



Assessing and Using Partner Government Systems for Public Financial Management and Procurement

Guideline

10 April 2019

Executive summary

Consistent with requirements contained in the DFAT *Aid Programming Guide* this document provides guidance on assessing the risks and benefits of using partner government systems (PGS) for public financial management (PFM) and procurement at national, sectoral and sub-national levels.

This guideline:

- › defines key concepts relevant to PGS for PFM and procurement;
- › sets out the key steps in assessing PGS for PFM and procurement and deciding whether to use them to deliver aid funding; and
- › gives operational guidance on matters such as providing funds through PGS through another donor.

In this guideline, partner government systems for PFM and procurement are abbreviated as ‘partner government systems’ or ‘PGS’.

1. Introduction

Historically there has been a broad international consensus that more effective aid is essential to reducing poverty and inequality. Recognising this, international donors, including Australia, committed to increasing their aid effectiveness.

In 2005, donors and partner governments agreed to the Paris Declaration on Aid Effectiveness and its five principles (ownership, alignment, harmonisation, managing for results and mutual accountability). The declaration sets out donor and partner government commitments against each principle. Donors and partner governments reaffirmed their commitment to increased aid effectiveness in the Accra Agenda for Action (2008) and the Busan Partnership for Effective Development Co-operation (2011).

The Paris, Accra and Busan commitments recognise that the quality of a PGS is a key influence on its prospects for achieving sustained economic growth, better service delivery

and poverty reduction. The commitments are based on the premise that aligning aid with partner government plans, policies and systems gives donors the best chance of helping to improve their efficiency and effectiveness. By aligning aid, donors create opportunities to influence and improve how all of a country's resources are allocated and disbursed, not just donor contributions.

The Paris Declaration includes a commitment by donors to use country systems and procedures to the maximum extent possible and, where use of country systems is not feasible, to design safeguards in ways that strengthen rather than undermine country systems and procedures. The declaration also includes commitments to support partner governments to strengthen their capacity and improve the quality of their systems. This guideline helps DFAT staff to operationalise these various commitments.¹

The First High Level Meeting of the Global Partnership for Effective Development Cooperation (2014) recommitted parties to strengthen and use country systems and promote assessment and dialogue on the extent to which their use is appropriate.

A 2009 Australian National Audit Office (ANAO) report on the former Australian Agency for International Development (AusAID) recommended that the Agency develop policies on using PGS, to facilitate greater use of those systems in delivering aid, and to improve the effectiveness of the approaches adopted (see Box 1). This guideline also responds to that recommendation.

Box 1

Australian National Audit Office recommendation on use of partner government systems

To facilitate increased use of PGS in delivering aid, and improve the effectiveness of the approaches adopted, AusAID develops policies that address:

- › the benefits of using PGS and the lessons learned to date
- › how decisions to use PGS are reached, including thorough assessment of potential development benefits and associated risks
- › how the more significant risks of using PGS are managed by AusAID.

Source: ANAO (2009), 'AusAID's management of the expanding aid program'.

Using PGS can bring important benefits, but it can also present challenges and risks—using systems does not automatically improve them. Accordingly, this guideline does not position the use of PGS as an automatic choice or default option, but rather as a judgment reached on the basis of a comprehensive and context-specific assessment of risks and benefits. DFAT's analysis and assessments will enable the Department to use PGS to the maximum extent possible, and to justify decisions not to use them. It will also help DFAT better support partner government efforts to strengthen their own systems.

¹ This guideline does not address the Accra Agenda for Action commitment to use partner government social and environmental assessment procedures (see Environmental Safeguards staff in the Environment Safeguards, Public Finance Management and Aid Risk Section (aidsafeguards@dfat.gov.au)).

