WHAT ARE THE BENEFITS OF USING COUNTRY SYSTEMS?

Policy Brief 2

Benefits of using country PFM systems

Policy brief 2: Oversight institutions

The aid effectiveness commitments agreed upon in Rome, Paris and Accra call for an increase in the use of partner country systems, in particular the national budget and Public Financial Management (PFM) systems.

Recent assessments show that less than half of aid to governments currently uses partner country PFM systems,[1] and that progress has been slow over the past few years.

This briefing is aimed at donor and partner country oversight institutions, in particular Parliaments and Supreme Audit Institutions (SAIs). It provides a general explanation of what using country systems means and why it is important, considers the specific perspective of oversight institutions, and highlights the benefits of using country systems and relevant good practices.

Why should the use of recipient country PFM systems concern Parliaments and Supreme Audit Institutions?

By using country systems, aid can provide incentives and momentum to strengthen their capacity and performance, enhance domestic accountability mechanisms, and contribute to better public financial management. It thereby helps improve effectiveness of all public expenditure, not just what aid finances.

Oversight institutions in donor countries are strong promoters of more efficient and effective aid. Donor agencies are accountable to them for their risk management strategies and for the results achieved. The perspectives of parliaments and audit authorities strongly influence and sometimes constrain the degree to which each donor chooses to use partner country systems.

Oversight institutions in recipient countries are major beneficiaries from an increased use of country PFM systems by donors, and major players in securing increased use of country systems.

Table 1 provides further details on how specific oversight institutions' concerns may affect or be affected by the use of partner country PFM systems by donors.

1. The Paris Declaration surveys (2006 and 2008) provide the most comprehensive and only quantified cross-country and cross-donor measurement on the use of country systems (indicator 5a – budget execution, auditing and financial reporting, and indicator 5b – procurement). They indicate a slight increase between 2005 and 2007, from 39% to 45% of ODA to the government sector using recipient country PFM systems. The use of procurement systems has increased from 40% to 43%. These figures nevertheless hide significant disparities between countries and donors.

Table 1. Oversight institutions' concerns which may affect the use of recipient country PFM system

	Parliament	Supreme Audit Institution
Donor country	– Requirement to control allocations of aid (per country, per sector) and vote annual appropriations may lead to misalignment with recipient country fiscal year and lack of predictability in aid. – Focus on minimising fiduciary risk (risk of mismanagement of funds etc) and reputational risk may limit donor agency willingness to use partner country PFM systems. – Requirement for reporting on results achieved with donor funds may lead to a reluctance to use certain aid modalities where donor funds are mingled with those of recipient countries.	– Requirement to control allocations of aid (per country, per sector) and vote annual appropriations may lead to misalignment with recipient country fiscal year and lack of predictability in aid. – Focus on minimising fiduciary risk (risk of mismanagement of funds etc) and reputational risk may limit donor agency willingness to use partner country PFM systems. – Requirement for reporting on results achieved with donor funds may lead to a reluctance to use certain aid modalities where donor funds are mingled with those of recipient countries.
Recipient country	– Requirement to respect legal obligations in terms of coverage of the national budget and public accounts. – Willingness to improve allocation of national resources taking into account flows of external assistance. – Willingness to hold Government to account in terms of results and value for money for all funds included in national budget law.	– Focus on fiduciary risk, issues of corruption and mismanagement of funds for all funds included in the national budget. – Focus on value for money. – Requirement to respect legal obligations in terms of budgeting, expenditure and accounting processes for all expenditure included in the budget.

Using country PFM systems: what does it mean in practice?

