PFM systems. Part II was designed to collect information about specific examples of good practices, based on the donor's perspective and experiences, classified by type of partner country, aid modality, and PFM system. Annex 1 provides an overview of the methodology and responses, and Annexes 2 and 3 provide statistics on the responses. Annex 4 provides a bibliography.

Contextualizing Good Practice

> *Good practices are a point of reference rather than a matter of prescription for all development agencies, in all countries, at all times. They should be applied with flexibility and take into account partner country circumstances and donors' institutional mandates.*
>
> (OECD/DAC Guidelines and Reference Series, vol II p18)

According to this DAC definition, good practices on the use of country systems are very much defined by specific circumstances and priorities in the countries receiving external financing.

The Guide draws on the survey answers and related documentation provided, as well as the knowledge and experience of the task team and the Task Force on PFM, to present a number of procedures that can improve harmonization between donor and government procedures. It is intended to serve as a source of ideas or reference for PFM practitioners and should not be construed as an audit or evaluation report. Each donor will need to analyze these ideas to determine how useful they are for the donor's specific programs and circumstances.

SECTION I Determining the Use of Country Systems: Status of Current Approaches

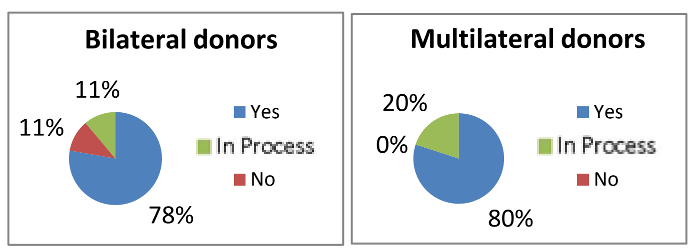
This section reports on donor preferences for and generic practices in using country systems. It represents an analysis of the 17 donor responses received to Part I of a survey conducted in May 2010. Part I of the survey contained a set of 44 questions to identify the overall donor policies and approach to using country systems; how compatible the donor's regulations are with the use of country systems (UCS); what the donor's preferences are regarding the use of PFM systems in its assistance programs; what tools the donor uses to assess country PFM systems; and which PFM or institutional aspects the donor considers in determining the use of the country PFM systems. This section also draws on and cites relevant supporting materials and documents.

This section uses the information from the survey and follow-up work to identify the main messages emanating from the work and reports on current practices in six broad categories:

- i. Donor policies: Coverage and compatibility
- ii. Donor decision-making processes in the use of country systems
- iii. Aid modalities and the use of country systems: Donor preferences
- iv. Analytical and diagnostic tools
- v. Implementing the use of country systems
    - a. Capacity building and training
    - b. Staff incentives
- vi. Disincentives to using country systems

Donor policies: Coverage and compatibility

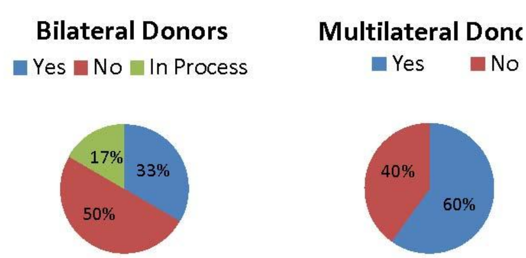
Figure 1. Donors with a specific policy on UCS



Almost all donors already have, or are preparing, an operational policy that encourages the use of country systems. Altogether 78% of bilateral and 80% of multilateral donors that responded to the question already had specific policies in place, and a further 11% of bilateral donors and 20% of multilaterals are in the process of developing specific policies (see Figure 1). Some of these policies explicitly discuss the need to understand the country systems to promote their strengthening as a direct or indirect objective of the assistance.

General review of assistance policies

Figure 2. Review of donor policies and procedures to integrate UCS



In addition, 60% of multilateral and 33% of bilateral donors have already reviewed their overall assistance policies and procedures to identify elements that are not compatible with the use of country systems, and have reviewed their operational procedures to identify what institutional strengthening they may require for a new operational environment incorporating the use of country systems. A further 17% of bilateral donors are now preparing amendments to their policies and procedures (see Figure 2).

Some donors reported that they face legal constraints to using country systems, and others have made specific efforts to overcome such legal constraints. Two bilateral and two multilateral donors reported having adjusted their policies and procedures specifically to overcome legal constraints, and one bilateral donor has addressed its constraint by undertaking a study that led to the redesign of its program document and contract templates.

Compatibility of policies and regulations with use of country systems

The survey queried donors on whether their regulations allow (i) the responsible government agency to take control of the program's execution, and (ii) the donor to use country systems and procedures within each component of the PFM cycle.

One of the most relevant issues when using country systems is the decision to provide the partner country government or ministry with control over program execution. Although the majority of donors responded that their policies envisage providing such control to the government, in some cases the control is limited to GBS. In other cases, the control is restricted in some aspects to the donor or to a steering committee. A few multilateral donors indicated that they prefer to devolve program control to a project implementation unit.

Specific survey responses:

- Only 1 of the 12 bilateral respondents reported that its policies do not allow the responsible government agency to take control of financial and non-financial issues in the program. One other bilateral donor could delegate control over financial issues, but not over non-financial issues. All multilateral respondents reported that they can delegate control for both financial and non-financial issues to the responsible government agency, but only three indicated that complete control can be delegated.
- With regard to specific components of the PFM system, all responding bilateral and multilateral donors reported that they can use country systems for all components: budget planning, treasury and banking, accounting, financial reporting, and internal and external auditing. However, for one bilateral donor, treasury and banking, accounting, and internal and external audit systems can be used only for financial and not technical cooperation; and one multilateral donor reported that it can use only those country audit systems that have been approved by the donor.

However, these survey responses need to be viewed against the modalities for which donors are prepared to relinquish control, or to use specific components of the PFM system. Most donor policies foster the use of country systems only for GBS or SBS assistance, but have no specific and explicit recommendations for project support (as evidenced by research from the Finnish Ministry of Foreign Affairs in Appendix 1 of its 2010 Policy Paper "General Budget Support and Sector Budget Support in Finland's Program-based Development Cooperation"). To put this in perspective, it is necessary to note that GBS and SBS account for a low proportion of the total aid provided: two bilateral donors (United Kingdom and Netherlands) stated that they apply budget support procedures in about 25% of the total amount of their aid programs, while the other bilateral donors use budget support procedures in 10% or less of the amount of the aid. Finland has a defined ceiling for GBS procedures (not SBS), which is a maximum of 25% of the total country-specific disbursed aid.

Donors' survey responses indicated that, in general, their regulations accept the use of the government's public accounting system. But in practice, recognising that public accounting is in many countries a weak link in PFM, some donors seek to identify how the system can be modified to accommodate donor-specific information requirements.

For internal audit, as for the public accounting system, donors' regulations generally have no specific requirements, and in practice only a few donors assess this function through such general assessment reports as Public Expenditure and Financial Accountability (PEFA) assessments. Conversely, some donors' regulations mention the external audit function, with specific considerations oriented to ensure a proper scope and coverage of the audit of donor-financed operations, including not only the financial management aspects but in some cases also general program performance and evaluation of outcomes and goals.

Donor decision-making processes in the use of country systems

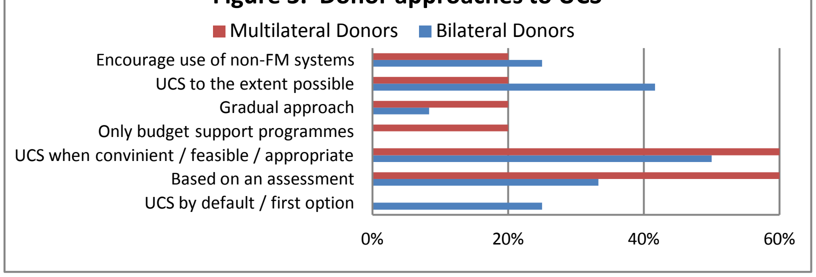
The survey covered three main aspects: (i) the main approach to using country systems: is it by default, when circumstances allow, following a risk assessment, and so forth; and (ii) at which point in the programming cycle, by whom, and on what basis the decision is made to use country systems, and what is the role of risks and benefits in the decision.

Main approach to decision-making on use of country systems

Although almost all donor policies encourage the use of country systems, and some donors require "maximum use of country systems," the core decision-making rule for using country systems differs across donor agencies (see Figure 3).

- In one group of bilateral donors, their policies require the full use of country systems as the default procedure. These policies commonly state that when country systems are not used, a transparent justification of why country systems are not used must be provided (18% of all survey respondents chose "Use of country systems by default" in the survey; donors could select more than one option).
- For a second group of donors, their policies encourage the maximum use of country systems, but condition this statement on the results of a fiduciary risk analysis following specific assessment methodologies and procedures (44% of all survey respondents chose "UCS when based on an assessment").
- A third group of donors have fewer specific policies and prescribe the use of country systems "when feasible," "to the extent possible," or "when convenient," leaving the decision to the discretion of the team preparing the assistance program (56% of all survey respondents chose "UCS when feasible, possible or appropriate," and 37% chose "UCS to the extent possible").

Figure 3. Donor approaches to UCS



- One donor has policies that recommend the use of country systems only in relation to budget support.

Some multilateral agencies also specify that the use of country systems must be a consequence of an official request from the government for using such systems in the program, and not a decision taken solely by the donor.

With the exception of one bilateral donor, all responding donors reported that they take a case-by-case approach to the decision at both the country level and the level of the specific aid program or project.

Who is involved in the decision?

Across donors, the decision to use country systems involves a higher level of authority at the country level more often than at the program/project level. In other words, for some donors, once approval to use country systems is in place at a higher level, field staff have more freedom to take the decision.

- For most donors (12 of the 14 who responded to the survey), the decision to use country systems at the country level involves either the relevant political authority or headquarters staff. Two bilateral donors responded that the field office or embassy makes the decision. For half of bilateral donors, political authority is required.

Figure 4. Basis for UCS Decision (Country level)

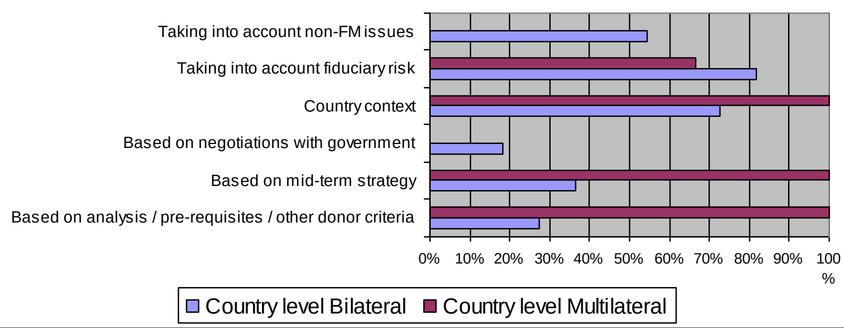
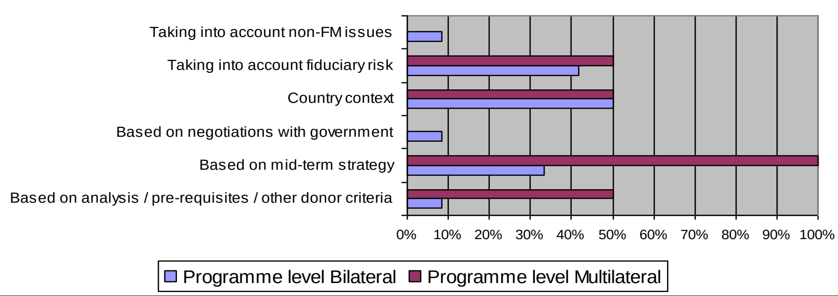


Figure 5. Basis for UCS decision (programme level)



- At the program or project level, only one bilateral donor still involves political authority in the decision to use country systems. However, half of both bilateral and multilateral donors who responded to this set of questions reported that headquarters staff are still involved. Of the 12 bilateral donors who responded to the question, 4 reported that the appraisal mission/field office/embassy makes the decision at program/project level.

On what factors is the decision based?

At both the country level and program level, country context is important to both multilateral and bilateral donors (see Figures 4 and 5). At both levels, multilateral donors stated that their medium-term strategy is also important; for bilateral donors that strategy is less important. At the country level, more than at the program level, the three multilateral donors that answered the set of questions also refer to analysis undertaken, donor prerequisites, and other criteria.

A higher proportion of bilateral donors than of multilateral donors reported that they take into account fiduciary risk at the country level. However, at the program level this becomes a more important factor to multilateral donors, with 50% taking it into account.

For the responding multilateral donors, non-PFM factors do not play a role in the decision to use country systems at either the country or program level. For bilateral donors, however, it is more important: over 50% said that such factors affect their country-level decisions. Eight bilateral donors base their decisions on risk analysis or on "partner country-specific circumstances, specifically the adherence to the so-called underlying principles (human rights, good governance, and democratic principles) as well as absorptive capacities of partner country systems and institutions."

Several donors mentioned, either directly or indirectly, the "critical view of parliament" and the "reluctance because of persisting political, reputational and fiduciary risks in many partner countries." However, donors suggested that it is possible to reduce the effect of these perceptions by strengthening partner countries' PFM systems through using them: this will facilitate implementing national policies and improving governance, implementing anticorruption measurements, and improving opportunities for effective development.

One bilateral donor stated that the decision is based on a comprehensive analysis of the country, including in some cases certain preconditions such as medium governance level and positive development trend.

Multilateral donors did not indicate that country negotiations influence their decision. However, for two bilateral donors this was a factor at the country level.

In summary, then, in deciding on the use of country systems, country context is important at all levels for all donors. In addition, the following factors inform the decision:

- For multilateral donors: country context, medium-term strategies, and the analysis undertaken, together with prerequisites. For some, fiduciary risk enters the picture, but only at the program level.
- For bilateral donors: fiduciary risk and non-PFM factors are important for the country-level decision. Government negotiations and non-PFM issues also play a role.

Are risks and benefits taken into account?

Altogether 62% of bilateral donors and 67% of multilateral donors reported that they assess the potential benefits, and 80% of bilateral donors and 67% of multilateral donors reported that they assess the risks. Only 30% percent of bilateral donors declare that they balance risk and benefits to their programs; and 70% of donors declare that they monitor the program benefits using indicators.

What risks are taken into account?

A 2008 study of donor approaches to managing risk when using country systems (Mokoro/CIPFA, 2008: *Stocktake on donor approaches to managing risk when using country systems)* classified the main risks identified by donors as development risk, fiduciary risk, nonfinancial risk, procurement risk, and reputational risk (see Table 1). The study showed that

- Most donors focus their assessment on fiduciary risk and corruption, using such instruments as the PEFA, Country Procurement Assessment Report (CPAR), Report on the Observance of Standards and Codes, and fiduciary risk assessment.
- Very few donors analyse the risks in terms of achieving poverty reduction objectives (developmental risk) when considering the use of country systems.

Table 1. Risk typology

<table>
<tr><th colspan="2">Risks</th><th>General definition: Risk that…</th></tr>
<tr><td colspan="2">Development risks</td><td>…poverty reduction objectives are not achieved</td></tr>
<tr><td colspan="2" rowspan="3">Financial (or fiduciary) risks</td><td>…funds are not used for the intended purposes</td></tr>
<tr><td>…funds are not properly accounted for</td></tr>
<tr><td>…funds do not achieve value for money</td></tr>
<tr><td rowspan="3">Non-financial risks</td><td>Macroeconomic risks</td><td>…poverty reduction objectives (and PFM standards) are compromised by macroeconomic framework</td></tr>
<tr><td>Governance risks</td><td>…poverty reduction objectives (and PFM standards) are compromised by governance context</td></tr>
<tr><td>Partnership (or dialogue) risks</td><td>…partnership is threatened by government action</td></tr>
<tr><td colspan="2">Procurement risks</td><td>…proper and effective use of aid is compromised by procurement standards</td></tr>
<tr><td colspan="2">Reputational risks</td><td>…donor reputation is threatened by:
• governance issues
• perceived misuse or poor use of funds</td></tr>
</table>

Source: Mokoro/CIPFA (2008) p19.

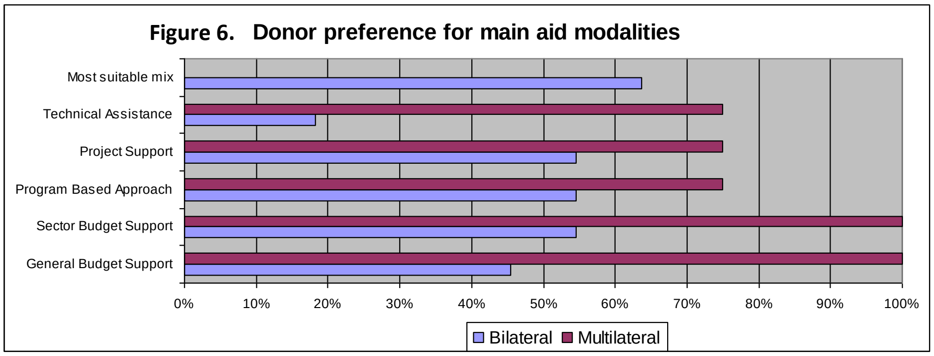
Other studies also indicate that donors give more weight to short-term, internalized risks such as fiduciary and reputational risks and less to the risk of not achieving the long-term and more externalized benefits arising from the use of country systems—such as stronger systems that reduce reputational and fiduciary risks and increase the developmental impact of aid funds, not only for any single donor but for all donors (Knack and Eubank, 2009: *Aid and trust in country systems*, World Bank Policy research working paper 5005, as cited by OECD/DAC, Policy Brief 1: *Benefits of Using Country Systems*, 2011).

Aid modalities and use of country systems: Donor preferences

In practice, the use of country systems is often associated with different aid modalities (Box 2 defined aid modalities): a shift to GBS and SBS implies a shift to using country systems. However, in principle all aid modalities and types of aid flows (loans, grants, and equity investments) can use country systems, to a greater or lesser degree. A key aspect of whether project support, for example, uses country systems is whether the funding is channelled through government systems, even if the donor retains control over programming the project, allocating the funds to activities, and auditing.

The survey probed donor preferences for (i) advancing the use of country systems by choosing aid modalities such as budget support and (ii) preferences for specific funding channels or procedures.

Choice of aid modalities



Of the 11 bilateral and 4 multilateral donors that responded to the survey question on preferred aid modalities, 55% reported that they do not have a preferred aid modality (see Figure 6). However, 70% of the responding bilateral donors indicated that their preference is for a suitable mix of modalities; in that group, an equal proportion of respondents used SBS, program-based support, and project support, although they less often selected project support as a first preferred modality. Multilateral donors indicated a high preference for GBS and SBS, with 3 of the 4 respondents reporting a preference for technical assistance, project support, and PBAs.

Choice of funding mechanisms/channels

The survey identified three types of funding mechanisms:[3]

i. Donors retain control of the funds themselves and directly provide goods and services, or use third-party agents such as outsourced firms or NGOs, rather than transferring the funds to government accounts.
ii. Donors disburse all of the funds to the government.
iii. Donors provide their assistance by combining the two options above.

Assistance delivered as goods and services; no funds disbursed to the government. Four bilateral donors stated that they can provide assistance as goods and services rather than cash; and four bilateral donors and one multilateral said that a decision to use this mechanism depends on the country context or convenience. Four bilateral and two multilateral donors declared that they do not use such channels, or require them to be properly justified. No donor identified this as the only way in which assistance is provided.

Assistance provided as funds to the government. Under this option, the donor disburses 100 percent of the funds to the government, and here there are three donor-preferred categories, as discussed below.

1. ***Funds are disbursed to a program-specific account and managed with donor procedures.*** Four bilateral and two multilateral donors (38% of respondents) declared that funds could be provided in this way. Of these, two bilateral donors and one multilateral use this procedure by default; and for five of these six donors, the decision depends on the country context. Another 25% of donors reported that they do not use this procedure, or use it only when it is properly justified.

2. ***Funds are disbursed to a program-specific account to be managed with country procedures.*** Six bilateral donors and three multilateral donors declared that they can manage funds in this way.

[3] Responding donors indicated whether they use each of the funding mechanisms/channels and whether it is their only mechanism for providing assistance.

No donor declared this option to be the only preferred option, but two bilateral and two multilateral donors (25%) use it by default. However, for four bilateral donors and one multilateral, country context is a factor in making the decision. Four bilateral donors and one multilateral donor reported that this procedure is used only when properly justified. However, of all respondents only one bilateral reported that this procedure is not used.