2. Key concepts

2.1 What are partner government systems?

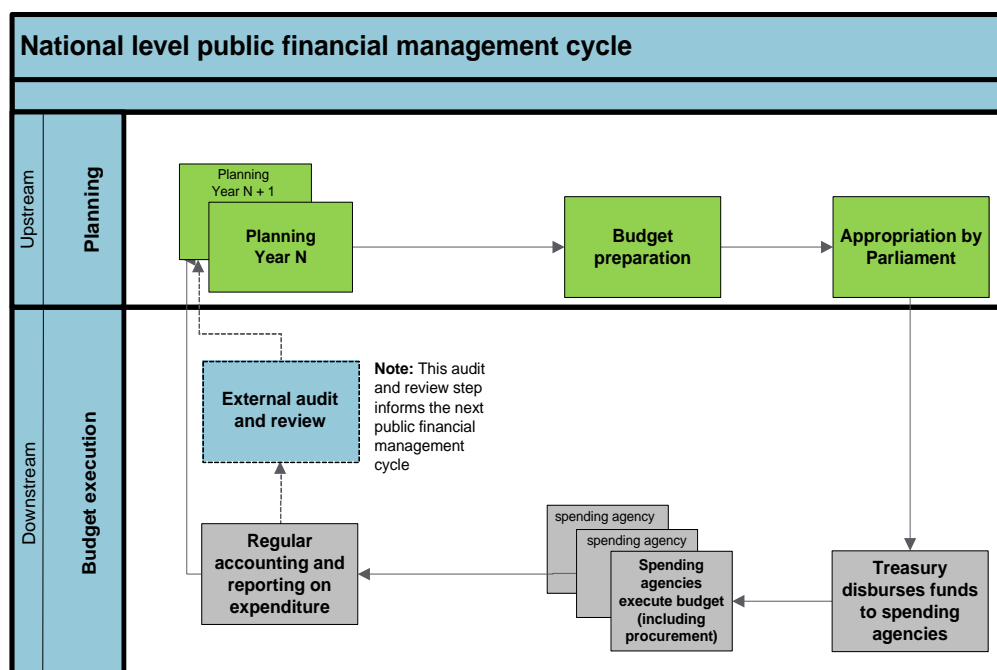
PGS have many elements, both formal and informal. Formal systems include the overall structure of government (which allocates responsibility and authority to different parts of government), and core public administration systems, including the arrangements for setting policy, the PFM system and the human resource management system. Informal systems comprise the cultures, political dynamics and practices that shape how, and to what extent, formal systems are implemented. No two country systems are the same.

This guideline is about partner government PFM systems. The term ‘PFM’ means different things to different people, but for many, it is understood to cover all key elements of a country’s budget process. This includes the key elements upstream from funds expenditure (relating to budget planning—such as strategic planning, revenue and expenditure forecasting and annual budgeting) and those downstream (relating to budget execution—such as disbursement, procurement, accounting, reporting, monitoring and evaluation, and audit). Although procurement is a component of the PFM system, the Paris Declaration and this guideline treat procurement as requiring separate consideration and assessment.

The purpose of a PFM system is to manage public revenues, expenditures and levels of debt to achieve the government’s overall policy objectives as efficiently and effectively as possible. The extent to which PFM systems achieve this varies significantly, depending on the quality of the systems themselves, the quality of the political decision making process, the performance of public officials and the level of corruption. The quality of systems may vary across and within sector ministries, as they may have distinct strengths and weaknesses at national level. Many countries have an additional layer of systems at a sub-national level of government, and the quality of these systems may also vary.

A country’s national PFM system will typically work in a cyclical, usually annual, fashion. The key components of such a system are shown in simplified form in Diagram 1.

Diagram 1: The national public financial management cycle



2.2 What is meant by 'using partner government systems'?

Broadly, an activity uses PGS if its funds are channelled through any key component of the partner government's PFM system, including procurement. Activities can be designed to use all components, or just some, and may use components with or without additional risk treatments or controls in place.

DFAT applies the following definitions:

- › An activity uses PGS in full if its funds use all components of the PFM system.
- › An activity uses PGS in part if its funds use some, but not all, components of the PFM system.

Understanding the difference between upstream (planning) and downstream (budget execution) components of PGS is important. It is possible to align with upstream components without using downstream components – this is relatively low risk in most country contexts. Potentially greater fiduciary risk is associated with using downstream components as well as upstream ones, so additional assessment is required before deciding to use these.

One way to understand how activities might use different components of PGS is shown in Table 2, which describes eight key components of PGS, and what it means to use (or to be 'on') each.

Table 2: Using different components of partner government systems

	Component	Definition
Upstream	On Plan	Aid funds are On Plan if they are incorporated into partner government spending agencies' strategic plans and into the supporting documentation for the policy intentions behind their budget requests.
	On Budget	Aid funds are On Budget if they and their intended use are incorporated into the partner government's budgeting processes and reflected in its budget documentation.
	On Parliament	Aid funds are On Parliament if they are included in the appropriation bills approved by the Parliament of the partner country.
Downstream	On Treasury	Aid funds are On Treasury if they are disbursed into the partner government's main revenue funds (or accounts), typically a Treasury account, and then managed according to the government's regular systems for disbursement and financial control.
	On Accounting	Aid funds are On Accounting if they are recorded and accounted for in the partner government's accounting system, in line with its own classification system.
	On Procurement	Aid funds are On Procurement if aid-funded procurements follow the partner government's procurement procedures.
	On Report	Aid funds are On Report if they are included in the financial and non-financial reports that monitor and report on the partner government's expenditure.
	On Audit	Aid funds are On Audit if they are audited by the partner government's internal and external auditing systems.

