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## 2017 ANNUAL REPORT ON RESULTS AND IMPACT OF IFAD OPERATIONS (ARRI)

### Learning Theme on Financial Management and Fiduciary Responsibilities in IFAD-funded Operations

#### I. Introduction

1. As agreed by the Executive Board in September 2016, the learning theme for the 2017 Annual Report on Results and Impact of IFAD Operations is financial management and fiduciary responsibilities in IFAD-funded operations. Although government performance has improved in recent years, financial management and fiduciary responsibility remain a factor hampering further improvements in the performance of IFAD's portfolio. Therefore, the objective of this learning theme is to provide IFAD management and staff with lessons, practices and insights on financial management and fiduciary responsibilities of IFAD-funded projects towards improving the Fund's overall operational performance and institutional efficiency and effectiveness.
2. Learning themes are not evaluations as such, but rather a review that highlights key lessons based on existing IFAD evaluation reports and other evaluative evidence. To provide meaningful lessons based on comparable experiences, this learning theme concentrates on project loans<sup>1</sup> that have been completed since 2009, after the approval of the direct supervision policy. Supervision<sup>2</sup> by cooperating institutions, with their different fiduciary models, was phased out in 2007 when IFAD introduced the policy on direct supervision and implementation support. Therefore, in order to fully appreciate the effects of the policy at the operational level, the sample of projects reviewed by the learning theme will comprise evaluated projects exiting the portfolio in the period 2009-2015.<sup>3</sup>
3. In addition, this learning theme takes into account IFAD policies, guidelines and institutional practices related to the financial management and fiduciary responsibilities in IFAD-funded operations. It also draws on IFAD Management's own assessments through regional portfolio reviews and project status reports since IOE evaluations only selectively review financial management and fiduciary

<sup>1</sup> Project loans constitute the bulk of IFAD's operations. In addition, in 2017 the Office of Audit and Oversight is conducting an Audit of Grant Fiduciary Management.

<sup>2</sup> Supervision ensures compliance with loan covenants, procurement, disbursement and the end-use of funds, and is an effective tool for promoting efficiency and good governance.

<sup>3</sup> It is important to note that IOE introduced the first edition of the evaluation manual in 2009; thus evaluations conducted from that year onwards follow the same methodology.

issues under government performance. It also has been informed by the findings of the previous ARRI learning themes on project management (2014) and efficiency (2011).

4. **Definition and operational framework.** Fiduciary responsibility is the key principle of IFAD's financial management, whereby "the proceeds of any financing are [to be] used only for the purposes for which the financing was provided, with due attention to considerations of economy, efficiency and social equity," as stated in the Agreement establishing IFAD. Since IFAD-financed projects are nationally managed using national public financial management systems, IFAD requires assurance from borrowers/loan recipients that they meet IFAD's fiduciary standards, notably by maintaining adequate financial management<sup>4</sup> arrangements. To that end, IFAD oversees the effectiveness of financial management arrangements in place and supports the Borrower's fiduciary capacity, both at the project design stage and during implementation.
5. Assuring fiduciary compliance starts at project design, when financial management arrangements and various capacity-building activities are put in place to safeguard projects against inherent risks in the immediate project environment. Fiduciary monitoring of financial management helps projects identify departures from fiduciary standards during implementation. IFAD promotes corrective measures through its supervision, enforcement infrastructure and implementation support.
6. The operational framework of fiduciary responsibility is based on an integrated set of policies and guidelines as outlined in box 1.

Box 1

**Fiduciary responsibility – operational framework**

- (i) **The General Conditions for Agricultural Development Financing**, last updated in 2014, provide the frame of reference for IFAD lending operations and hence fiduciary responsibility, in which the general conditions and procedures for loan withdrawals and project implementation, including procurement, monitoring and evaluation, financial accounts, audits and reporting, and remedies (loan suspension/cancellation), are outlined.
- (ii) **Borrowing countries' fiduciary responsibility** is more closely delineated in the project financing agreement. Borrowers commit to adhere to IFAD's policies and procedures, notably the guidelines on Project Procurement (2010) and Project Audits (2011). Manuals and handbooks, such as the Loan Disbursement Handbook (2009), assist project implementation agencies in discharging their responsibilities by conforming to IFAD policies and procedures. At the project level, fiduciary arrangements and procedures are captured, as applicable, in the Project Implementation Manual.
- (iii) **IFAD's roles and responsibilities** are established by the guidelines on "Supervision and implementation support of projects and programmes funded from IFAD loans and grants." First issued in 2007, they were revised in 2014 to bring procedures in line with implementation experience.\*

\* A policy on Supervision and Implementation Support drafted in 2012 complements these guidelines.

Source: Agreement establishing IFAD, 1976, p.12 - Article 7 (c).

7. Responsibility for fiduciary supervision is now divided between the Financial Management Services Division (FMD), which handles almost all financial management aspects, and the Programme Management Department (PMD), which is in charge of the procurement dimension within the context of its overall implementation planning,<sup>5</sup> monitoring and support function. Supervision and

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<sup>4</sup> "Financial management" refers to the organization, budgeting, accounting, internal control, funds flow, financial reporting and internal and auditing arrangements by which Borrowers/Recipients receive funds, spend them and record their use. (Financial management and Administration Manual 2016, p. 3)

<sup>5</sup> Notably, the Annual Work Plan and Budget process.

implementation support missions play a central role in IFAD's fiduciary management.

8. Since the adoption of the new operating model of direct loan supervision and implementation support in 2007, assurance of fiduciary requirements has been a continuing concern for IFAD: fiduciary risk is now a central organizing principle for financial management and administration (Financial Management and Administration Manual, 2016).

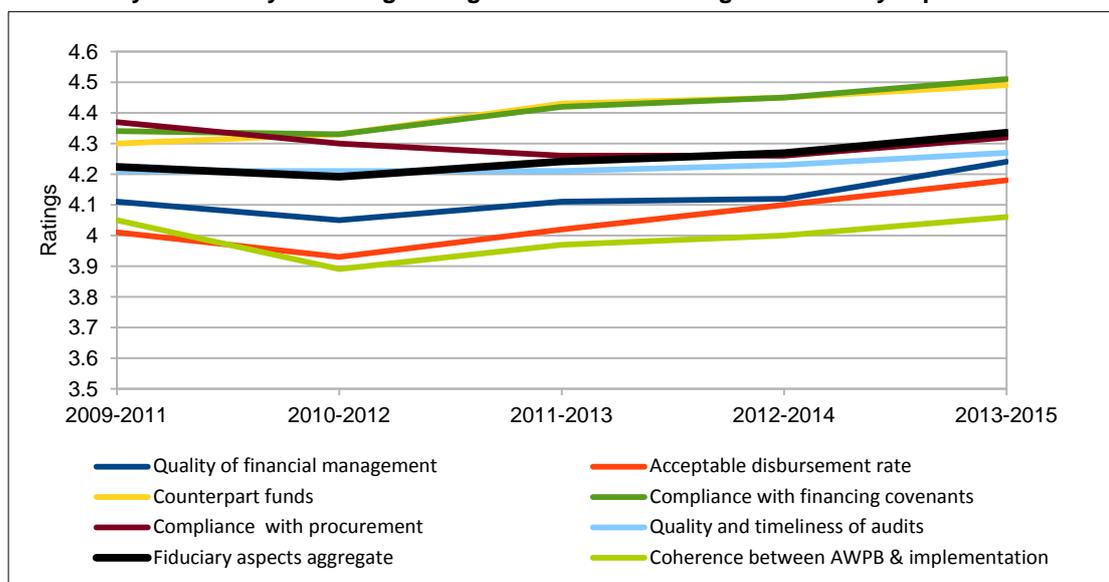
## II. Main findings

### A. Statistical analysis

9. A trend analysis reveals that fiduciary compliance has been improving over the review period, particularly since 2010. The average aggregate rating on fiduciary aspects rose, albeit only modestly, as did most of its component indicators, as detailed in chart 1. Overall the mean ratings for the various fiduciary indicators remains around 4 – which is moderately satisfactory – with the exception of ratings for counterpart funds and compliance with financing covenants, which have moved towards the satisfactory zone.

