COUNTRY FINANCIAL ACCOUNTABILITY ASSESSMENT
GUIDELINES TO STAFF

The World Bank is engaged in a review of its diagnostic work in public financial management. The findings of that review may be reflected in a future revision of these guidelines.

FINANCIAL MANAGEMENT SECTOR BOARD
MAY 27, 2003

ABBREVIATIONS AND ACRONYMS

CAS	Country Assistance Strategy
CFAA	Country Financial Accountability Assessment
CPAR	Country Procurement Assessment Report
CONTACT	Country Assessment in Accountability and Transparency
ESW	Economic and sector work
FM	Financial Management
HIPC	Heavily Indebted Poor Country
IDA	International Development Association
IGR	Institutional and Governance Review
IMF	International Monetary Fund
MDB	Multilateral development bank
NAI	National audit institution
NGO	Nongovernmental organization
OP/BP	Operational Policy/Bank Procedure statement
OPCS	Operations Policy and Country Services
PER	Public Expenditure Review
PFM	Public financial management
PREM	Poverty Reduction and Economic Management (Network)
PRSC	Poverty Reduction Support Credit
QAG	Quality Assurance Group
ROSC	Report on Observance of Standards and Codes
SAI	Supreme audit institution
SAP	Systems, Applications, and Products in Data Processing

Country Financial Accountability Assessment
Guidelines to Staff

Contents

COUNTRY FINANCIAL ACCOUNTABILITY ASSESSMENT
GUIDELINES TO STAFF

I. INTRODUCTION

1. These guidelines, prepared to assist staff in carrying out Country Financial Accountability Assessments (CFAAs), replace the guidelines dated September 28, 2000. They have been approved by the Financial Management (FM) Sector Board. Individual Regions may provide additional guidance to staff to respond to particular Regional circumstances or the World Bank's administrative processes in that Region. Technical guidance notes and examples of good practice will be issued from time to time to further assist staff.

II. BACKGROUND

2. Effective management of public finances is an essential ingredient of development and the implementation of poverty reduction strategies. The CFAA is a diagnostic tool that provides information to client country governments, the Bank, and other donors on the state of public financial management (PFM) systems.[1]

3. ***Objectives.*** The CFAA supports the Bank's *development objectives* by identifying strengths and weaknesses in country PFM systems.[2] It facilitates a common understanding among the government, the Bank, and development partners on the performance of the institutions responsible for managing the country's public finances. This common understanding helps to identify priorities for action and informs the design and implementation of capacity-building programs. Information obtained in CFAAs also helps the Bank to meet its *fiduciary objectives* by identifying risks to the use of Bank loan proceeds posed by weaknesses in borrower PFM arrangements.

4. ***The Role of the Government and Partners.*** The Bank shares an interest with borrower governments and other donors in ensuring that PFM systems function well. The Bank encourages government ownership and leadership of the CFAA process to ensure that the product is responsive to the country's development priorities and is positioned in a broader institutional and governance context. The Bank also supports the involvement of other donors active in the country.[3] The CFAA should be conducted with open and transparent processes, and the Bank encourages the public disclosure of CFAA reports.

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[1] The CFAA was formally designated as an economic and sector work (ESW) product of the World Bank in July 2000.

[2] CFAAs are not audits. They do not seek to provide assurance on individual items of expenditure, nor do they provide a "pass" or "fail" assessment of a country's public financial management system in terms of its adequacy for managing external funds.

[3] The Bank endorses the Good Practice Paper of the Development Assistance Committee of the Organization for Economic Co-operation and Development *Measuring Performance in Public Financial Management,* December 2002; and it is a party to the *Framework for Collaboration between Multilateral Development Banks on Financial Management Diagnostic Work,* February 2003.

5. ***The CFAA in Bank Operations.*** Information obtained from the CFAA, taken together with that obtained from other Bank diagnostic products and other sources (see paras. 6-7), supports the preparation of an integrated fiduciary assessment.[4] The results of this assessment inform the preparation of the Bank's Country Assistance Strategy (CAS), particularly the sections dealing with the size of the support program, the sectors to be supported, selection of lending instruments, and approaches to risk management.[5] The CFAA is particularly important where Bank resources are managed by the country's own PFM system, as in the case of adjustment lending. In investment lending projects, as the Bank moves to make greater use of country PFM systems rather than separate "ring-fenced" systems, CFAAs will increasingly support management of the Bank's loan portfolio, informing decisions on the scope and depth of financial management assessments of implementing entities for individual projects, financial reporting and auditing arrangements for the portfolio, and approaches to the supervision of financial management aspects of the portfolio. CFAAs also provide valuable information to help with the design of Bank-supported capacity-building operations.

6. ***Other World Bank Diagnostic Products.*** Besides the CFAA, the Bank has other diagnostic economic and sector work (ESW) products that address aspects of country PFM systems.

- ***Public Expenditure Reviews*** (PERs) analyze the country's fiscal position, its expenditure policies (in particular the extent to which they are pro-poor), and its public expenditure management systems. They may also examine institutional arrangements for public expenditure management, civil service reform, and revenue policy and administration. PERs may vary considerably in the coverage of issues because they have no formal guidelines; however, they are included in draft guidelines on the Bank's Work on Public Expenditure Analysis and Support, issued in March 2001.[6]

- ***Country Procurement Assessment Reviews*** (CPARs) examine public procurement institutions and practices in borrower countries. CPARs are governed by an instruction issued by the Procurement Sector Board in May 2002.[7]

- ***Institutional and Governance Reviews*** (IGRs) evaluate the quality of accountability, policymaking, and service-delivery institutions. The IGR

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4 Guidance on the preparation on integrated fiduciary assessments will be prepared by the Operations Policy and Country Services (OPCS) and Poverty Reduction and Economic Management (PREM) Networks.

5 See *Treatment of Procurement and Financial Management Issues in Country Assistance Strategies: Interim Guidelines to Staff,* Procurement and Financial Management Sector Boards, June 25, 2001; and forthcoming CAS guidelines from OPCS.

6 See draft guidelines on the Bank's Work on Public Expenditure Analysis and Support.

7 See CPAR instruction issued by the Procurement Sector Board.

relates to the CFAA in its diagnosis of the shortcomings of formal PFM systems that are due to inadequate capacity, incentives, or signals.[8]

In addition, the World Bank and the IMF jointly undertake assessments of country PFM systems under the Heavily Indebted Poor Countries (HIPC) initiative, using benchmarks for budget formulation, execution, and reporting—many of the areas that are also covered by a CFAA.[9]

7. ***Other Organizations' Diagnostic Products.*** The IMF Fiscal Transparency (ROSC) Review uses the Code of Good Practices on Fiscal Transparency adopted by the IMF in 1998. Guidance on the implementation of the Code is provided through a Manual of Fiscal Transparency and a related questionnaire.[10] Other development partners also produce PFM diagnostic products: for example, the Asian Development Bank's Diagnostic Study of Accounting and Auditing, the European Commission's ex ante assessments of country financial management, and the United Nations Development Program's Country Assessment in Accountability and Transparency (CONTACT).