3. ***Funds are disbursed to the Treasury, and the government has control and the decision-making authority over the use of the funds.*** Six bilateral and three multilateral donors (43% of respondents) declared that they can provide funds directly through government accounts. However, only one of these, a bilateral donor, declared that it uses this procedure by default and requires justification when it is not used. For three other bilateral donors and one multilateral donor the decision depends on the country context. Two bilaterals and one multilateral (19% of respondents) reported that they do not use this procedure to provide assistance (even if their regulations allow it). One multilateral donor made a distinction between development lending and investment lending programs: the former would use this channel to disburse development assistance funds, and the latter would not.

A combination of funding mechanisms. Almost 60% of responding bilateral donors indicated that their preference is to use a combination of assistance provided as goods and services and assistance provided as cash (through any of the three channels). However, of the responding multilateral donors, 50% indicated that they prefer not to use a mix funding mechanisms in their assistance programs.

Analytical and diagnostic tools

For all donors, assessing the partner country's financial management functions is a priority when deciding to use country systems. Since each donor has its own assessment requirements and objectives, the depth, scope, objective, and methodology of the assessment can differ. For example, some donors assess the monitoring capacity of the country systems in reference to the implementation, results, and benefits of the program; other donors are mostly concerned with fiduciary risk and the operational procedures for program execution.[4]

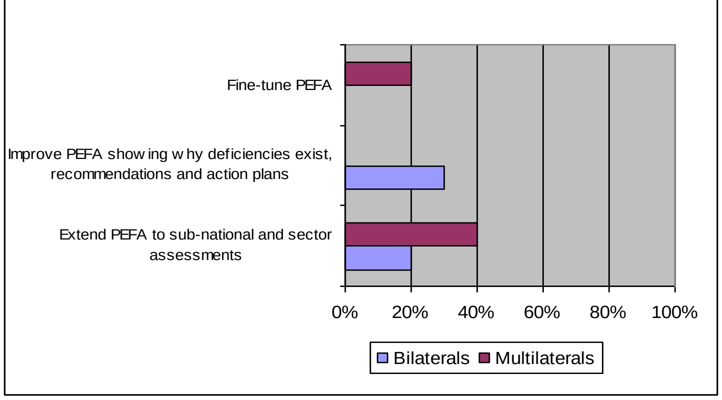
The survey probed the extent to which donors use harmonised tools to assess country systems, already have or are developing their own tools, and identify gaps in existing tools. In addition, it checked which country PFM systems donors commonly assess in deciding to use country systems.

While 38% of responding donors make use of harmonised tools like PEFA, CPAR, and the Country Financial Accountability Assessment (CFAA),[5] a larger proportion of donors (56% overall—63% of bilateral respondents and 40% of multilateral respondents) use these harmonised tools in combination with their own tools. One bilateral and one multilateral donor use only their own tools. One bilateral and one multilateral donor deem PEFA sufficient on its own, but only if it is backed by a PFM reform program to address the weaknesses identified.

---

[4] OECD-DAC, Stocktaking Study of PFM Diagnostics (forthcoming 2011).

[5] The PEFA Framework is a whole-of-PFM-system diagnostic framework developed by a group of donors. The CPAR (Country Procurement Assessment Report) assesses procurement systems. The CFAA (Country Financial Accountability Assessment), assesses countries' core budget, budget execution, accounting, and audit systems and institutions.



The PEFA report is direct and easy to understand, covers the most relevant aspects of the PFM system, and provides a good understanding of the country's budgetary performance. However, by its nature it provides "high-level" information, and donors often use complementary drill-down fiduciary assessments to make decisions on the use of country systems, particularly for risk assessment and for the design of capacity-building and risk-mitigation actions in the context of project assistance. Therefore, many donors indicated that they either already use or are in the process of developing their own tools and reports. Of the multilaterals, 80% already had their own tools at the time of the survey; of the bilateral respondents, 27% had their own tools and 45% indicated that they are developing their own tools and reports.

Almost one-third of respondents were not aware of gaps or deficiencies in the existing tools. The remainder either required improvements in the PEFA Framework or felt the need to develop specific other tools. Both multilateral and bilateral donors perceived a need to extend PEFA to cover sub-national governments[6] and specific sectors (see Figure 7). While multilaterals perceived a need to fine-tune the PEFA framework as is, bilaterals wanted the PEFA methodology/report to be extended to better explain the reasons for weaknesses and provide recommendations. Only one donor expressed an interest in tools to assess governments' sustainable revenue capacity, and three bilateral and three multilateral donors (40%) highlighted the need for further specific tools to satisfy donor requirements that are not included in existing assessments.

Commonly assessed PFM sub-systems

Table 2 reflects donor responses to the series of survey questions on the PFM sub-systems that are assessed before using country systems. Whereas all responding donors assess budget preparation and classification systems, not all assess treasury, budget execution, and accounting systems. The systems that are assessed by the fewest donors are external oversight by parliament, the integrated financial management information system (IFMIS), and treasury procedures to manage local and foreign currencies. Most donors did not indicate that they use PEFA to assess these systems, which suggests that PEFA plays a lesser role in fiduciary risk assessments than donors' own tools.

[6] The PEFA Program has developed guidance for application of the instrument to sub-national governments.

Table 2. Donor assessments of PFM sub-systems for the use of country systems

Main PFM system	PFM subsystem	Issue assessed*	Only for budget support and basket funding**	PEFA used**
Budgeting	Budget classification	100%	Not asked	29%
	Budget formulation	100%	Not asked	23%
	Budget execution	100%	7%	29%
Treasury	Use of local and foreign currencies	71%	Not asked	Not asked
	Cash programming	92%	Not asked	33%
	Payments	92%	Not asked	33%
Accounting and reporting	Recording policies and procedures	93%	Not asked	31%
	Financial reports and statements	93%	7%	29%
Internal controls procedures	Scope and quality	93%	8%	31%
	Internal audit	93%	8%	31%
External oversight	Audit scope and reports	93%	8%	31%
	Legislative oversight	86%	17%	33%
IFMIS	Functionality, integration, and coverage of system	80%	8%	25%

* Of the total number of donors responding to the question
** Of the total number of donors that assess the subsystem

Other issues assessed

The survey probed the degree to which donors assess sector-specific, entity-specific, and sub-national PFM systems before deciding to use country systems (see Table 3). More than half of donors always assess specific entities, while fewer report doing the same for sectors (42%) and sub-national (46%) systems. No more than 25% of donors use sector-specific assessments when appropriate, when deciding on the use of budget support, or on a case-by-case basis. When donors perform entity-specific assessments, they do so mostly because they deem it appropriate. Roughly equal proportions of donors use sub-national assessments when appropriate. When funding the sub-national government, this depends on the scope of the program.

Table 3. Assessment of sector-, entity-, and sub-national-specific systems

Assessments done for UCS	No answer provided	Answer provided				
		Always	*When appropriate**	*When deciding on budget support**	*Case-by-case / when funding**	*Depending on scope of program**
Sector-specific	24%	42%	17%	25%	17%	8%
Entity-specific	35%	55%	18%	9%	9%	9%
Sub-national	24%	46%	15%	8%	15%	15%

* These categories are not mutually exclusive.

Developing internal capacity to use country systems

The survey reviewed the following dimensions of donor practices on building capacity for the use of country systems: training, the development of handbooks and other guidance documents, and the use of incentives.

Training and development of guidance

Donors offer courses that range from raising awareness of new assistance policies to training on PFM. Donors reported providing introductory and advanced courses on PFM systems (84% of responding donors); on PBAs, SBS, and GBS using country systems (54% of responding donors), and on the Paris Declaration and Accra Agenda for Action (31% of responding donors). However, only 46% of donors offer training specifically on the use of country systems. Training is offered to both head office and field staff (each mentioned by 80% of responding donors) and to government officials (38% of responding donors).

In addition, donors have developed or are developing handbooks and guidance documents related to implementing programs using country systems, or providing guidance and methodology for assessing PFM and fiduciary risk. All multilateral donors and 7 of 12 bilateral donors reported having in place specific guidance on the use of country systems, and 4 more bilateral donors are developing guidance.

Providing incentives to use country systems

The survey probed whether donors offer their staff incentives to use country systems, and what kinds of incentives they offer. While 45% of bilateral and 25% of multilateral donors do not provide direct incentives to staff to use country systems, 20% of all donors reported that they provide training as an incentive, or that the incentive comes from achieving the aid effectiveness objectives of simplified and harmonised procedures. Altogether 27% of responding bilateral donors and 75% of multilateral donors do provide incentives directly to staff. One multilateral donor uses monetary and nonmonetary incentives to increase the use of country systems.

Disincentives to using country systems

Donor agencies and staff also face disincentives to using country systems. The survey provided a checklist of key constraints on the use of country systems that donor institutions may face, and donor respondents identified the following constraints.

- ***The fiduciary risk resulting from the partner country's operational and fiscal environments.*** Altogether 56% of respondents indicated that operational and fiduciary risk present a constraint, while 37% and 35%, respectively, indicated that partner countries' lack of operational and PFM capacity are constraints. In elaborating on their survey responses, donors made specific reference to weak PFM systems, lack of capacity, and weak accountability frameworks as leading to high fiduciary risk. Weak capacity of Supreme Audit Institutions and their lack of independence were also mentioned as a specific constraint. Donors also indicated that they are cautious about using country systems when there is macroeconomic instability in partner countries or when there is a perception of corruption in the public sector. When there is weak political commitment in partner countries to key changes, it acts as a disincentive for the use of country systems for some donors.
- ***The limited preparedness of the donor systems to use country systems.*** Altogether 25% of responding donors identified donor lack of know-how, tools and manuals as a constraint. Insufficient operational capacity and resources were also noted by 12.5% of donors, and donor regulations and procedures were also seen as a constraint (by 25% of responding donors). Progress in the use of country systems can be slowed down because of a lack of clarity and coherence in donors' policies around the minimum standards required to define "sufficiently

robust" systems in multi-donor programs. The lack of effective guidance on the mitigation of short-term fiduciary risks—to make it possible to support and permit more long-term development effects through the use of country systems—also constrains progress.

- ***Partner countries' preference for the use of parallel systems.*** Nearly 19% of donor respondents identified partner country preferences for parallel systems as a key constraint. Some partner countries do not always want all donors to use their country PFM systems for the provision of aid. Due diligence checks and the time it can take to reach agreement on using partners' systems can sometimes act as a disincentive. At the recipient institution level, sector/line ministries sometimes prefer parallel systems to ensure funding or to avoid the additional workload associated with use of country systems—for example, the burden of control over fund execution or additional reporting requirements. The use of country systems is perceived to delay disbursements, either because of slow treasury systems or because the budgeting and control framework limits swift expenditure implementation.

Conclusion

Overall, the survey provided evidence that all participant donors support the use of country systems in their programs. Although at present the extent of such use is diverse, almost all the responding donors declared their intention to increase this kind of support. Many have already approved medium-term action plans with such goals as increased support to aid modalities that use country systems.

All multilateral donors and almost all bilateral donors have, or are developing, an institutional base for using country systems. Many donors are improving their institutional preparedness by updating their assistance policies, improving their operational procedures and manuals, and providing training to their staff at the central and field level. However, understanding and harmonizing donor and government procedures and requirements is a significant challenge and requires a transition process.

The survey also shows key gaps in donor preparedness for the use of country systems. For most donors, delegating to the partner country control over development assistance programs is possible only for budget support modalities. Donors do not commonly provide guidance on using only some components of a PFM system, or on maximizing use within any one component. They do not identify options for safeguards that have low transaction costs and can allow country teams to use country systems in more cases. Moreover, few donors have in place internal systems to monitor the use of country systems, with a view to lesson-learning, although some donors are undertaking knowledge management efforts around the use of country systems.

SECTION II A Framework for the Use of Country Systems

Section I described donor practices in the use of country systems. This section draws on the identified good donor practices and key gaps to propose a high-level framework to guide practitioners in using country PFM systems[7] for donor-financed programs. The framework includes (i) key principles for the use of country systems, (ii) mechanisms, systems, and practices that donors need to have in place to achieve maximum use of country systems, and (iii) options for using country systems at the country and aid program/project levels on which the development of donor policies and procedures can draw. The discussion also describes good practice examples in which partner countries and donors are already implementing some of the options.

Key principles for using country PFM systems

In line with the Paris Declaration and Accra Agenda for Action commitments, the following core principles inform this Guide and should underpin all donors' use of country systems (Box 3 highlights some good partner country practices).

- ***The use of regular country PFM systems and institutions for donor-financed projects is actively encouraged.*** Donors should develop policies and practices that ensure the use of country systems to the maximum extent possible. For activities managed by the public sector, donor policies should ensure that country systems are used as a first option and that any choice not to use country systems can be justified.
- ***The use of country PFM systems is not an "all-or-nothing" approach.*** In a given country, a donor could use country systems for some or all components of PFM systems (e.g., on plan, on budget, on treasury, on parliament, on procurement, on account, on report, and on audit) or in specific sectors or institutions, as appropriate.
- ***The use of country systems should be applied in all aid modalities.*** Donors' use of country systems should not be restricted to budget support modalities only; they should use country systems to the maximum extent for all aid modalities.
- ***Donors should respect country ownership of and leadership in the choice to use country systems.*** Partner countries also face risks when donors use country systems; donors should ensure that at the country level, the use of country systems is agreed to in the framework of the partnership dialogue.
- ***Donors should minimize risk to partner countries.*** When using country systems, to ensure that the implementation of assistance programs and projects minimizes risk to partner countries, donors should provide aid in a transparent and predictable manner so as not to disrupt the implementation of domestic budgets.

[7] The original terms of reference for this task foresaw the preparation of this document, followed by reference materials to complete a full Practitioner's Guide. Once the proposed framework for the Practitioner's Guide is discussed and endorsed by the Task Force on PFM, it is expected that it could serve as basis for the development of reference materials, if agreed by the Task Force and if funding is secured.

Box 3. Partner country good practice in accelerating the use of country systems

This Practitioner's Guide focuses on good donor practices for the use of country systems. However, as the good practice examples show, making progress in using country systems also depends on the leadership partner countries demonstrate in fulfilling their commitments under the Paris Declaration and the Accra Agenda for Action. The following are some partner country actions that can accelerate progress.

- Providing a clear legal framework that covers the main components of PFM, and ensuring the enforcement of the framework.
- Providing clear guidance to donors on the formats for and timing of information on all modalities and types of flows of development assistance, so that it may be integrated with planning and budgeting systems.
- Setting up systems to integrate aid management and financial management procedures—for example, aid management information systems that capture information on aid flows in partner country budget classifications.
- Creating common treasury mechanisms for development assistance flows that use transparent disbursement mechanisms for project funds even if these are not fully integrated with core treasury systems.
- Developing robust financial management procedures, particularly an IFMIS, that can provide, for example, (i) assurance on internal controls, (ii) coding mechanisms to integrate aid flows into country budgeting systems while being able to track flows separately, and (iii) the ability to extract information to meet donor requirements with minimum additional transaction costs.
- Building capacity in internal and external audit systems, to provide assurance on the integrity of financial statements and the regularity of financial management procedures.
- Agreeing with donors at the country level on mechanisms to facilitate the use of partner country systems, if necessary, donor by donor.

Source: CABRI, 2011: Improving Aid Transparency (forthcoming); also, analysis of donor responses to survey.

- ***In instituting special arrangements based on a risk management plan, donors should ensure that they are designed to strengthen—and not undermine—the country's PFM systems.*** When a country's regular PFM institutions or systems have weaknesses, donors' special arrangements should not bypass the systems, but rather supplement them (in consultation with the country) or reinforce them by external controls (e.g., additional independent audits and reviews). Such supplemental measures should be designed to be phased out as the system's performance improves.
- ***The operational design of projects and programs should emphasize and support capacity-building and policy actions to improve the country's PFM performance and human resource skill base.*** This approach will facilitate the greater use of country systems over time, and the gradual withdrawal of any additional safeguards.
- ***Donors should establish monitoring systems to track progress in using country systems and to share lessons.*** At the country level, tracking the performance of PFM systems informs decisions to phase out additional safeguards that may have been incorporated.
- ***When assessing country systems and undertaking other analytical work for the use of country systems, donors should seek to collaborate with partner governments and each other.***

Donor policies and procedures

A donor's decision to use country PFM systems in operations it funds should be based on clear policies applicable to different assistance modalities; clear procedures and institutional capacity for deciding on, managing, and monitoring the use of country systems; the use of analytical tools at the country level and, as necessary, at the sector, ministry, and sub-national levels, to influence operational design and manage PFM risks; and the use of supporting mechanisms that go beyond strengthening and building capacity in PFM.

Existence and coverage of donor policies

Donors should provide clear guidance to field offices and aid program/project teams on the use of country systems. This guidance should comprise two aspects: development of a separate policy to address key aspects of the use of partner country systems, and a review of all policies to ensure that there are no contradictions and to integrate provisions for the use of country systems with existing guidance (for example, a policy on managing project-type modalities would need to be adjusted to reflect the decision on which country systems can be used under which circumstances to which degree to deliver project-based assistance).

A donor's policies on the use of country systems should do the following:

- Make explicit the core approach, and its application to different modalities, components of the PFM system, and country circumstances.
- Ensure that donor decisions take full account of partner country leadership.
- Establish clear decision-making processes, roles, and responsibilities.
- Establish a clear basis for decisions.
- Provide guidance on risk-management mechanisms.
- Make provision for building institutional and staff capacity to use country systems.
- Consider country context in the development of country-level strategies for the use of country PFM systems.
- Make provision for monitoring the use of country systems.

In addition, the donor should introduce supporting mechanisms to help ensure the successful implementation of its policies on the use of country systems.

Core approach to using country systems

A donor policy can state (i) when country systems must be used, (ii) when they may not be used (what the exceptions are), and/or (iii) when they can be used (minimum conditions). In practice, donors combine these approaches to either a "must use except when," or a 'can use as long as' position.

The Accra Agenda for Action committed donors to use country systems as a first option and to provide a rationale when they do not: the 'must use except when' approach. The benefit of this approach is that not using country systems implies a more onerous decision-making process as it is non-use that needs to be justified. In practice however, only 20% of responding donors indicated that they have operationalized this approach: in these cases an assessment of a partner country's systems fulfils the purpose of ensuring that the exception conditions do not apply. To ensure the maximum use of country systems under this rule and limit the number of instances when the default approach does not apply, a donor's policies should make explicit what the exception conditions are.

Most donors opt for the second approach: their assistance programs and projects can use country systems, but only if certain (usually fiduciary risk) conditions are fulfilled. An assessment of a partner country's systems then fulfils the purpose of ensuring that the conditions are met. There are various approaches to the minimum conditions: they may concern a standard of PFM, or they may just require that the partner country be willing to improve systems or illustrate progress toward improved systems.

Considering the Accra Agenda for Action commitments, a purely "can use as long as" approach is less than ideal, even if it is modified to a "use to the maximum extent as long as" approach, particularly for assistance that is delivered by the public sector. It is therefore important that donors (i) limit the exceptions to using country systems, and (ii) provide options for still using country systems even when the limits apply.

Donors can use the framework proposed here to create a set of decision-making rules that provides explicit guidance to field offices that "to the maximum extent possible" means that all aid assistance must use country systems, even if it is only to some degree or with some safeguards (see Box 4).

Box 4. Options for the use of country systems

Recognising that donors have different priorities and different approaches to using country systems, policies and procedures to use country systems to the maximum extent should include options for

i. using ("unpacking") some components of a PFM system;
ii. using system components, if not fully, to the maximum degree possible; and
iii. balancing the use of more "traditional" aid modalities and disbursement mechanisms with those that use country systems more fully.

The framework in this Guide sets out options for (i) and (ii) and illustrates how they apply to different modalities to provide donors with a menu of options.

Given current donor practices and constraints, this represents a pragmatic approach to increasing the use of country systems. However, in the spirit of the commitments in the Accra Agenda for Action, donors should review their position at regular intervals—at both the policy (cross-country) and operational (country) levels—to move closer to a full-fledged "'must use, except when' position.

Finally, it is important that an implicit condition in donor policies is not that the assistance can only use partner country systems when such assistance is provided as budget support. Donor policies for the use of country systems should be explicit that country systems can be used for all assistance modalities.

Decision-making processes for the use of country systems

Donor policies should ensure that, for every aid type and flow type, the programming of all assistance, at both the country level and aid activity level, should include a decision point on the extent to which country systems will be used. Donor processes to make decisions at each of these levels should be integrated, so that (i) using country systems can be a first option once the decision is made at the country level (see Box 5); or (ii) when this is not possible, authority to decide on the use of country systems for each program is fully delegated to the country level.

