

Harmonization of Practices in Financial Management by Development Partners¹

Prof Marius Koen

**Senior Financial Management Specialist, Africa Region, World Bank
and Honorary Professor of the Department of Auditing, University of Pretoria**

The following views represented here are exclusively those of the author and represent no endorsement, concurrence or agreement on the part of the World Bank, who employs the author.

NEED FOR COLLABORATION AND HARMONIZATION

Donor assistance is characterized increasingly by high transaction costs and excessive demands on recipient administrative capacity. More than 60,000 aid projects are under implementation globally. In some highly aid dependent countries, the governments has to deal with as many as 800 new development activities each year. A 1996 academic study found that one country's 600 development projects translated into 2,400 quarterly reports a year to supervisors, and more than 1,000 annual missions to monitor and evaluate the work. Naturally, each visitor needs to meet with key officials and each wants the government to comment on their findings. This is a growing concern as aid dollars shrink, and as pressures mount for fresh injections of aid to produce scaled-up results.

While the ultimate benefit that the donor community seeks from the support it gives is poverty reduction, as measured by progress towards the Millennium Development Goals,² multilateral and bilateral development partners with partner countries, have been working to address these problems by beginning to harmonize their policies, procedures and practices. This practical reform agenda covers a broad range of activities: country strategies, analytical work, technical assistance, operations (projects, sectors, and budget support), and regional and global programs.

On February 24-25, 2003, a path-breaking meeting, the *High-Level Forum on Harmonization*³ took place in Rome. Senior officials of over 20 multilateral and bilateral development organizations and about 50 countries spent two days discussing how they can improve the effectiveness of their work — how they can better fight poverty — by working more closely together. The main message, expressed through the *Rome Declaration on Harmonization*,⁴ is clear: donor aid, however well-intentioned, has come to levy a high toll on recipients in terms of transaction costs. Donors can alleviate this problem by doing more to coordinate their efforts, harmonize (and thus reduce) their multiple requirements, and assist partner countries to take charge of their own development process. At the Forum, donors and partners presented their plans for carrying this work forward. They also agreed to meet again in 2005 to take stock of concrete progress.

HISTORICAL OVERVIEW OF DEVELOPMENTS IN HARMONIZATION OF FINANCIAL MANAGEMENT PRACTICES

Within the past two years or so, two major groups of development institutions that are involved in the harmonization effort — the multilateral development banks (MDBs) and the Development Assistance Committee of the Organization for Economic Co-operation and Development (OECD-DAC) — have worked through various technical groups on issues such as donor

cooperation, country analytic work, financial management, procurement, and environmental assessment. The groups, made up of technical experts in each of the fields, anchored their work firmly in the broader context of aid effectiveness. The principal charge of each of these groups was to develop a set of good practice standards, principles, or products that donors and partner countries alike could use as a basis for harmonizing their policies, procedures, and practices.

In February 2001, the Presidents of five *multilateral* development banks decided to create a working group to address the harmonization of their financial management issues. This group identified priority areas for harmonization: financial reporting and auditing, financial management diagnostic reviews, and financial analysis in such areas as tariffs, affordability, subsidies, and ratios and covenants. The participating MDBs agreed to collaborate in the overall coordination of diagnostic work as well as in planning, conduct and sharing of results of work in individual countries. In February 2003 the working group established the following frameworks for collaboration in financial management:

- ***Framework for Collaboration among Participating Multilateral Development Banks on Financial Management Diagnostic Work.*** Diagnostic reviews provide knowledge about financial accountability arrangements in the Participating MDBs' client countries. They support the discharge of the Participating MDBs' fiduciary responsibilities by identifying the strengths and weaknesses of financial accountability arrangements and the risks that weaknesses may pose to the use of MDB funds. They also support the achievement of the Participating MDBs' development objectives by facilitating a common understanding by the borrower, the MDBs, and other development partners of the country's financial management arrangements. The Participating MDBs agree to collaborate with each other in the overall coordination of diagnostic work in financial accountability, as well as in the planning, conduct, and sharing of results of work in individual countries. They will decide the extent of collaboration in conducting assignments in each country on a case-by-case basis, taking into account the views of the borrower, the agreed division of labor between Participating MDBs active in that country, and the country strategy of the Participating MDBs concerned.
- ***Framework for Collaboration among Participating Multilateral Development Banks on Financial Reporting and Auditing.*** Borrowers and MDBs have a shared interest in ensuring that financial reports are prepared in accordance with acceptable standards. Interim financial reports should provide project authorities and the Participating MDBs supporting the project with the information they need to oversee project implementation, including comparing financial and operational aspects. Annual financial reports should be audited in accordance with acceptable auditing standards by auditors acceptable to the Participating MDBs supporting the project. The Participating MDBs agree to work toward common approaches to financial reporting and auditing. They agree to pursue high standards of reporting and auditing through region- and country-specific approaches that are responsive to borrower circumstances and needs. Each Participating MDB agrees to consider what changes are needed to its individual policies and procedures to support harmonized approaches.

Harmonization of financial management practices among *bilateral development partners* has been led by the OECD-DAC. The DAC created a Donor Practices Task Force in January 2001 to coordinate its work on harmonization. Financial management and accountability is one of the three priority areas of the Task Force. The Task Force has submitted *Good Practice Papers – Harmonising Donor Practices for Effective Aid Delivery* to the senior level meeting of the DAC

for approval in December 2002. Two of the six Good Practice Papers deal with financial management issues, which are summarized below:

- **Nr. 3 - Measuring Performance in Public Financial Management.** Donors should rationalize the scope, timing, and conduct of diagnostic reviews to alleviate the burden on countries. These reviews should be conducted according to open and transparent processes. Donors and partner country governments should collaborate on setting and monitoring country-specific performance indicators in public financial management
- **Nr.5 - Financial Reporting and Auditing.** Donors should rely on country financial reporting systems and auditing systems to the extent possible, and should help build capacity as needed. The aim should be to obtain a financial report or audit opinion that meets the needs of both the project management team and donors.

OECD-DAC invited 16 developing countries,⁵ representing different geographical areas and different levels of development, to participate in the meetings; while the MDB groups did not make such formal consultation arrangements, they did benefit from the comments of shareholders, including partner countries. The groups established their own working arrangements and meeting schedules. When their charges overlapped, they made arrangements to coordinate their work: for example, the MDB working group on financial management and the DAC/OECD working group on financial management were chaired by the same person, and some of their meetings were held jointly.

Closer to Africa, other *institutional activities* have also been taking place, some of which have become increasingly coordinated with the work of the OECD-DAC or the MDBs. The harmonization-related activities of the Strategic Partnership with Africa (SPA) have included developing common assessment tools in the areas of public financial management and working on coordinated and harmonized donor support for Poverty Reduction Strategy Papers (PRSPs) in consultation/cooperation with the DAC, Economic Commission for Africa, IMF, World Bank, and the United Nations. Part of its agenda has included action learning field visits in 2002 to Ethiopia, Rwanda, and Senegal, oriented toward identifying ways to (a) increase the alignment of assistance to national strategies; (b) reduce transaction costs through greater alignment of procedures (improve predictability of eligible funding support, harmonize performance monitoring and evaluation) and practices (e.g., conduct joint missions, streamline conditionality) and (c) enhance national capacity, particularly in public financial management.

FROM CONSULTATION TO IMPLEMENTATION

The February 2003 Rome Forum resulted in, *inter alia*, an agreed upon framework for collaboration among participating multilateral development banks on financial management diagnostic work. They also endorsed the good practices issued by the OECD-DAC Donor Good Practices Task Force in December 2002 and reiterated the commitment to apply them to the extent practicable. The delegates to the Forum issued the following statement related to financial management:

- “We welcome the collaboration of the OECD-DAC and the MDBs in the work on public financial management. We note the agreement that good public financial management should cover the preparation of the budget, internal control and audit, procurement, disbursement, monitoring and reporting arrangements, and external audit, and should promote overall fiscal discipline and efficient allocation of resources to priority needs. This collaboration reflects the importance we place on an improved accountability relationship

between a partner developing country and its own citizenry that can be achieved in part through transparent public financial management processes and systems.