8. ***Coverage, Frequency, and Scope.*** The increased reliance on country systems for managing Bank-provided resources has led to an increase in demand for CFAAs and similar diagnostic ESW reviews. Over time, it is expected that CFAAs will be in place for all active borrowers to which significant levels of resources are transferred.[11] Within these parameters, the timing of CFAAs and frequency of update is decided by the country team within the Bank, in consultation with the borrower government and, as appropriate, other interested donors. The scope of the work to be carried out in each CFAA is determined by the knowledge required, taking into account the availability of reliable information from other sources. The knowledge required is determined by (a) the Bank's planned resource transfer pattern (including lending volumes, instruments to be used, and the sectoral and institutional focus of the program), (b) the views of the government, in particular in terms of alignment with its poverty reduction strategy, and (c) agreements reached with other donors.

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[8] Further information on IGRs is available at http://www1.worldbank.org/publicsector/igrs.htm.

[9] See Actions to Strengthen the Tracking of Poverty-Reducing Public Spending in Heavily Indebted Poor Countries (HIPC), IMF Fiscal Affairs Department and World Bank PREM Network, March 22, 2002, www.worldbank.org/hipc.

[10] ROSC stands for Reports on the Observance of Standards and Codes. The assessments, the Code, the Manual, and the questionnaire are publicly available at http://www.imf.org/external/np/fad/trans/manual/index.htm.

[11] The Bank is working toward having current (i.e., no more than 5 years old) CFAAs, PERs, and CPARs for all active borrowers. The IDA13 Replenishment agreement contains further specific targets on CFAA coverage. Bank guidelines for poverty reduction support credits (PRSCs) require an "ex ante fiduciary assessment of the country's public expenditure, procurement and financial management systems" (see *Interim Guidelines for Poverty Reduction Support Credits (PRSCs)*, May 31, 2002, paras. 4 and 7). The new Operational Policy/Bank Procedure (OP/BP) on adjustment lending (forthcoming) will have similar provisions for all adjustment lending.

III. COVERAGE OF A CFAA

9. The CFAA is intended to give the Bank a sound knowledge of the country's PFM system, as a basis for broadly assessing the likelihood that Bank funds will be appropriately managed. In carrying out a CFAA, Bank staff should assess the country's PFM system—budget development, budget execution and monitoring, external fiscal reporting and transparency, internal and external auditing, and legislative scrutiny of budget execution—as an integrated whole (Annex A covers each of these components). However, depending on the country's specific circumstances, not all CFAA reports need to cover all these components in the same detail. This section outlines the contents of a CFAA and discusses the circumstances that would indicate the need for a greater or lesser scope of work. It then provides more specific guidance on one aspect of a CFAA, the financial management risk assessment.

A. Contents

10. The CFAA report should contain an executive summary of up to five pages in length. The body of the report should not exceed 50 pages. Annexes may be used to elaborate on aspects of the report. In general, all CFAA reports should cover the following:

1. General Description

- *Objectives and scope of the CFAA*, including why it has been undertaken at this time.
- *Process*, including the roles and contributions of the government and development partners.
- *Information from other sources*, including World Bank ESW, government, organizations in the country, and development partners.
- *The World Bank's relationship with the country*, including the present and proposed loan portfolio, and a discussion of the fiduciary issues covered in the CAS.

2. PFM System

- *Legal framework and institutional arrangements for the PFM.*
- *Relationship between national and subnational governments*—their relative responsibilities, size, fiscal arrangements, and the fiscal flows between levels.
- *The government's fiscal record in budget implementation.*
- *Recent work to assess and reform PFM*, including an evaluation of progress.

- *The country's PFM arrangements,* including an evaluation.

3. Analysis and Conclusions

- *Analysis of the strengths and weaknesses of PFM arrangements.*

- *Assessment of the financial management risk* that PFM arrangements may pose to World Bank funds.

- *Actions suggested to address identified weaknesses,* and details of any agreed action plan.

- *Government response to CFAA* (unless the government is a full partner in the CFAA report and accepts its conclusions and recommendations).

B. Scope

11. The scope and level of the CFAA's coverage should take account of the country's size, stage of development, and relationship with the World Bank and development partners. For example, for higher-income countries with relatively well-developed PFM systems, or governments whose track record of reforms demonstrates a commitment to improving the PFM system, a less detailed CFAA is normally appropriate. In countries where the Bank and development partners provide a substantial share of the budget resources, the CFAA is normally more comprehensive in its coverage.

12. ***Factors to Consider.*** Several factors may influence the scope of CFAA work:

- ***Availability of relevant information on PFM.*** Existing PERs, HIPC tracking assessments, IMF Fiscal Transparency Reviews, government documents, documents from development partners, or country reports may provide the information needed for a CFAA (Annex B provides a list of such information sources). While such work may not have been part of the formal CFAA process, its conclusions should be discussed in the CFAA report. In a few cases there may even be an existing PFM diagnostic study, undertaken by either a development partner or the client country, that meets the requirements of a CFAA, or would do so with a small amount of additional Bank work. Once Bank staff review such a study to determine its acceptability, and carry out any additional work it may need, they may use it in place of a CFAA.

- ***Agreed division of work with a development partner.*** When the Bank undertakes a CFAA jointly or in parallel with another partner, both agree on the scope and coverage of the CFAA and the division of work.

- ***The focus of the World Bank program and resource transfers.*** If there are problems in a particular area of the PFM system, the CFAA may focus on that area. Where resource transfers are planned to one or more states in a federal structure, the CFAA may focus on those states. Where the bulk of Bank lending is intended to support programs in certain sectors, the CFAA may concentrate on those sectors. Where Bank lending is small in absolute terms a less detailed CFAA is appropriate.

13. ***Additional Guidance.*** Annex C provides guidance on a range of issues that can affect the boundaries or scope of a CFAA: subnational governments, nongovernmental organizations (NGOs), public enterprises, Bank-financed investment projects, private sector accounting and auditing, and official corruption and the PFM system.

C. Financial Management Risk Assessment

14. A CFAA contains an assessment of the risk to Word Bank funds that are managed through the country's PFM system. (This risk also applies to the country's own funds and those of other development partners that are managed through the PFM system.) It is a relatively brief analysis, which normally forms part of the CFAA document (although in certain circumstances it may be a stand-alone or internal Bank document[12]). This section provides some details on what the risk assessment section of the CFAA should cover.

15. ***What Is Not Covered.*** The CFAA does not examine developmental risk—the risk that Bank funds, as part of the budget flowing through the country's PFM system, will not be well spent on poverty reduction. It does not aim to assess the quality, value-for-money, or poverty focus of public spending. Nor does it assess the level of financial or sovereign risk—the risk that the World Bank funds might not be repaid or might not be repaid on time. The World Bank uses other mechanisms to assess these kinds of risk.