Box 5. Good practice example: Defining use of country systems at the country level - China

At the country level in China, the World Bank's approach to using country systems is to use "customized" arrangements for accounting and financial management and full country systems for audit. In January 2000 the World Bank and the government of China signed an agreement "customizing" all accounting regulations and financial management reports for all World Bank operations in the country. The agreement defined and standardized the following accounting and financial report elements: chart of accounts; detailed accounting instructions for each project account; project financial statements; instructions on the preparation of project financial statements; balance sheet; notes to the financial statements; statement of sources and uses of funds by project components; statement of implementation of the program; and statement of the "special account." With these customized elements, World Bank-funded projects now use country systems.

For several years the China National Audit Office (CNAO) has been auditing foreign-funded projects in accordance with International Standards on Auditing and the government auditing standards of the People's Republic of China. A Provincial China State Audit Bureau can be identified as auditor for each project. CNAO's institutional capacity is well recognized in the region; indeed, CNAO supports SAIs of neighbouring countries by providing training on the auditing of foreign funds and audit quality assurance and information technologies.

Having to refer to the political authority or head office of a donor agency the decision on the use of country systems for each individual program or project is a powerful disincentive to the use of country systems. If a donor is not able to delegate to country-level processes full authority for the use of country systems in individual assistance programs and projects, it can delegate it to the maximum extent possible—in other words, either up to a monetary threshold or only for some components of a PFM system beyond a certain degree.

The basis for decision-making: Balancing risks and benefits

Whether a donor stipulates that country systems are used on a "must use except when" basis or a "can use as long as" basis, the donor should make clear what the conditions are under which country systems will and will not be used, and how systems will be assessed against those conditions. This means that the policy must specify (i) the factors that the donor will take into account, (ii) the standards that will be applied to these factors, and (iii) the tools that the donor will use to assess the factors.

Factors in the decision to use country systems

In essence, the decision to use country systems is usually based on the trade-off between the risks/costs and the benefits to the country and to the donor. Thus donor policies and procedures should ensure that both short- and long-term risks and benefits are considered (see Table 4 for an overview of typical risks and potential benefits that donors should take into account). Some risks and benefits affect the donor directly in terms of its accountability for the use of funds to its own stakeholders (parliaments, boards, and so forth); others affect the donor indirectly because their impact creates worse or better country-level conditions for development. Both dimensions should matter to donors, but the first often matters more as the impact is typically (although not always) short-term and internalized; for the second group of risks and benefits, the impact is often long-term and external, and, therefore specific mechanisms are required to ensure their inclusion in an assessment.

Table 4. Risks and benefits associated with the use of country and parallel systems

	Risks	Benefits
Use of country systems		
Donors	**Fiduciary risk**: Funds not used as intended, not accounted for, value-for-money compromised. **Reputational risk**: Misuse of funds, governance issues, and poor disbursement record can threaten donor reputation. **Development risk**: In short term, implementation of assistance programs affected by weak government capacity. **Other**: Loss of visibility threatens aid budget; partnership threatened if issues arise; control of funds for own strategic purposes diminished; implementation of programs can be threatened by country macroeconomic instability; increased transaction cost.	**Development**: More strategic and broader dialogue with country; long-term sustainability of development impact because of assistance facilitated. **Reputational**: Achievement of Paris Declaration commitments enhances donor reputation.
Countries	**Fiduciary risk**: Late or no disbursement forces the country to draw on its own funds to cover shortfalls. **Reputational risk**: Late or no disbursement leads to the lack of achievement of planned activities for which government now has responsibility.	**Development (aid effectiveness)**: Better country ownership of donor funds; lower transaction cost; harm of parallel systems avoided; donor resources available to build country, rather than parallel systems. **Development (budget impacts)**: Better macroeconomic management; enhanced budget comprehensiveness, better integration of donor and domestic resources and improved policy coherence and efficiency of allocation; strengthened parliamentary processes; improved and more predictable cash management; enhanced capacity and pressure for performance across budget cycle; increased transparency at country level, facilitating better governance of budget.
Parallel systems		
	Risks	**Benefits**
Donors	**Reputational risk**: Corruption, poor value for money, and poor management of funds affect donor reputation directly. **Development risk**: Diversion of country and donor resources to maintain parallel systems reduces development impact; poor integration with country budget leads to duplication and wasted resources.	**Fiduciary**: Risk of misuse of funds, poor value of money directly controlled by donor. **Ownership and control**: Donor has more control over allocation of funds to priorities that are of concern to donor or in its strategic interest. **Reputational**: Visibility of contribution of development assistance in partner country, domestically and internationally.
Countries	**Development risk**: High transaction cost reduces resources available for management of own funds; funds not aligned with country priorities; weakened accountability and coordination as country institutions have other sources of funds.	**Development (budget impacts)**: Faster implementation of assistance programs

Source: OECD-DAC, Policy Brief 1: Benefits of Using Country Systems, 2011.

Donors also have to take into account the costs and savings associated with using country systems and consider them against the potential benefits (see Box 6). For example, processes to improve aid transparency entail the once-off costs associated with reorienting donor aid information management systems and retraining donor staff so that aid information is provided routinely in formats that fulfill partner country information needs. Aid transparency is essential to many of the Paris Declaration commitments and is the subject of specific commitments in the Accra Agenda for Action. From the perspective of use of country systems, transparency is an essential first step in the use of country systems.

Box 6. Typical costs and savings of using country systems instead of parallel systems

Transition costs

- Developing and reviewing policy
- Developing new capacity and skills; retraining
- Adjusting information systems to provide information in formats that are compatible with partner country budgets
- Promoting the use of country systems to domestic stakeholders

Recurrent cost not incurred under parallel systems

- Country-level strategic capacity for partnership dialogue
- Information provision in line with partner country budget processes
- PFM capacity to support improvement in country systems
- Continuous assessments of country systems
- Additional cost of monitoring implementation of programs and projects through country systems (compared to monitoring in parallel systems)

Recurrent savings

- Administration cost of third-party implementing agents
- Cost of programming (for GBS and SBS modalities)
- Cost of parallel systems (procurement, financial management, audit)

For each donor, however, the net costs need to be assessed against the benefits of using country systems over the long term (see Box 7). Donor policies and procedures for using country systems have to ensure that such appraisals are a formal component of the donor agency's decisions to use (or not to use) country systems across countries, in a given country, and for a given program.

Box 7. Good practice examples: Weighing fiduciary risk against development benefits

UK Department for International Development (DFID) “[…] takes the view that using imperfect systems as far as possible is both a more sustainable way of providing assistance, and the most effective strategy for strengthening the systems themselves. DFID therefore weighs the development benefits against the fiduciary risk, and can opt to direct its funds through the budget provided that the partner country has a credible commitment to strengthening its systems (OECD-DAC, 2011, p59).

The **Canadian International Development Agency** (CIDA) states in its fiduciary risk policy that the level of acceptable risk for a PBA initiative varies according to the extent of expected benefits (e.g., poverty reduction, strengthening of institutions). Ultimately, an assessment should be made as to whether the residual fiduciary risks are acceptable given the expected benefits.

The **Swedish International Development Cooperation Agency** (SIDA) has a PFM handbook that explains how to draw conclusions on the overall positive effects and trade-offs of aligning in a given country and specifies that, when assessing whether budget support should be provided to a partner country, Sweden must weigh the risk of the budget funds being used for purposes other than those intended against the likely benefits that such support would have for PFM systems (SIDA, 2007, and OECD-DAC 2008, p.16)

*Source: OECD-DAC, Policy Brief 1: Benefits of Using Country Systems, 2011 and Mokoro/CIPFA, Stocktaking of Donor Approaches to Managing Risk, p. 59.

The benefits to using country systems are significant. The good practice examples donors submitted in the survey highlight how the shift to using country systems focuses donor resources on strengthening those systems: almost all included the development objective of strengthening the partner country’s PFM system. Some donors performed specific strengthening actions for accountability institutions such as SAIs; addressed specific operational aspects such as the strengthening of public information systems; addressed legal, regulatory, and operational frameworks; addressed human resources shortfalls by providing training and assisting entities in hiring qualified personnel, mostly in the accounting and audit areas; fostered the standardization of procedures; and supported regional cooperation efforts for improving PFM through common tools and procedures. Donors’ use of country systems, therefore, is seen as a powerful tool to foster the improvement of the PFM system and thus reduce fiduciary risk, resulting in increased effectiveness of the assistance program not only in developing PFM and other operational aspects, but also in improving governance and transparency.

However, these benefits can materialize only if (i) donors invest in the development of the country systems they aim to use, (ii) enough donors in a given country use the country systems to a sufficient degree, and (iii) the level of additional safeguards across donors does not impose high transaction costs (OECD-DAC, *Policy Brief 1: Benefits of Using Country Systems*, 2011.)

Threshold standards

Donor agencies also have different approaches to the threshold or eligibility criteria for using country systems. Some donors consider that they can use only country systems that comply with international standards or practices (such as accounting, auditing, and procurement standards and environmental safeguards). DFID and the European Community, for example, consider that they can use country systems that are not yet in line with international standards but are evolving in a positive direction. However, experience shows that there is no minimum threshold of use below which the benefits of using partner country PFM systems do not materialize, as long as partner governments are clearly committed to improving the quality of these systems (see Box 8).

Box 8. Good practice examples: Country development benefits

Donors provided many good practice examples in their survey responses. These included:

- A World Bank-funded poverty reduction support operation in Laos has supported the creation of centralized treasury and revenue functions and the implementation of the government financial information system across all ministries and provinces. Both measures were substantive improvements that positively affected several financial management functions and facilitated fiscal and macroeconomic management, helping the country develop a medium-term fiscal framework. Improvements in the budgetary, treasury, and accounting aspects allowed, among other advantages, the reduction of salary and expenditure arrears and the improvement of the revenues forecast. The autonomy of the SAI has also improved.

- In Madagascar, Irish Aid general budget support supported the improvement of budgetary and financial reporting aspects. Revenue forecasting was improved, and expenditure management procedures were streamlined. Cash flow management and commitments control were strengthened. A substantial part of the large backlog of annual accounts/settlement bills were cleared and audited.

- The SIDA Budget Support Initiative for the Education Sector in Senegal uses resources allocated to the budget and financial reform program to provide administrative training for accountants. A financial report must be produced and disseminated every six months on budget appropriations, committed, liquidated, and authorized; this has resulted in the use of data produced by SIGFIP, the public sector financial management information system. Donor funding for the budget and financial reform program has made it possible to extend SIGFIP to all regions of Senegal. The content, format, and timing of program/operation financial reports used for donor disbursement and financial supervision purposes are consistent with the country government's own financial reporting arrangements. Ad hoc reports for donors are prepared with marginal transaction cost.

- The World Bank's poverty reduction support credit in Vietnam supported the introduction of a medium-term expenditure framework in four ministries within a sustainable medium-term fiscal framework, the streamlining of budget execution processes, and the implementation of a treasury and a budget management information system. Additionally, fundamental transparency reforms were implemented, including the publication for the first time of the entire State Budget Plan, audited financial statements, and budget execution reports. The operation also supported the transformation of the SAI into a specialized agency reporting to the National Assembly, improving budget oversight by the National Assembly.

Analytical tools

Even when donors are deciding on whether to use country PFM systems in the context of an individual operation, they should refer to existing PFM diagnostic/analytical tools for risk management and operational design purposes. The scope of these tools can vary. If they are to be useful to inform decisions on the use of country systems, they should cover at least the following PFM elements:

- *Budgeting system:* budget classification, budget formulation, budget execution.
- *Treasury operations:* use of local and foreign currencies, cash management, banking arrangements, and payment controls.
- *Accounting and financial reporting:* accounting policies and procedures, financial reports and statements.

- *Internal control systems and internal audit function.*
- *External oversight:* external audit scope and reports, legislative oversight, access to information (see Box 9).
- *Financial management information systems:* functionality, integration, and coverage.

In addition, when the donor provides earmarked funds, to assess fiduciary risk, design program implementation, and define the appropriate risk management measures, it needs to have a clear understanding of the capacity and performance of the implementing sector, ministry, or sub-national entity in operationalizing the country PFM system.

Box 9. Good practice example: Using country external audit findings for fiduciary risk assessments

The CAG/NAO, Tanzania's SAI completes financial audit reports nine months after the end of a fiscal year and submits them to the President and Parliament. It may submit performance and special audits at other times. The Parliamentary Accountability Committees (the Public Accounts Committee, the Local Authorities Accounts Committee, and the Public Authorities and Other Bodies Committee) review and debate the audits and the management responses to them. The development partners use the audit reports not only for dialogue with the Government, but also in their own assessments of fiduciary risk. When discussing PFM issues and action plans, the Government and donors incorporate some of the matters raised in the audit reports; this provides ongoing strengthening of the external audit function and increases reliance on the country's system of external audit. The audits have also resulted in improved public financial management: the number of qualified audits of ministries, departments, and agencies and local government agencies has decreased significantly.

According to the Paris Declaration and Accra Agenda for Action commitments, donors and partner countries should undertake assessments jointly using mutually agreed diagnostic tools. This means that donors should (i) endeavor to jointly develop tools to address gaps in existing common instruments; or (ii) apply division of labor principles and share the assessments of countries, sectors, or institutions that they have carried out. Most donors have indicated that they use PEFA in combination with additional tools. This makes it all the more important that donors make efforts to develop joint instruments that provide the additional coverage needed.

Risk management

Short-term fiduciary and reputational risks weigh heavily in donors' decision on whether to use country systems, potentially skewing the risk/benefit calculation. For some donors, the emphasis on narrow fiduciary concerns in the management of assistance programs originates from their own domestic stakeholders and is difficult to overcome in the short term. Donors that are constrained in this way apply various risk mitigation strategies, including using some, but not all, aspects of country systems; spreading their risk across various aid modalities; and investing in capacity development. They can also request measures to supplement the use of country systems—for example, enhanced information flows, additional audit scrutiny, earmarking of donor funding or tracking of expenditures, and capacity enhancement. While such mechanisms allow these donors to use country systems, the risk is that they increase transaction costs and deflect focus from developing better systems for domestic budget expenditure overall. Donors should use such mechanisms only when they are also relevant to the complementary domestic budget expenditure and can be scaled up to improve overall PFM systems over time.

To prevent the default use of additional safeguards, the fiduciary risk assessments of using country PFM systems should not take place in isolation, but be done in relative terms to the risk involved (or risk assurance provided) by alternative arrangements. Hence, the process should seek to:

- Measure the level of control risk involved with the use of the government PFM systems.
- Compare this level of risk with the use of alternative FM arrangements (e.g., parallel FM systems, project implementation units).
- Only when the comparative risk of using the country PFM system is higher, design and use mitigating actions ("safeguards") that effectively lower the risk level and build upon, rather than circumvent, the government PFM systems (see Boxes 10-12).

Box 10. Good practice example: Diagnostic process leads to greater use of country systems - Serbia

A diagnosis of Serbia's treasury and its financial management systems recommended that, to use country systems, programs must have electronic access to the treasury system, increasing the flow of donor funds through the National Bank of Serbia rather than through commercial banks. The Government accepted the recommendation. Once a framework agreement is signed, all loan proceeds from existing and new projects in Serbia will flow through the National Bank of Serbia—a significant milestone for the country, representing a large step forward in donor use of country systems.

Box 11. Good practice example: Building country systems to use for assistance programs

Many donors are supporting programs for improving partner countries' IFMIS and other PFM systems. In some cases, however, such an initiative grew from an operational necessity for implementing a program using country systems. For example, to be able to use Guyana's systems, although the country's financial management was not robust, the Inter-American Development Bank supported the upgrading of the IFMIS through a project that was used as a pilot to test and improve the entire system's capacity and capabilities. Similarly, donors in Ethiopia (DFID) and Rwanda (the World Bank) provided resources to employ accountants and auditors in order to strengthen accounting and auditing as means to strengthen and increase use of country PFM systems.

Box 12. Good practice example: Mitigating risk in the use of country systems - Mozambique

To scale up the use of country PFM systems while ensuring adequate fiduciary assurance, the World Bank's Africa Region developed a methodology to systematically assess the fiduciary risks of using country systems, identifying areas where the country systems could be used as well as capacity-building and performance-improvement measures to be implemented in areas where the country systems could not immediately be used.

This approach was pioneered in Mozambique through an assessment performed in July 2008. The conclusion was that using the country's systems would not increase the Bank's fiduciary risk, if the authorities implemented some cross-cutting measures—addressing, for example, the roll-over of unused project funds at year-end, the timeliness of the issuance of audited project financial statements, and satisfactory modalities of collaboration between private sector auditors and the SAI. The authorities and the Bank have identified solutions for these cross-cutting issues. Since the assessment was concluded, Bank-funded projects approved for Mozambique—in sectors as diverse as private sector development, health, telecommunications, decentralised finance, and rural development—use country PFM systems along with interim supplemental measures in specific areas of weakness.

To facilitate a transition to the full use of country systems, the Bank is actively supporting Mozambique's development of PFM capacity, particularly in the area of internal and external oversight. The government has welcomed the work, perceiving clear benefits in terms of increased cash flow, comprehensiveness and timeliness of budget execution data, and reduction in transaction costs. The initiative has attracted extensive interest from bilateral and multilateral partners.

Donor skills for the use of country systems

A key constraint some donors identified in the survey is their own limited capacity to manage assistance using country systems. This takes four forms:

i. Donor systems are still oriented to managing development assistance through parallel systems. For example, donor systems collect information on flows to partner countries in formats that are useful to the donor, not formats that enable donors to integrate the assistance with partner country systems.

ii. The more assistance is managed through country systems, the more the skill requirement on donor offices shifts from program management/implementation to skills that enable strategic engagement with partner countries and other development partners.

iii. Donor country and desk teams have insufficient knowledge of the use of country systems generally, and of changes to their policy and procedural environments in particular, to incorporate the use of country systems.

iv. Donor country and desk teams have insufficient knowledge of the PFM systems in the countries where they operate to facilitate decisions on the use of country systems.

Donors' policies and procedures on the use of country systems should incorporate capacity-building strategies to address these dimensions. For example:

- Even if policies stipulate the use of country systems "only to the extent possible," donors should give immediate attention to awareness raising in the use of country systems.

- Donors should update their training and capacity-building programs to cover the use of country systems and operation of PFM systems.
- Donors should re-orient their information systems to facilitate the use of country systems.
- Donors should build an up-to-date knowledge base of PFM systems in the countries where they operate and ensure that all relevant staff have access to it.
- Some of these activities can be harmonised among donors at the country level.

Given resource constraints, donors' policies on the use of country systems should make clear the appropriate sequencing of these activities so that the most pressing constraints and/or "quick win" activities are addressed first.

Country context

While maintaining core approaches and policies and procedures to decide on and manage risks related to using country systems, donors should understand the political economy, change management and technical factors that can enable the use of systems in a particular country context. Donors should encourage the use of this knowledge to formulate innovative, country-specific strategies to support the strengthening and increase the use of country PFM systems. In formulating these strategies, respecting partner country leadership is critical.

The focus on country-level engagement should come before addressing operational- or project-level activities. More systematic treatment of the use of country PFM systems in country-level dialogue and strategies can lead to realistic country-level improvement programs, supported by demand-led and targeted technical assistance, with donor assistance increasingly harmonized around country systems and country priorities. In turn, the country-level strategies should serve as point of reference when teams engage with central and line ministries and agencies on the use of country systems for each sector, assistance program or project managed by the public sector.

Fragile states

The OECD/DAC defines fragile states as "states that are failing to provide basic services because they are unwilling or unable to do so." In 2009, official development assistance to fragile states increased in real terms by 11%, from US$3.8 billion to US$40.5 billion. This increase represents a third of all aid flows to developing countries that year and accounts for 36% of the total increase in ODA between 2008 and 2009.

Donors supporting fragile states have to balance the potential high fiduciary risk of using country systems with the significant negative development impact of not using country systems to deliver what is often a high volumes of aid compared to country resources. These countries' limited human, physical, operational, and financial resources makes it difficult to implement assistance programs in the public environment. However, experience has shown that a country's status as a "fragile state" does not preclude donors' using its systems: to a significant degree, donors must be willing to do exactly that in combination with support to build systems. For example, providing GBS assistance in such critical situations can help to rebuild the PFM systems and ensure that the budget can be used as an effective tool for economic management, and donors can adapt their disbursement policies to facilitate the government cash management system and enable predictable resource flows to service delivery (see Boxes 13 and 14).