Source: Adapted from Mokoro Ltd (2008), 'Putting Aid On Budget: Synthesis Report'.

Note that it is possible to use components of PGS without fully meeting these definitions. For example an investment might use government audit systems but with the right to commission independent external audits, or rely on partner government procurement systems but require independent review/approval at key stages in procurement processes above a certain value.

Many other PGS are also relevant to the quality of PFM. For example, the quality of human resource management affects whether suitably skilled and qualified people are recruited for PFM positions, and what incentives they have to perform well once recruited. Poor human resource management may impact on program performance and risk levels, for example by undermining efforts to strengthen PFM systems through engagement of more competent PFM staff. The quality of these systems should be taken into account when considering whether and how to use PGS in a country.

The different components of PGS are especially relevant when choosing the type of aid to deliver funds. Each type of aid typically uses PGS to a different extent (although there is some flexibility within each). Box 2 gives examples.

Box 2

Use of partner government systems and types of aid

Aid given through General Budget Support usually uses PGS in full, because funds are transferred to the partner government's general Treasury account, and spent in the same way as government revenue.

Project funds do not normally enter the general Treasury account (not On Treasury) and are not subject to the decision making of, or accountability to, Parliament on the allocation of the resources (not On Procurement), meaning that projects cannot use PGS in full. However, a project could be designed to have its funds deposited into a government account and managed according to the government's own rules and procedures (for example, On Accounting, On Report, On Procurement).

More information on types of aid is available in the Guideline: *Choosing Approaches and Types of Aid for Working in Partner Systems*. Detailed information on using different components of PGS is available in the Background Note: *Using Components of Partner Government Systems*.

2.3 Key benefits and risks of using partner government systems

2.3.1 Benefits

Evaluations conducted to date show that using PGS can help to strengthen systems, and improve the quality of service delivery. Table 3 overleaf summarises the potential benefits.

Table 3: Potential benefits of using partner government systems

Category	Potential benefits
Policy alignment	Improved alignment with partner government policies, enabling dialogue and capacity to focus on those policies rather than on the often narrower objectives of donor support initiatives.
Systems alignment	Greater alignment with partner government systems (financial management, procurement and/or performance assessment systems), enabling dialogue and capacity to focus on those systems.
Ownership and accountability	Increased partner government ownership of policy and the development agenda, where donor funds align with government policy and development plans. Improved domestic accountability through increased focus on the government's own accountability channels (most likely if supported by demand for good governance initiatives).
Strengthening systems	Can strengthen PFM, procurement and reporting systems (in the medium to long term). Can improve the efficiency of public expenditures.
Good donorship	Higher potential for overall impact (encourages broader dialogue, streamline process of formulating reforms). Greater predictability of funding (mixed evidence on how much this happens in practice). Improved harmonisation among donors, enabling scarce capacity to focus on the domestic system rather than meeting fragmented accountability demands from donors. Greater sustainability of donor programs.
Transaction costs	Lower transaction costs for partner government (likely at implementation stage, not up-front). Lower transaction costs for donors (limited evidence). Increases the partner government's absorptive capacity.

Source: Various, including Organisation for Economic Co-operation and Development's Development Assistance Committee (OECD-DAC) (2006), 'Joint evaluation of general budget support' and OECD-DAC (2010), 'Benefits of using country public financial management systems: literature review'.

Use of PGS offers donors opportunities for broader influence and impact. These include opportunities for dialogue on the plans, policies, systems and processes that determine how all of a partner government's resources are allocated and disbursed (rather than just the funds associated with a specific aid activity). This is a key element in supporting the partner government to reform and strengthen PGS, and broadens the potential impact of aid by aligning it with the partner government's resource envelope and budget priorities.

Benefits are not always or automatically realised. The extent to which benefits are realised depends on a number of factors:

- › Whether the activity uses PGS with or without the imposition of additional or special requirements. Imposing special requirements on donor funds, such as additional financial reports, independent external audits or different procurement procedures, may be necessary to manage risk, but can create additional work for partner government officials and may distract the government from better understanding and applying its own requirements.