Chart 1

Trend analysis: Three-year rolling averages for the mean ratings on fiduciary aspects



Source: Project Supervision Report database (projects completed 2009-2015).

10. An analysis of available ratings<sup>6</sup> shows a high correlation between fiduciary standards and practices and overall project implementation progress. Using the average of the six customary indicators on fiduciary aspects<sup>7</sup> and the overall project implementation progress score included in the Project Supervision Report (PSR), the correlation measure comes in at a 0.79 on a scale from 0 to 1.<sup>8</sup> As shown in table 1, individual fiduciary compliance scores also exhibit moderate to strong correlation with overall implementation progress.
11. As for correlation with IOE independent composite ratings (project performance and overall project achievement), correlation levels are mostly moderate (with the

<sup>6</sup> Deriving from 118 projects evaluated by IOE with completion dates between 2009 and 2015 (PCR/PPE data series) and PMD self-evaluation project performance ratings for the same projects.

<sup>7</sup> (i) Quality of financial management, (ii) acceptable disbursement rate, (iii) counterpart funds, (iv) compliance with financing covenants, (v) compliance with procurement, and (vi) quality and timeliness of audits.

<sup>8</sup> The aggregate fiduciary score, being a mean of a mean, in this case turned out to be higher than individual correlations of component fiduciary aspects and implementation results. Notwithstanding the likely overstated strength of the correlation, it demonstrates the positive overall correlation between fiduciary compliance and implementation performance.

exception of compliance with procurement, which displays weaker correlation). Good fiduciary performance generally points to satisfactory implementation performance and overall project achievement. In turn, projects marked by fiduciary weaknesses are more likely to experience difficulties in reaching their implementation results.

Table 1

**Correlation analysis: Fiduciary aspects and overall project implementation progress, project performance and overall project achievement (N=118)**

	Quality of financial management	Acceptable disbursement rate	Counter-part funds	Compliance with financing covenants	Compliance with procurement	Quality and timeliness of audits	Aggregate fiduciary score
Overall project implementation progress*	0.57	0.70	0.54	0.74	0.53	0.57	0.79
Project performance	0.42	0.49	0.46	0.55	0.36	0.46	0.59
Overall project achievement	0.41	0.47	0.43	0.54	0.38	0.45	0.58

Source: PSR database and IOE ratings database (projects completed 2009-2015) \* PSR indicator.

- In a broader context, a correlation analysis was also conducted of the mean rating for government performance as a partner (which includes fiduciary aspects) with the mean rating for project efficiency (which includes financial management). The correlations between these two IOE evaluation criteria are fairly strong, with a correlation coefficient of 0.71 across all evaluated IFAD projects,<sup>9</sup> ranging from as high as 0.81 in the West and Central Africa Division (WCA) region to a more moderate 0.56 in the East and Southern Africa Division (ESA) region (as shown in table 2). These findings confirm results similar to those reported in the corporate-level evaluation on "IFAD's institutional efficiency and efficiency of IFAD-funded operations,"<sup>10</sup> illustrating that government performance as a partner has a bearing on project efficiency.

Table 2

**Correlation analysis: Aggregate fiduciary score across the five IFAD regions and by year of completion**

<i>Correlation coefficient: Efficiency ratings and Government performance</i>	
<b>By IFAD region</b>	
WCA	0.81
LAC	0.71
NEN	0.67
APR	0.61
ESA	0.56
<b>By year of completion</b>	
2009-2011	0.75
2010-2012	0.82
2011-2013	0.70
2012-2014	0.64
2013-2015	0.59
<b>2009-2015</b>	<b>0.71</b>

Source: IOE ratings database (projects completed 2009-2015).

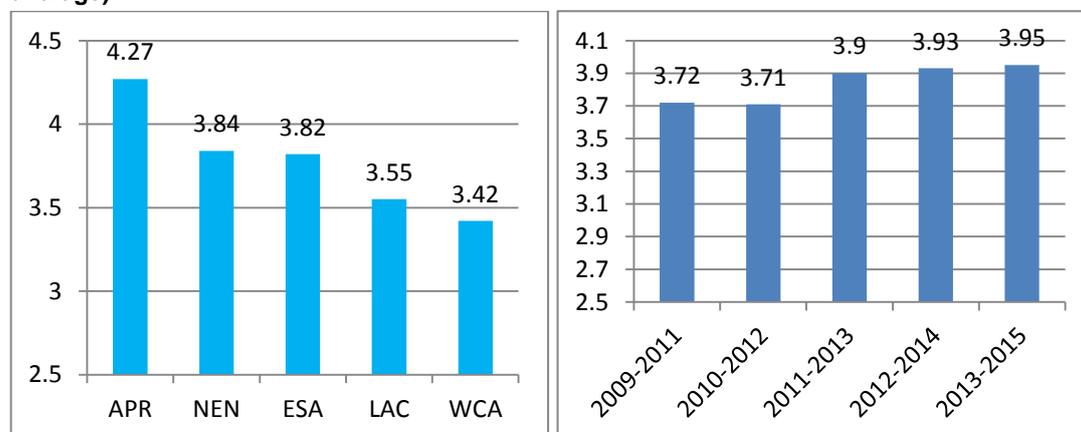
<sup>9</sup> 118 projects evaluated between 2009 and 2015 (PCR/V/PPE data series).

<sup>10</sup> July 2013, p. 108.

13. Weak government performance as a partner, including in financial management and fiduciary compliance, remains a concern. While there has been a discernible improvement in government performance ratings from 3.72 in the 2009-2011 cohort to 3.95 in the 2013-2015 cohort, regional differences remain – ranging from as high as a 4.3 mean rating for the Asia and the Pacific Division (APR) region to a low of 3.4 mean rating for WCA (see chart 2).

Chart 2

**Comparative analysis: Government performance as a partner across the five IFAD regions; and Trend analysis: Government performance as a partner by year of completion (3-year rolling average)**



Source: IOE ratings database (projects completed 2009-2015)

14. In summary, performance in fiduciary aspects, with the exception of procurement, are moderately correlated with the evaluation criteria indicative of project performance and overall project achievement. The evaluation criteria “government performance as a partner” and “project efficiency” also include financial management aspects and are correlated with one another. Based on these findings, the next section identifies and examines factors contributing to financial management and fiduciary compliance by governments and IFAD.

## B. Qualitative analysis

15. Five major lessons emerge from this analysis and provide the structure for the discussion, which draws on evaluative evidence from evaluation reports and portfolio reviews to identify drivers of and impediments to the successful management of fiduciary responsibilities.

**LESSON 1: Introducing measures that address identified weaknesses in institutional and project management capacity, ahead of implementation, reduces unnecessary exposure to fiduciary risk.**

16. The starting point of reflection for Lesson 1 is an assessment of how IFAD’s fiduciary risks associated with its loans are perceived and managed. This risk assessment ahead of implementation follows precautionary principles, which are coherent with the guidelines on the “Supervision and implementation support of projects and programmes funded from IFAD loans and grants.”
17. IFAD projects are exposed to multiple risks such as: country or sector governance issues (including corruption); complex, unclear or ineffective rules, regulations and legal structures; weak institutions and capacities; and other variables which weigh on project implementation and undermine financial management and fiduciary compliance. Project design itself may add to the risks, if it is not adapted to prevailing conditions (for example, complex implementation arrangements). Inherent risks are more present in fragile contexts, where solutions are more difficult to implement. WCA, with the highest number of countries in fragile situations, is particularly affected by this problem, as projects consistently perform worse than their peers in other regions despite higher than average portfolio

management costs.<sup>11</sup> One such example is PRODER I in the Republic of Congo, which was rated, by the Project Completion Report and the Project Completion Report Validation (PCRVR) alike, and in terms of overall project achievement and performance of partners, clearly in the unsatisfactory range. This case infers that the precautionary principles of identifying weaknesses ahead of implementation were not part of project design.<sup>12</sup> Still, high-risk projects also exist in more stable countries.