Box 13. Good practice example: Budget support in Afghanistan

The World Bank uses general budget support to provide assistance for institution building in Afghanistan. The use of country systems has strengthened national budgetary, accounting, and treasury procedures and has led to the institutionalization of the midyear review as a mechanism to transparently adjust allocations on the basis of performance. The use of country systems was made possible because Afghanistan's IFMIS allowed budget support funds to be managed in line with international standards. Supplementary support was provided for the preparation of a new financial management law, which established a sound budget preparation framework, transparent budget documentation, accounting procedures, regular financial reporting and external audit, and parliamentary oversight of financial statements.

Box 14. Good practice example: Budget support enables predictable cash flow to service delivery in Sierra Leone

Budget support to Sierra Leone has helped to rebuild the financial management system and to ensure that the budget could be used as an effective tool for economic management. For example, DFID's budget support is an integral part of Sierra Leone's budget and of the medium-term expenditure framework Programme funds are disbursed directly into the government's consolidated revenue fund through an external account of the Bank of Sierra Leone. The funds are included in the budget as a separate line item on the revenue side, but on the expenditure side are treated with domestic revenue. The program monitoring relies on the government budgetary reporting, supplemented with independent and IMF analyses.

Given the country context, donor disbursements were previously less predictable, making it difficult to program and forecast the Government's cash flow. With budget support, donors are disbursing earlier in the year to facilitate in-year cash management. After some significant improvements, the public accounting system is now producing timely reports. Programme transactions are now registered explicitly in the annual accounts, enabling them to be audited. The Government produces financial reports without any further transaction costs. For donors' ad hoc requests, the information is readily available and is quickly provided by the Budget Bureau and Economics Unit of the Ministry of Finance.

Low-income countries

According to the survey responses, the impact of using country systems in low-income countries can be significant, producing improvements in financial management issues. Donors noted that using country systems for budget support programs and PFM projects encouraged the development of budget systems at the institutional level and strengthened the link between the budget and the medium-term expenditure and fiscal frameworks (see Boxes 15 and 16). When donors utilised budget support modalities, they supported strengthening treasury procedures, financial reporting, and external audit, reflecting not only their own operational requirements but also their requirements for improved transparency, financial oversight, and reduction of fiduciary risk. However, the survey responses reflect limited attention to internal audit systems.

Box 15. Good practice example: Using country systems for a PFM basket fund - Rwanda

In Rwanda a recently established PFM Reform Basket Fund is considered a major step forward in the use of country systems and in the harmonization of donor approaches in the area of PFM reform. These actions were also aligned with the government's national PFM Reform Strategy (2008-2012) and managed by the Ministry of Finance and Economic Planning. The funds fully use country systems. It is envisioned that the PFM Reform Basket will bring together the different programs and approaches by the donors contributing to PFM reform in Rwanda, and includes a plan to harmonise the funding of all donors in the PFM area. The reported assistance uses project support modality, with both sub-national and district coverage. All activities are fully executed using country systems.

Box 16. Good practice example: Strengthening policy dialogue through systems

The Irish Aid budget support programs in Mozambique, Tanzania and Uganda were implemented using country systems in full. For Irish Aid the use of budget support and country systems has facilitated alignment with government's poverty reduction strategy and has improved the quality of its partnership dialogue.

Middle-income countries

Donors' preferred modality in middle-income countries is program- and project-based support, and they provided examples of their efforts to use country systems for project support. An important factor that facilitates the use of country systems for projects is the high use of functional IFMISs, which allow tracking of project expenditures through government systems. However, budget support is also used in these countries, particularly where government capacity is significant. Many of the examples provided in this document for the use of country systems for program-based and project support occur in middle-income countries (Box 17).

Box 17. Good practice example: Strengthening and using country PFM systems in Indonesia

Through budget support, the World Bank has supported the Government of Indonesia's policies to strengthen its PFM systems. Among other government achievements, international budget classification has been implemented, comprehensive fiscal information is included in budget documentation, a medium term budget framework has been developed, a Treasury Single Account has been adopted in all regional Treasury offices (consolidating around 1,000 Treasury accounts), and annual accounts have been produced and published on a timely basis, applying new government accounting standards.

The Bank, together with donors contributing to the Government Financial Management and Revenue Administration Program (GFMRAP), have provided harmonized support to the government's PFM modernization initiatives affecting the whole budget cycle, the integrated financial management information system (SPAN), consolidation of the treasury single account, government accounting and financial reporting, and the oversight role of parliament (DPR). The Bank is also supporting the internal audit institution in developing a strategic plan for risk-based internal control implementation in selected ministries, and the Supreme Audit Institution (BPK) with the preparation of a new strategic plan.

World Bank-financed projects form integral part of the authorized project (DIPA), and project payments are channeled through the national treasury system with participation of the same Treasury offices (KPPN) in charge of domestic resource management. Recently, the Bank agreed with the Ministry of Finance and the BPK that the country's SAI will carry out the audit of five newly approved Bank-funded projects. The vision is to move gradually toward full reliance on the SAI as its capacity increases.

Monitoring the use of country systems

Donors that do not fully use country systems should regularly review their policies, decision-making rules, decisions, and practices with a view to increasing their use of country systems. The Paris Declaration Survey Monitoring Reports track the use of country PFM, procurement, and audit systems across countries and donors. However, each individual donor should supplement this report with more extensive efforts to (i) monitor the degree to which it uses partner country systems, and (ii) document lessons learned in using country systems. Such monitoring systems should be used over time to increase the use of country systems, for example, by using more components of a country's PFM systems, using them to a greater degree, or removing additional safeguards that result in additional transaction costs.

Supporting mechanisms

Partner countries' development of credible PFM reforms and sustainable PFM capacity involves long-term and complex efforts that are of obvious relevance to increasing reliance on country PFM systems.[8] However, factors other than the quality of PFM systems also constrain increased use of those systems.[9] For example, a donor's domestic stakeholders may resist the use of country systems because of a focus on fiduciary risk, the desire to see discrete results from specific assistance programs, or a desire for visibility of reform efforts. Or country institutions may resist using country systems, preferring not to

[8] This document does not deal directly with PFM reform and capacity building, which is the subject of another Task Force deliverable.

[9] See OECD/DAC Joint Venture on PFM, *Report on the Use of Country Systems in Public Financial Management*.

have funding “on plan,” “on budget,” or “on treasury,” lest their domestic budget allocations decrease. Donor operational staff who are not familiar with PFM may also not be inclined to use country systems to avoid perceived high fiduciary risks.

In addition to the policies and procedures discussed earlier, measures to help address these factors include:

- ***Gaining support from a broader array of national stakeholders.*** From a country perspective, the case for strengthening and using country systems needs to be framed in ways that build consensus and strengthen local ownership. Support for increasing the use of country PFM systems is likely to be enhanced by articulating the benefits to a wider audience of key decision-makers (including legislatures and civil society).
- ***Using greater communications and outreach, quantitative targets, and reporting requirements to strengthen donor incentives for action to deepen/accelerate the use of country PFM systems*.** This measure would involve (i) conducting greater outreach to non-PFM technical specialists to relay the benefits of using country systems[10] and enhancing awareness of international commitments to increase the use of country PFM systems, (ii) setting expectations and monitoring performance, and (iii) if applicable, ensuring that operational discussions/documentation transparently state the rationale for not using country systems.
- ***Using international partnerships to foster change*.** International platforms (e.g., the Working Party on Aid Effectiveness), with partner country participation, can be used to highlight discrepancies between policy at headquarters level and incentives/transaction costs at field level, with a view to leveraging change in donor approaches.

Options for using country systems in practice

From the perspective of supporting partner countries in building robust, transparent, and accountable systems for managing their own resources, the full use of country systems is the ideal delivery mechanism for development assistance (see Box 18). However, all donors place limitations on the use of country systems. This section discusses different options that donors may use—regardless of their risk policies or the modality of assistance—to use country systems to some degree for all of their development assistance.

[10] Another Task Force deliverable deals specifically with communicating the benefits of using country PFM systems.

Box 18. Managing aid with full use of country systems

Provision of aid using country PFM systems fully would resemble the following arrangements:

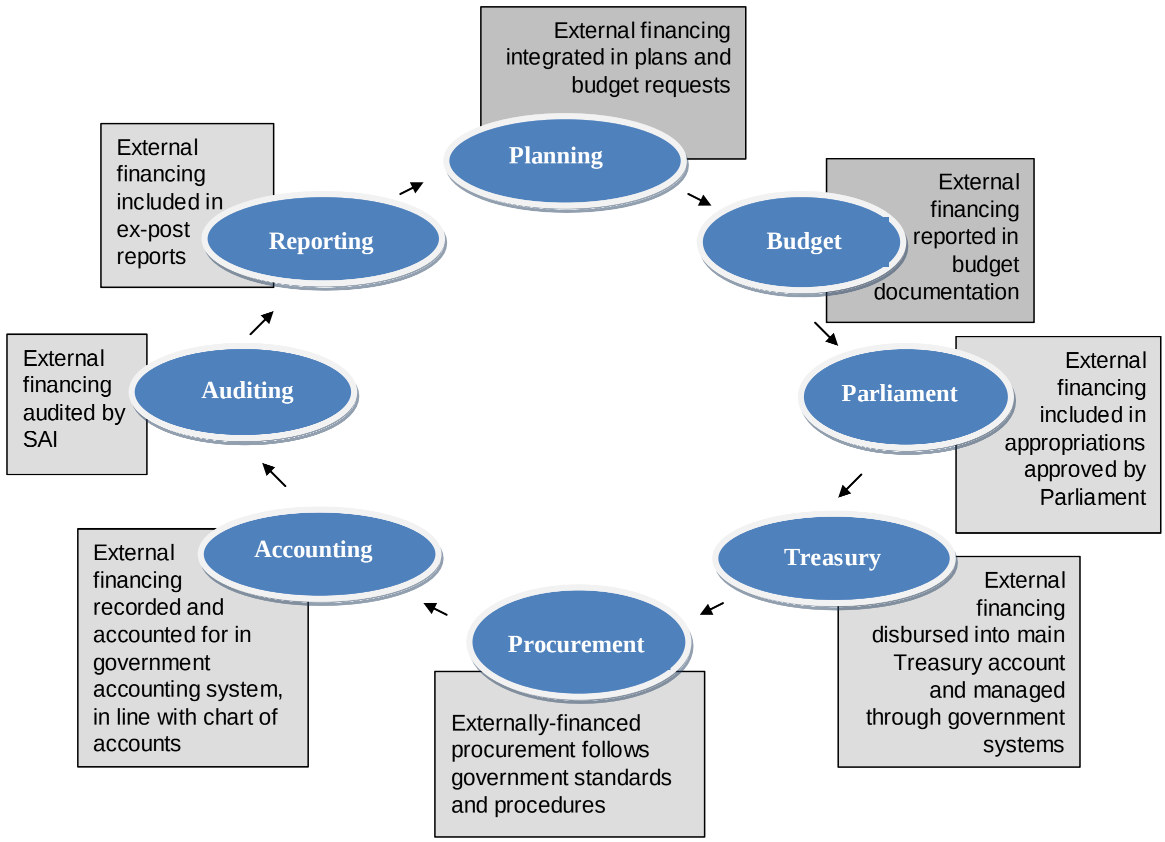
- The development assistance would be programmed (unpacking the objectives and stipulating what activities will be undertaken) and budgeted (assigning budgets to objectives and activities over the duration of the program) by partner country institutions using partner country procedures.
- The expenditure would be included in the partner country budget documentation and (if the country's legal framework allows) approved by its parliament.
- The regular staff of the implementing entity would be responsible for project financial management and implementation. They would be the "counterparts" with whom the donor would carry out discussions/dialogue. If needed, with the government's agreement, additional staff or consultants who report to and work under the supervision of the implementing agency's regular staff could be hired to provide additional capacity and expertise.
- Donor disbursements would be made through the central bank, into the country's treasury accounts that the country uses for its domestic resources.
- Regular country budget execution procedures (commitments, warrants, and payments) would be followed for projects implemented by ministries, departments, and agencies.
- Payments would be made through the treasury system using the concerned sector ministry's and treasury's regular payment verification and authorization procedures, for entities that fall under the treasury's jurisdiction. For other entities (e.g., state-owned enterprises that operate outside the treasury system), the entity's regular payment procedures would be used.
- Project expenditures would be accounted for using the government/entity's regular chart of accounts and accounting system.
- The entity's regular financial reports would form the basis for financial reporting to development partners.
- The government/entity's regular internal control systems and procedures would apply.
- Internal audit would be done by the regular internal audit arrangements.
- Donor-financed projects would be subject to external audit by the country's SAI, without special arrangements.
- Institutional oversight (i.e., review, approval, and oversight of financial management aspects by the legislature, the entity's board of directors, governing body, or other similar body, and its audit/finance committees) would be carried out in accordance with the relevant statute for the implementing entity.

Using country systems is not an all-or-nothing decision: donors can opt to use country systems to various degrees across aid flows or for any one program or project. Donors can opt to (i) use only some of the components of the country PFM system, (ii) limit the degree to which each component is used, and (iii) use a mix of modalities across their programs, each of which uses country systems to a greater or lesser degree. This section discusses these options. It is structured according to the components of country PFM systems, showing how they can be used, depending on a donor's appetite for risk, and on how distinctions might apply across different modalities.

Components of country PFM systems

Aid can be integrated with different phases of the national budget process, each of which is associated with a PFM system component: planning, budget preparation, approval by parliament, budget execution through treasury, procurement, accounting, auditing, and reporting (see Figure 8). Aid can therefore be "on plan," "on budget," and so forth, or on various components simultaneously (as highlighted in the work by CABRI).

Figure 8. Using components of country PFM systems



Source: Based on CABRI, 2009: Putting Aid on Budget: Good Practice Note.

Different modalities (see Box 19) are traditionally associated with different degrees of using country systems. However, depending on the characteristics of the donor-financed operation and the level of development and operation of PFM systems, a donor's risk management strategy for all modalities can call for the selective use of certain PFM elements with a gradual and sequenced process to expand to full use and to the other components of a PFM system.

Box 19. Defining modalities

General budget support. GBS is a method of financing a recipient country's budget by transferring resources to the recipient government's national treasury. The funds thus transferred are managed in accordance with the recipient's budgetary procedures. Funds transferred to the national treasury for financing programs or projects managed according to different budgetary procedures from those of the recipient country, with the intention of earmarking the resources for specific uses, are therefore excluded.

Sector budget support. SBS, like GBS, is a financial contribution to a recipient government's budget. However, in SBS, the dialogue between donors and partner governments focuses on sector-specific concerns, rather than on overall policy and budget priorities.

Program-based approach. PBAs have four features: (a) leadership by the host country or organization; (b) a single comprehensive program and budget framework; (c) a formalised process for donor coordination and harmonisation of donor procedures for reporting, budgeting, financial management, and procurement; and (d) efforts to increase the use of local systems for program design and implementation, financial management, and monitoring and evaluation. In this Guide, mechanisms such as SWAps and pooled or basket funds are considered PBAs.

Project. A project is a set of inputs, activities, and outputs, agreed with the partner country, to reach specific objectives/outcomes within a defined time frame, with a defined budget, and in a defined geographic area. Projects can vary significantly in terms of objectives, complexity, amounts involved, and duration. Smaller projects might involve modest financial resources and last only a few months, whereas large projects might involve more significant amounts, entail successive phases, and last for many years.

Technical assistance. This term refers to a wide variety of non-financial assistance provided to partner countries, for example, training and research; language training; south-south studies; research studies; collaborative research between donor and recipient universities and organizations; local scholarships; development-oriented social and cultural programs; and ad-hoc contributions such as conferences, seminars, workshops, exchange visits, and publications. Other forms of assistance, such as scholarships, can be managed through the use of country systems in similar ways as technical assistance, and therefore this Guide does not discuss them separately.

Source: OECD/DAC, 2009. Reporting directives for the Creditor Reporting System: Addendum on types of aid; OECD/DAC, 2005: Paris High Level Forum on Aid Effectiveness.

Using country systems: External financing "on plan" and "on budget"

- *Full use of country planning and budgeting systems means that for all aid modalities donor assistance is programmed through partner country systems.*
- *With a supplemental form of using country planning and budgeting systems, programming is driven by country institutions, even if additional donor-oriented documentation is produced.*
- *Donors should expect partner countries to reflect all assistance "on plan"— doing so carries no risk for donors.*

At a minimum, all donor assistance programs, whatever their modality, should be reflected in partner country planning and budgeting documentation. Note that reflecting aid in countries' budget documentation does not imply approval by country parliaments; it merely means that information on development assistance is included in the documentation that is submitted with the budget legislation. This is important for budget transparency: it is necessary to provide a comprehensive overview of all the resources that are used to deliver public goods and services, even if they are not appropriated by parliament in the budget act. When counterpart resources are required, it is crucial that aid programs be reflected in country planning processes (see Box 20).

From an aid effectiveness perspective, budget transparency is essential for partner country ownership of donor assistance, alignment of aid, donor harmonisation, managing for results, and mutual accountability. From a country systems perspective, when aid is not reflected "on plan" and "on budget," partner country planning for the use of domestic resources cannot take adequate account of donor-financed activities; this may result in overlap and duplication, and contribute to weak local accountability.

While reflecting aid "on plan" and "on budget" carries no risk for donors, it does carry costs, particularly the one-time cost to adjust donor aid information management systems to deliver to partner country systems information on all aid programs and projects—regularly, on time, and in the right formats for integration with domestic resources.

Box 20. Good practice example: Putting aid "on budget" - Rwanda

Three donors in Rwanda (KfW, the World Bank, and DFID) reported that their support, whether it is general budget, sector budget, or project support, is aligned with the government program budget in the medium-term expenditure framework. In Rwanda all donor funding is reported in an annex to the finance law, while only funds that are executed fully through country systems are included in the finance law for parliamentary approval.

For budget support, donors' contributions are disbursed according to the schedule agreed with the government of Rwanda in the framework of the Budget Support Harmonization Group, which envisions (i) several months of front-loading disbursements before the budget is drafted and the new fiscal year begins, and (ii) indicative commitments for the medium-term expenditure framework.

Fully reflecting donor assistance "on plan" and "on budget" enables countries to improve their macroeconomic management, improves transparency and accountability in the budget process, and contributes to improved policy coherence and efficiency of allocation. Full use of country planning and budgeting systems implies that country planning and budgeting systems are used to program aid assistance. For budget support modalities this is by definition the case. However, for program-based, project, and technical assistance modalities, aid is fully "on plan" and "on budget" if country institutions use country planning and budget preparation systems to decide on the use of available assistance. Using country institutions to program these types of support is not the same as budget or sector budget support, since donors can agree with countries on precise earmarking for funds. The difference is that countries drive the programming of the resources (see Boxes 21-23).

Box 21. Good practice example: Project support in Liberia

For one donor providing support to a project in Liberia, the estimated receipts and expenditures were included in the annual budget proposal submitted to the legislature for approval. The project is executed by the government ministry using its own administrative resources and the country's government budgetary procedures, and its budget execution is reported using the country budgetary reports; in addition, the government budget classification and budget controls support the formulation, execution, and reporting processes.

Box 22. Good practice example: Preparing project budgets using country systems in Moldova

The World Bank-funded Health and Social Assistance project in Moldova uses country systems to program funding. The ministry team prepares annual budgets for the components of the project. The budgets are prepared in accordance with the Ministry of Finance's reporting formats (categories, components and activities, financiers, and account codes, broken down monthly and quarterly). Budgets are initially approved by the ministries before being submitted to the Ministry and the Treasury. The approved annual budgets are then entered into each ministry's accounting systems and used for continuous monitoring and periodic comparison with actual results as part of the interim reporting.

Box 23. Good practice example: Using country systems to budget for externally-funded projects in Tunisia

Tunisia's budgeting process, started annually in January of the preceding year, covers budgets for the World Bank-financed projects. The budget is approved before December 31 of each year. All expenditures during the year are committed and paid for only if they were included in the approved budget. Strict budgetary control is in place through the computerized public sector budgetary system.

SWAps and basket funds—in whose management the government is a lead or significant partner—are important instruments for increasing the use of country systems for planning donor resources. However, the use of these instruments is not in itself equal to the use of country systems: it is only where the joint planning, budgeting, budget execution, accounting, reporting, and auditing of pooled funds, for example, is done through country systems that these instruments contribute fully to progress in the use of country systems.