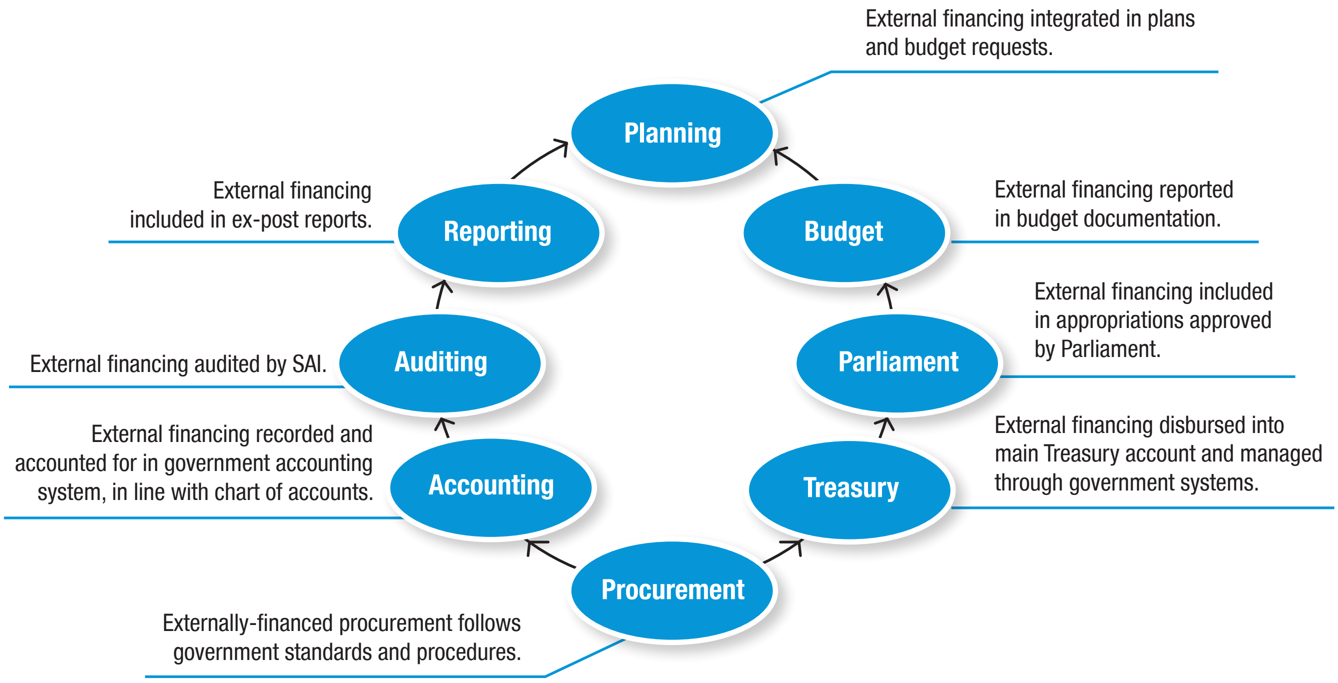
In order for aid to "use country systems", it has to pass through some or all of the components in existing mainstream national systems, respect the same laws, rules, procedures and formats and be managed by the same institutions.

What are the different components of the PFM system that aid can "use"?

Aid can be integrated with different phases of the national budget process: planning, budget preparation, approval by Parliament, budget execution through Treasury and procurement, accounting, auditing and reporting. Aid can therefore be on plan, or on budget, or on various components simultaneously (see Figure 1).

The use by donors of each specific component of PFM systems carries specific expected benefits, as well as risks and transaction costs. For example, ensuring that aid is adequately reflected on plan, on budget or on report carries minimal risks for donors but may bring about significant benefits in terms of transparency, allocative efficiency, ownership and accountability, thereby enhancing the role of recipient country oversight institutions.

Figure 1. **Using partner country PFM systems at different stages of the budget cycle**



Source: Derived from Mokoro (2008).

Are country systems relevant for all aid modalities?

Budget support, by definition, uses country systems. But it is a mistake to assume that the use of country systems necessarily implies a shift to budget support. On the contrary, progress can and should be made for every aid modality while recognising the different challenges they represent. Projects, HIPC funds, and pooled funds may all use country systems at different stages in the budget process, but do not systematically do so. Similarly, Programme Based Approaches (PBAs) and Sector Wide Approaches (SWAps) may be implemented through a range of aid modalities and do not systematically imply the use of country systems, although it is one of their objectives in the medium term. Box 1 provides an example of a donor's efforts to move to using partner country procurement systems with project aid.

BOX 1: USING PARTNER PROCUREMENT SYSTEMS THROUGH PROJECT AID

In the framework of the German-Moroccan Co-operation, the national water authority (ONEP-Office National de l'Eau Potable) revised their procurement guidelines for supply and service contracts with the assistance of KfW. The revisions of these guidelines were accomplished in 2008 and contain general principles of fairness, transparency, non-discrimination and cost-effectiveness in procurement. For the implementation of its investment projects since 2008, KfW accepts these guidelines and only monitors the process, which significantly reduces transaction costs.

Source: German Co-operation.

Towards a balanced assessment of risks and benefits

What benefits can be expected from the use of country PFM systems?