16. ***What Is Covered.*** The main component of financial management risk is the probability that the PFM system will not provide appropriate management of all public funds. Also at issue in financial management risk is whether there is sufficient transparency (quality of information) to determine how funds are spent or managed. The CFAA should analyze the following key aspects of these risks:

- ***The budget is not implemented as passed; in particular funds are not spent for the purposes set out in the budget.*** This problem could indicate unrealistic budgets (on both the revenue and expenditure sides) and inadequate internal controls, including information flows, to allocate budget funds and adhere to budget limits. Other factors could be a lack of commitment to fiscal discipline, including budgets that are not "owned" by spending ministers or ministries.

- ***Significant government activities are not covered by the budget.*** Since funds are fungible, this situation indicates a risk that World Bank budget support will allow other government funds to be diverted to off-budget activities for which there is little transparency.

[12] When public disclosure of the risk assessment is an issue, the risk assessment should not be included in the CFAA document; see discussion of disclosure in Section IV of these guidelines.

- ***There is insufficient reliable and timely information on budget execution.*** The available information should cover revenues, expenditures, and fiscal position, both in aggregate and composition. Lack of such information may reflect inadequate internal controls and accounting systems or general lack of fiscal transparency.

- ***Practices do not match rules.*** Institutional or governance factors may lead to gaps between formal PFM regulations or procedures and actual practices (e.g., a technically sound internal control is not enforced).

These components of fiduciary risk are reflected in several key cross-cutting issues that are covered in CFAAs: budget comprehensiveness; budget realism; adequacy of internal control systems, including information flows; and adequacy of internal and eternal fiscal transparency (see Annex A).

17. ***Types of Risk.*** Risk is commonly analyzed as either an inherent or a control risk.[13] *Inherent risk,* which arises from environmental factors in the country or organization concerned, may reflect, for example, attitudes toward fiscal discipline or corruption. *Control risk* is the risk that systems of control will not function adequately; it includes the risk that reporting systems do not provide accurate or timely information.

18. ***Overall Assessment.*** A risk assessment must focus on several key indicators. It should designate the financial management risk as high, significant, moderate, or low, and provide an explanation for this assessment. (The World Bank is collaborating with development partners to develop a common approach to this risk assessment and will provide further guidance in due course.)

19. ***Risk Assessment and Adjustment Lending.*** Adjustment lending involves two additional types of financial management risk: the likelihood that adjustment lending funds will reach the country's foreign exchange reserves and the budget, and the likelihood that the use of foreign exchange reserves will be subject to appropriate controls by the central bank. These two issues are handled through the Bank's option to require an audit of the deposit accounts at the central bank, and through the use of the IMF safeguards assessment reports on central banks. Guidance on this aspect of financial management risk is under preparation.

20. ***Risk Assessment and the Country Assistance Strategy.*** The risk assessment in the CFAA informs the overall assessment of fiduciary risk to Bank funds that is included in the CAS, which assesses the following:

- Financial management risk, drawn from the CFAA;

- Procurement risk, drawn from the CPAR; and

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[13] The International Federation of Accountants standard on auditing, risk assessment, and internal control provides further guidance on this issue.

- The risk of misuse of Bank funds through official corruption, drawn from World Bank anticorruption diagnostics and elsewhere.

IV. CFAA PROCESS

21. The CFAA process is most successful when the country team remains closely involved with the CFAA team throughout. This section provides general guidance on the process for carrying out a CFAA. Individual Regions may have specific process requirements that staff should also follow.

A. Budget

22. The country management unit is responsible for providing adequate budget for the CFAA work, and development partners are frequently able to provide additional funding. Although there is no standard cost for a CFAA, experience suggests that the average total cost of a CFAA in a medium-sized country would be about US$125,000,[14] and it is generally not possible to carry out a CFAA of adequate quality for less than US$50,000. In any specific case, the budget should be based on the agreed scope of the review, the level of complexity, and the availability of other reliable sources of information.

B. Management and Quality Assurance

23. The CFAA should be carefully tailored to the specific country context and should have a strong analytic framework supported by sound empirical data. The CFAA should follow a logical sequence—the report should identify the issues, provide the supporting analysis, link the issues and analysis to the conclusions and recommendations, and, where appropriate, develop an action plan. World Bank ESW products, including CFAAs, are subject to review by the Quality Assurance Group (QAG) for strategic relevance, technical quality, dialogue, dissemination, and likely impact. For guidance on this review, CFAA teams should consult the 2002 QAG ESW assessment questionnaire.[15]

1. Regions

24. The Regions are responsible for CFAA quality: the country director has final sign-off authority, and the Regional financial management manager is accountable for the quality of CFAAs undertaken in the Region. Team composition and budget should make appropriate provision for quality assurance inputs, including peer reviews.

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[14] This is based on an estimate of 20 to 25 staff weeks, plus travel.

[15] See http://lnts022.worldbank.org/mds/mdoqa/qagreports.nsf/(resultsweb)/B251704D94CFEA9F85256C79005F6791.

2. FM Board and FM Anchor

25. The FM Board is responsible for the overall development of the CFAA as a diagnostic product, overall monitoring of quality, and identification of actions needed to improve quality. Supporting the Board, the FM Anchor reviews initiating memoranda and may provide peer review assistance, or, in limited cases, participate in the CFAA work. The FM Anchor is also available to provide general advice to teams on aspects of these guidelines or on PFM issues generally.

3. CFAA Team

26. The team leader, who has the principal role in ensuring a high-quality product, is normally a World Bank staff member with extensive knowledge and understanding of PFM issues. The team leader may be based in Washington or in a country office. Regional staff normally have an important role in maintaining contact with the government and development partners in the Region throughout the CFAA process, and in follow-up to the CFAA. Other team members may include FM specialists, either from Washington or a country office, and external consultants.[16] In most cases, it is also desirable to have a PREM staff person as a team member, particularly to provide input on the "upstream" aspects of the budgetary processes and other institutional or governance issues. Government officials may also be part of the team, as may consultants funded by development partners participating in the CFAA. The team leader needs to be satisfied that all team members are appropriately qualified. The team should be kept to a manageable size—a particularly important consideration where several development partners wish to participate in the CFAA. In higher-income countries with well-developed PFM systems, a stronger team may be needed for the dialogue with country officials.

4. Peer Reviewers

27. Peer reviewers are key to the quality of the CFAA. They should be specialists who can commit an average of three to four working days to the review, and the cost of their time should be included in the CFAA budget. The peer review team should include an FM specialist from outside the Region, a PREM staff member familiar with "upstream" public expenditure management issues,[17] and, where appropriate, reviewers from development partners and the Procurement Network.