18. On a more general level, and going beyond institutional and project management capacity, country policy changes during implementation also can increase fiduciary risks. One such example is the curtailing of financial autonomy of local governments by central government in projects designed to build on local government capacities to co-finance project activities.<sup>13</sup> The reshuffling of ministries during project implementation is another contributor to higher fiduciary risks – which, as such, are not foreseeable at design – as the recent Nicaragua Country Strategy and Programme Evaluation (CSPE) suggests.<sup>14</sup>
19. The design and selection of project management arrangements needs to reflect these risks. *Financial management assessments* (FMAs) are critical in identifying inherent risks<sup>15</sup> as part of the overall project fiduciary risk assessment process (introduced in 2012), which occurs initially during project design and is then reviewed at least annually throughout the life of the project. FMAs gauge whether financial management systems and processes<sup>16</sup> of the implementing entity are adequate for managing, controlling and reporting project finances, and propose measures to address any specific financial management weaknesses so as to guard projects against the risks present in the environment, including the project's financial management supervision approach (scope and frequency). They provide a crucial input into the design of every project by establishing whether IFAD can have confidence that the implementing agency has sufficient capacity to effectively manage and control project financial resources. In general, the higher the inherent risk, the greater the importance of appropriate financial management arrangements to contain the risks to the project.<sup>17</sup> In the context of IFAD's risk-based management framework, risk assessments are now updated on a periodic (annual) basis.
20. Fiduciary safeguards are integral to the *project financing agreement* establishing the fiduciary relationship between IFAD and the Borrower. As such, no withdrawal, except for start-up costs, can be made from the loan and/or grant accounts until the first annual work programme and budget (AWPB) has received a no-objection from the Fund and IFAD has determined that all other conditions of disbursement (if applicable) have been fulfilled. Those conditions include: the establishment of the project management unit (PMU); putting in place the accounting systems,

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<sup>11</sup> Operating costs, which average some 15 per cent of the programme budget, may be as high as 25 per cent in regions with a large proportion of fragile states such as WCA.

<sup>12</sup> IFAD. République du Congo. *Projet de Développement Rural dans les Départements des Plateaux, de la Cuvette et de la Cuvette Ouest (PRODER I)*, PCRVR, Rome, 2013.

<sup>13</sup> IFAD. Republic of Uganda. *Country Programme Evaluation*, Rome, April 2013.

<sup>14</sup> IFAD, República de Nicaragua. *Evaluación de la Estrategia y Programa en el País*, 2017.

<sup>15</sup> A financial management assessment and fiduciary summary at the country level inform the project-level FMA. They draw on review of the relevant documentation available on: governance; Transparency International's most-recent Corruption Perceptions Index scores; findings of any recent donor-funded financial management diagnostic reviews; and any recent reports from donors and development partners (e.g. Public Expenditure and Financial Accountability assessments or similar). Supplemented by data on each ongoing IFAD country portfolio and the financial management risk ratings assigned to it.

<sup>16</sup> FMA will cover the following key financial management elements: (i) Organization and staffing; (ii) Budgeting (systems for annual budget preparation and monitoring of execution); (iii) Funds flow and disbursement arrangements; (iv) Internal controls; (v) Accounting systems, policies and procedures (including information technology systems); (vi) Reporting and monitoring; (vii) Internal audit; and (viii) External audit.

<sup>17</sup> IFAD Financial Management and Administration Manual 2016, p. 26.

financial management procedures, and internal control systems; and the opening of the designated account and project account(s).<sup>18</sup>

21. Project management structures, encompassing oversight by the steering committee, ministry senior management as well as the PMU, are essential organizational elements of an enabling implementation environment.<sup>19</sup> The unplanned absence of a steering committee in The Marine and Agricultural Resources Support Programme in Mauritius, for example, deprived the project of adequate guidance and coherence, with repercussions on fiduciary compliance, as audits did not meet the required standards, and the planning and budgeting of the project were weak and not properly aligned with the Government's programme-based budgeting. The lack of a dedicated PMU also impaired project implementation.
22. Due to the significant fiduciary risks to which projects are exposed, PMUs and Project Implementation Units remain the modality of choice for a vast majority of projects.<sup>20</sup> Depending on the circumstances, different types of units are used, ranging from a single PMU for all projects fully integrated into the existing government organizational structure and systems, to stand-alone units using their own systems.<sup>21</sup> The topic is further discussed in the 2014 ARRI Learning Theme on Project Management.
23. The Single Project Implementation Unit (SPIU) for IFAD operations in Rwanda is a good example of the former and also showcases good fiduciary management. The Rwanda SPIU helped, inter alia,<sup>22</sup> the Support Project for the Strategic Plan for the Transformation of Agriculture to deliver on all fiduciary aspects: disbursement was 100 per cent on target; agreed counterpart funds were released in a timely manner; loan covenants and financial agreements were fully respected; procurement rules were followed; and audits of good quality were ensured in a timely manner. The management arrangement was instrumental in establishing consistent practices across all projects for financial matters, procurement and audits, and performed well in the face of the particular risks of more complex projects. The continuity in project management arrangements fostered efficiency in project implementation, reduced transaction costs, minimized start-up delays, and enhanced learning.
24. At the opposite end of the spectrum are dedicated "ring-fenced" PMUs specifically for the project, outside the government or ministry organizational structure, with their own discrete financial management systems, staffed by external specialists and mainly non-governmental staff. These played a useful role in particularly risky country contexts marked by weak government institutions, and notably in countries in fragile situations. In WCA, with its large number of countries in fragile situations, this type of project management set-up remains the standard. The units are frequently attached to the ministry of agriculture or a related institution which ensures general oversight and participates in setting up the unit, including recruitment of staff. Autonomous financial management removed from often lengthy and cumbersome ministry procedures enables the units to react more flexibly in difficult operating environments. Yet despite targeted efforts to provide a

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<sup>18</sup> Ibid., p. 18.

<sup>19</sup> ESA Portfolio Review, 2014, p.19.

<sup>20</sup> PMUs provide oversight and facilitate project implementation. PMUs may coordinate and, in some projects, implement specific components. However, IFAD-funded projects are primarily implemented by district- and field-level extension personnel, MFIs, NGOs and client farmers. Frequently, there is no direct administrative or contractual relationship between the PMU and implementers; thus the importance of proactive engagement by ministry senior management with counterparts in other institutions to forward the project's agenda both within steering committees and bilaterally through regular contact.

<sup>21</sup> Most implementing agencies rely on PMUs that are embedded in sector ministries, with varying use of country public financial management systems and with most project financial staff being seconded by the government.

<sup>22</sup> Other projects supported by SPIU include the Kirehe Community-based Watershed Management Project and the Project for Rural Income through Exports.

more favourable set-up for managing projects, these special units were far from immune to the general weaknesses of the institutional environment.<sup>23</sup>

25. As the quality of the project team and its management are key to financial management and project success, capacity development and institutional strengthening are a primary means of mitigating fiduciary risks. Financing agreements therefore should include adequate provisions to ensure that a sufficient number of staff will be involved in project activities on a full-time basis. The selection and retention of competent staff are critical for safeguarding the project against avoidable implementation risks.<sup>24</sup> IFAD therefore assists projects in the recruitment process (terms of reference preparation and CV review); moreover, competitive pay and contractual terms are used to attract and keep the right project management staff. However, while special contractual arrangements provide short-term relief in terms of fiduciary risks (higher-quality teams and reduced turnover), they create a risk of micro-management by IFAD, and their contribution to sustainable national structures and solutions is limited at best, as further discussed below.