Governments have a crucial role in providing services for poverty reduction and economic development. Effective services require good public financial management in developed and developing countries alike.

Where government systems are weak, donors have tended not to use them but to set up parallel systems. This creates duplication and increases transaction costs, hampers alignment with country priorities and ownership, and constrains efforts to strengthen national capacity. For example, bypassing the national SAI directly undermines its credibility of and confidence in it, and weakens it further.

Conversely, by using recipient country PFM systems, aid can provide incentives and momentum to strengthen domestic capacity and systems, contribute to better public financial management, and enhance domestic accountability processes:

– **Strengthening domestic capacity and systems.** Ensuring that aid is adequately integrated with the recipient country's budget preparation, execution, accounting, auditing and reporting processes can shift the focus both of donors and of recipient governments towards strengthening the recipient country's own systems as opposed to developing parallel ones. This is expected to reduce the transaction costs involved in managing aid for partner countries, and to lead to more sustainable improvements in the long term. Box 2 below illustrates how the use of recipient country PFM systems has contributed to strengthening national audit capacity in Uganda and Mozambique, by stimulating demand and increasing the focus on national systems. It is important to ensure that the SAI is notified when audits are taking place and if possible manage the process (including private auditing firms) whilst taking care not to overburden the SAI.

BOX 2: SUPPORTING THE CAPACITY OF SAIS

Support to the capacity of audit bodies is likely to be a long term requirement... Direct support can be complemented by efforts to strengthen the demand for audit services. For example in Uganda, in the context of the move towards budget support, the Auditor General has benefited from significant institutional support in recent years, and also the timely preparation of audits has been a key focus of budget support conditionality. This has helped underpin improvements in quality and timeliness of audit reports. Similar developments are taking place in Mozambique where, with the growth of budget support to the government, several donors have started supporting the Administrative Tribunal (the body responsible for external auditing) with various capacity building initiatives which have improved the scope and quality of its audit exercises on the budget, including its externally funded components.

Source: Mokoro (2008), p. 56.

– **Contributing to better PFM.** Aid that uses recipient country systems can also contribute to establishing widely accepted good PFM practices, especially transparency and comprehensiveness. It can also lead to more efficient allocation of domestic resources. This is expected to make recipient countries' public financial management as a whole more efficient, including both domestic and external funding.

A recent IMF study underlines the crucial importance of budget transparency in contributing to improved budget processes and outcomes: "the fact that a more transparent and comprehensive budget seems to matter more [to promote fiscal discipline] than rules and top-down procedures may indicate that, for low-income countries, budget procedures that facilitate external monitoring are more credible mechanisms for ensuring proper fiscal responses than procedures that facilitate government self-monitoring." (IMF, 2010, p.27)

Box 3 below provides an illustration of the ability of the recipient government to better balance recurrent and investment expenditure thanks to a shift by donors from project to budget support modality.

BOX 3: BALANCING RECURRENT AND INVESTMENT EXPENDITURE IN RWANDA

The donor shift from projects to the sector budget support aid modality has helped rebalance the recurrent/investment composition of the education budget. In particular, it has allowed consideration of the recurrent implications of investment expenditures, in a way that project aid did not support as much in the past... A concrete example was given by the Director of Construction in MINEDUC [Ministry of Education], whereby the increase in sector budget support has enabled MINEDUC to provide schools with transfers for school maintenance (through the capitation grant), which did not happen in the past despite significant amounts being spent through projects on school construction. Although he recognised that further efforts are required to increase maintenance expenditure and provide further guidance to schools, the Director felt that this was a very significant and positive outcome of donors' shift to SBS.

Source: Mokoro & ODI (2009a), para. 163.

– **Enhancing domestic accountability processes.** Ensuring the national budget and public accounts are more transparent and comprehensive, including all relevant information on aid, can strengthen the domestic accountability processes, between Ministry of Finance, line ministries, Parliament, Supreme Audit Institution, and citizens. Box 4 below provides an example drawn from Uganda, Tanzania and Mozambique.

BOX 4: USE OF COUNTRY SYSTEMS AND ACCOUNTABILITY IN UGANDA, TANZANIA AND MOZAMBIQUE

The increased amount of sector funding making use of domestic systems in all three countries has increased the scope of formal budgeting and accountability systems to cover more sector funding. This subjects donor funding to formal government accountability systems, which was not the case before, and shifts the spotlight to these systems. This has important effects for incentives. Sector institutions, as well as cabinets and parliaments, now have a greater incentive to engage with domestic budgetary processes, and this reinforces domestic incentives. In parallel, increased attention has been given to domestic accounting and audit systems in all three countries, which has contributed to the progress that has been observed in improving their effectiveness.