The examples in Boxes 24 and 25 illustrate how multi-donor efforts can facilitate the establishment of specific mechanisms and safeguards for all donors that promote the benefits of using country systems while mitigating perceived fiduciary risks. The Morocco example illustrates how the use of country procedures allows for commingling of government and donor funds in what is effectively a "budget support" operation, but earmarked for specific activities and objectives.

Box 24. Good practice example: Using country budgeting systems to allocate project funds in Vietnam

The Rural Transport III Project in Vietnam is part of a multi-donor project for which the funds use Government policies and procedures. At the central and provincial levels of the ministry, the project's plans and budgets are integrated into the medium-term expenditure plan and the national and provincial budgets. The project funding is identified in sector budgets.

For execution, donor disbursements and program payments are made in two modalities:

- *Through the joint financing centralized payment system:* A USD special account was established in a local commercial bank to receive all donors' funds. Payments in foreign currencies are paid directly from this account, and each month the remaining funds are transferred to a project account in the central Treasury. From this same account, all the beneficiaries at the central, provincial, and district levels are paid in accordance with the instructions and payments claims received from the ministry and using government procedures.
- *Through the joint financing decentralized payment system:* The Provincial Treasury Department makes payments in accordance with normal government procedures only in provinces that have PFM capacity and meet the project and fiduciary requirements.

Box 25. Good practice example: Commingling government and donor funds in a SWAp, using country procedures

The Morocco Rural Roads Project uses a SWAp approach that emphasizes the use of national procedures instead of the parallel systems traditionally set up for donor-financed projects. This approach involves (i) the pooling of funds mobilized from donors and local authorities, without distinguishing specific activities by their funding source; and (ii) a disbursement mechanism based on the release of donor funds in tranches, as a function of overall program execution, rather than on the basis of individual operations. The donor operations, except for reporting, are fully integrated in the government budget. The ministry and its decentralized offices execute the projects using budgetary credits allocated in accordance with traditional public expenditure execution procedures. The accounting system is based on public accounting rules applicable to all the government's financial and accounting operations. The system of internal controls over public expenditures ensures a separation of functions by means of several layers of control. A first level of ex ante control involves three independent actors: the officer who requests/processes the expenditure, the controller of expenditure commitments, and the public accountant. A second level of ex post control occurs through the internal audit unit and/or through the General Finance Inspectorate.

Practical considerations

In principle, development assistance programs and projects should be integrated "on plan" and "on budget," but program government planning and budgeting systems are complex and differ from country to country. The following are some elements to consider.

- ***The budget process instruments and their integration with annual and multiyear planning instruments.*** Countries take different approaches in integrating their longer-term and short-term planning instruments with their budget process. Common elements on the planning side are long-term development plans, sector strategic or medium-term plans, and annual operational planning. On the budgeting side, many developing countries now use medium-term expenditure frameworks and processes. For some countries annual planning is subsumed in a medium-term budgeting process; others run a two-phased budget process in which annual budget planning follows a strategic, medium-term budget phase. To promote the integration of information about development assistance, donor country staff should be knowledgeable about these instruments and about what information is required when (see Box 26).

Box 26. Good practice example: Country budget mechanisms allow for the management of externally financed projects - Ecuador

In Ecuador both the World Bank and the Inter-American Development Bank execute projects in the environment and transport sectors using the integrated country financial management system (e-SIGEF), which includes budgeting, accounting, and basic treasury operations. The budget classifications and chart of accounts allow project information to be registered directly. Budget reports are issued by the e-SIGEF system, but accounting reports must be prepared manually using e-SIGEF data. The National Secretariat of Planning verifies that institutional planning and budgets support the national objectives and goals set out in the medium-term National Development Plan.

- ***Budget process timeline.*** Each country has a unique budget process and sequence of decision-making to determine the overall volume of resources and their allocation among priorities. If country systems are to be used, the country must have indicative information on medium-term aid in the early phases of the process, when the first determination of overall available resources is made. As more detailed decisions are made and earlier assessments of overall resources are revised, the information on aid flows must become more reliable. Donors should be aware of country budget process timelines and provide the best possible information, given their own planning and budgeting cycles (see Box 27).

Box 27. Good practice example: Providing relevant information on assistance for inclusion in government budgets

In Burkina Faso the World Bank's annual review of its budget support program is the basis for preparing a disbursement plan for the next two years and makes possible the inclusion of the program on the Government budget and in the medium-term expenditure framework. The program uses the Government's budgetary and accounting charts of accounts. The funds are channelled through the national Treasury according to the annual disbursement plan. The program financial reports are prepared directly from the Government's information system, and their content, format, and timing are consistent with the Government's financial reporting arrangements. Internal audit is performed by the institutional internal audit unit according to a risk analysis. The external audit function for the program—including opinion on financial statements, compliance with the donor agreement, and assurance on the operation of internal controls—is executed by the country's SAI.

The program has positively affected three key aspects of PFM management in Burkina Faso:

- decreased transaction costs for identifying and implementing government priorities;
- government ownership in implementing and reporting the activities; and
- the timely availability of funds, hence the timely implementation of the activities planned.

- ***Coordination between institutions.*** The coordination of planning and budgeting across central, sector, and (where relevant) sub-national institutions also differs from country to country. As some donors reported in the survey, a few countries have specific arrangements to sequence intergovernmental transfers, within which donor funding can be critical. For example, Rwanda requires consideration by the Country Development Fund—a body that determines the distribution of funds at the provincial level—at the time of budget preparation; and in India sector costs are shared between the central and state governments.
- ***Planning and budgeting formats.*** Countries use different formats to plan and budget. For most countries budget classifications are linked to the chart of accounts and define the categories to which funds are allocated, in terms of institutions, objectives of expenditure, and different inputs. The capacity for tracking spending by administrative units and against economic, functional, and programmatic aspects depends on how these classifications follow internationally agreed standards. Since budgetary systems differ from country to country, it is necessary for donor staff to understand how a specific country's system allocates, manages, and reports on the use of funds if they are to (i) provide information in the right formats, and (ii) determine whether the information formats will satisfy donor needs if country systems are used fully (see Box 28).

Box 28. Good practice example: Using country budget classifications for program formulation, execution, and reporting - Zambia

The Irish Aid support program in Zambia uses both country and donor systems to account for assistance, depending on whether the funding is provided as budget support or program support. However, all activities funded are formulated and incorporated into the budget using government budget classifiers. The estimated receipts and expenditures for the program are included in the annual budget proposal submitted to the legislature, and also in the medium-term budgeting framework. All activities are also reported using country budgetary reports. The government's budget classification thus supports the formulation, execution, and reporting processes for the program. The program is executed by the country's institutional agencies using their own administrative resources and the government budgetary procedures.

The benefits of including aid "on plan" and "on budget" will only materialise if quality information (completeness, reliability, predictability, level of disaggregation) is provided in a timely manner and if government systems are of sufficient quality incorporate information on aid flows.[11] It is important that donors work at the country level to provide reliable information, and particularly to ensure that the aid flows that are included "on budget" are predictable.

[11] OECD/DAC, Policy Brief 1: Benefits of Using Country Systems, 2011, p.24.

Using country systems: External financing "on parliament"

> - *Some flow types and some categories of aid should be on parliament, to support local accountability and the rule of law in resource management. Country legal frameworks determine which aid should be on parliament, and to what degree.*
> - *Donors can support increased use of country systems in this phase of the budget process by (i) supporting countries in improving the transparency of aid "on parliament", and (ii) providing reliable, comprehensive, and timely information in partner country budget formats for inclusion "on parliament".*

When external financing is "on parliament", development assistance programs and projects are approved by partner country legislatures. The quality of parliaments' engagement with aid flows is determined by the coverage and quality of the information in the finance law.

Whether aid flows should be approved by parliament is a function of country constitutional law, organic law, and/or public financial management legislation and budget instructions. In some countries (for example, Kenya) all flows have to be approved, whatever the flow type and modality; in other countries only some flows are included (for example, when they are managed fully through country systems, as in Rwanda).

Donors can nonetheless contribute to improving the effectiveness of including development assistance flows 'on budget' and 'on parliament,' in three interdependent ways (see also Box 29):

- They can provide support to assist the government in integrating recurrent and development budgets, thereby improving budget transparency and parliamentary oversight.
- They can provide information on their own assistance programs using detailed budget classifications, agreed with the government, for all assistance. If donors have already provided information in formats that align to partner country planning and budget preparation instruments, or used country planning and budgeting systems to program their assistance, only a final update is required.
- The information that donors provide to ensure that aid flows are "on parliament" should be reliable. This is important for macro-economic and budget management, particularly for budget support and sector budget support. In addition, in principle implementation agencies must refer to parliament for modifications within donor programs and projects between years, or expenditure items beyond the limit specified in country legislation. This is rarely done in practice, so unreliable information does not directly affect implementation of the donor program; however, it undermines the rule of law in the country's budget systems, with significant long-term cost to the development of sound PFM institutions.

Box 29. A guide to putting aid "on parliament"

In principle, whether aid should be "on parliament" or not can be approached from an accountability perspective. When partner country parliaments approve aid flows through budget laws, they provide a country legal basis for the executive to commit expenditure from external financing. This action also provides a basis for holding the executive to account for the implementation of planned expenditure in line with the budget law.

A first necessary distinction is between aid flows that are in terms of an agreement with the government, and flows that are not. Aid flows that do not have the recipient country as a partner to the agreement cannot be on partner country budgets.

A second useful distinction is between loan-financed and grant-financed development assistance. Given the commitment of future resources that loan financing entails, all loan-financed assistance, whatever the modality and disbursement channel, must be "on parliament". Government is accountable for ensuring value-for-money in these projects and programs.

For grant-financed flows that occur in terms of an agreement with the government, a further distinction can be made between aid that is managed by country public institutions (to a greater or lesser degree) and aid that is managed completely outside the government.

- Grant assistance provided under an agreement with the government but managed completely outside the government (through NGOs or by the donor itself) need not be "on parliament," as the government has no control over expenditure decisions or implementation and thus cannot be held fully accountable for value-for-money in these programs. However, as the funds were agreed to on behalf of partner countries' citizens, and for policy coherence with domestic funding, such aid should still be "on budget".
- Grant assistance provided under an agreement with the government and managed, at least to some extent, by country institutions should be "on budget" if not "on parliament," as the government accepts the funds on behalf of citizens and has some control over implementation. Funds that are implemented through government systems to a larger degree must be approved by parliament in some form, as government institutions will be acting on behalf of citizens in committing funds to expenditures.

Source: CABRI, 2009. *Improving aid on budget in Rwanda*.

Using country systems: External financing "on treasury"

- *Using country treasury systems fully means that development assistance flows are disbursed using the same treasury systems and banking arrangements used for disbursing the government's domestic resources. By definition, GBS and SBS use country treasury systems fully.*
- *A supplemental version of using country systems—one that provides more assurance to donors—is to use special accounts that manage donor funds separately from a country's own resources, even if disbursement processes are managed by country institutions through common treasury systems.*
- *Special accounts can be kept with the central bank or in other banking institutions. They can be controlled by the central treasury, or by implementing agencies –depending on the country's treasury model. They can operate as (i) fixed disbursements made to the implementing agency account against a work or cash flow requirement plan, and subject to ex-post report; or (ii) payment requests submitted by the agency to the central treasury. When the country requests payment directly from the donor to suppliers, which should be used only in exceptionally qualified situations, the transaction should still be recorded in the government accounting system.*
- *The degree to which benefits from using country systems are realized depends on the extent to which core treasury systems are used, the degree to which the systems are used across donors, and the predictability of disbursements.*
- *A good understanding of country banking, cash management, and budget execution procedures and capacity is necessary to properly define the terms in which the program resources will be provided, managed, and recorded in the PFM system.*

Treasury operations refer to banking, cash management, and disbursement arrangements for public funds. Many countries have implemented "treasury single account" systems (TSA), meaning that, with some minor exceptions, the treasury controls and supervises all the funds and bank accounts of the central government entities, and in some cases of decentralized entities and public enterprises. "Single account" procedures improve the treasury's management, control, and reporting of funds, as well as its accountability for them.

A careful compatibility assessment of the "single account" system with donor regulations is recommended for properly harmonizing them and for defining disbursement and banking procedures for the program. As donors reported in the survey, many countries have a TSA system—in most countries only at the national government level, but in some at the provincial or state level also (see Box 30).

Box 30. Good practice example: Using treasury systems to support sub-national governments

World Bank-funded projects in Pakistan are implemented using provincial financial management systems. Disbursements, converted to Pak Rupees by the State Bank of Pakistan, are made to the Provincial Government Consolidated Fund through a report-based method: reports are prepared directly from the IFMIS, cleared by the Chief Program Manager, validated by the Accountant General, and approved by the Department of Finance. Transactions are recorded and reported in local currency. The program's budget is part of the government budget, but additional codes were added to the chart of accounts to identify the source of funds. Project expenditure elements are classified according to the government's chart of accounts. The system produces quarterly and yearly financial management reports for the program. The annual financial statements of the program are audited by the Auditor General of Pakistan, as independent auditor for all the activities undertaken by provincial and district governments. Government procedures for resolution and settlement of audit observations are applicable to the program.

When external financing is "on treasury," aid is disbursed using treasury systems—that is, donors use either (i) the main treasury system used for the partner country's domestic resources, or (ii) special accounts that are under the control of country institutions and legal country instruments, but that manage donor resources separately from the partner country's domestic resources (discussed below). A variation on this system is that the separate nominal accounts form part of the TSA system (with cash balances zeroed on a daily basis), even if accounting balances remain positive. Other treasury-operated systems that can also be used are country cash planning and management institutions.

Benefits from the use of country treasury systems include improved cash management, more predictable transfers to lower levels, higher budget execution rates, and improved treasury systems—through the enhanced encouragement for performance that is associated with the use of country systems, but mostly through focused and coordinated support. However, for these benefits to materialize, donor funds should form part of the government's cash reserves, and a significant proportion of donor support needs to use treasury systems.[12]

An additional benefit associated with the use of country treasury systems is that information on aid that is disbursed through country systems is available for use in country budgetary systems. This overcomes the transparency disadvantages of using donor-controlled disbursement channels, under which central budget agencies in particular have to rely on implementing institutions or donors to provide aid flow information for incorporation in budget planning and reporting.

Full use of partner country treasury systems implies that donor flows are disbursed through the treasury system used for government's own resources. The most typical mechanism is that the donor disburses the program funds (or loan proceeds) into an account that forms part of the country's official foreign exchange reserves, and an equivalent amount is credited to a government account to finance budgeted expenditures, using country PFM systems.

Supplemental versions of the use of country treasury systems entail the use of special accounts that allow donor funds to be accounted for separately in treasury systems, even when the cash can be absorbed into a TSA. When donors disburse funds for program-based and project support modalities using country systems, they normally use some form of special account:

[12] OECD-DAC, Policy Brief 1: Benefits of Using Country Systems, 2011, p24.

- When project accounts have traditionally been managed outside the national treasury systems, the transition towards country systems usually requires carefully managed processes involving all pertinent actors, as exemplified by Armenia and Mongolia (see Box 31).
- The special account can be maintained in the central bank, with country systems providing for the mechanisms to trigger disbursements for authorized payments (as in the Ecuador good practice example), for reimbursements from this account to implementing agencies (as in the case of Rwanda), or for fixed disbursements against a preapproved work plan (Box 32 illustrates these uses).
- Special accounts can also operate between the treasury and implementing agencies, using other banking arrangements outside of the central bank (see Box 33), as in the El Salvador and Mexico examples.

When project accounts are operated directly by line ministries and agencies, care should be taken that the central budget authority/treasury has full and timely information on these accounts' transactions and balances for sound budget and cash management.

Box 31. Good practice example: Transitioning to country treasury systems – Armenia and Mongolia

Armenia. At the request of the Government, the transfer of project accounts for World Bank-financed operations to the Armenia Treasury systems was completed recently. The Bank and the Government worked closely to develop the methodology and transition plan (e.g., the procedural implications of opening of foreign currency accounts for donor-financed projects). An advanced Treasury-Client on-line system has been introduced, and is now used on all the Bank-financed projects in Armenia and –most importantly– is now available for all other budget programs. It is expected that this development will bring improved cash management and financial savings to the Government.

Mongolia. The Treasury Department of the Ministry of Finance (MOF), the Mongolian National Audit Office (MNAO) and Project Management Units, with support from the World Bank, worked in collaboration on a pilot program for the migration of project accounts to the National Treasury System. The relevant preparatory policy and institutional development work included, but was not limited to, implementation of the Government Financial Management Information System (GFMIS), which now has nationwide coverage; establishment of the relevant resolutions and procedures governing the pilot both at the decision-making and technical levels; integration of donor funds into the government budget through ministries' appropriations; and strengthening of MNAO's capacity to audit government accounts. This migration of donor funds to the Government's own PFM system is expected to increase country ownership and project sustainability, promote donor harmonization and alignment, and improve effectiveness and efficiency for both the Government and the Bank.

Box 32. Good practice examples: Using treasury and central bank payment arrangements to execute projects through country systems

Ecuador. The Inter-American Development Bank executes projects in the environment and transport sectors using the integrated country financial management system (e-SIGEF), which includes budgeting, accounting, and basic treasury operations. Each quarter the government assesses budget execution, including that of investment programs. A TSA system is in place, but the Treasury system maintains special accounts for projects that are not part of the TSA system. Payments are made by the Treasury on the basis of the entities' payment orders registered in e-SIGEF. The Treasury verifies the appropriateness of the payment request and orders the Central Bank to process the payment via electronic bank transfers directly to the beneficiary's bank account. Payments are made from the special account or from the treasury common fund as requested. The projects are subject to the ministry's institutional internal control system.

Rwanda. Three donors (World Bank, DFID, and KfW) reported using country systems. Although all modalities use the TSA procedures, for budget support donors' contributions are disbursed according to the schedule agreed with the government in the framework of the Budget Support Harmonization Group which envisions: i) several months of front-loading disbursements prior to the drafting of the budget and the beginning of the new fiscal year; and ii) indicative commitments for the medium-term expenditure framework. All donors' funds are controlled by the Treasury. For project support, the donor disbursements are mostly controlled by the country's actions, depending on the ministry's capability to carry out expenditures. The financial contribution is made to a special account in the National Bank of Rwanda—a revolving disposition fund that functions through an initial provision of funds and subsequent replenishments of the fund against proof of receipts and as requested on a rolling basis, with disbursement flows limited primarily by the ministry's capacity to identify and execute suitable infrastructure projects.

India. The World Bank-funded elementary education and child health programs use country systems. The program is implemented at both the federal and state government levels, so that a budget for the program is included in the overall budget for the sector ministry and at the state level for the sector department. For each state affected, the program is prepared in the form of an Annual Work Plan and Budget, which is the basis for funds transfers and monitoring. Donor funds in foreign currency are disbursed into the special account maintained at the Reserve Bank of India, and the rupee equivalent is transferred to the Consolidated Fund of India. The government releases the states' funds (based on the approved Annual Work Plan and Budget) in two installments—50% at the beginning of the year and the rest upon documented requests at midyear. Twice a year the government consolidates the accounting information provided by the states, using a unique chart of accounts for the entire public sector, and prepares a donor report that includes the program's financial management information. Each program is audited by each district/state and consolidated in a single report prepared by the Comptroller and Auditor General.

Box 33. Good practice examples: Executing projects using arrangements between treasuries and implementing institutions – El Salvador and Mexico

El Salvador. An Inter-American Development Bank-financed housing program is executed using the integrated country FM system (SAFI), which includes budgeting, accounting, and basic treasury operations. Programs are included in the national budget, but only with aggregate amounts in accordance with the national budget classification. This means that program financial statements must be prepared manually or outside of the SAFI, but using SAFI data. Donor funds are disbursed into a special account controlled by the Treasury. Payments are made by the ministries and agencies from institutional accounts authorized by the Treasury, and the Treasury replenishes the funds each month in response to documented requests from each institution. Projects are subject to the institutional internal control system of the ministry.

Mexico. Funds for programs financed by multi-lateral development banks are allocated and designated within the Federal Expenditure Budget. In accordance with regular practice in Mexico, the government finances the program and the donor subsequently reimburses eligible expenditures recorded under the government budgetary lines earmarked for the project. Payments are made by the Federal Treasury, which manages the government's TSA. Donors disbursements are subject to requests prepared by the line ministry that identifies eligible payments and present aggregate and summarized data in a Statement of Expenditures (SOE), which is submitted to a financial agent designated by the Ministry of Finance (financial agents are national development banks that manage funds on behalf of the Ministry of Finance). Financial reports for the program are prepared manually by the Ministry, based on its accounting records. In addition to the national budget regulations and procedures, the ministry is subject to its own Operational Rules and to the Federal Public Administration Internal Control Standards issued by the Ministry of Public Administration (SFP), which as a whole provides for sound internal control arrangements for the program. External audit is also coordinated by SFP, using independent audit firms.