**LESSON 2: Managing fiduciary responsibilities through national systems and regulations may entail a trade-off between short-term risks and longer-term sustainability.**

26. Lesson 2 puts emphasis on the use of national systems and regulations, which is a postulate stemming from the Paris Declaration<sup>25</sup> and the subsequent documents building on its principles. As the paragraphs below show, IFAD projects are only rarely managed by embedded national units that existed before them and that are part of the in-country set-up after the termination of such projects.
27. IFAD projects use country public financial management systems,<sup>26</sup> where feasible. As government systems regularly struggle to meet IFAD's fiduciary requirements (e.g. integrated work planning and budgeting, financial reporting and procurement), project implementation is bound to increase fiduciary risks.<sup>27</sup> Measures to mitigate these risks usually involve capacity building focused on the immediate project financial management environment. Yet, to the extent that more comprehensive national capacity building is beyond IFAD's remit, project-specific measures shielding financial management from the risks inherent in the existing systems are necessary. Often reinforced by additional IFAD implementation support, they contain fiduciary risks in the short term, but they also undermine the longer-term sustainability of project capacities.
28. There is an obvious trade-off between sustainability and rapid implementation progress: Country systems, in particular, for budgeting and procurement, are frequently responsible for implementation delays. Yet, limited de facto implementation capacity within government agencies fails to be reflected in realistic disbursement and results targets.<sup>28</sup> There are also examples that exhibit significant performance gaps within the same line ministry and the same mode of implementation. The recent Nicaragua CSPE<sup>29</sup> assigns ratings of satisfactory (5) and unsatisfactory (2) to the efficiency of two distinct projects, both implemented

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<sup>23</sup> IFAD. République démocratique du Congo, Évaluation de la stratégie et du programme de pays, Rome, 2016.

<sup>24</sup> Retaining, whenever possible, experienced and performing staff from previous projects, involving them in design for greater ownership and easier start-up, and systematic and periodic capacity building / financial management training at start-up and throughout implementation. (WCA Portfolio Review, 2015).

<sup>25</sup> High Level Forum. Paris Declaration on Aid Effectiveness. Ownership, Harmonization, Alignment, Results and Mutual Accountability. Paris, February 2005.

<sup>26</sup> Including single treasury accounts, budgets, integrated financial accounting systems, internal audit institutions, and administrative procedures for authorization of expenditures or SAIs.

<sup>27</sup> IFAD Project Status Reports.

<sup>28</sup> ESA Portfolio Review, 2015.

<sup>29</sup> IFAD, IOE. República de Nicaragua, Evaluación de la Estrategia y Programa País. March 2017.

by the Ministry of Family, Associative and Cooperative Economy. These ratings significantly reflect the respective performances of financial and administrative management against the disbursement and results targets of these projects. Even though both project implementation units operated under the same authority, the project with the satisfactory efficiency rating was a straightforward value-chain promotion project in areas of good geographic accessibility. The other project had an overly complicated and ambiguous management framework, with the aim to bring indigenous communities into the mainstream economy. Thus, specific project features can override the simple distinction of whether country systems are used or not.

29. Similarly, stand-alone Project Management/ Implementation Units are the implementation arrangement used in many IFAD projects to get projects implemented on time, with minimal political interference and at expected levels of quality.<sup>30</sup> However, they are less appropriate for creating sustainable institutional capacities in countries. Since they generally cease to exist after project closure, they can only be expected to make negligible contributions to nurturing the institutional memory of the lead implementing agency. The creation and the subsequent dismantling of stand-alone Project Management/ Implementation Units entails considerable transactions costs, without leaving behind institutional assets. As such, these costs are only insufficiently captured by ex-post efficiency indicators, e.g. proportion of project management cost versus total project cost. In the long run, the continued absence of sustainable human and institutional assets relevant for financial management and fiduciary responsibilities in concerned lead ministries may exceed the directly measurable inefficiencies in the project themselves.
30. Ultimately, sustainability of project benefits can only be assured by national implementation capacities; this entails gradually building skills and fiduciary capacity to recognize, report and address problems. At the same time, projects whose implementation arrangements are fully mainstreamed within government institutions are often among the weakest performers (Botswana, Eritrea, Malawi, Mozambique and Tanzania).<sup>31</sup> However, there are exceptions, such as the IFAD Programme Support Cell (CAPFIDA) established by the Malagasy Ministry of Agriculture in 2006. According to the Madagascar CPE,<sup>32</sup> CAPFIDA was created as a “hybrid” solution before an IFAD country presence office was opened in 2012. The CPE assessed portfolio efficiency as moderately satisfactory (4) and explicitly attributed this rating to CAPFIDA. CAPFIDA played a major role in the organization and implementation of supervision missions. Even after the opening of the IFAD office, CAPFIDA continued to operate as a coordinating unit for IFAD operations within the Ministry of Agriculture. As such, CAPFIDA can be regarded as an entity enhancing the ownership of the line ministry.
31. The weaker the national administration capacity, the greater the reliance will be on dedicated systems for IFAD project implementation. While the need to better anchor projects and project teams within their national systems is an important goal to pursue, doing so will most likely remain a major challenge where the institutional capacity of most technical line ministries, particularly agriculture, is very weak. Nonetheless, although limited, the use of national financial management systems is making progress. For example, IFAD-funded projects in Ghana and Sierra Leone were, for the first time, audited by supreme audit

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<sup>30</sup> ESA Portfolio Review, 2014.

<sup>31</sup> ESA Portfolio Review, 2015.

<sup>32</sup> FIDA, Bureau Indépendant de l'Évaluation. République de Madagascar, Évaluation du Programme de Pays. October 2013.

institutions. Further related capacity-building initiatives should make it possible to rely even more on in-country supreme audit institutions.<sup>33</sup>

32. Reliance on country financial management and procurement system poses a dilemma for all International Financial Institutions (IFIs) as they need to reconcile country ownership and leadership in programme design and implementation with weaknesses in country fiduciary compliance and their own fiduciary requirements. Their loan operations therefore routinely integrate efforts to reinforce country financial management capacities. Despite the risks involved, the other IFIs make far greater use than IFAD of government departments and agencies as implementing agencies for their projects. This facilitates the continuation of project functions when the project ends, whereas IFAD's stronger reliance on PMUs tends to weaken sustainability since their financing beyond the project is not assured. For the Asian Development Bank (ADB) supported projects, ad-hoc financial management systems should be the last resort, to be adopted only when existing systems are found completely unreliable and unacceptable. The World Bank even considers the risks of proposed fiduciary arrangements on the achievement of greater use of country systems and strengthening capacity.
33. Hence, the longer-term risk of strong fiduciary controls for sustainability and the accrued risk in relying on national capacities for fiduciary compliance need to be carefully weighed. Risk mitigation measures need to be checked for their compatibility with enhanced country ownership through better-quality exit and phasing-out strategies, as well as by mainstreaming newly-created institutions within government programmes.<sup>34</sup> Apart from the previously mentioned SPIU in Rwanda, the Guangxi Administration Centre of Foreign Funded Projects for Agriculture provides another example from which to draw lessons regarding reliance on national systems in project management. The Guangxi Administration Centre of Foreign Funded Projects for Agriculture in China was a permanent feature of the Ministry of Agriculture, which overtook the function of the Project Management Office of the West-Guangxi Poverty Alleviation Project when it was planned and implemented. Moreover, county programme management offices in all the project-supported counties mirrored the project implementation set-up at regional level.<sup>35</sup>

**LESSON 3: Effective fiduciary monitoring enhances financial management controls and fiduciary compliance, but does not eliminate fiduciary risks.**

34. Lesson 3 infers that fiduciary risks during implementation are directly proportional to the managerial weaknesses found in the administrative units responsible for all stages of management in the project cycle. It can be argued that effective fiduciary monitoring – while a prerequisite for fiduciary compliance – would find more fertile ground if the respective project management units could be strengthened on a long-term basis, and thus be available for similar operations in the future and be allowed to grow in management capability. With no medium- to long-term strategy to build such capacity, the voids left behind by the repeated build-up and deconstruction of project management units deepen financial management and fiduciary liabilities.
35. In spite of the care taken during project design to contain inherent risks through relevant management arrangements and contractual safeguards, significant risks continue to weigh on project implementation. Inadequate assessment of the implementing institutions is, next to overambitious designs, seen as one of the

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<sup>33</sup> WCA Portfolio Reviews, 2014 and 2015.