Source: ODI (2008), p. 29.

Other observed benefits include improved predictability of transfers to decentralised levels, better value for money, or improved quality of the donor-partner country dialogue (more focused on policies and strategies, enhanced trust, better donor insight on key institutional and capacity constraints).

Partner country PFM systems that are already strong can bring about additional benefits, and reduce the fiduciary risk for donors. However, experience shows that there is no minimum threshold for the benefits of using partner country PFM systems to materialise, as long as partner governments are clearly committed to improving the quality of these systems.

Immediate benefits relate to the transition from using parallel systems to using the mainstream domestic PFM systems, thereby avoiding the harms associated with bypassing government systems. The scale of benefits depends on how this transition is implemented: what share of aid uses country systems, how predictable it is, the extent to which mainstream country systems are modified by special donor requirements, etc.

How do donors assess the risk involved with using country systems as opposed to parallel ones?

Donors base their decision to use country systems on an assessment of risks involved. Box 5 presents different types of risks potentially involved with the use of country systems.

For example, a donor's choice on whether to rely on SAIs in partner countries is based on a risk assessment focused on: institutional framework and SAI independence, skills, staffing, use of international standards for auditing and audit coverage.

BOX 5: RISK TYPOLOGY

Risks		General definition: Risk that…	Examples
Developmental risks		– Poverty reduction objectives are not achieved.	– Despite donor support in education, education goals are not achieved.
Financial (or fiduciary) risks		– Funds are not used for the intended purposes. – Funds not properly accounted for. – Funds do not achieve value for money	– A study reveals that only a small percentage of funds for decentralised levels actually reaches them.
Non-finan-cial risks	**Macroeconomic risks**	– Poverty reduction objectives (and PFM – standards) are compromised by macroeconomic framework.	– Excessive inflation increases cost of key resources such as textbooks.
	Governance risks	– Poverty reduction objectives (and PFM standards) are compromised by governance context.	– Upcoming elections lead to overspending on non-priority items in the budget.
	Partnership risks	– Partnership is threatened by government action.	– A controversial policy decision is taken without donors being consulted or informed in advance.
Procurement risks		– Proper and effective use of aid is compromised by procurement standards.	– A case of corruption in the procurement of drugs is discovered.
Reputational risks		– Donor reputation is threatened by: i. governance issues; ii. perceived mis-/ poor use of funds.	– Donor seen as supporting a government that commits human rights abuses, tolerates corruption or makes questionable spending decisions (*e.g.* presidential jet).

Source: Author, based on Mokoro (2008), p. 19.

Various agencies, in various contexts, apply various responses to the risk assessed. These risk mitigation strategies include derogations to the use of country systems or specific safeguard measures; maintaining a portfolio of various aid modalities; and support to capacity development. While donor agencies are committed to "*establish additional safeguards and measures in ways that strengthen rather than undermine country systems and procedures*" (Accra Agenda for Action para.15), further work is needed to monitor and assess the impact of different measures and develop less harmful alternatives.

How and why is a more balanced analysis of risks and benefits needed?

Overall, donors have in general focused their risk assessment on financial, procurement and reputational risks. Very little analysis is done of the benefits of using country systems, for example in terms of sustainability, capacity, systemic improvements, or overall development outcomes.

Two of the main reasons for this lack of analysis are that (i) benefits are generally long-term and diffuse and sometimes difficult to quantify, while the perceived risks are short-term and specific; (ii) donors and their domestic stakeholders have often focused on the risks involved specifically with the management of donor funds, as opposed to taking a more systemic approach to the overall risks at country level.

This imbalance has led to a conservative approach to using country PFM systems by many donors, both at institutional and at staff level, with reluctance to use country systems unless they are in line with international standards, multiplication of derogations and potentially harmful safeguards, and lack of clear guidance and incentives for staff in particular at country level.

Box 6 provides an example of the analysis as carried out by Sida, which illustrates the value of a balanced analysis of risks and benefits.