- › The country context is important: the broader governance and institutional environment in a partner country, including a lack of political will for reform, may significantly limit opportunities to strengthen systems and/or initiate policy dialogue. Without partner government commitment to PFM reform and policy dialogue, the use of PGS is unlikely to succeed in achieving development benefits and outcomes.
- › The scale of the shift to using PGS matters: Since the time and money required to assess PGS are substantial, small-scale use of PGS may not result in an overall reduction in transaction costs, particularly where the shift to using PGS is not associated with a reduction in the use of other types of aid.
- › Achievement of benefits depends on the objectives and design of the activity: these need to be informed by a strong understanding of the systems in question, and complemented by ongoing policy dialogue and capacity development measures to support systems reform.
- › DFAT needs people with the right skills and experience to maximise the Department's influence and usefulness in policy dialogue, and to monitor the performance of PGS over time. Additionally, human resource requirements for managing activities that use PGS are often greater than for traditional stand-alone projects.

The timeframe for achieving most benefits is medium to long term (at least five to 10 years). Sustainable reform to a country's PFM and procurement systems takes many years to achieve, and may involve several successive activities.

2.3.2 Risks

Donors also recognise that using PGS involves risks that must be identified, assessed and managed. While no aid activity is risk-free, use of PGS may affect both the potential severity of different types of risk and the allocation of risk. Some key consequences or risk impacts of using PGS are listed in Table 4.

Table 4: Potential consequences/risk impacts of using partner government systems

Risk categories	Sub-categories	Definition of risk impact: Risk that ...
1. Development risks (risk that development objectives will not be achieved)	Implementation	Development objectives are not achieved due to limited capacity or other constraints.
	Sustainability	Development objectives are not financially sustainable in the longer term, after donor funds are withdrawn.
	Macroeconomic	Development objectives are compromised by the macroeconomic framework.
	Governance	Development objectives are not achieved because of poor governance (examples: weak poverty reduction plans or policies, or limited will to implement them; major changes in partner government policy settings).
2. Fiduciary risks (associated with entrusting funds to another party)	–	Funds are not used for intended purposes (they may be inadvertently misused, or corruptly misappropriated).
		Funds are not properly accounted for (it is not possible to determine if funds were used for intended purposes).

		Funds do not achieve value for money (they are not used efficiently and effectively).
3. Reputational risks	–	Donor reputation is threatened by governance issues or by perceived misuse and/or poor use of funds.

Source: Various, including Danida (2009), 'Technical note on programme support preparation'; Mellors J (2009), 'Public financial management: issues for AusAID'.

While many of these risks are common to all aid activities, use of PGS typically involves a different risk profile from, for example, parallel contractor systems. Fiduciary risks are potentially greater with activities that use the downstream components of PGS (although careful identification, assessment and management can mitigate these risks). Not using PGS, however, carries significant longer-term risks of its own. Activities that do not use PGS require establishing parallel funds management systems, which may pose a risk to achieving sustainable development outcomes, and reduce transparency and government ownership. Parallel funds management systems may also increase the cost of aid administration through the use of comparatively expensive contractors.

More broadly, use of PGS alters the allocation of risk: with it, DFAT assumes implementation and other risks which in the past were typically borne by contractors. To manage these risks, DFAT staff need to understand, engage with and influence PGS that are often complex and variable. DFAT needs to ensure that staff have the skills and time to do so.

The realisation of risks is most likely to be avoided when program support: is designed around comprehensive systems analysis and risk assessment; supports the partner government's existing PFM reform program; and is complemented by policy dialogue, ongoing monitoring and risk assessment, capacity development measures and supplementary risk treatments if required. It is also important that risks are monitored throughout the activity, and adjustments to the risk profile and risk treatments and controls are made as appropriate.

Where risks are very high in the short term, use of PGS may not be appropriate until after a significant period of support in which donors help the partner government to strengthen its systems.

3. Assessment of national systems

An assessment of national systems (ANS) is ideally done as part of the preparatory work for the aid investment plan, so it can guide thinking on country strategy objectives that relate to using PGS. Once an ANS has been completed it must be updated every three years. Exceptional updates of the ANS should also be undertaken as required. Further information on the up-date process can be found in Section 6.2.

An ANS must be conducted for all countries except those in which DFAT is not using or contemplating using PGS, those in which the use of PGS will only be through other donors, or where the amount of funds to be provided is not material. For guidance, please consult PFM staff in the Environment Safeguards, Public Finance Management and Aid Risk Section.

Countries in which DFAT is not using or contemplating using PGS include those with poor human rights records where Australia would not want to support the government, and

countries in which the aid program is delivered entirely through non-government organisation funding or scholarship activities.