<sup>34</sup> ESA Portfolio Review, 2014.

<sup>35</sup> IFAD, People's Republic of China. West Guanxi Poverty Alleviation Project, Project Completion Report. September 2010.

main causes of non-performing projects.<sup>36</sup> Institutional provisions put in place regularly fail to perform as expected and hence inherent risks become control risks.

36. Weak management remains one of the core challenges to fiduciary compliance. It is frequently linked to the failure to secure adequate staffing arrangements in terms of skills and numbers, combined with turnover of key positions. Insufficient management capacity translates into ineffective and often unrealistic planning, procurement delays, disrupted flow of funds, inadequate follow-up on project activities, and ultimately sub-optimal returns on investment. Insufficient financial controls frequently cause implementation delays and at times lead to project failure.<sup>37</sup>
37. A case in point is the Sivas-Erzincan Development Project in Turkey, where inadequate staffing at regional level constituted a significant handicap to project implementation. Ignoring IFAD's calls to improve staff salaries, the project failed to attract high-calibre staff to work in the remote and disadvantaged project area provinces. Operating with fewer staff than envisaged, the project failed to deliver on its potential. In Ethiopia, the Agricultural Marketing Improvement Programme was confronted with almost complete staff turnover that left the project in disarray. Indeed, the 2016 Ethiopia CSPE noted that high levels of staff turnover in PMUs was a generic issue affecting IFAD projects (as well as projects of most other donors) and an impediment to implementation performance.
38. To keep fiduciary risks in check, project-level monitoring of financial management needs to focus particularly on the following risk control areas: (i) disbursement / withdrawals; (ii) work planning and budget; (iii) audits for internal management and contractual compliance; and (iv) procurement. Their fiduciary importance is discussed in the paragraphs that follow.
39. **Disbursement/withdrawals.** Disbursement in accordance with work planning ensures that projects have adequate liquidity to implement their activities. In turn, low disbursement rates constitute a fiduciary risk in that funds are not used efficiently. Indeed, disbursement delays commonly foreshadow project extensions that add to the management and supervision costs of a project; moreover, they are disruptive to IFAD's cash flow management and capital replenishment. For example, the Sustainable Development Project for Agrarian Reform Settlement North-East (Dom Hélder Câmara Project) in Brazil experienced a 24-month delay in becoming effective and required an extension of three and a half years to compensate for the late start and the initial disbursement delays. Such a prolonged duration inevitably brought about an increase in IFAD and government expenditure on management and supervision. Disbursement delays may also signal underlying weaknesses with regard to other fiduciary aspects of a project, notably unrealistic planning, slow procurement, or problems related to the funds-flow mechanism.
40. Disbursement performance is therefore regularly monitored by projects and receives special scrutiny in loan withdrawals (withdrawal application process). Proactive management becomes necessary when disbursement lags put projects at risk (potential or actual problem projects). Disbursement delays at project start-up are very common; they often reflect "lack of readiness at approval and weaknesses in implementation and fiduciary capacity on the client side" and are a cause of "slippages in project implementation schedules, increase in overhead costs and significant cancellations of loan amounts".<sup>38</sup> A recent in-depth study on IFAD's disbursement performance (2016) documents generally mediocre disbursement performance, especially at start-up, with disbursement readiness (i.e. the average

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<sup>36</sup> NEN Portfolio Review, 2015.

<sup>37</sup> Weaknesses in client capacity for fiduciary aspects, as well as complex accounting and procurement procedures, added to IFAD administrative costs and contributed to delays in project implementation. Timely release of counterpart funds was also a problem in some cases. (Corporate-level Evaluation – CLE - Efficiency, 2013, p. 56.)

<sup>38</sup> CLE Efficiency 2013, p.113.

time from approval to effectiveness/first disbursement/second disbursement) in the order of 17.6 months. With regards to disbursement effectiveness, the study found that IFAD's overall disbursement rate at financial closure amounts to 84.4 per cent<sup>39</sup> and that projects are generally slow in disbursing funds, reaching 33 per cent at the project mid-term and not more than 71 per cent at the original completion date. The study pointed to factors under IFAD's control that could reduce disbursement delays, which include reliance on Country Presence Officers (CPOs) in IFAD country offices, more experienced Country Programme Managers (CPMs) with reasonable workloads, and maintaining CPM continuity during the start-up phase.<sup>40</sup>

41. In practice, disbursement delays were caused by a variety of conditions, often specific to a project. One recurrent problem appeared to be "administrative and procedural challenges that PMUs faced in carrying out their fiduciary responsibilities at project inception,"<sup>41</sup> including long and often problematic recruitment processes. At times, political interference provoked a slowdown, as was the case in the "Programme d'appui au développement des filières agricoles" in Congo and the "Projet de lutte contre la pauvreté dans l'Aftout sud et le Karakoro Phase II" in Mauritania. In the "Programme de Promotion des Opportunités Economiques et Sociales" in Cabo Verde, delays were due to difficulties in complying with labour legislation for the establishment of staff contracts. In the "Programme for Rural Outreach of Financial Innovations and Technologies" in Kenya, the "Rural Financial Intermediation Programme" in Lesotho and the "Marketing Infrastructure, Value Addition and Rural Finance Support Programme" in Tanzania, difficulties establishing flow of funds mechanisms delayed project effectiveness. Projects in countries in fragile situations were particularly prone to disbursement delays.<sup>42</sup>
42. **Work planning and budget.** Disbursement delays often arise from unrealistic project planning and budgeting. Lack of coherence between the AWPB, the principal instrument for project planning, and actual implementation is very common. In many instances, AWPBs are overly ambitious and take little account of previous experience and the absorptive capacity of the various entities involved in implementation. Weak planning capacity, limited availability of qualified service providers and lengthy government procurement systems tend to result in long implementation delays.<sup>43</sup> Management costs are frequently higher than anticipated due to unforeseen or underestimated costs, the difficulty to attract and retain competent staff and service providers in remote areas, and the need to recruit extra staff. The difficulties are often exacerbated in fragile situations.
43. An illustration of shortfalls in the planning systems is the PRAPE project in Congo, where underestimation of unit costs of infrastructure resulted in significant cost overruns, failure to deliver, and delivery of poor quality structures. Similarly, in the "Programme National de Développement des Racines et des Tubercules" in Cameroon and the "Projet de Réhabilitation Rurale et de Développement Communautaire" in Guinea Bissau, PMU operating costs led to cost overruns for project management, which disrupted project implementation. A positive example of the effective use of planning systems can be found in the "Projet d'appui aux

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<sup>39</sup> Highest to lowest disbursement rates by region: Near East and North Africa (NEN) (90.8 per cent); APR (88.4 per cent); Latin America and the Caribbean (LAC) (85 per cent); ESA (81.5 per cent); and WCA (79.7 per cent).

<sup>40</sup> The study also found that female CPMs tend to have quicker-disbursing projects than male CPMs, with statistically positive effect during the phase from approval to entry into force and from first to second disbursement. Notably, at the end of 2015, only 25 per cent of CPMs in IFAD were female.

<sup>41</sup> CSPE Mozambique, 2016.

<sup>42</sup> This is supported by the IFAD disbursement study, which found that country-level factors affect both disbursement readiness and effectiveness, in particular countries in fragile situations. A fragile MIC with constrained fiscal space and concurrent elections has a high likelihood of having delayed first and second disbursements, whereas a non-fragile LIC with a stable local currency and frequent cycle of elections and natural disasters (e.g., droughts) tends to have higher disbursement rates.