BOX 6: BALANCED ANALYSIS OF RISKS AND BENEFITS – EXAMPLE OF SIDA

Sida's analysis of risks shall [start] from the assumption that the government's systems shall be used as far as possible. Exceptions from this rule must be substantiated and based on the assessment of risks, the relative trend and reform efforts planned. The risks shall be weighed against the positive effects of using government systems. Some of the potential positive effects are more efficient national systems, reduced transaction costs as compared to the use of parallel systems, improved overview of all resources, and improved focus in the budget dialogue and resource provision.

The result of the analysis may be that some, but not all, national systems can be used or that the national systems shall be used but that, in addition, certain risk mitigation measures need to be put in place.

In cases of doubt of the Government's capacity to contain risks, it may be necessary to demand and engage in more frequent analysis, audit and control of budget execution records, in order to put on the brakes if funds are poorly utilised or used for the wrong purposes.

Source: Sida (2007), p. 83.

What role for Parliaments and Supreme Audit Institutions?

What role for Parliaments and SAIs in donor countries?

The role of donor Parliaments is essential to support donor agencies in their efforts to use recipient country systems, and to work jointly with Parliaments in partner countries. Although Parliaments' focus has often been – understandably – on donor internal accountability, and therefore on issues of visibility and fiduciary risk, it is essential that further reflection is carried out on the risk of excessive visibility requirements or restrictive attitudes to fiduciary risk with regard to development outcomes and aid effectiveness.

Donor SAIs have a key role to play in supporting a better balance in risk assessment of using country systems between fiduciary risk and developmental risk, as well as consideration of potential benefits. They are also major actors in strengthening the capacity of recipient country SAIs, either directly (as done for example by SAIs of Sweden, UK, Netherlands, and Norway) or through international organisations such as the International Organisation of Supreme Audit Institutions *(www.intosai.org)*. Donor SAIs can actively engage in such fora (or within the relevant sub-bodies of the Working Party on Aid Effectiveness) to ensure that a strong platform for knowledge sharing exists on how best to support the strengthening of a country's audit systems but also how to encourage their use by donor institutions.

What role for Parliaments and SAIs in partner countries?

Partner country oversight institutions play a key role in the integration of aid with the budget process. They should contribute actively to the debate between donor and recipient countries on the use of country systems.

Better integration of aid with national processes offers the opportunity for strengthened scrutiny by Parliament and SAIs. Greater use of country systems also contributes to enhancing national lines of accountability.

Moreover, the quality of Parliamentary and SAI involvement is an important factor in building donor trust – an essential element in allowing more aid to use country systems.

A stronger role for oversight institutions in partner countries requires capacity support and clearly defined institutional roles. A recent report by the Inter-Parliamentary Union provides practical guidance for Parliaments on their role in development effectiveness. It provides useful guidance and suggestions on strengthening parliamentary engagement in the budget, which in itself is essential to contribute to a more effective budget process and build donor trust in recipient country systems (see Box 7).

BOX 7: STRENGTHENING PARLIAMENTARY ENGAGEMENT IN THE BUDGET

– Strengthening the legal framework: reviewing legislative powers to provide Parliament with the legal basis for meaningful engagement with the budget process.

– Enabling legislative input during medium-term budget policy formulation.

– Building capacity for engagement.

– Expanding the role of Parliamentary Committees such as those with a focus on Budgets, Finance, Public Accounts and Poverty Reduction so that they can better call for transparency and ensure oversight.

– Establishing independent budget research capacity – a Budget Office – to provide individual MPs and committees with research into the nation's finances and economy, research into estimates of the government (*i.e.* planned expenditure), and estimates on the financial costs of any proposal on issues over which parliament has jurisdiction.

– Broadening access to information, including information on aid flows from donors and of conditions attached, so that it is clear to Parliaments how much aid is received, from whom and for what purpose.

Source: Inter-parliamentary Union (2010), p. 14.

Box 8 below provides an illustration of the positive effects of enhanced Parliamentary capacity on donors' willingness to use country systems.

BOX 8: BUILDING PARLIAMENT'S CAPACITY IN UGANDA AND ENHANCING DONOR TRUST IN COUNTRY SYSTEMS

For over a decade now, a number of Development Partners have engaged in parliamentary strengthening in Uganda with USAID, UNDP, AWEPA and DFID playing particularly important roles. Considerable efforts have been made to put in place some key parliamentary institutions including the Parliamentary Commission, the Parliamentary Service, the Parliamentary Budget Office, and the Parliamentary Development and Coordination Office. A Parliamentary Strategic Investment and Development Plan (PSIDP) was also developed.