- We note the good practice emphasis on working closely with governments on public sector financial reviews, and integrating these reviews into countries' poverty reduction strategies, donors' country assistance programs, and the decision-making cycles of both governments and donors. We believe that financial reviews should take account of initial country conditions; international standards, codes, and approaches; and capacity-building requirements toward compliance with these standards and codes. The OECD-DAC and MDBs have requested the International Federation of Accountants to consult broadly with donors and developing countries and prepare an accounting standard for development assistance by 2004, and we look forward to the outcome of this effort.
- We acknowledge the considerable scope for simplified and harmonized approaches to financial reporting and auditing, including the form and content of financial reports, the financial reporting period, auditing standards, the qualifications of auditors and quality of audit firms, the selection and contracting of audit firms, the terms of reference for auditors, the due date for submission of audit reports, the coverage of management letters, and the follow-up to audit findings."

DIRECT BENEFITS OF HARMONIZATION AND COLLABORATION

Below is a list of some of the benefits that are envisaged if development partners and partner countries adopt the abovementioned practices:

- The number of separate diagnostic reviews in partner countries will be reduced, the aim being coverage without duplication.
- Aid effectiveness would be enhanced by planning and executing diagnostic reviews in the context of a government-led strategy for improving the overall management of public finances, with diagnostic work fully integrated with performance measurement and capacity building efforts.
- Impact would also be enhanced by more participatory approaches to the conduct of reviews, and their wider dissemination.
- Recognising the absence of a comprehensive, internationally-accepted performance measurement framework in public financial management, adoption in individual countries of common performance indicators by donors should avoid governments being presented with an excessive number of potentially conflicting targets, and would help co-ordinate donor capacity building efforts.
- The Governments' internal accounting and reporting system will be utilized to meet financial management needs of programs/projects.
- Partner country capacity in accounting and auditing would be enhanced by progressively aligning donor requirements with strengthened national accounting and auditing processes and by increasing donor investment in building capacity.

- The effectiveness of aid delivery would be enhanced by providing common financial reports that reflect all project funds, and which meet the reporting requirements of Government and the funding agencies.
- The number of financial reports and audit opinions that partner countries are required to provide to donors will be significantly reduced.
- Common selection criteria would be established for the selection of private sector auditors with sufficient capacity and experience to audit the project/program's financial reports.

CONCLUSION

It is now widely acknowledged by development partners that while their historical origins, institutional mandates, governance structures, and authorizing environments vary, in many instances they can simplify and harmonize their requirements and reduce its associated costs, while improving fiduciary oversight and public accountability and enhancing the focus on concrete development results. According to Paul Bermingham (Director of the World Bank Financial Management Sector) "there is consensus among all partners that the real gains from harmonization come on the ground, in our day-to-day operational interaction with clients and partners."⁶ It is believed that the cumulative effect of these efforts could be to change the way development business is conducted in the 21st century.

Endnotes

¹ Currently the term "Development Partners" is preferred above "Donors". However, the terms are being used interchangeable in this article.

² Refer to the web page: http://www.worldbank.org/wbi/reprohealth/cc_2003/html/mdg.htm

³ Refer to the web page: <http://www1.worldbank.org/harmonization/romehlf/>

⁴ Refer to the web page: <http://www1.worldbank.org/harmonization/romehlf/Documents/RomeDeclaration.pdf>

⁵ Bangladesh, Bolivia, Cambodia, Egypt, Guatemala, Kenya, Kyrgyz Republic, Mali, Morocco, Mozambique, Pacific Forum, Romania, Senegal, Tanzania, Uganda, and Vietnam

⁶ Refer to the World Bank Financial Management web page: <http://opcs.worldbank.org/fm/Partner/tenthings.html>