<sup>43</sup> WCA Portfolio Review, 2013.

filières agricoles” in Senegal. The project executed 100 per cent of its AWPB due to effective participatory processes that involved all project staff, and regular reviews of progress against key indicators.<sup>44</sup>

44. Weaknesses in the use of the AWPB, marked by inadequate analytical programming and budgeting of activities,<sup>45</sup> lead to reduced efficiency in the use of funds and therefore diminish fiduciary compliance as budgets are underutilized or approvals of AWPB are delayed relative to the liquidity requirements for project implementation. Inadequate planning capacity and lack of a management-for-results culture are largely responsible for unsatisfactory planning practices. All too often, the AWPB is seen primarily as an IFAD reporting requirement rather than an essential tool for project planning and monitoring.
45. **Audit and internal controls.** Internal and external audits are critical in implementation-stage monitoring of the quality of financial management and hence for controlling fiduciary risks. Audits routinely identified issues with the financial systems and internal controls and provided recommendations on corrective actions concerning: (i) *accounting and procedures* - unreliable accounting systems and procedures and incomplete and/or erroneous recording of transactions, overpayments, insufficient maintenance of audit trails, or difficulties/delays in preparing withdrawal applications; (ii) *reporting and monitoring* - inadequate understanding of IFAD reporting requirements, leading to unacceptable financial statements, and irregular interim reporting resulting in sub-optimal monitoring of financial performance; and (iii) *compliance with financing covenants* - the late submission of the AWPB, slow preparation and update of the Project Implementation Manual and infrequent steering committee meetings.<sup>46</sup>
46. The past few years have seen noticeable improvements in the quality and timely execution of audits. Compliance with IFAD auditing standards has improved across programme regions.<sup>47</sup> Evaluation reports appear to corroborate this trend as audit issues were mentioned only infrequently. Still, the quality of audit reports remained highly dependent on existing in-country audit capacities, private auditors and supreme auditing institutions.<sup>48</sup> Likewise, internal audits, were not performed on a systematic basis, and not always given due attention. In general, the effectiveness of audit in controlling fiduciary risks was boosted when the internal audit function was properly integrated with a project’s operating structure. The Rwanda SPIU is an example of the proper use of internal audit for strengthening project financial management (Kirehe Community-based Watershed Management Project and Project for Rural Income through Exports in Rwanda); audit performance in Senegal and The Gambia was also commended.
47. **Procurement.** Procurement in IFAD loan projects is commonly governed by the rules and regulations of the borrowing country and implemented through national systems, with national implementing agencies responsible for ensuring that procurement action meets the fiduciary standards specified in the loan agreement and IFAD’s procurement guidelines. This is far from straightforward despite IFAD’s involvement in the process via mandatory ‘no objections’ for procurement plans and the review of the pre-qualification of bidders and the procurement process. This involvement calls attention to the need for specialized knowledge in procurement management for IFAD’s supervision.

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<sup>44</sup> WCA Portfolio Reviews, 2014 and 2015.

<sup>45</sup> Better monitoring of implementation progress and more flexible updating of work plans and budgets, both with respect to the timing of activities and their costing, would improve the coherence between the AWPB and actual project execution. (WCA, 2015).

<sup>46</sup> ESA Portfolio Review, 2015 and APR Portfolio Review 2015.

<sup>47</sup> Almost 9 in 10 auditors now state that they follow either the International Standards on Auditing (LAC, 2013) or the International Standards of Supreme Audit Institutions (11 per cent) and almost all provide the three audit opinions that IFAD requests (Financial Statements, Statement of Expenditures and Designated Account). (ESA, 2015.)

<sup>48</sup> WCA Portfolio Review, 2014 and ESA Portfolio Review, 2015.

48. Procurement issues loom large in projects experiencing disbursement problems. For instance, in the ESA 2014 portfolio review, 70 per cent of the problem projects were affected by procurement-related constraints and delays, including: inefficient institutional arrangements; lack of clarity in terms of accountability; weak capacity that hinders effective communication and coordination among key players in the procurement process; irregular tender committee meetings; ineligible expenditures due to non-adherence to procurement rules; lack of capacity by the local government authorities to implement comprehensive national regulations combined with the lack of incentives to follow procedures; and lack of experience and capacity within the implementing agency.
49. Efficiency of procurement processes was undermined by: inadequate bid solicitation and document preparation; inconsistencies in applying the procurement methods; unacceptable conduct of evaluations; inadequate filing systems/poor record-keeping; non-compliance with prior review procedures; and weak contract management. Slow government processes responding to heavy national procedural requirements mean that planning becomes essential for the project's success.<sup>49</sup> However, procurement planning and monitoring are often weak, as the preparation and updating of procurement plans and their linkage to AWPBs are neglected.<sup>50</sup> The result is delayed delivery of goods and services not meeting technical specifications and thus, ineffective and inefficient use of project funds.
50. A few countries stand out for their procurement performance. In the ESA region, the Rwanda country programme continues to be the best performer in terms of procurement. Well-structured public procurement reforms with integrated capacity building over the past decade, and the results-oriented mentality within government, are responsible for this good performance. In the LAC region, El Salvador has a particularly good record in procurement. It can be attributed in part to special procurement arrangements supported by UNDP.<sup>51</sup> The above factors, plus the examples cited in paragraph 46 may be drivers to consider devising the multi-donor-sponsored creation of permanent project management units in key ministries relevant for IFAD. Done with a medium-term perspective, such an institutional investment needs to be made with conditions related to staff quality and continuity, but also come with possible co-benefits for the countries and ministries in question, e.g. systematic capacity upgrading of permanent PIU staff. Such measures may fulfil the promise to substantially improve the financial management of projects and reduce related fiduciary risk.

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<sup>49</sup> ESA Portfolio Review, 2015.

<sup>50</sup> Eighty per cent of sampled procurement plans (eight countries and 13 projects) are not updated regularly; information is therefore often inadequate and cannot be relied upon. (ESA 2015; WCA, 2015, 2014 and before.)

<sup>51</sup> Project for Reconstruction and Rural Modernization and Rural Development and Modernization Project for the Eastern Region in El Salvador are among the positive outliers in terms of their procurement scores.

Box 2

**Fiduciary responsibility. When all goes well ...**

The **Microfinance for Marginal and Small Farmers Project** in Bangladesh performed well on all fiduciary aspects. The loan became effective in a record 6.9 months after IFAD Board approval, upon fulfilling the accompanying effectiveness conditions, notably the prompt recruitment of project personnel. Being able to rely on the well-established project management capacity of the not-for-profit Palli Karma-Sahayak Foundation proved to be a major strength. As the implementing agency for project, the Foundation carried out all fiduciary and administrative aspects of project management, including the management of all project-related accounts, the preparation and signing of withdrawal applications, and procurement in accordance with IFAD procurement guidelines. The Ministry of Finance had no direct implementation role, which prevented potential bureaucratic delays. Rather, it limited itself to effective facilitation of the project, including the review and approval of annual workplans and budgets, and organizing and chairing coordination and wrap-up meetings of supervision missions.

Supervision of the project was also unproblematic. The presence of local experts in supervision missions was valued as it allowed further consultations on technical matters. Continuity of IFAD experts on design and supervision missions advising project implementation was considered to be instrumental, as was the participation of the country programme manager (or field presence officer). The project was able to maintain its project management performance throughout implementation and excelled at the extremely low cost of 2 per cent of the total project cost for the project management component.

Source: Project Performance Assessment, February 2014.