The establishment of a Parliamentary Budget Office and the strengthening of parliamentary oversight committees have generated a lot of optimism among the donor community on the performance of Parliament as a ''watch dog" over public resources. Such positive outlook by donors is believed to have improved their faith in use of the country PFM systems, although they recognise that it will take a sustained effort from Development Partners and from Parliament itself – alongside a favourable shift in the political landscape – to build a Parliament that is an effective and independent player in the country's system of governance. (drawing on Tsekpo and Hudson 2009).

Finally, strengthened co-operation between Parliaments and SAIs in recipient countries can be instrumental in making their work more effective. Box 9 summarises the findings of a study outlining ways in which legislatures can play a role in helping SAIs respond to challenges such as imposing their recommendations on the executive and improving communication on audit reports to increase their impact.

BOX 9: ENHANCING COLLABORATION BETWEEN SAIS AND PARLIAMENTS

– SAIs could benefit substantially from *involving the legislature in determining its audit programme and priorities*. There are many formal and informal means by which the knowledge of the legislature can be integrated into decisions on what to audit without undermining the independence of the SAI. Legislators, especially those who sit on PACs [Public Accounts Committees], often have extensive experience of overseeing service delivery and/or access to substantial information networks that can help SAIs identify audit projects…

– *Public legislative hearings on audit reports* can have a multitude of benefits for SAIs. Firstly they provide access to the full array of non-legislative actors – CSOs, academics, and professional bodies – to present further evidence on and insight into the audited entities. Making the PAC hearings open to the public also creates pressure for the executive to implement the recommendations of the SAI and PAC.

– PACs are also in a good position to *mobilise other legislative committees* to support the work of the SAI. Joint hearings between PACs and departmental committees can be set up, as well as SAI support to departmental committees through advice and secondments.

– *PACs can support implementation of audit recommendation* through:

  - Regularly following up on implementation
  - Making such follow-up meetings open to the media and the public
  - Limiting the time that the executive has to implement audit findings

– Probably the single most important step that SAIs can make to mobilise the help of the legislature, CSOs, and citizens is to *make every effort to report on time.*

– Apart from some generic practices like clarity and succinctness, some of the other ways in which *SAIs can ensure that their potential partners penetrate the technical nature of audit reports* could include:

  - Produce glossaries of technical terms.
  - Produce non-technical summaries of reports with key findings included.
  - Limit the length of audit reports and place technical details in annexes.
  - Indicate priority of audit findings.
  - Actively seek to report on issues – corruption, gross mismanagement, failure to deliver the services which voters are particularly concerned about – which will be attractive to members of the PAC

– *Empowering members of parliament and CSOs* creates an audience for the difficult technical content produced by SAIs. Not many people have the capacity to engage with SAIs reports, so training them give SAIs an opportunity to increase the number of people who can receive, read, and respond to their reports. Such training could be made available to the media for the same reasons.

– *SAIs and legislatures may create a parliamentary liaison office/officer*. The creation of a liaison institution can ensure continuity and availability and send a strong signal of co-operation and goodwill. Such units' responsibilities may include maintaining day-to-day contact and communications with the relevant parliamentary committees. In this capacity, the parliamentary liaison unit can ensure that the SAI is aware of current parliamentary interests and concerns that may need to be considered in developing the annual audit programme. The unit can also ensure that interested legislators are kept informed of SAI work that may be of material interest to them. And the liaison unit can provide a useful channel through which legislators can convey their views to the SAI on matters of mutual interest.

Source: Van Zyl *et al.* (2009).

Further reading

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Acronyms and abbreviations

AWEPA	Association of European Parliaments with Africa	**ODI**	Overseas Development Institute
CSO	Civil Society Organisation	**OECD**	Organisation for Economic Co-operation and Development
DAC	Development Assistance Committee	**PBA**	Programme Based Approach
DFIC	Department for International Development (UK)	**PFM**	Public Financial Management
HIPC	Heavily Indebted Poor Country	**SAI**	Supreme Audit Institution
IATI	International Aid Transparency Initiative	**SBS**	Sector Budget Support
IMF	International Monetary Fund	**SWAp**	Sector Wide Approach
MTEF	Medium Term Expenditure Framework	**UNDP**	United Nations Development denme
ODA	Official Development Assistance	**USAID**	United States Agency for International Development

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