C. Collaboration

28. When planning CFAAs, staff should first review any relevant ESW products. If relevant ESW studies are planned or under way, the CFAA team should meet with the teams concerned to ensure coordination of the World Bank's overall diagnostic work. The

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[16] A list of potential external consultants for CFAA work is maintained in the FM Anchor and is available on the FM website.

[17] A list of potential peer reviewers from the PREM network is maintained in the FM Anchor and is available on the FM website.

scope of the CFAA work may be reduced by incorporating other diagnostic work, and the CFAA timing and process can be affected by agreeing to an integrated product, or by carrying out diagnostic work simultaneously or sequentially with other ESW products. Before initiating any work, the CFAA team should agree on administrative arrangements with the borrower, striving to integrate processes, teams, report, or all three. Staff should also consult development partners about their PFM diagnostics needs and plans and the potential for collaboration.[18] Such internal and external collaboration on diagnostic work should improve quality, reduce transaction costs (particularly to the country), and increase the likelihood that agreed reforms will be implemented. This section provides guidance on various aspects of collaboration.

1. With PREM and Procurement Networks

29. An increasing number of CFAAs are being undertaken in conjunction with PERs and CPARs, with the PREM and Procurement Networks, as part of an integrated approach. However, such an approach may not always be possible because of unavoidable differences for each of the three products in their timing or in the time required to complete them. Different approaches that are emerging from the Regions are being studied to develop good practice guidelines. One clear lesson is the need for early, upstream agreement on the nature of collaboration and processes for it.

2. With the Government

30. Staff should consult with government agencies and representatives in planning, preparing, and reviewing a CFAA to ensure acceptance and ownership of CFAA results and of any ensuing action program. In these discussions, staff should emphasize the CFAA's objectives and their value to both the World Bank and the borrower as fiduciary and developmental tools. Furthermore, the CFAA team should encourage broad participation within civil society, which may include professional bodies, private industry, NGOs, and academics. QAG assessments suggest that participatory approaches generally increase the quality of ESW products.

31. ***Government Participation.*** Some governments may agree to participate as a full partner in the CFAA, jointly publishing the CFAA report, and this level of involvement should be strongly encouraged. However, governments and their officials participate to varying degrees. For example, the government may designate a senior agency official who has overall responsibility for PFM as the prime liaison or contact person with the CFAA team; nominate a country counterpart team comprising officials from all relevant ministries and the national audit institution to work with the CFAA team and carry out portions of the work; and/or provide staff for the CFAA team and prepare or contribute to the draft report

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[18] For example, the World Bank and the IMF Fiscal Affairs Department share their work programs on CFAAs and Fiscal Transparency Reviews. Staff should pursue the desirability of integrating HIPC expenditure tracking assessments or follow-up with CFAA work. The work plans of most development partners will be available in due course on the Country Analytic Work website, http://www.countryanalyticwork.net.

in other ways. In all cases, the World Bank should collaborate closely with the country authorities, keeping the government fully informed at all stages of the CFAA—even if the Bank is "holding the pen" in writing the CFAA. The World Bank also ensures quality control to its standards.

3. With Other Donors

32. In carrying out PFM diagnostic work, the World Bank actively seeks collaboration with development partners. The principal partners include the IMF; the multilateral development banks (MDBs); the Strategic Partnership for Africa public financial management and accounting task force; and such other donors as the United Nations Development Program, European Commission, and the United Kingdom Department for International Development. This collaboration is reflected in two major documents: (a) an agreement developed by the MDB financial management harmonization working group to undertake a number of joint CFAAs in the next few years, with guidelines also developed for such collaboration,[19] and (b) a good practice reference note developed by the OECD/DAC Task Force on Donor Practices on collaboration on country PFM diagnostics.[20]

33. ***Benefits of Collaboration.*** Collaboration can take the form of joint preparation with partners, with each partner taking the lead in particular issues, or partners conducting parallel reviews. Such collaboration can lead to more cost-effective PFM diagnostic work by reducing the burden on both borrower and donors. Collaboration may also promote harmonization among development partners in designing and implementing capacity-building programs and improving quality by drawing on a larger pool of information and expertise. However, because a collaborative approach entails additional consultation and coordination, it can also require additional time (and therefore costs), which must be allowed for. Joint products must also meet World Bank requirements, and it is essential to review the quality of all work carried out.

D. Planning the CFAA

1. Gathering Background Information

34. Staff planning for a CFAA should begin with desk work to identify sources of reliable and current information on public financial accountability in the country. Much is available from World Bank documents that can be retrieved from the World Bank Intranet or the Bank's Internal Documents Unit (a list of sources is provided in Annex B.) This information should be taken into account in planning and conducting the work. The planning process should include making early contact with in-country World Bank staff involved in procurement and public expenditure management.

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19 Memorandum of Understanding among Participating Multilateral Development Banks on Financial Management Diagnostic Work (February 17, 2003).

20 Measuring Performance in Public Financial Management, Good Practice Paper, OECD/DAC (December 2002)

2. Planning Mission and Workshop

35. In some cases, to obtain better information on which to plan the CFAA, staff may decide to undertake an initial planning mission to discuss the CFAA with the government and other development partners. This decision depends on the significance of the CFAA in the country's borrowing program, the amount of existing knowledge on the country's PFM system, and the availability of funds to conduct the assessment. Staff may wish to hold a workshop for country officials to explain the purposes of the CFAA and to request country participation. Before such a mission, staff should prepare a draft Initiating Memorandum on the basis of the background information gathered. Following the mission, this draft should be revised as a formal Initiating Memorandum.

3. Initiating Memorandum

36. The CFAA team should prepare an Initiating Memorandum (or Concept Paper) before they begin their in-country work. The Initiating Memorandum, which generally should not exceed 10 pages, should focus on key PFM issues (Annex D provides an illustrative list of the issues to be covered in the Initiating Memorandum). The Initiating Memorandum, and the comments of peer reviewers, should be discussed at a review meeting chaired by the country director and attended by key members of the country management team, staff familiar with the PFM arrangements in the country, and peer reviewers. The team leader should prepare a note of decisions made at the meeting, submit it to the meeting chair for clearance, and distribute it to attendees.

4. Pre-Mission Questionnaire

37. Providing the government with advance questionnaires that focus on the key issues to be addressed in the CFAA may speed up CFAA work and increase country understanding of and participation in the report. Individual Regions have developed such questionnaires.

5. Obtaining Empirical Evidence for the CFAA

38. The CFAA should include empirical evidence of what is actually happening on the ground, as opposed to what the institutional rules say should be happening. Gathering this evidence is an important but difficult aspect of CFAA preparation. Ideally, teams should undertake discussions with, and visits to, spending ministries and central agencies (e.g., Ministry of Finance or equivalent) and to regional or decentralized spending ministry locations. While an audit of transactions is not part of a CFAA, teams may wish to examine (ex post) European Commission audit reports, where available, to determine the extent to which systems are functioning as intended. Early discussions with the national audit institution may also be a useful source of information. Discussions with NGOs and community and business groups may also provide useful information on the operation of the PFM system—for example, evidence that payments are in arrears or that the budget is not being executed.