Predictability of donors' funding is crucial for government cash management and budget programming. Donors can increase the predictability of their funding by agreeing on an annual or multiyear disbursement plan in time to allow its inclusion in the institutional plan and budget of the implementing ministry and the financial plan of the ministry of finance, or by disbursing against expenditures incurred by the government –which, in turn, can be facilitated through fund advances. Some countries require donor programs for which funds are disbursed using treasury systems to provide cash requirement forecasts for the year, in the same formats used for the country's own revenue (see Box 34).

Some donors have adjusted their disbursement plan to (i) disburse earlier in the year to facilitate government cash management (see DFID example in Box 7); (ii) disburse all the program funds in the first quarter of the year in SBS programs; or (iii) disburse funds in accordance with the planned disbursement plan in a general budget support agreement (for example, KfW in Rwanda).

Box 34. Good practice example: Cash management in donor projects using country systems - Uruguay

In Uruguay all donor programs must be registered in the national budget for execution. When projects are executed using Treasury systems, ministries must prepare an annual cash program and confirm monthly requirements. Each ministry pays project expenses by issuing cheques from their program bank account, which the Treasury replenishes every month according to the program requests and after clearing expenditures already made. Programme reports are based on a parallel accounting system, even if disbursement is through government systems.

Using country systems: Aid "on procurement"

Aid is on procurement when personnel and goods and services are procured using the country's legal framework and procedures for procurement. The use of country procurement systems can have significant benefits, not only for the delivery of public services, but also for economic growth and development: it can channel more donor resources to local businesses and lowers the transaction cost for local businesses to provide services to development assistance programs and projects. This document does not provide separate guidance on the use of country procurement systems, which is covered by the Task Force on Procurement.

Using country systems: External financing "on account"

- *External financing is on account when government accounting systems are used to manage, classify, and record development assistance program and project transactions and produce financial reports.*
- *Programs and projects are fully on account when the government system is used as is and government financial reports are accepted without any additional safeguards or reporting.*
- *A supplemental form of "on account" occurs when donors execute projects using government accounting systems, but require government systems to be modified to allow tracking of program expenditure or additional reporting.*
- *In practice donors often use country accounting systems for projects when countries have a functional IFMIS that allows donors to track project expenditures and receive additional reports.*

Donors use country accounting systems when transactions involving donor development assistance funds are managed, classified, and recorded using country accounting systems:

- The transactions are recorded and maintained in the country government's accounting system, including related subsidiary records.
- The financial statements are reported using the country government's accounting system.
- The government accounting classification (chart of accounts) and standards support the recording and financial statement presentation processes.

- The government accounting controls support the recording and financial statement presentation processes.

Accounting is a core element of a PFM system. Accounting standards, policies, and practices can differ across countries; however, in recent years partner countries have increasingly adopted standards that resemble the International Public Sector Accounting Standards (IPSAS). For example, of 48 countries for which PEFA assessments looked at accounting standards between 2005 and 2010, 16 used IPSAS in their systems; 25 applied standards that were consistent with IPSAS, but did not use IPSAS as such; and the remainder did not apply standards consistently, or did not disclose standards. But even where governmental accounting standards and policies are in place, they may not be applicable to all public institutions. (Box 35 discusses the relationship between “on treasury,” “on controls,” and “on account.”)

Box 35. “On treasury” normally implies “on controls” and “on account”

Using country systems “on treasury” often goes together with using them “on account”. Almost all the examples provided in the survey refer to donors disbursing funds through one or another form of government treasury system, using government internal procedures and controls for execution (“on controls”) *and* accounting systems to record the transactions. In fact, modern financial management systems integrate the sequence of PFM functions involved in receiving funds, controlling and recording commitment and payment transactions in the accounting system, and reconciling accounts, which means that donors would use these functions as a “package,” even if they apply additional safeguards or reporting procedures.

It is, however, possible for assistance programs to be reflected formally in government accounting systems, even if disbursement does not use treasury systems. In Rwanda, for example, where the budget is comprehensive in its coverage, the government collects information on assistance programs to be included in the government accounts, whether treasury systems are used or not. In Tanzania the government systems allow for the issuance of a dummy voucher to bring assistance programs that do not use treasury systems and government budget execution procedures onto the government accounting system (CABRI, 2009: *Aid on Budget Synthesis Report*).

It is also possible that even with funding “on treasury” and “on controls,” a donor would require a use of a parallel accounting system when the government’s own accounting system does not comply with pertinent standards or does not record all the information required for donor reporting. In Sri Lanka, for example, the World Bank requires separate accounting for the projects it funds, but uses country systems to disburse funds and country procedures to execute projects.

In modern systems, an IFMIS provides the tools to integrate budget management, from budgeting through budget execution and accounting to financial reporting. Core modules of an IFMIS cover the budget execution controls and procedures and the accounting and financial reporting functions. An IFMIS should allow the simultaneous recording of budget and accounting transactions at common stages such as commitment and payment, affecting both budget execution and accounting balances. As some donors reported in the survey, in some countries, although an IFMIS is in place, accounting is not necessarily fully integrated with the budgetary system or the IFMIS is not fully implemented in all public institutions; such a situation calls for greater attention to integrity and reconciliation of data. It is also notable that most of the examples of donors using country systems for accounting purposes—particularly for project expenditures—refer to the existence of a functional IFMIS.

The chart of accounts is a critical instrument for proper classification and reporting of accounting transactions. Detailed analysis of the chart of accounts can allow donors to understand how program transactions will be classified and to what extent this classification provides sufficient information for monitoring purposes. Source of funds codes in chart of accounts should allow donor funding to be identified for the management of project funds using country systems. In other cases, an IFMIS project module can allow for the management of projects separately but securing linkages with the national budgeting, treasury and accounting records (see Boxes 36 and 37).

Box 36. Good practice example: Using country systems for accounting and financial reporting

In Rwanda, accounting is processed through the Government's computerised system (SMARTGOV), a system that uses the Government chart of accounts to manage basket funds and the costs of activities and programs. This system is able to produce timely financial reports as well as a consolidated public accounting. Both the World Bank and DFID use Government financial reports and internal audit systems in all the programs they fund, and the system satisfies their requirements. Each year, multi-donor programs publish a financial report for all contributing donors together. The report includes a chapter for each donor, with detailed information on its projects; the report is drawn from the Government's information systems, and, since it is also used for internal reporting purposes, there is little transaction cost involved. Although relatively new, the SAI is auditing the Government funds, and donors use its reports for GBS and SBS programs.

Box 37. Good practice example: Using country PFM systems in Colombia

In Colombia, as in China, after conducting a country assessment, the World Bank uses country systems for financial management arrangements. This means that all program expenses for country projects are integrated into the national budget and subject to government regulations. In 2006 the Bank and the government signed an agreement defining and standardizing all the financial management reports for all the donor's operations in the country. The ministry prepares the financial reports in conformity with that agreement: (i) a report of payments generated from the project accounting report of commitments, (ii) the balance sheet, and (iii) the cumulative investment statement (with actual and budgeted figures).

Project budgets are fully integrated with ministries' budget cycle and are processed through the integrated FM system (SIIF), which integrates budgeting, accounting, and treasury operations and is implemented by the government in all ministries and central agencies. Once a loan agreement is signed, the accounting for the associated project(s) in each agency is defined through the "online internal designation" (cost centres) created.

The projects are subject to the internal control framework and internal auditing procedures of the Internal Control Office at each ministry.

The use of country accounting systems ensures that information on the actual use of donor funds is captured comprehensively and reliably for financial reporting purposes and in formats that are compatible with the government's own accounting and budget classifications. This increases transparency in the presentation of integrated financial information and improves the monitoring of and accountability for aid disbursements and transfers to lower-level agencies. Using government accounting systems also provides an incentive to donors to encourage better performance of these systems at the levels of government that they support, and brings resources into building capacity for accounting.

Full use of government accounting systems implies that transactions for donor funds are classified and recorded using the government's chart of accounts, accounting procedures, and standards. Using the public accounting system as a source for financial management information for donor-financed programs requires an understanding of how the system works, the basis of accounting for the reported values, and how accurate the reported values are. The survey responses included examples of both GBS and SBS programs and projects using government accounting systems fully.

Supplemental use of country accounting systems occurs when donors require additional safeguards or measures to minimise fiduciary risk. Such cases usually apply to program-based and project modalities. The following types of measures might be used:

- Agreeing on improvements in the country financial management system overall to allow the use of systems countrywide (see, for example, the discussion on the World Bank's agreement with China in Box 5).
- Agreeing on additional codes, usually on the source of funds, to be added to the IFMIS to allow tracking of expenditures through the system for particular projects.
- Using a conversion matrix in the IFMIS that allows country-oriented reporting formats and classifications to be aligned with and converted to donor-oriented formats and classifications.
- Agreeing on specific donor reports to be produced from the government's accounting systems.

Boxes 38-40 describe good practice examples of the use of country accounting systems.

Box 38. Good practice example: Using country financial management systems to channel sector funds

In Bangladesh, the multi-donor-funded Health, Nutrition and Population Sector Program was designed to use the country's financial management systems to channel donor funds following treasury rules, and to use the government's internal controls. The progress achieved includes:

- Development of procedures for operation of the foreign exchange account to reimburse the government's expenditure in the health sector. This first attempt by pool funders has been critical in facilitating the streamlining of funding through country systems in the health sector.
- The financial management unit in the ministry carries out all financial management activities. There are no project implementation units or dedicated staff to deal with financial matters separately for the program.
- Donor funds are disbursed on the basis of health sector financial management reports, prepared by the ministry after data validation and reconciliation with the Controller General of Accounts. Bangladesh has a computerized management accounting system that is connected with all cost centres. The Accounts Code, Treasury Rules, and General Financial Rules of the government form the basis for accounting, which is adequate for preparing sector accounts.
- The program uses approved guidelines for Government Expenditure Management in respect of letters of credit, NGO payment and the treatment of advances.

The government and the donor agreed to the use of a single set of financial monitoring reports based on the financial statements prepared by the ministry, to include additional reports on funds sources and sector expenditures. They also agreed to a single audit arrangement for the sector. The terms of reference (TOR) for the annual audit are agreed-upon by the Comptroller, the Auditor General, and the donors. An Audit Committee was recently reconstituted with an enhanced mandate.

Box 39. Good practice example: Using country systems to account for project funds against donor requirements - Argentina

In the Province of Santa Fe, Argentina, the World Bank-funded Road Maintenance Project relies fully on the provincial financial management institutional arrangements with minimal or no additional safeguards. The program is fully integrated in the provincial budget.

The Province Integrated Financial Management System (SIPAF) is used for processing and recording the project transactions, with some systematic modification for donor requirements, reducing the need for manual conversions. The province-wide system operates under the oversight of the Province Accountant General and the Budget Office, providing an adequate control environment for the project's operations. The sources of funding in SIPAF are classified by external and local funds, and the project expenditures classification reflects both the loan disbursement categories and the project components. SIPAF statements of cash receipts and payments are also used for financial reporting to the donor; a conversion matrix is used to report the project transactions processed in SIPAF according to the donor's reporting requirements.

Box 40. Using a functional IFMIS to manage donor disbursements and expenditures in Brazil

In Brazil, sector support programs funded by both the World Bank and the Inter-American Development Bank use the country's IFMIS, which operates nationwide with the same rules in all public institutions. The IFMIS functions include the recording of budget and financial programming; the centralized and integrated recording of the processing of the State's budgetary, accounting, and financial transactions; and the controlling of the allocation and use of budgetary resources. The IFMIS supports the control and the authorization of electronic payments to suppliers and beneficiaries; and by producing financial statements and budget/accounting reports that fulfil the donors' requirements, it supports administering and/or reconciling the State's TSA and other bank accounts. Budget and accounting regulations at the State and federal levels are harmonized, providing confidence to donors. Donor projects use the government's medium-term planning and annual budget. Disbursements and expenditures of donor funds are identified using country classifications for the sources and uses of funds: this enables expenditures to be lodged against the specific donor codes. Audits are increasingly done by State audit organizations, and thus the country's State SAI is also strengthened by the programs.

In the area of accounting, as well as in any other area of PFM country systems, it is important that any additional safeguards required by donors are not so extensive that they in effect equal the establishment of a parallel system, particularly if the additional requirements have little relevance to improving the management of countries' domestic resources through their accounting system.

Using country systems: Aid "on audit"

- *External financing is on (external) audit when development assistance programs and projects are audited by country auditing institutions in accordance with country legal frameworks and audit frameworks and procedures.*
- *Full use of country audit systems means that donors are satisfied with the audit coverage, approach, and frameworks of the country's SAI and do not require any additional, duplicative audits.*
- *Supplemental use of country audit systems occurs when donors use the country SAI but require specific audits of donor programs, normally using donor-specified TOR. Such additional audits may be carried out by the SAI's own staff or by a private firm approved and quality-assured by the SAI.*

Donors use country systems "on audit" when development assistance programs and projects are audited by country auditing institutions in accordance with country legal frameworks and audit frameworks and procedures:

- The external audit function for development assistance programs and projects—including an opinion on financial statements, compliance with the donor agreement, assurance on the operation of internal controls, and other work as applicable (for example, performance audits)—is performed by the country's SAI or by an audit firm under commission and terms agreed by the SAI.
- The external audit arrangements for the program/operation are based on a risk-based work program prepared by the SAI.

- The timeliness and effectiveness of management actions in response to audit findings is monitored through the external audit follow-up system.
- Sanctions imposed by the courts of accounts in judicial systems are enforced.
- The government's external audit standards and modalities support external audit processes.

Donors usually require independent external audits on project operations. The functioning of external audit for the public sector at large is also a consideration in budget support operations—as part of the fiduciary risk assessment, the policy actions supported by the operations, or both. External audits in most countries are performed by the SAI (see Box 41), but an SAI could use the service of independent audit firms to supplement or even improve its audit capacity through knowledge transfer.

Box 41. SAIs in Westminster and judicial systems of accountability

Although countries' external audit systems can vary widely, two common systems include the Westminster or judicial systems of accountability. Westminster systems are often associated with countries that have a British administrative heritage, while countries that have a French, Portuguese, or Arabic administrative heritage often use a judicial system.

- The Westminster model emphasizes the role of parliament, and the work of the SAI—the Office of the Auditor General—is intrinsically linked to the system of parliamentary accountability. An annual cycle starts with parliament's authorization of expenditure, followed by the production of annual accounts by all government departments and other public bodies, the audit of those accounts by the SAI, the submission of audit reports to parliament for review by a dedicated committee, and the issue of reports and/or recommendations by the Public Accounts Committee (PAC) to be adopted by parliament. The cycle concludes when the government responds to the PAC reports.

- In a judicial system, the SAI—known as "Court of Accounts" or "Chamber of Accounts"—forms part of the judiciary. The work of these bodies generally includes, but is normally not limited to, assessing the adequate processing and legality of financial transactions. Public accountants in judicial systems are placed in each government entity and are personally responsible for the proper expenditure of funds and for drawing up annual financial statements and reports. When the SAI judges the legality of the public accountant's actions it can either "discharge" the public accountant from further liability if it is satisfied that the transactions are legal, or impose a penalty or sanction on the public accountant if it finds that illegal transactions have occurred.

  The further responsibilities of the SAI may include reporting to parliament on the audit of government accounts compiled annually by the ministry of finance. Parliament can rely on this report in granting a "discharge" of responsibility to the government if it is satisfied with the way the government has managed public funds in the year. In addition, the SAI may also be mandated to audit individual government entities.

  Countries with a judicial system of accountability also often have an Inspector General of State reporting either to the President or the Prime Minister instead of parliament.

Using country audit systems benefits donors and partner countries through the development of audit capacity and the focus on enhancing performance (see Box 42).

Box 42. Good practice example: Relying on external audits in Tanzania

In Tanzania the CIDA-funded Education and Health Basket Fund increasingly relies on the external audits of the Tanzania Controller and Auditor General/National Audit Office (CAG/NAO) to monitor, assess, and control fiduciary risk. Once operational, the programs no longer need the same level of donor-financed auditing by private sector auditors. Donors and the Government of Tanzania use information from the audits in high-level policy and operational dialogue on improving efficiency and effectiveness and reducing corruption and waste. Donors' increasing reliance on the country system audits has in turn led to a strengthened external audit function.

The Public Financial Management Reform Program has financed training and tools to strengthen the NAO. The Government of Tanzania has also provided increasing resources for this program, noting that it has as great an interest as its donor partners in effectiveness and efficiency and in combating corruption. Combined, the strengthened resources are allowing the CAG/NAO to achieve AFROSAI (African Organization of Supreme Audit Institutions) Level 3 standards, which incorporate responsibilities to provide procurement, risk-based, and performance audits as well as financial audits. Donors' "crowding in" the external audit function has facilitated the development of its capacity, with benefits for public financial management. Donors also consider external audit reports to be valid as fiduciary risk assessments, reducing transaction costs in the use of country systems.

Full use of country external audit systems is common for GBS and SBS, in which donor funds are commingled with a country's own revenue and budgeted, disbursed, executed, and accounted for using country systems. Full use of country systems for program-based approaches and projects would imply that donors are satisfied with an audit by the country institution. For most donors this is not possible: their own legal frameworks for providing development assistance may require specific audits of some or all programs.

Supplemental use of country systems occurs when donors use country SAIs to some extent, but have separate TOR that apply particularly to their program or project.[13] The country SAI can be involved either in conducting the audit following the donor's TOR (see Boxes 43 and 44) or by reviewing and approving TOR for application by a private firm of auditors which it approves and for which it provides quality assurance (see Box 45). In this case the audit would still be considered a country audit, but it would not make full use of country systems and would impose some additional cost on the system.

[13] OECD-DAC, Good Practice Note on Supporting SAIs (forthcoming).

Box 43. Good practice example: Using country systems to the maximum extent possible, with additional safeguards

The World Bank provides sector support under the Afghanistan Reconstruction Trust Fund. The financial management arrangements for the program rely on country systems with some additional safeguards. A SWAp is used to maximise the use of country systems for components of the support. A budget committee coordinates the preparation of annual work plans and the derivation of the annual budget, as well as the quarterly budget reviews, to ensure adequate budget discipline and control. The committee is responsible for ensuring that all project expenditures for each fiscal year are captured in the Government's development budget. The funds are disbursed into a designated account managed and controlled by the special disbursement unit in the Treasury Department of the finance ministry. Requests for payments are made to the Treasury, which maintains a proper system of accounting for all expenditures incurred, along with supporting documents. The project accounts are audited by the Auditor General with advice by an Audit Advisor according to the TOR agreed with the donor. The assistance is, therefore, on budget, partly on treasury, on account, and on audit.

Box 44. Good practice example: Using the SAI and donor TOR - Poland

The Polish SAI performs an annual audit of the overall state budget, including externally-funded projects. Since not all projects are audited annually, it is possible to request the SAI to include some specific projects in its annual audit plans, giving preference to large projects in advanced stages of implementation. The World Bank has an agreement with Poland's SAI to perform financial audits and other reviews on an annual basis, according to the TOR agreed with the Bank. As a result, the Bank receives clear and concise audit reports focusing on key financial aspects and overall results and findings.

Box 45. Good practice example: Using country systems for auditing project support - Rwanda

In Rwanda the SAI is involved in audits for operations financed by the World Bank and DFID, insofar as it approves the TOR and the private firms hired to undertake the audits of project support funds. For GBS and SBS funds, the donors use the SAI audits of government funds.

Internal audit

These guidelines place emphasis on using country external auditing institutions in the delivery of development assistance. However, it should be noted that when donor programs and projects are executed using country systems and their transactions are recorded and classified through country accounting systems, the projects and programs should fall under country internal audit requirements—preferably risk-based internal audit, provided that it is required within the country legal framework. Donors should familiarize themselves with country internal audit standards, modalities, and capacity to determine whether internal audit will be executed through country systems. If not satisfied, donors could work with internal audit units to develop specific TOR for the audit of donor programs and projects in ways that will contribute to the development of internal audit capacity for the government's own budget execution functions.