51. Procurement is a major item on the IFI fiduciary agenda. All other IFIs have recently<sup>52</sup> initiated broad-based reforms to modernize their procurement frameworks with a view to speeding up complex and inflexible procurement processes and aligning procurement with “value-for-money” risk management and anti-corruption efforts. A more dynamic risk-based procurement framework able to adapt to changing circumstances involved: enhanced ex-ante assessment of procurement risks at country, sector and agency levels in return for – conditions permitting<sup>53</sup> – a more hands-off approach to procurement operations. For low-risk procurement, the review of contracts after they have been awarded would establish ex-post accountability and hence maintain the necessary fiduciary standards. A more discriminating and flexible application of procurement guidelines is set to further streamline processes and reduce cost. Measures include the use of advance contracting and retroactive financing, e-procurement systems, customized methods and procedures for more complex procurement, and ex-post review of a sample of contracts.<sup>54</sup>
52. **LESSON 4: Project supervision contributes to fiduciary compliance if and when it is backed by credible enforcement and matched by effective implementation support.**
53. Project monitoring of fiduciary risks is complemented and reinforced through IFAD supervision. The purpose of this supervision is to: (i) oversee the functioning of project-level risk controls and thus to improve project compliance with loan fiduciary requirements; and (ii) enhance the capacity of projects to properly manage their activities in general, and finances in particular. To these ends, IFAD keeps an eye on possible performance shortfalls in the controls, and provides appropriate incentives for improved control performance. It also identifies impediments to project implementation with a view to directly mitigating the associated risks through necessary capacity and implementation support.

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<sup>52</sup> AfDB, 2014; ADB, 2015; World Bank 2016.

<sup>53</sup> Award process would be more closely supervised only when risks are high.

<sup>54</sup> Post-review sampling is expected to reduce the number of contract reviews by regional departments by 25 per cent and shorten the procurement process for many operations.

54. **Supervision of fiduciary aspects.** Supervision starts with the fiduciary risk assessment during the design stage of the project, but takes its full value during implementation by monitoring disbursement and flow of funds, compliance with loan covenants, administrative management and financial management aspects of implementation such as budgeting and accounting, treasury management, financial planning, internal controls, financial reporting and audit compliance. Supervision missions review and score six aspects of project fiduciary compliance to support IFAD's project and portfolio risk management.<sup>55</sup> IFAD's fiduciary supervision is centred on the quality of project controls of annual work planning and budgets, procurement and audits.<sup>56</sup> Through the withdrawal application process, disbursement authorization is conditioned on risk assessments and supervision results, thereby providing a key lever for enforcement of compliance with fiduciary responsibility.<sup>57</sup>
55. Unsatisfactory scores on the project controls prompted IFAD to assist projects by improving the control instruments and capacities and using persuasion and, as necessary, stronger enforcement measures to obtain compliance with fiduciary standards. With fiduciary scores guiding IFAD priority actions, fiduciary performance on the whole did improve over the review period, with the notable exception of procurement and work planning. The last-mentioned areas are therefore high on IFAD's fiduciary agenda.
56. In recent years, supervision of project financial management/fiduciary aspects has become more focused as financial management specialists are now systematically included in supervision missions. The shift of responsibility for loan administration and oversight of financial management from PMD to FMD, starting in 2012, has reinforced financial management expertise.<sup>58</sup> More frequent in-depth portfolio reviews, now quarterly rather than annually, allow closer monitoring of fiduciary risks. An enhanced quality screening for financial management and procurement consultants through a formal accreditation process was introduced in 2016.
57. Furthermore, the mainstreaming of the risk-based control framework is helping IFAD to better manage fiduciary risks across its portfolio, as more systematic assessment and profiling of country and project risks on entry set the tone for the rigour of supervision and ultimately the ease of disbursement.<sup>59</sup> Investment in the automation of the withdrawal application process is generating efficiencies in loan disbursement, notably shorter processing delays.<sup>60</sup>
58. For other IFIs, as with IFAD, supervision missions have traditionally played a central role in the fiduciary oversight, with usually at least one full supervision mission per year and more frequent missions for projects at early stages of implementation or "at risk". Yet increasingly, fiduciary oversight functions are farmed out to specialists in country offices (World Bank, ADB) or regional resource centres (African Development Bank - AfDB); in turn, smaller missions, carried out at various times throughout the year, focus on technical and institutional issues of

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<sup>55</sup> Quality of financial management, acceptable disbursement rate, counterpart funds, compliance with loan covenants, compliance with procurement, and the quality and timeliness of audits.

<sup>56</sup> Audit results and recommendations are of special importance to supervision missions in identifying shortcomings in financial management. Supervision mission reports provide the status on the follow-up of audit recommendations. Also control through external (financial) audit is required once a year.

<sup>57</sup> No-objection clauses for annual work plans and budgets and procurement reviews, as well as audit TOR and auditor selection, ultimately rely on the incentive effect of the disbursement authorization process.

<sup>58</sup> Until now financial management consultants have been working for PMD, but budgets and oversight will be completely shifted to FMD by 2018, having started in LAC and WCA in December 2016.

<sup>59</sup> Withdrawal applications in a low-risk environment would be implemented with a view to smoothly supporting the flow of funds (with simplified disbursement and higher thresholds). Risk indicators would allow IFAD to keep risks in check. In general, "a higher level of controls should be applied to areas and processes with relatively higher risk, while lower-risk areas may be managed adequately through the periodic conduct of ex-post controls on a sample basis." (Risk-based controls in accounting, payroll and payments processes – A conceptual framework, p. 3.)

<sup>60</sup> Flexcube (FXC) since 2013, WA Tracking System (WATS), online e-WA since 2016. WA processing time declined from a high of 36 days to reach 18 days by the end of 2015, reaching the IFAD9 target of less than 18 days.

project implementation.<sup>61</sup> In this model, less frequent full-scale supervision missions are sufficient (World Bank, ADB). AfDB is considering moving towards a model of continuous supervision. Due to its limited country office capacities, IFAD continues to rely principally on regular supervision missions which include primarily regional financial management consultants or financial officers based in headquarters.<sup>62</sup> Even so, IFAD country offices and regional hubs have also started taking up fiduciary supervision functions, particularly when the CPM is based there.

59. **Enforcement.** Supervision report findings and recommendations were not always sufficient for projects to adopt the necessary measures to overcome shortcomings with regards to fiduciary controls, and additional compliance measures became necessary. In the interest of project continuity, sanctions stipulated by the financing agreement and General Conditions were only used as the last recourse. Most of the time, lower-level measures would succeed in redressing fiduciary controls. Thus, IFAD and the borrower would identify a time-bound path to resolving a problem with, e.g. improvements to the accounting system or refunding ineligible expenditures, becoming a disbursement condition. But stronger formal sanctions are required at times. In any event, sanctioning measures need to be properly tailored to the fiduciary incident to help resolve fiduciary problems.<sup>63</sup>
60. Project-specific suspensions, possibly restricted to a specific component or to selected categories of expenditure, or even suspension of an entire country were possible when major fiduciary breaches occurred. In Sierra Leone, for example, an organizational audit carried out by the national auditor confirmed misappropriation of project resources. Project suspension pending refund of ineligible expenditures, revision of the Project Implementation Manual and payment of counterpart funds prompted the Government to comply with almost all requirements so that the suspension could be lifted, as reported the 2015 WCA regional portfolio review. Regularly, though, the simple threat of suspension can be effective. When legal suspension notices were sent to the Agricultural Marketing Improvement Programme in Ethiopia and the Rural Diversification Programme in Mauritius warning them of the possible suspension of disbursements due to non-receipt of audit reports within the due period, the audit reports were sent. Therefore, the notices did not have to be enforced.<sup>64</sup>

**LESSON 5: Implementation support diminishes fiduciary control risks, but is limited by high transaction costs.**

61. Implementation support measures boost fiduciary control as they take on ongoing weaknesses in project financial management. Following up on problems identified in the course of project supervision, IFAD provided advisory support to resolve specific problems and training to develop local capacities. By and large, its measures, spanning the whole range of fiduciary concerns – including work planning and budget preparation and execution, technical issues, the monitoring and evaluation system, reporting tools, the financial management system, procurement and other financial issues – helped to improve fiduciary performance of the project.<sup>65</sup> Pro-active management of potential fiduciary issues, including through better use of MTRs,<sup>66</sup> contributed to the effectiveness of measures. Projects starting up or “at risk” usually required more intensive implementation support through more frequent and enhanced supervision and implementation

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<sup>61</sup> The World Bank and ADB, for instance, now have 70 per cent of supervision missions led by staff in the field, whereas the majority at IFAD are led by staff from headquarters, especially with regards to financial management.