E. Writing and Reviewing the Draft Report

1. Writing for the Reader

39. The CFAA report should be clear to all audiences, including country team staff and senior officials who may have little or no technical background in PFM. Consideration should be given to employing a professional editor to finalize the report.

2. Review Meeting

40. The internal quality and likely impact of the draft report are usually discussed in a review meeting chaired by the country director. The review meeting also assesses the implications for the World Bank's program and for follow-up work.

3. Discussions with Government and Other Partners.

41. Following this review, the CFAA team should share the report with country authorities and participating partners. The CFAA team should encourage the government to conduct workshop discussions on the draft report with a wide variety of stakeholders, including external parties, before giving its comments. The team should consider these comments carefully, make any appropriate changes to the report, and incorporate an overall government response as a section in the CFAA report, if necessary. (This may not be necessary if the government is a full partner in the CFAA and has accepted its conclusions and recommendations.) The government should reflect in its comments any disagreement between the CFAA team and the government.

F. Disclosing the Final Report

42. The CFAA conclusions become publicly known through the workshop discussions of CFAA reports described in the previous paragraph. In addition, CFAA reports should be made widely available to the public. At an early stage, the CFAA team should inform the government in writing that Bank policy assumes disclosure of ESW.[21] Nevertheless, because government cooperation is essential to the value of the assessment, CFAAs are not be disclosed without the government's agreement. Thus the team should discuss and agree on disclosure arrangements with the government.

43. ***Risk Assessment.*** However, the country may request that the risk assessment not be made public, or the country director and Regional finance manager may advise that such disclosure is not appropriate. In such cases the CFAA team should prepare the risk assessment as a separate document that may be circulated internally with the main CFAA report but not disclosed.

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[21] *World Bank Policy on Disclosure of Information* (January 2002) available at http://www1.worldbank.org/operations/disclosure/documents/disclosurepolicy.pdf and the revised Disclosure Handbook available at Disclosure Handbook, (January 2003).

44. ***Disclosure Arrangements.*** For publications processing, CFAAs should follow standard ESW processing arrangements established in Regional guidelines. All CFAA reports are available on the Bank's internal FM website, and publicly disclosed CFAAs will appear on the external FM website now being developed. Some completed CFAAs have not been disclosed because no agreement was requested from the government. All CFAAs will appear on the Country Analytic Work website hosted by the World Bank as part of the harmonization agenda development,[22] with accessibility to different users reflecting the agreement with the government. CFAAs are also maintained in the ImageBank.

G. SAP Processes

45. Since July 1, 2000, CFAAs have been considered a formal ESW product of the World Bank. The team leader should obtain an ESW code for the assignment, and at the end of the process the team should prepare an Activity Completion Report. The Systems, Applications, and Products in Data Processing (SAP) system provides a record of the date the CFAA is "delivered to client." Several drafts of the report may be discussed with the government before it is finalized, so the CFAA team must exercise judgment on what constitutes "delivered to client"—generally when the report is in sufficiently final form; for example, when it is considered ready for a QAG review.

46. ***Integrated Assessments.*** A CFAA can now be categorized as part of an integrated assessment (that also includes a PER and CPAR) rather than as a stand-alone diagnostic. Integrated assessments are recorded under "PFP" in SAP and are recorded as all three products. However it is not yet possible to separately record the costs of each CFAA using the PFP designation.

V. CFAA Follow-Up

47. Following up on recommendations is critical to the impact of the CFAA, but has often been a weak aspect of CFAAs (and all ESW in general). The government must take the lead in follow-up. Also, collaboration with other parts of the World Bank and with development partners is as important for follow-up as it is for other aspects of the CFAA From the outset of the CFAA exercise there should be an understanding with the government that if the CFAA identifies significant deficiencies in PFM, it should be the basis for remedial actions, normally incorporated in some form of agreed action plan. The World Bank and any development partners will need to anticipate the likely need to provide technical assistance, capacity development, and financial resources to assist in implementing such an agreed action plan. The Bank should include significant aspects of the agreed action plan in the CAS. However, the FM group and the World Bank may not necessarily undertake all the technical assistance or capacity development arising from a CFAA.

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[22] Country Analytic Work website: http://www.countryanalyticwork.net.

A. Action Plan

48. Country circumstances dictate whether an action plan is necessary and, if it is, what its level of detail should be. If the government is already implementing PFM improvements and has a good record of implementation, a less detailed plan may suffice. Countries with greater capacity may prefer to use the CFAA as the basis for developing their own action plan.

49. ***Content.*** Experience suggests that improving PFM is a long-term exercise that requires realistic targets and expectations. The action plan should focus on key issues and desired outcomes that are tailored to the country's needs and are affordable, and not just on specific actions and processes. It should take account of existing reform programs agreed among the country, the World Bank, and development partners. Recommendations should be prioritized and their impact clearly linked to improved PFM. Recommendations may also be categorized into short-, medium-, and long-term impact. The action plan should estimate any requirements for technical assistance, capacity development, and financial support from Bank sources such as IDF grants, learning and innovation loans, or lending operations, or from CFAA development partners.

50. ***Responsibility for Follow-Up.*** As far as possible, the CFAA team and government should designate a lead agency for the overall follow-up and an implementing agency for each of the recommendations. Although in principle the government is responsible for coordinating action plans and follow-up work, the World Bank or a development partner may sometimes need to initiate this action.

B. Follow-Up through Other World Bank Operations

51. An action plan for improving PFM should also feed into subsequent World Bank adjustment lending operations, for which appropriate PFM conditions, triggers, and benchmarks should be developed. This is particularly important in programmatic operations, such as PRSCs, in which a sequenced program of reform can be linked with funds to be released at each tranche. Further guidance will be provided in a forthcoming guidance note on financial management issues in adjustment lending.

C. PFM Monitoring

52. PFM diagnostic work does not end with the completion of the CFAA report and recommence a few years later with the preparation of the next CFAA. Instead, the county team should use routine missions and other sources of information to maintain their up-to-date knowledge of the country's PFM system

53. ***Benchmarks and Indicators.*** A monitoring strategy with benchmarks is essential to track PFM improvements. Benchmarks are normally generic indicators of PFM performance, developed for tracking overall progress in PFM—Country Policy and Institutional Assessment ratings, adjustment lending conditions, triggers and benchmarks,

HIPC expenditure tracking benchmarks, and so forth. The World Bank is working with development partners on developing a harmonized set of PFM indicators.[23]

[23] The OECD/DAC Good Practice Paper Measuring Performance in Public Financial Management, Good Practice Paper, OECD/DAC (December 2002) discusses principles and good practices in developing such performance measures

COMPONENTS OF A PFM SYSTEM

This annex sets out the key issues a Country Financial Accountability Assessment (CFAA) should address in describing and analyzing a country's public financial management (PFM) system.[1] In describing the operation of the PFM system, two approaches may reduce the amount of descriptive material and aid clarity and concision: (a) a diagrammatic depiction of the flow of funds between the budget and off-budget entities (including public enterprises), subnational governments, and donors; and (b) the use of flow charts to describe the operation of the budget and internal control systems.