Use of country systems: External assistance "on report"

- *Aid on report refers to both financial information and reporting on the implementation and effectiveness of development assistance programs and projects.*
- *Together with putting aid "on plan" and "on budget", ensuring that comprehensive, accurate, timely, and useful information on all aid flows is available at the country level for inclusion in government reports is a minimum level of use of country systems that should apply for all donors.*
- *Full use of aid on report means that donors are satisfied with country reports—content, format, and timing—for their own purposes. Supplemental use occurs when donors require only minimal additional reporting and impose little recurring cost on the country system.*

Donors use country reporting systems when they rely on country financial and nonfinancial reports and/or reporting standards and formats for their own monitoring and evaluation purposes:

- The content, format, and timing of the financial reports used for donor disbursement and financial supervision purposes are consistent with the country government's own financial reporting arrangements.
- The content, format, and timing of nonfinancial reports for donor disbursement and evaluation purposes are consistent with the country's own reporting arrangements.
- Audited financial statements and other financial reports are subject to the country's access to information systems and procedures.

Full use of country reporting systems that meets all these elements would ensure that development assistance is fully integrated in the government's internal reporting. A supplemental version of using country system occurs when donor flows are reflected on government reports, even if donors require parallel reporting for their own fiduciary risk and strategic management purposes. In these cases, care should be taken that the modifications do not require high or recurrent transaction cost.

Ensuring that aid is "on report", ensuring that comprehensive, accurate, timely, and useful information on all aid flows is available at the country level for inclusion in government reports, is a default minimum use of country systems for all country-programmable aid flows. Meeting this minimum level of use of country systems can mitigate a significant degree of the harm done by parallel systems by (i) enabling better country ownership, alignment, donor harmonization, management for results, and mutual accountability, and (ii) contributing to improved macroeconomic management, policy coherence, efficiency of allocations, and transparency and accountability within partner countries.

Conclusion

While both multilateral and bilateral donors committed to the use of country systems – as a first option for aid programs in support of activities that are managed by the public sector – progress has been slow. These guidelines provides practical advice to donors on their own system requirements to use country systems, factors and tools to consider when making the decision to use country systems and options at country level for using country systems, based on donor and country experience in practice.

At a minimum, donors are encouraged to adjust their policies and invest in the adjustment of their systems and capacity so that quality information on their programs and projects can be reflected in country planning, budgeting and reporting documentation and integrated into processes. This alone will contribute not only to increased aid effectiveness, but also improved country-level fiscal and policy management, without incurring any risk on the part of donors.

Other key adjustments for donor systems to allow progress on the use of country systems are to develop specific policies and review all policies to ensure that they support the use of country systems for all assistance modalities. Particular actions should include providing more comprehensive guidance on different options for using country systems; appropriately delegating authority from headquarters; adapting management systems; and making good use of country-level coordination mechanisms for sharing information. Donors should also ensure that the necessary capacity in terms of skills and knowledge is available at the country level.

General and sector budget support modalities by definition use country systems in all respects. However, donors can and should use country systems for other aid modalities, too.

The use of country systems need not be an “all-or-nothing” approach. Every donor program or project can move beyond the minimum level of reflecting aid information “on plan,” “on budget,” and “on report,” to using more components of country systems to a higher degree (see Table 5). For all components of the PFM system, donors’ experience has shown that if full use of country institutions and procedures is not possible, donors can require some safeguards or additional features to satisfy their fiduciary risk or information needs. As long as these departures from standard country systems and procedures do not impose high continuous transaction costs on countries, such supplemental use of country systems represents significant progress over using completely parallel systems. The improved visibility of aid within country systems, combined with the additional encouragement to perform, will trigger sustained development benefits.

Table 5. Options for using country systems

USE OF COUNTRY SYSTEMS			
PROGRESS TO BE MADE	MINIMUM	SUPLEMENTAL	FULL
MODALITIES	All program- and project-based support	Some program- and project-based support	All GBS and SBS Some program- and project-based support
On plan, on budget	Reliable information on assistance—that is programmed through donor systems—is available in time to be considered in country planning and budgeting processes and reflected in country planning and budgeting documentation	Programming of assistance and the development of annual operational plans and budgets are driven by country institutions, even if donor formats are used or donor-orientated documentation is produced.	Assistance is programmed using country institutions' planning processes and budgets are prepared using country budget procedures.
On parliament		Information on aid programs and projects is submitted to parliaments.	Budgets for aid programs and projects are approved by country parliaments.
On treasury		Disbursements for aid programs are channelled through country treasury systems, but donor funds are kept in separate bank accounts	Disbursements for aid programs are channelled through the core treasury systems used to disburse the country's own funds.
On account		Donors use partner country accounting systems, but require derogations from country accounting policies and standards or additions to the chart of accounts	Aid program transactions are classified, recorded, and reported on in accordance with country accounting policies, standards, and chart of accounts
On procurement	Work undertaken by Task Force on Procurement Systems.		Personnel and goods and services for aid programs are procured using country policies, standards, institutions, and procedures.
On audit		Donors use country external audit institutions, but require programs to be audited specifically and/or modify TOR to adjust audit coverage and scope.	Donors are satisfied with partner country audit coverage, policies, and procedures and require no additional audits.
On report	Comprehensive and accurate information on actual use of aid in assistance programs is available in partner country formats, in time to be reflected in partner country reports.	Donors use partner country reporting systems, but require either additional reports or additional information in reports for their purposes.	Donors use standard financial and non-financial reports produced by partner countries for their own purposes.

ANNEXES

Annex 1. Survey scope and methodology

The survey was sent in May 2010 to 6 multilateral organizations and 37 bilateral organizations, in 24 countries. Part I of the survey was designed to obtain relevant information on the donor's overall approach to using PFM systems; and Part II was designed to collect information about specific examples of good practices, based on the donor's perspective and experiences, classified by type of partner country, aid modality, and PFM system.

Specifically, Part I of the survey contained a set of 44 questions to identify (1) what were the overall donor policies and approach to using country systems; (2) how compatible the donor's regulations were in reference to the use of country systems; (3) what the donor's preferences were regarding the use of PFM systems in its assistance programs; (4) what tools the donor used to assess the country PFM system; and (5) which PFM or institutional aspects the donor considered in determining the use of the country PFM systems. Additionally, relevant supporting materials and documents were requested.

Part II of the survey was designed to obtain (1) a representation of good practices from the donors' work in fragile states, low-income countries, and middle-income countries; (2) a representation of various donor assistance modalities (i.e., budget support, sector budget support, project support); and (3) a representation of the various subcomponents of the PFM systems used in such good practices (i.e., budget, treasury, accounting, financial reporting, and internal and external audit).

As of August 12, 2010, 17 donor answers were received. Six donors completed Part I, attached copies of their policies and guidance documents, and provided good practice cases (Part II). Six other donors provided answers only to Part I and attached copies of their policies and guidance documents on using country PFM systems. One donor provided answers to both Parts I and II. Four donors provided answers to Part I only.

For Survey II the examples were classified first on the basis of the countries' income, considering three types of countries: fragile states, low-income states (excluding fragile states), and middle-income states (excluding fragile states). Secondly, the practices were classified according to six financial management components: budget, treasury, accounting, financial reporting, internal audit, and external oversight. Finally, the aid modality in which the practices were implemented was taken into account: general budget support, sector budget support, and project support or program-based approach.

Donors were able to submit 199 examples, involving 46 countries from around the world. The following table shows the distribution of reported cases according to the type of country, the aid modality, and the type of donor. A list of programs and projects highlighted is provided by country group and country in Annex 3.

		Cases reported by Donors							
		# of cases				% of cases			
		Fragile States	Low Income States	Middle Income States	Total	Fragile States	Low Income States	Middle Income States	Total
Multilateral Donors	**GBS**	6	16	7	29	4%	11%	5%	21%
	SBS	4	7	25	36	3%	5%	18%	26%
	PS	0	4	71	75	0%	3%	51%	54%
Bilateral Donors	**GBS**	8	17	2	27	11%	24%	3%	38%
	SBS	2	31	1	34	3%	43%	1%	47%
	PS	3	6	2	11	4%	8%	3%	15%
All Donors	**GBS**	14	33	9	56	7%	16%	4%	26%
	SBS	6	38	26	70	3%	18%	12%	33%
	PS	3	10	73	86	1%	5%	34%	41%

A statistical analysis of the replies against the components of the PFM system and budget modalities is as follows:

		Number of comments about each FM issue/Assistance modality									
		Budget	Treasury	Accounting	Fin. Reports	Internal Audit	External Audit	All Issues / Modalities	Budget Sup.	Sec. Budget Sup.	Project Sup.
Fragile States	Afghanistan	5	4	1	0	0	2	12	4	6	2
	Georgia	1	1	0	1	0	1	4	4	0	0
	Liberia	1	0	0	0	0	0	1	0	0	1
	Palestine Area	1	0	0	0	0	0	1	1	0	0
	Sierra Leone	1	1	1	1	0	1	5	5	0	0
Low Income States	Bangladesh	1	1	1	1	0	1	5	0	5	0
	Burkina Faso	2	1	1	1	1	2	8	2	6	0
	Ethiopia	1	0	1	1	1	1	5	0	5	0
	Ghana	2	0	0	0	0	0	2	0	1	1
	Lao PDR	1	1	1	1	0	1	5	5	0	0
	Madagascar	1	0	0	1	0	0	2	2	0	0
	Mozambique	2	1	0	1	1	0	5	2	2	1
	Rwanda	6	6	6	5	5	6	34	16	12	6
	Senegal	1	1	1	1	0	0	4	0	4	0
	Tanzania	0	0	1	0	0	3	4	3	1	0
	Uganda	0	1	0	0	0	0	1	0	1	0
	Vietnam	2	1	0	1	0	1	5	3	0	2
	Zambia	1	0	0	0	0	0	1	0	1	0
Middle Income States	Argentina	1	0	1	1	0	0	3	0	0	3
	Albania	0	0	0	1	0	0	1	1	0	0
	Brazil	2	1	2	2	0	2	9	0	5	4
	Chile	0	0	0	0	0	1	1	0	0	1
	China	0	0	1	1	0	1	3	0	0	3
	Colombia	1	0	1	1	1	1	5	0	0	5
	Costa Rica	2	2	2	2	2	2	12	0	6	6
	Dominican Republic	0	0	1	0	0	0	1	0	0	1
	Ecuador	1	1	1	0	0	0	3	0	0	3
	El Salvador	1	1	1	1	1	1	6	0	0	6
	Guatemala	1	0	1	0	0	0	2	2	0	0
	Guyana	0	0	1	0	0	0	1	0	0	1
	India	1	1	1	1	0	1	5	0	5	0
	Indonesia	1	1	0	1	0	0	3	3	0	0
	Iraq	0	0	0	0	1	0	1	0	0	1
	Jordan	1	0	0	0	0	0	1	0	0	1
	Macedonia	0	1	0	0	0	0	1	0	0	1
	Mexico	1	1	1	1	1	1	6	0	0	6
	Moldova	1	0	0	0	0	0	1	0	0	1
	Morocco	1	1	1	0	1	0	4	0	4	0
	Nicaragua	1	1	0	0	0	0	2	2	0	0
	Pakistan	2	2	2	2	0	1	9	0	5	4
	Peru	1	1	1	1	1	1	6	0	0	6
	Philippines	1	0	1	0	0	1	3	1	0	2
	Poland	1	1	0	0	0	1	3	0	0	3
	Serbia	0	1	0	0	0	0	1	0	0	1
	South Africa	1	0	0	0	0	0	1	0	1	0
	Sri Lanka	1	1	1	0	1	1	5	0	0	5
	Tunisia	1	0	0	0	0	0	1	0	0	1
	Turkey	1	1	0	0	0	0	2	0	0	2
	Uruguay	1	1	1	1	1	1	6	0	0	6

Annex 2. Statistical Summary of Donors' Answers – Survey, Part 1

Donor/Development Partner		Bilateral YES	Bilateral NO	Bilateral N/A	Bilateral OTHER	Multilateral YES	Multilateral NO	Multilateral N/A	Multilateral OTHER
Policies and Procedures									
1) Overall donor policy and approach									
a) What is your policy with regard to the use of country PFM systems? (please attach any relevant document)	Answer?	11	1	0	0	5	0	0	0
	Do you have a specific policy on UCS?	7	1	0	1	4	0	0	1
	UCS by default / first option	3	0	0	0	0	0	0	0
	Based on an assessment	4	0	0	0	3	0	0	0
	UCS when convenient / feasible / appropriate	6	0	0	0	3	0	0	0
	Only budget support programs	0	0	0	0	1	0	0	0
	Gradual approach	1	0	0	0	1	0	0	0
	UCS to the extent possible	5	0	0	0	1	0	0	0
	Encourage use of non-FM systems	3	0	0	0	1	0	0	0
b) What do you see as the main constraints to an increased use of partner country PFM systems in your institution?	Answer?	12	0	0	0	4	1	0	0
	Donor lack of operational capacity / resources	2	0	0	0	0	0	0	0
	Donor lack of know how / lack of manuals or guidance	4	0	0	0	0	0	0	0
	Lack of country's operational capacity	3	0	0	0	3	0	0	0
	Lack country's PFM capacity	3	0	0	0	2	0	0	0
	Lack of political willingness of governments to engage important changes	0	0	0	0	2	0	0	0
	Critical view of Parliament	2	0	0	0	0	0	0	0
	Countries reputational & fiduciary risk	6	0	0	0	3	0	0	0
	Donor's regulations / procedures	2	0	0	0	2	0	0	0
	Use of PBA	1	0	0	0	0	0	0	0
	Country's preference for non UCS /using parallel systems	2	0	0	0	1	0	0	0
	Context not adequate for UCS	1	0	0	0	0	0	0	0
c) What do you see as the main opportunities for progress?	Answer?	12	0	0	0	4	1	0	0
	Strengthen its own weaknesses	5	0	0	0	2	0	0	0
	Use PBA	2	0	0	0	0	0	0	0
	Improve the Donors coordination / multi-donor programs	4	0	0	0	2	0	0	0
	Foster political commitment Paris & AAA	1	0	0	0	0	0	0	0
	Increased awareness on Aid effectiveness & UCS	1	0	0	0	0	0	0	0
	Improve dialogue with governments	0	0	0	0	1	0	0	0
	Increasing partners ownership	2	0	0	0	1	0	0	0
	Increasing partners PFM capacity / better public services delivery	3	0	0	0	4	0	0	0
	Evidencing benefits of UCS	2	0	0	0	0	0	0	0
	Stimulate sustainable economic growth	1	0	0	0	0	0	0	0
	Improve countries SAI capacity	1	0	0	0	1	0	0	0
	Extended / flexible approach on aid modalities	2	0	0	0	2	0	0	0
d) Which measures have you taken to increase use of country PFM systems? i) Staff training	Answer?	9	1	0	2	4	1	0	0
	Training for HQ staff	7	0	0	0	4	0	0	0
	Training for field staff	7	0	0	0	4	0	0	0
	Training for Gov. officers	1	0	0	0	4	0	0	0
	Training on UCS	3	0	0	0	3	0	0	0
	Training on PFM	7	0	0	0	4	0	0	0
	Training in PBA &/or SBS &/or GBS	4	0	0	0	3	0	0	0
	Training on aid effectiveness agenda	4	0	0	0	0	0	0	0
	Permanent training system	2	0	0	0	3	0	0	0

Donor/Development Partner		YES	NO	N/A	OTHER	YES	NO	N/A	OTHER
		Bilateral				Multilateral			
ii) Developing guidance or manuals	Answer?	12	0	0	0	4	1	0	0
	Own guide o manual on UCS exist?	7	1	0	2	3	1	0	0
	Docs in UCS?	6	0	0	2	2	0	0	0
	Docs in BS, GNS, SBS, PBA?	6	0	0	1	4	0	0	0
	Docs in PFM?	5	0	0	1	4	0	0	0
	Docs in program / risk management?	6	0	0	1	3	0	0	0
	Docs Paris & AAA declarations?	1	0	0	0	2	0	0	0
iii) Specifying a preferred aid modality (If yes which modality, how is this policy applied in practice, is there a requirement for justification to be provided if this modality is not used)	Answer?	11	1	0	0	4	1	0	0
	There is preference?	4	6	0	0	1	3	0	0
	Project Support	6	0	0	0	3	0	0	0
	Programme Based Approach	6	0	0	0	3	0	0	0
	Sector Budget Support	6	0	0	0	4	0	0	0
	General Budget Support	5	0	0	0	4	0	0	0
	Technical Assistance	2	0	0	0	3	0	0	0
	Most suitable mix	7	0	0	0	0	0	0	0
	According to country context / when convenient	6	0	0	0	3	0	0	0
	Other / none of the mentioned / Grants	3	0	0	0	0	0	0	0
	Pool funding & common sector support	1	0	0	0	0	0	0	0
	By default/first option	2	0	0	0	0	0	0	0
iv) Efforts to overcome legal constraints (please specify which ones and how)	Answer?	9	2	0	1	3	1	0	1
	Any recent effort was made?	1	6	2	0	1	0	1	0
	Have/had any kind of legal constrains?	1	0	0	0	0	0	0	0
	Have special study about the issue?	1	0	0	0	2	0	0	0
	Donor documents/procedures were/are upgraded by this reason?	2	0	0	0	2	0	0	0
	Problem is solved now?	2	0	0	0	2	0	0	0
v) Policy change (please specify)	Answer?	10	1	1	0	3	1	0	1
	Policy change was necessary recently?	5	5	0	0	2	1	0	0
	Policy evolved to an effective agenda?	4	0	0	2	3	0	0	0
vi) Staff incentives (please specify)	Answer?	11	1	0	0	4	1	0	0
	Any staff incentive is in place?	3	5	3	0	3	1	0	0
	Monetary?	0	0	0	0	1	0	0	0
	Non monetary awards?	0	0	0	0	1	0	0	0
	Training?	1	0	0	0	2	0	0	0
	Simplifying operations / harmonization?	2	0	0	0	1	0	0	0
e) When is the decision taken to use partner country PFM systems in your programming cycle, what factors is this decision based on, and who has responsibility for this decision (HQ, field, joint, partner government, etc)? i) Country Programming stage	Answer?	11	1	0	0	3	2	0	0
	Donor (political authorities)	5	0	0	0	0	0	0	0
	Donor (headquarters staff)	4	0	0	0	3	0	0	0
	Donor (field staff) / Appraisal mission	3	0	0	0	3	0	0	0
	Based on analysis / pre-requisites / other donor criteria	3	0	0	0	3	0	0	0
	Based on mid-term strategy	4	0	0	0	3	0	0	0
	Based on negotiations with government	2	0	0	0	0	0	0	0
	Country context	8	0	0	0	3	0	0	0
	Taking into account fiduciary risk	9	0	0	0	2	0	0	0
	Taking into account non-FM issues	6	0	0	0	0	0	0	0
	Decision case-by-case basis	10	0	0	0	3	0	0	0
ii) Project/program development	Answer?	12	0	0	0	2	3	0	0
	Donor (political authorities)	1	0	0	0	0	0	0	0
	Donor (headquarters staff)	6	0	0	0	1	0	0	0
	Donor (field staff) / Appraisal mission	8	0	0	0	2	0	0	0
	Based on analysis / pre-requisites / other donor criteria	1	0	0	0	1	0	0	0