<sup>62</sup> There is increasing emphasis to use the supervision report to focus on key issues and risks that are important going forward.

<sup>63</sup> FAM and Regional Portfolio reviews.

<sup>64</sup> ESA Portfolio Review, 2010.

<sup>65</sup> WCA Portfolio Review, 2013.

<sup>66</sup> NEN Portfolio Review, 2015.

support missions.<sup>67</sup> Sustained capacity-building and training efforts were often needed, particularly in countries in fragile situations and with weak institutions.<sup>68</sup>

62. Yet the de facto high cost of supervision missions has limited their use. Therefore IFAD initiated a series of measures to improve the efficiency and effectiveness of supervision and implementation support missions, which reduced their number by 22 per cent between 2012 and 2016.<sup>69</sup> For instance, IFAD was able to achieve economies of scale by using missions tasked with covering the whole country programme to also include a thorough supervision of one project and follow-up of any other ongoing projects. Better cross-regional knowledge-sharing and exchanges of experiences helped IFAD not only to reduce costs, but also to promote organizational learning, innovation and sharing of good practices on specific thematic areas and management issues.<sup>70</sup> IFAD also streamlined its use of expert resources by drawing on IFAD staff and experienced project staff to support projects in critical areas, such as financial management, procurement and monitoring and evaluation. Development of staff competencies was reported to be instrumental in improving the quality of support.
63. Organizational efforts to enhance the quality and effectiveness of IFAD's supervision and implementation support included: increasing the use of decentralized IFAD country offices and regional hubs (Hanoi and Nairobi) with financial administration specialists from FMD and the Field Support Unit, for closer and more continuous implementation support; partnerships with other in-country institutions; and policy dialogue with governments. Country offices have been helpful in supporting the timely resolution of implementation issues through their closer monitoring of project progress and interaction with stakeholders and government counterparts. This is, for instance, confirmed in the Uganda CPE,<sup>71</sup> inferring that the Field Presence Pilot Programme (launched in 2003) has provided useful insights for introducing direct supervision and implementation across the Uganda portfolio in recent years, as well as establishing and consolidating a country presence in Kampala. Yet the division of labour and communications between headquarter and IFAD Country Offices (ICOs) still needs fine-tuning, and the small capacity of the ICO, at times with only one Country Presence Officer (CPO), clearly limits the potential.<sup>72</sup> The combined measures brought about further improvements to the quality of financial management and fiduciary supervision and implementation support.

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<sup>67</sup> NEN Portfolio Review, 2015 and WCA Portfolio Review 2013.

<sup>68</sup> WCA Portfolio Review, 2015.

<sup>69</sup> The number of supervision and implementation support missions across regions declined from a high of 517 in 2012 at the end of IFAD8 to 405 in 2016 at the start of IFAD10. The reduction ranges from 4 per cent in APR and LAC to 20 per cent in WCA and 41 per cent in ESA and NEN.

<sup>70</sup> Peer review processes have become an effective tool for enhancing quality of supervision and reporting. For example, in NEN, all supervision and MTR reports are systematically reviewed by a group of peers, the direct supervision support team, CFS and an external reviewer. In WCA exchange visits between good performers and those needing improvement are organized and experienced "retired" project managers are being called upon to coach newcomers. (WCA 2015)

<sup>71</sup> IFAD, IOE. Republic of Uganda, Country Programme Evaluation, Rome, April 2013.

<sup>72</sup> WCA Portfolio Review, 2015.

**Fiduciary responsibility. A more challenging environment ...**

The **Roots and Tubers Market-Driven Development Programme** in Cameroon attests to the challenges of ensuring fiduciary compliance. Even though weak management capacities were a known risk to project implementation in the country, the project was not effective in containing the risk. Related training efforts proved to be insufficient. Overambitious design in a challenging governance environment enhanced implementation risks. Unsuitable institutional arrangements and difficulties with the project management unit linked to staff selection and cohesion contributed to weak project administration and financial management performance, as the project encountered significant delays in project start-up, annual work plans, procurement, contract management and payments.

An audit review flagged some of these problems and alerted IFAD to the need for more intense supervision and support. A six-month action plan with targeted technical support and training, including the recruitment of local service providers for capacity building, helped improve financial execution during the last two years of the project. After formal notification by IFAD, the Government undertook the necessary corrective measures regarding procurement, accounting and internal control. The opening of an IFAD country office also had a positive effect on governance and implementation results in IFAD-supported projects, including the project in question. Still, some fiduciary compliance issues, especially in regard to counterpart financing, remained unresolved. Contract delays and higher implementation costs ultimately led to lower rates of return for the project.

Source: Project Completion Report Validation, June 2015.

### III. Way forward

64. The lessons emerging from this study are testimony to the challenges of fiduciary risk management. Squaring IFAD's loan fiduciary responsibility towards its contributors with project implementation by borrowing country institutions that have limited management capacities, while sharing responsibility for development results, is by no means an easy task. Fiduciary compliance requires institutional and procedural responses that are carefully tailored to highly diverse conditions and dynamics of countries. Sustainability of project results, in turn, calls for national institutions to drive these solutions, with IFAD standing by to assist in implementation. Hence, the primary conclusion that emerges for IFAD is that:

**Successful management of fiduciary responsibilities needs rigour rather than rigidity in preparation, design, supervision, enforcement and backstopping of projects.**

65. Ultimately, the only way to address fiduciary risk is to help build institutional capacity; only a medium-to long-term time horizon appears realistic to meaningfully reduce risk levels. Inasmuch as IFAD, with its relatively modest resources, cannot take on broader national capacity building, its fiduciary risk focus needs to be on achieving the proper balance between short-term compliance with fiduciary responsibilities and the broader prospects for development goals and sustainability. As part of this more holistic approach, risk tolerance based on prospective development benefits is necessary, and short-term fiduciary risk management cannot be designed to straitjacket implementation, but rather to avail projects with the required liquidity for smooth implementation.
66. Still, risk has to be carefully managed. While IFAD's own fiduciary duties call for rigour in adhering to established fiduciary principles and standards, excessive and potentially disruptive rigidity in the management of fiduciary compliance at the project level can be avoided if risks are properly anticipated; hence, the focus on regular risk assessments throughout the project cycle. However, to be able to deal with risks in a preventive manner, it is essential to have risk surveillance that is more continuous than that afforded by the current annual risk reviews, which tend to identify risks once they have already materialized. Complementing the present

system of pro-active management of projects that are potentially at risk and actual problem projects, ongoing risk monitoring would allow IFAD to more closely assess the evolution of these risks, the effectiveness of the mitigation measures being implemented, and the possible need for changes in the course of action. It would have to be based on a coherent set of experience-based, early-warning indicators/signals. The current system of fiduciary indicators is ill-suited to this task, but continues to be a useful, if perfectible,<sup>73</sup> measure of overall fiduciary performance.

67. Lastly, the systematic risk-based management approach, adopted by IFAD and other IFIs, allows for more efficient fiduciary management as it aligns risk control and mitigation structures to levels of assessed risks. Instead of applying a standardized set of fiduciary procedures across all countries and projects, a risk-differentiated approach with respect to financial management arrangements, audits, field supervision and disbursement methods makes it possible for IFAD to direct more of its management attention and resources to those fiduciary circumstances that need it most.<sup>74</sup>

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<sup>73</sup> Fiduciary scores should not be based on an arithmetic average, but rather reflect weights relative to possible impact on implementation. There is a need to make scores more consistent and comparable across the Organization, to reduce the degree of subjectivity and align with the operational risk assessment for portfolio management.

<sup>74</sup> The corporate-level evaluation on IFAD's engagement in fragile and conflict-affected states and situations (2015, p. 75) posited, "More flexibility in compliance with fiduciary requirements - Additional budget to work in fragile contexts (e.g. additional costs of transportation, higher consultant fees, need for much closer supervision/higher number of supervision missions, etc.)."