A. Institutional and Legal Framework for PFM

Is there an appropriate legal framework covering all aspects of PFM—budgeting, accounting, reporting, and auditing?

Are the legal requirements observed in practice?

What are the roles of, and relation between, the executive and the legislative branches in PFM?

Within the executive branch, what different central institutions are concerned with budgeting, accounting, reporting, and auditing? Are their responsibilities clearly defined so as to avoid duplication? Are the responsibilities of spending ministries vis-à-vis central agencies clearly and appropriately defined?

How adequate (in terms of quality and quantity) is PFM staffing in both central agencies and spending agencies?

B. Fiscal Record

Are there clear medium-term fiscal targets that direct government operations? Has the government achieved these targets in the past five years?

What is the record in terms of implementing the budget as passed, both in aggregates and in composition?

Are there payment arrears? Are they significant? Are they increasing or reducing?

C. Budget Development

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[1] These issues are discussed in greater detail in the Bank's Public Expenditure Management Toolkit and Public Expenditure Management Handbook; the IMF's Fiscal Transparency Code, Manual and Questionnaire; and the assessment of Tracking of Poverty Reducing Expenditures in Heavily Indebted Poor Countries (see 15 benchmarks against which countries were assessed).

A general issue is how far "upstream" the CFAA should go in looking at budget development issues. It should look no further back than budget construction processes; it should not address issues of budget policy or quality of expenditure allocations (which are covered by a Public Expenditure Review [PER]), nor the linkages between national planning and the budget. It does not cover issues of fiscal sustainability, which are normally addressed in a PER, but it may include available information on this subject as background information.

The following budget development issues should be reviewed. Most of these issues would normally have been covered in a PER, and the PER work may be used in summarized form.

1. Budget Comprehensiveness

What is the extent of extra-budgetary funds? Are they closely integrated with the budget, or do they operate in apparent isolation? Do extra-budgetary funds operate with little transparency or external oversight?

To what extent are donor funds (including project funds) integrated into the overall budget, and into the government's accounting system?

Is the scope of the budget in line with the Government Finance Statistics definition of general government?

Is any separate investment budget adequately integrated with the recurrent budget?

To what extent does the budget include transfers whose final expenditures will be undertaken by subnational governments or nongovernmental organizations (NGOs)?

2. Budget Realism

Are budget expenditure and revenue estimates realistic?

To what extent is the budget implemented as passed? (Budget variance analysis may have been undertaken in a PER.)

Is there a need for frequent adjustments to the budget during the year—reflecting unrealistic budgets, lack of policy stability, etc.?

Is there a system of cash rationing to allow for revenue uncertainty overestimation and/or expenditure underestimation?

3. Budget Classification

Is the budget classification system adequate for budget management? To what extent does it provide for a classification based on functions, programs, projects, responsibility centers, and objects of expenditure? To what extent does the system diverge from Government Finance Statistics?

4. Budget Construction

Is the budget developed by an orderly process of consultation between the budget office and spending ministries? Do ministries appear to own their budget and understand the basis on which it has been determined, and therefore what activities they are able to undertake?

What is the role of the legislature in developing the budget or reviewing budget proposals? To what extent are any problems in the budget system (e.g., unrealistic budgeting) attributable to the legislature, and outside the control of the executive branch?

Is the budget constructed through an open and participatory process in which external stakeholders participate?

D. Budget Execution and Monitoring

Is the budget allocated within ministries to responsibility centers, or is it centralized?

Are spending ministries and program managers held accountable for budgetary control?

Is there a system of budget programming, under which a plan for the release of funds during the year is set out for all interested parties?

Is a "cash rationing" system in place? If so, does it appear to effectively utilize available cash? Are there transparent criteria for allocating available cash?

How predictable is the flow of funds to spending ministries? If it is not predictable, is there any information on the impact on service delivery?

Do spending ministries generally receive their full budget allocation?

What are the arrangements for adjusting budget allocations during the year, including the management of any budget contingency reserve?

Are the rules for budget execution observed? To what extent are "exceptional" procedures followed to authorize expenditure not provided for in the budget?

How effectively does cash management operate during the budgetary process—minimizing interest costs, avoiding idle funds?

Does the internal control system operate effectively to ensure proper authorization of expenditures in accordance with budget, and proper authorization of payments (e.g., through segregation of duties)?

Are there appropriate provisions for the management of government records, including controls over accountable documents, both stores and used (records management)?

Are payroll controls adequate to ensure that only legitimate civil servants are paid (no "ghosts")?

Does an adequate system of internal audit review the adequacy of control systems and monitor compliance with the system?

Is there an effective system of commitment control (in the case of cash-based budget appropriations)?

What are the quality and timeliness of budget monitoring reports available to the Ministry of Finance, spending ministries, and program managers within spending ministries?

Are these reports acted on so as to maintain budget control and hold spending units accountable?

E. Revenue Issues

Revenues, as one side of the budget, are an important factor in overall cash management, and especially in the implementation of the expenditure budget. The term *revenues* should not be seen as referring only to tax revenues; it also includes nontax revenues, such as user charges, dividends from profitable public enterprises, and privatization proceeds. In considering tax revenues, however, the CFAA does not cover issues of tax policy or tax administration, or the extent to which taxes that should be collected are in fact being collected; these issues may be covered by a PER or by separate Bank or IMF reviews of tax administration. A CFAA should cover the following revenue issues:

- Adequacy of revenue estimation procedures. This is part of budget realism and would normally be available from a PER.
- Comprehensiveness of revenue estimates (this relates to comprehensiveness of the budget).
- Prompt collection of all revenues—no unreasonable gap between date due and actual collection.
- Adequacy of revenue monitoring as part of overall budget monitoring and cash management.

- Proper audit of revenues (see section J below).

F. Asset Management

Are there adequate controls for the safeguarding and management of assets? Are asset registers adequately maintained? What incentives does the system provide for adequate maintenance of assets and effective utilization of assets?

G. Debt Management

The CFAA does not cover issues related to the appropriate risk profile or other matters of debt management policy. It should address the following debt management issues:

Are there adequate institutional arrangements for debt management—a debt management office linked to the Budget office, professionally trained staff, etc.?

Is there an adequate information system for recording public debt and incorporating debt servicing into the budget?

H. Contingent Liabilities

Contingent liabilities are possible future liabilities, contingent upon some event or happening. Examples are guarantees or indemnities provided by the government, and undecided law suits involving the government.

To what extent are contingent liabilities considered when the budget strategy is developed?