Donor/Development Partner		YES	NO	N/A	OTHER	YES	NO	N/A	OTHER
		Bilateral				Multilateral			
	Based on mid-term strategy	4	0	0	0	2	0	0	0
	Based on negotiations with government	1	0	0	0	0	0	0	0
	Country context	6	0	0	0	1	0	0	0
	Taking into account fiduciary risk	5	0	0	0	1	0	0	0
	Taking into account non-FM issues	1	0	0	0	0	0	0	0
	Decision case-by-case basis	11	0	0	0	2	0	0	0
f) When making the choice to use partner country PFM systems (or any of their components), do you balance risks and benefits? How do you assess potential benefits? How do you monitor them?	Answer?	10	1	1	0	3	1	0	1
	Do you assess potential benefits?	6	1	0	0	2	1	0	0
	Do you assess risks?	8	0	0	0	2	0	0	0
	Do you balance risk and benefits?	3	2	0	0	0	0	0	0
	Do you monitor program benefits?	7	1	0	0	2	0	0	0
g) What key messages would be useful to convey to key stakeholders in your organization (SAI, Parliament/Board, Civil society) to facilitate the use of partner country PFM systems in your institution?	Answer?	8	1	0	3	2	1	1	1
	Linkages between UCS and development results	4	0	0	0	0	0	0	0
	Importance of risk analysis / balancing risk with benefits	2	0	0	0	0	0	0	0
	Importance of strengthening partners accountability through UCS	3	0	0	0	0	0	0	0
	Political willingness and acceptance of larger risk is crucial to go further	1	0	0	0	0	0	0	0
	Reduction of transaction costs.	0	0	0	0	1	0	0	0
	Simplifying procedures and increasing ownership by UCS	0	0	0	0	1	0	0	0
	Development assistance is intended to help develop local capacity	1	0	0	0	0	0	0	0
	Donors' funding is a small part of developing country expenditure	1	0	0	0	0	0	0	0
	To demonstrate that results are being achieved	0	0	0	0	1	0	0	0
	Robust due diligence processes must be undertaken prior to providing support through UCS	1	0	0	0	0	0	0	0
	UCS allows to partners parliament oversight the use of donor funds	1	0	0	0	0	0	0	0
2) Donor regulations allow:									
a) To give the control of the program execution to the responsible Government entity.	Answer?	12	0	0	0	5	0	0	0
	Delegate control for financial issues?	11	0	0	0	5	0	0	0
	Delegate control for non-financial issues?	10	1	0	0	5	0	0	0
	Complete control to the government	10	1	0	0	3	0	0	0
	Shared by government and donor	2	0	0	0	0	0	0	0
	To the Project Implementation Unit	0	0	0	0	1	0	0	0
	Only for budget support or when UCS	0	0	0	0	1	0	0	0
b) To use the country systems/procedures for: i) Budgeting	Answer?	11	1	0	0	5	0	0	0
	Allowed?	11	0	0	0	5	0	0	0
	Restrictions or conditions?	0	11	0	0	0	5	0	0
ii) Treasury & banking	Answer?	11	1	0	0	5	0	0	0
	Allowed?	11	0	0	0	5	0	0	0
	Restrictions or conditions?	1	10	0	0	0	5	0	0
iii) Accounting	Answer?	11	1	0	0	5	0	0	0
	Allowed?	11	0	0	0	5	0	0	0
	Restrictions or conditions?	1	10	0	0	0	5	0	0
iv) Financial reporting	Answer?	11	1	0	0	5	0	0	0
	Allowed?	11	0	0	0	5	0	0	0
	Restrictions or conditions?	0	11	0	0	0	5	0	0
v) Internal auditing	Answer?	11	1	0	0	5	0	0	0
	Allowed?	11	0	0	0	5	0	0	0
	Restrictions or conditions?	1	10	0	0	0	5	0	0
vi) External auditing	Answer?	11	1	0	0	5	0	0	0

Donor/Development Partner		YES	NO	N/A	OTHER	YES	NO	N/A	OTHER
		Bilateral				Multilateral			
	Allowed?	11	0	0	0	5	0	0	0
	Restrictions or conditions?	1	10	0	0	1	4	0	0
3) Donor preferred procedures are:									
a) Providing goods and services directly, or through outsourced firms or NGOs, rather than transferring funds to government accounts.	Answer?	12	0	0	0	3	2	0	0
	Provide good & services directly?	4	3	1	0	0	2	0	0
	Is this the only preferred procedure	0	8	0	0	0	1	0	0
b) Providing all the funds to the government: i) Funds are disbursed to a program-specific account to be managed with donor procedures.	Answer?	12	0	0	0	4	1	0	0
	Provide funds as stated is acceptable?	4	3	1	0	2	1	0	0
	Is this the only preferred procedure	0	8	0	0	0	3	0	0
ii) Funds are disbursed to a program-specific account to be managed with country procedures.	Answer?	12	0	0	0	4	1	0	0
	Provide funds as stated is acceptable?	6	1	1	0	3	0	0	0
	Is this the only preferred procedure	0	8	0	0	0	3	0	0
iii) Funds are provided to the Treasury and the government has control and decision over the use of the funds.	Answer?	12	0	0	0	4	1	0	0
	Give full control over the funds to the Treasury?	6	2	1	0	3	1	0	0
	Is this the only preferred procedure	1	9	0	0	0	4	0	0
c) Providing part of the assistance in goods and services and part in funds, applying any of the above mentioned methods.	Answer?	12	0	0	0	4	1	0	0
	Provide funds & goods as stated is acceptable?	7	2	0	0	0	2	0	0
	Is this the only preferred procedure	1	7	0	0	0	2	0	0
Use of analytical tools in determining the use of country PFM systems									
4) Country PFM diagnostic tools									
a) What PFM Diagnostics or other analytical tools do you use to make decisions on whether to use country systems (or not)? (Please specify or attach if it is an instrument prepared specifically for your organization).	Answer?	11	1	0	0	5	0	0	0
	PEFA, CPAR, CFAA, CFA, etc.	5	0	0	0	1	0	0	0
	PEFA, CPAR, CFAA, etc. plus own tools	7	0	0	0	2	0	0	0
	Just own PFM assessment tools	1	0	0	0	1	0	0	0
	PEFA when strengthening reform is in place	1	0	0	0	1	0	0	0
b) What other support tools, internal guidance or manuals have you developed? (please specify, and attach)	Answer?	9	3	0	0	4	1	0	0
	Have other own developed tools and manuals?	3	1	0	0	4	0	0	0
	Tools & Manuals are being developed/updated?	5	0	0	0	0	0	0	0
c) Are there any gaps or deficiencies in existing PFM Diagnostics which need to be addressed in order to improve decisions regarding the use of country systems?	Answer?	10	2	0	0	5	0	0	0
	Not to be aware	3	0	0	0	1	0	0	0
	Extend PEFA use to sub-national and sectors	2	0	0	0	2	0	0	0
	Improve PEFA showing why deficiencies exist, recommendations and action plans	3	0	0	0	0	0	0	0
	Fine tuning PEFA	0	0	0	0	1	0	0	0
	Assess the country capacity to produce sufficient revenues to sustain its growing	1	0	0	0	0	0	0	0
	Donor procedures require other specific assessments	3	0	0	0	3	0	0	0
PFM aspects considered by the Donor in determining the use of country PFM systems									
5) Legal and regulatory framework, and operational practices for:									
a) Budgeting i) Budget classification	Answer?	10	2	0	0	4	1	0	0
	Do you asses this issue when UCS?	10	0	0	0	4	0	0	0
	Use PEFA as assessment?	4	0	0	0	0	0	0	0
ii) Budget formulation	Answer?	9	3	0	0	4	1	0	0
	Do you asses this issue when UCS?	9	0	0	0	4	0	0	0
	Use PEFA as assessment?	3	0	0	0	0	0	0	0
iii) Budget execution	Answer?	10	2	0	0	4	1	0	0
	Do you asses this issue when UCS?	10	0	0	0	4	0	0	0
	For BS and baskets only	1	0	0	0	0	0	0	0
	Use PEFA as assessment?	4	0	0	0	0	0	0	0
a) Treasury operations i) Use of local and foreign currencies	Answer?	9	3	0	0	5	0	0	0
	Do you asses this issue when UCS?	6	3	0	0	4	1	0	0
ii) Cash programming	Answer?	9	3	0	0	4	1	0	0

Donor/Development Partner		YES	NO	N/A	OTHER	YES	NO	N/A	OTHER
		Bilateral				Multilateral			
	Do you asses this issue when UCS?	8	1	0	0	4	0	0	0
	Use PEFA as assessment?	4	0	0	0	0	0	0	0
iii) Payments	Answer?	9	3	0	0	4	1	0	0
	Do you asses this issue when UCS?	8	1	0	0	4	0	0	0
	Use PEFA as assessment?	4	0	0	0	0	0	0	0
a) Accounting and financial reporting i) Recording policies and procedures	Answer?	10	2	0	0	4	1	0	0
	Do you asses this issue when UCS?	9	1	0	0	4	0	0	0
	Use PEFA as assessment?	4	0	0	0	0	0	0	0
ii) Financial reports and statements	Answer?	11	1	0	0	4	1	0	0
	Do you asses this issue when UCS?	10	0	0	0	4	0	0	0
	For BS and baskets only	1	0	0	0	0	0	0	0
	Use PEFA as assessment?	4	0	0	0	0	0	0	0
a) Internal control procedures i) Scope and quality of institutional internal controls	Answer?	10	2	0	0	4	1	0	0
	Do you asses this issue when UCS?	9	0	0	0	4	0	0	0
	For BS and baskets only	1	0	0	0	0	0	0	0
	Use PEFA as assessment?	4	0	0	0	0	0	0	0
ii) Internal audit	Answer?	10	2	0	0	4	1	0	0
	Do you asses this issue when UCS?	9	0	0	0	4	0	0	0
	For BS and baskets only	1	0	0	0	0	0	0	0
	Use PEFA as assessment?	4	0	0	0	0	0	0	0
a) External oversight i) Audit scope and reports	Answer?	10	2	0	0	4	1	0	0
	Do you asses this issue when UCS?	9	0	0	0	4	0	0	0
	For BS and baskets only	1	0	0	0	0	0	0	0
	TOR must be approved by Donor	0	0	0	0	1	0	0	0
	Use PEFA as assessment?	4	0	0	0	0	0	0	0
ii) Legislative oversight	Answer?	10	2	0	0	4	1	0	0
	Do you asses this issue when UCS?	9	0	0	0	3	0	0	0
	For BS and baskets only	1	0	0	0	1	0	0	0
	Use PEFA as assessment?	4	0	0	0	0	0	0	0
a) Financial management information systems i) Functionality, integration and coverage of the system	Answer?	10	2	0	0	5	0	0	0
	Do you asses this issue when UCS?	8	1	0	0	4	1	0	0
	For BS and baskets only	1	0	0	0	0	0	0	0
	Use PEFA as assessment?	3	0	0	0	0	0	0	0
6) Other considerations									
a) Sector-specific FM arrangements	Answer?	8	3	1	0	4	1	0	0
	Always	1	0	0	0	4	0	0	0
	When appropriate	2	0	0	0	0	0	0	0
	When deciding UCS in BS	3	0	0	0	0	0	0	0
	Case by case	2	0	0	0	0	0	0	0
	Depending the scope of the program	1	0	0	0	0	0	0	0
b) Entity-specific FM arrangements	Answer?	7	4	1	0	4	1	0	0
	Always	2	0	0	0	4	0	0	0
	When appropriate	2	0	0	0	0	0	0	0
	For funding the entity	1	0	0	0	0	0	0	0
	When deciding UCS in BS	1	0	0	0	0	0	0	0
	Depending the scope of the program	1	0	0	0	0	0	0	0
c) Sub-national-specific FM arrangements	Answer?	9	2	1	0	4	1	0	0
	Always	2	0	0	0	4	0	0	0
	When appropriate	2	0	0	0	0	0	0	0
	For funding the entity	2	0	0	0	0	0	0	0
	When deciding UCS in BS	1	0	0	0	0	0	0	0
	Depending the scope of the program	2	0	0	0	0	0	0	0

Annex 3. Good Practice Examples of Donor-financed Programs – Survey, Part 2

	Country	General Budget Support (GBS)	Sector Budget Support (SBS)	Project Support (PS)
Fragile States	**Afghanistan**	WB - PSIB; CIDA – Reconstruction Trust Fund (ARTF)	WB - Reconstruction Trust Fund (ARTF) CIDA – Reconstruction Trust Fund (ARTF)	CIDA – Reconstruction Trust Fund (ARTF)
	Georgia	WB - PRSO		
	Liberia	Irish DFA - Health Pooled Fund		
	Palestine Area	Greece - Greek contribution to PAA'S Rule of Law and Security		
	Sierra Leone	DFID – Poverty Reduction budget support		
Low Income States	**Bangladesh**		WB - Health Nutrition & Population Sector Program	
	Burkina Faso	WB - PRSC DANIDA - PFM		
	Ethiopia		DFID – Protection of Basic Services	
	Ghana		WB – Scaling up UCS	WB – Scaling up UCS
	Lao PDR	WB - PRSO		
	Madagascar	1. WB - PRSC		
	Mozambique	Irish DFA - budget support	Irish DFA – Health Program WB – Scaling up UCS	WB – Scaling up UCS
	Senegal	2.	3. CIDA - Budget Support Initiative for the Education Sector (IAPDE)	
	Rwanda	4. WB – PRSG 5. KfW – Macroeconomic Progr. Supp. 6. DFID - GBS	7. KfW – Accompanying Macroeconomic Programme Support 8. DFID - SBS (Education and & Health)	KfW - Common Development Fund
	Tanzania	Irish DFA – budget support CIDA - Education and Health Basket	CIDA - Education and Health Basket	
	Uganda		Irish DFA – Education program	
	Vietnam	9. WB - PRSC		10. WB - Rural Transport 3 project
	Zambia		Irish DFA – budget support	
Middle Income States	**Albania**	Greece - Empowering the local communities of Foiniki and Messopotamos through agricultural extension		11.
	Argentina			12. WB - Santa Fe Road Infrastructure Project
	Brazil		IDB – ProFisco WB - Improving Quality & Efficiency of public Mgmt &	

Country		General Budget Support (GBS)	Sector Budget Support (SBS)	Project Support (PS)
			Education Basic Services, Pernambuco SWAp WB - Ceará SWAP 2 WB - Minas Gerais Partnership for Develop II WB - Road Transport Project (SWAP)	
	Chile			13. Greek contribution to the government of Chile: Relief from the humanitarian crisis caused by the massive earthquake in Central Chile
	China			14. WB - Hubei Shiman Expressway Construction project 15. WB - Guangxi Integrated Forestry Development & Conservation proj 16. WB - Liuzhou Environment Management project 17. WB - Technical Vocational Education project
	Colombia			WB - Consolidation of National Public Management Informat. Sys. WB - Support for the 2nd Phase of the Expansion of the Programme of Conditional Transfers-Familias en Accion Project WB - Justice Services Strengthening WB - CO Sustainable Development Inv Project WB - Strengthening Public Information, Monitoring, Evaluation for Results Management WB - Agricultural Transition WB - Rural Education Project (APL Phase II)
	Dominican Republic			WB - DO Social Sectors Investment Program
	Ecuador			IDB - Coastal Resource Management Project – Stage II IDB - Early Warning and Natural Risk Management IDB - First Road Infrastructure and Maintenance Program
	El Salvador			18. IDB - Housing Program
	Guatemala	WB - DPL		
	Guyana			IDB - Second Low Income Settlement Program
	India		WB - Elementary Education (SSA II) WB - Reproductive & Child Health Phase 2	

Country		General Budget Support (GBS)	Sector Budget Support (SBS)	Project Support (PS)
	Indonesia	WB - DPL		
	Iraq			Greece - Grant to the Iraqi Ministry of Planning and Development Cooperation for the financing of five laboratories of the Central Standardisation Organization
	Jordan			WB - Regional and Local Development WB - Amman Development Corridor WB - Social Protection Enhancement WB - Educat Reform for Knowledge Economy II
	Macedonia			WB - Regional & local roads program support WB - Agriculture strengthening and accession WB - Second trade and transport facilitation WB - Railways reform
	Mexico			WB - Information Technology Industry Development (PROSOFT) WB - Environmental Services Project WB - MX Tertiary Education Student Assistance WB - Support to Oportunidades Project
	Moldova			WB - Health Services & Social Assistance Project
	Morocco		WB - Rural Roads WB - Rural Roads II	
	Nicaragua	WB - PRSC		
	Pakistan		WB - Punjab Education Sector Project WB - Sindh education sector project	
	Peru			19. IDB - Decentralized Rural Transport & Departmental Road Program
	Philippines	Greece - Greek contribution to the government of Philippines: Relief from the humanitarian crisis by the typhoon "Ketsana"		WB - Kalahi-CIDS WB - Social Welfare and Development Reform WB - ARMM Social Funds
	Poland			WB - Odra river basin flood protection WB - Post-accession rural support project
	South Africa		Irish DFA – Limpopo Education	
	Sri Lanka			WB - Provincial roads WB - Emergency northern recovery project WB - 2nd community develop. & livelihood improvement WB - Dam safety and water resources planning WB - Road sector assistance project WB - Education sector development project WB - North east housing reconstruction program WB - Community livelihoods in conflict affected areas WB - Health sector development WB - Renewable energy for rural economic

Country		General Budget Support (GBS)	Sector Budget Support (SBS)	Project Support (PS)
				development
	Tunisia			WB - ICT Sector Development WB - Education PAQSET 2 WB - Urban Water Supply WB - Tunis West Sewerage WB - Water Sector Investment II; WB - Energy Efficiency and Renewable Investment WB - Export Development II WB - NW mountainous and Forest Areas Development
	Turkey			WB - Health transformation and social security reform WB - Private sector renewable energy and energy efficiency WB - Fourth export finance intermediation loan WB - Turkey land registration and cadastre modernization WB - Electricity distribution rehabilitation project WB - Access to finance for SMES WB - Avian influenza & human pandemic preparedness & response WB - Energy community of south east Europe WB - Municipal services project WB - Seismic risk mitigation project WB - Energy community of south east Europe WB - Anatolia watershed rehabilitation project
	Uruguay			20. IDB - Apoyo a la Productividad de Nuevos Productos Ganaderos

Annex 4. Bibliography

Asian Development Bank. (2010). *Progress on Aid Effectiveness: 2010 Update.*

Austrian Development Cooperation. *2010 Unternrhmenskonzept.*

Austrian Development Cooperation. (2010). *Accra Agenda for Action Austrian Action and Implementation Plan 2009–2011.*

Austrian Development Cooperation. (2009). *Budget Support - Strategy.*

CABRI, 2009: *Putting Aid on Budget: Good Practice Note*

CABRI, 2009: Putting Aid on Budget: Synthesis Report

CABRI, 2009: Improving aid on budget in Rwanda, Briefing Paper 2009/1

CABRI, 2011: Improving aid transparency (forthcoming)

Canadian International Development Agency. *Aid Effectiveness Action Plan 2009-2012.*

Canadian International Development Agency. (2010). *CIDA's Operational Guide to Program-based Approaches - Vers. 2.0.*

Canadian International Development Agency. *Fiduciary Risk Evaluation Tool.*

Canadian International Development Agency. (2010). *Investment Risk Register.*

Canadian International Development Agency. (2007). *Policy on Fiduciary Risk Assessment.*

Canadian International Development Agency. (2009). *Policy on PBA.*

Canadian International Development Agency. (2002). *Policy Statement On Strengthening Aid Effectiveness.*

Denmark, Ministry of Foreign Affairs. (2009). *General Budget Support- Programme Preparation.*

Denmark, Ministry of Foreign Affairs. (2009). *Guidelines For The Provision Of General Budget Support.*

Denmark, Ministry of Foreign Affairs. (2011) Aid Management Guidelines Glossary, http://amg.um.dk/en/servicemenu/Glossary/Glossary.htm, accessed May 2011.

Finland, Ministry of Foreign Affairs. (2004). *Guidelines - Budget Support Cooperation.*

Finland, Ministry of Foreign Affairs. (2010). *Policy Paper - General Budget Support and Sector Budget Support in Finland's Programme-based Development Cooperation.*

Germany, KfW. (2010). *Structured Analysis Of Fiduciary Risk In Budget Support.*

Inter-American Development Bank. *Financial Management Operational Guidelines for IDB Financed Projects.*

Inter-American Development Bank. *Financial Management Policy for IDB Financed Projects.*

Knack and Eubank, 2009: *Aid and trust in country systems*, World Bank Policy research working paper 5005

Netherlands, Ministry of Foreign Affairs. *Extra Efforts for Better Aid - Netherlands Action Plan Paris/Accra.*

Netherlands, Ministry of Foreign Affairs. *Track Record User Guide.*

NZAid. (2008) *Guideline on Aid Modalities*

OECD/DAC Guidelines and Reference Series. *Harmonising Donor Practices for Effective Aid Delivery.*

OECD/DAC Guidelines and Reference Series. *Harmonising Donor Practices for Effective Aid Delivery, Vol.2: Budget Support, Sector Wide Approaches and Capacity Development in PFM.*

OECD-DAC, Policy Brief 1: Benefits of Using Country Systems, 2011

PEFA Secretariat. (June 2005). *PEFA - PFM Performance Measurement Framework.*

Swedish International Development Cooperation Agency (SIDA). (2009). *Action Plan on Aid Effectiveness 2009-2011.*

Swedish International Development Cooperation Agency (SIDA). (2008). *Guidance on Programme-based Approaches.*

Swedish International Development Cooperation Agency (SIDA). (2008). *How to Start Working with a Programme-Based Approach.*

Swedish International Development Cooperation Agency (SIDA). (2007). *Public Finance Management in Development Cooperation - Handbook.*

The World Bank. (2009). *Interim Guidance Note - Asessment Fiduciary Risks In Using Country FM Systems.*