Is there a process for systematically monitoring and evaluating contingent liabilities?

Are contingent liabilities fully reported in the financial statements?

I. External Fiscal Reporting and Transparency

Do the central budget office and spending ministries receive timely and accurate information to enable them to monitor budget implementation? Do they act on this information?

Is this information provided according to the same classification as the budget construction?

Is there regular external reporting on budget implementation?

What are the quality and timeliness of the government's annual external fiscal statements? Do these statements reflect budget results, extra-budgetary operations, information on assets and liabilities? Do they exclude or not identify any significant parts of government activity?

What standards are used in their preparation—Government Finance Statistics, International Public Sector Accounting Standards, or modifications of either ? Are they applied consistently ?

Are the statements used for any accountability or decisionmaking purposes?

How reliable is the published information? Are the statements audited? Are any suspense accounts reconciled/closed before the end of the year? Are the fiscal and monetary data reconciled?

J. External Auditing

Some of the issues in this category may be covered in existing reviews of the acceptability of national audit institutions (NAI) as auditors of Bank-financed projects.

How adequate are institutional arrangements for the independence of the NAI as regards

- Appointment and tenure of the auditor-general (or equivalent),
- Funding of the NAI,
- Powers of access to information, and
- Powers to report publicly?

How well does the NAI cover the public sector by the NAI—does it audit all national government institutions and subnational governments?

What is the scope of audit work—does it cover financial as well as compliance audit? Does it cover all revenues?

What is the quality of the audit work as regards

- Adequacy of professional staffing,
- Extent of annual coverage of government bodies,
- Apparent use of modern audit systems and international standards (INTOSAI, IAPC), and
- NAI peer review activity or other external accountability of the NAI?

What is the apparent impact of NAI as regards

- Significance of issues raised in NAI reports,
- Timeliness of audit reports,
- Apparent impact through media and parliamentary follow-up, and
- Government implementation of NAI recommendations?

K. Legislative Review of Budget Execution

What are the arrangements for parliamentary follow-up of NAI reports as regards

- Adequacy of powers and resources available,
- Existence of any formal follow-up mechanism involving a government response, and
- Apparent impact of this follow-up work?

L. Human Resources for Public Financial Management

Do the central and spending agencies have appropriate numbers of professional budgeting/accounting staff to operate the financial management systems and monitor progress? If not, what are the major barriers to meeting this need?

OTHER SOURCES OF RELEVANT INFORMATION

Information that can be used in a Country Financial Accountability Assessment is available from many sources. This annex lists some of them.

Bank Reports

- Country Assistance Strategy
- Previous Country Financial Accountability Assessment or Country Profile of Financial Accountability
- Country Procurement Assessment Review
- Public Expenditure Review
- Heavily Indebted Poor Countries Expenditure Tracking Assessments
- Country Policy and Institutional Assessments – particularly rating on Quality of Budgetary and Financial Management
- Institutional and Governance Reviews
- Anticorruption diagnostics and surveys
- Appraisal documents and supervision reports on Bank operations (including grants) designed to strengthen financial accountability

Other Bank Information

- Operations Evaluation Department reports on project performance, implementation completion, evaluation performance, etc.
- Country Portfolio Performance Review
- Project financial and/or procurement audit reports
- FM ratings in the Project Status Report
- Project Financial Management Assessments

IMF Reports

- "Red Cover" reports on Public Financial Management

- Reports on Observance of the Code of Good Practices on Fiscal Transparency

- Safeguards assessment of central banks (to be used under confidentiality arrangements)

Country Sources of Information

- Government budget documents and published financial statements

- Reports from official oversight agencies in the borrowing country (parliament, supreme audit institution, etc.)

Other Information

- PFM diagnostic work undertaken by other partners—for example, Asian Development Bank Diagnostic Study of Accounting and Auditing, European Commission ex ante assessments of country financial management, United Nations Development Program Country Assessment in Accountability and Transparency.

- Other publicly available information from international organizations, development partners, and nongovernmental organizations

ISSUES AFFECTING CFAA SCOPE

1. This annex provides guidance on a range of issues that can affect the boundaries or scope of a Country Financial Accountability Assessment (CFAA).

A. Subnational Government

2. CFAAs typically focus on national governments. However, the CFAA may evaluate the public financial management (PFM) systems of a subnational government that receives direct lending or manages a substantial portion of final expenditures from the national budget.

3. ***Rationale.*** Many countries have decentralization programs that have devolved or are devolving greater powers and responsibilities to subnational governments. In such cases, subnational governments are undertaking an increased proportion of total government spending, including spending for poverty-reducing activities. If the national government budget includes significant transfers to, or revenue sharing with, subnational governments, and the CFAA does not consider expenditures undertaken at the subnational level, the CFAA would not cover a significant amount of government activity and thus would fail to fully cover the risk to Bank funds.

4. ***Access and Limitations.*** Whether the CFAA can evaluate PFM at the subnational level depends not only on the availability of adequate time and resources but also on the size and capacity of subnational governments. Some subnational governments may have adequate capacity to provide the necessary information on PFM systems and actual revenues and expenditures; others may lack that capacity. Some coverage of subnational governments may be possible through focusing on one or two representative provinces or states, as already occurs in the case of subnational Public Expenditure Reviews (PERs).

5. ***Coverage.*** At a minimum, the CFAA should:

- State clearly what it does and does not cover, including the extent to which it covers PFM and revenues and expenditures at the subnational level, and explain why this level of coverage has been decided.

- Describe in general terms the nature of the fiscal relationships between national and subnational government—relative powers and responsibilities, patterns of resource flows and relative size, and any fiscal risks the national government might bear from subnational governments through provision of loan guarantees, etc. (see separate discussion of fiscal risk).

- Indicate whether future CFAA work is planned at the subnational level.

Since the fiscal relationships between the national and subnational governments may significantly affect the way the budget is developed, the extent to which it is realistic, the extent to which it is actually implemented as passed, and the extent to which there is overall fiscal transparency, the CFAA should address them separately where possible, but should also bring them together in summary form in the discussion of fiscal relationships.

6. ***Separate Assessments.*** The Bank is now undertaking some adjustment lending with subnational governments (India, Mexico, and Pakistan). Although this lending is channeled through the national government, it is based on policy actions agreed between the Bank and the subnational government. In these cases, the Bank carries out state- or provincial-level financial accountability assessments (FAAs), which must meet the general requirements for CFAAs, set out in these guidelines. In some other countries (Argentina, Brazil, Mexico), the Bank will soon undertake subnational FAAs because substantial final expenditures from the national budget occur at that level, and thus a substantial portion of Bank funds provided through the budget are in effect being managed at that level. Some of these assessments will focus on a particular sector. In such cases, a more flexible approach may be appropriate; the Bank will develop and disseminate guidance in this area on the basis of its early experiences.

B. Nongovernmental Organizations

7. In many countries nongovernmental organizations (NGOs) may undertake a significant amount of service delivery, and may sometimes receive significant transfers from the national budget. A CFAA is unlikely to be able to analyze the PFM systems of numerous small NGOs. However, where the flow of budget funds to NGOs is significant, the CFAA should at a minimum indicate the type and scale of NGO activity. In some cases it may be possible to obtain some assessment of the quality of NGO financial management through reviews of ring-fenced Bank (or other donor) projects involving particular NGOs.

C. Public Enterprises

8. As the CFAA focuses on the government's budget, it does not attempt to cover the overall performance and financial management of public enterprises, unless such enterprises are included in the Government Finance Statistics definition of general government. However, public enterprises may have a significant impact on the national budget, either through cash subsidies or capital injections received from the budget or, in some cases, dividends paid to the budget from profitable operations. Therefore, at a minimum, the CFAA should describe the size of the public enterprise sector, its relationship with the national budget, and the general arrangements for government oversight of public enterprise finances. Where public enterprises are significant, the CFAA should review the extent to which the PFM system provides for adequate performance accountability and transparency, including whether there are clear financial targets, any quasi-fiscal transactions are transparent, commercial accounting standards are used, and adequate external audit is provided (whether by the supreme audit institution [SAI] or private auditors). In addition, because guarantees of private enterprise debt may be a significant fiscal risk, the CFAA should discuss them in the risk section.

D. Bank-Financed Investment Projects

9. The focus of a CFAA is on Bank funds that flow through the country's PFM system or budget, usually by way of adjustment lending. Separate fiduciary rules govern Bank-funded investment operations (including sectorwide approaches, or SWAps), which are usually administered through ring-fenced financial management systems separate from the country's PFM system.[1] Risk assessments dealing with such operations also feed into the CAS, but through portfolio review exercises separate from the CFAA (normally through the Country Portfolio Performance Review and the financial management rating in the Project Monitoring Report).

10. ***Investment Projects in the CFAA.*** However, the financial management of Bank-financed investment projects may be relevant to the CFAA if such projects are administered through the country's PFM system. Thus a review of the FM performance of Bank-financed investment projects may give useful information on the operation of the country's PFM system. Even for ring-fenced systems, an assessment of the flow of counterpart budget funds to the project may provide information on the adequacy of the country's budget planning and execution. For example, lack of predictability in projects' receipt of country counterpart funds may indicate problems in the country's budget execution system. Likewise, the quality of any audits of Bank projects undertaken by the national audit institution may provide information on the capacity and performance of that institution. At a minimum, therefore, the CFAA should draw on information in the Country Portfolio Performance Review, PSR, audit reports, and other sources to describe the financial management arrangements that apply to investment projects (and to donor-financed projects in general) and their relationship to the country's PFM system. In some cases the undertaking of a CFAA may provide a window of opportunity for discussions with the government on improving the financial management of ring-fenced investment projects, and it may be appropriate to cover these issues in the CFAA.

E. Private Sector Financial Reporting and Auditing

11. The CFAA guidelines issued in September 2000 provided for coverage of private sector accounting and auditing arrangements, as well as of the PFM system. Since then the Bank has developed the Review of Accounting and Auditing Practices (ROSC)[2] which is intended to be the principal instrument for addressing financial reporting and auditing arrangements for the private sector. However, when a ROSC has not been carried out or planned for a country, it may be appropriate for the CFAA to briefly review these issues. (The Financial Management Sector Board is developing a brief guidance note on undertaking this review.) In addition, if private sector financial reporting and auditing requirements also apply to public enterprises, or if the CFAA discusses Bank-financed investment projects and private sector auditors are used for the audit of these projects, some review of private sector auditing may be needed in the appropriate section of the

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[1] This is a separate issue from whether such projects, and those financed by other donors, are included in the formal budget and public accounts. The Bank encourages such an approach.

[2] See the FM website for a discussion of these assessments.

CFAA. However, in neither case should any work undertaken by the ROSC assessment be duplicated.

F. Accounting and Auditing Profession

12. Reviews of the accounting and auditing profession in a client country, and of the use of international accounting and auditing standards, are also part of the ROSC Review of Accounting and Auditing Practices. Whenever it is deemed appropriate for the CFAA to cover private sector financial reporting and auditing, it should also cover the accounting and auditing profession. It is also important to address this topic in any CFAA, insofar as it applies to achieving adequate financial management and auditing staffing in the public sector.

G. Corruption Issues

13. Official corruption, which has complex causes and effects, may be a major risk to Bank and country funds. However, the complexity of this issue means that neither corruption diagnostics nor the development of broad anticorruption strategies can be undertaken as part of a CFAA. The Bank carries out corruption diagnostics, in some cases as part of Institutional and Governance Reviews. If such Bank diagnostic work is available, its findings should be used in the CFAA, particularly in developing the assessment of the risk to Bank funds. Other sources of information on corruption include the World Bank Institute's set of governance indicators covering control of corruption for 187 countries,[3] and other general assessments based on international benchmarks, such as the work of Transparency International. The CFAA should refer to any government anticorruption strategy and the involvement of country PFM institutions in that strategy. In addition, the CFAA should identify aspects of the PFM system that might facilitate corruption, or any in which improvements might reduce corruption—for example:

- the existence of many off-budget accounts, which may have limited transparency or receive little scrutiny;
- inadequate financial management information systems;
- inadequate systems of internal control (including internal audit) and financial reporting;
- excessively complex financial administration rules, including the existence of many "gatekeepers" whose approval may be required for transactions;
- "cash rationing" in the implementation of the budget, when the processes for determining what funds are released and what suppliers or other competing claims are paid may not be transparent;

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3 See http://www.worldbank.org/wbi/governance/

- inadequate external auditing and other external scrutiny (the lack of provision for audit of tax and privatization revenues may be relevant in some countries); or

- lack of fiscal transparency generally, covering both transparency of processes and availability of information.

A review of SAI reports and discussion with the SAI may also provide further information on the extent of official corruption, and changes in PFM systems that might reduce it.

ANNEX D

INITIATING MEMORANDUM

This annex outlines the contents of a Country Financial Accountability Assessment (CFAA) Initiating Memorandum, which should not exceed 10 pages.

Background

- Country background
- Objective of the CFAA
- Relationship to Country Assistance Strategy lending program, and policy dialogue with the country authorities

Scope

- Areas to be reviewed, and why they are to be reviewed
- Specific issues deserving attention, and why they are being focused on
- Other relevant sources of available information, and how the CFAA relates to them

Process

- Role and identity of country authorities and other in-country stakeholders
- Role and identity of collaborating development partners, including the IMF
- Planned contributions by country authorities, other in-country stakeholders, and partners
- Relationship to other Bank diagnostic economic and sector work and any lending operations supporting financial accountability

Reporting Arrangements and Timetable

Team Composition and Quality Assurance Arrangements

Budget