Countries in which use of PGS will only be through other donors or multilateral organisations might include those in which Australia's aid program is small relative to other donors' (see Section 7.3 for advice on using PGS through other donors).

In countries where DFAT is using or contemplating using PGS and another donor has done an assessment equivalent to an ANS² in the last 12 months, the program area may consult with PFM staff in the Environment Safeguards, Public Finance Management and Aid Risk Section (partner.systems@dfat.gov.au) about relying on the other donor's assessment in place of an ANS. In such cases, DFAT still needs to reach its own judgment about whether to further consider use of PGS, particularly downstream components.

The ANS draws on available fiduciary diagnostic assessments to give an overview of the strengths, weaknesses and risks (particularly fiduciary risks) associated with national PGS. It provides evidence-based support for DFAT's decisions on whether to channel aid through the PGS. The Guideline and Template: *Conducting an Assessment of National Systems* should be used for an ANS.

Although it is primarily focused on assessment of risk, the ANS can also contribute to dialogue with the partner government on the broader issues of:

- › establishing a shared understanding of the partner government's PFM and procurement systems
- › developing a long-term vision for the PFM and procurement systems
- › building ownership for solutions to current weaknesses
- › establishing a partner government-led process for planning and implementing solutions
- › identifying an independent framework for monitoring progress.

The ANS may be conducted by DFAT program area staff with substantive expertise in PFM and procurement. The participation of qualified professionals is required where this expertise is not available in-house. Advice on obtaining professional input may be sought from PFM staff in the Environment Safeguards, Public Finance Management and Aid Risk Section (partner.systems@dfat.gov.au).

Box 3 provides a number of lessons learned about conducting diagnostic analyses of PGS:

Box 3

Lessons learned about conducting diagnostic analyses of PGS

A number of lessons learned about conducting diagnostic analyses of PGS should be kept in mind when coordinating an ANS or other diagnostic work:

² Assessments that are generally equivalent to an ANS include the UK Department for International Development's (DFID) Fiduciary Risk Assessments, and World Bank assessments of fiduciary risk in the use of country financial management systems.

- › Diagnostic analyses of a PGS should be done jointly with the partner government and other donors wherever possible, and ideally led by the partner government (for example, the Ministry of Finance or Audit Office). This supports donor harmonisation, helps to build country ownership of the diagnostic analyses' findings, and avoids conflicting policy advice.
- › A good understanding of the political economy of public finance is essential. There is a wide range of stakeholders in any PFM system, drawn from political, bureaucratic and civil society realms. They have differing stakes and incentives, with some embracing reform and others wanting to maintain the status quo. Diagnostic analyses should address this political economy and not just the technical features of PGS.
- › No one size fits all—PFM systems are shaped by broader political, economic and social structures. These are unique to individual countries and this uniqueness needs to be recognised when applying diagnostic tools. Diagnostic findings should be based on what works in the individual country context, not on inflexible comparisons of the PGS to 'international best practice'.

3.1 Standard diagnostic assessments to be consulted

A range of assessments using standard analytical tools may be consulted for the ANS. Important among these are the Public Expenditure and Financial Accountability (PEFA) assessment and the OECD-DAC Methodology for Assessing Procurement Systems (MAPS) assessment. These assessments are available for many countries in which DFAT works, but where no assessment is available, one may need to be conducted (or repeated). Unlike the ANS, these assessments must be conducted by suitably qualified professionals³. The background note: Analytical tools for assessing partner government systems provides details of these tools.

It is also important to appreciate the limitations of the standard diagnostic tools. For example, PEFA assessments do not assess whether a government's expenditure program is fiscally sustainable or whether it is effectively targeting poverty reduction or the other MDG targets. As a result a range of other tools are used to assess PFM and procurement systems, and these supplement PEFA and MAPS assessments as well as provide additional context for the more detailed sector or agency assessments required if the use of downstream components of PGS is being considered. The Background Note: *Analytical Tools for Assessing Partner Government Systems* provides details of other diagnostic tools, and when to consult them.

3.2 Documenting the assessment of national systems

A report summarising the key findings of the ANS must be prepared in accordance with the template provided in the Guideline and Template: *Conducting an Assessment of National Systems*.

The ANS report should conclude with a reasoned judgment on whether use of PGS should be considered further, and on whether use of downstream components of PGS should be considered further. In general, use of downstream components should only be considered further if:

³ Contact PFM staff in the Environment Safeguards, Public Finance Management and Aid Risk Section (partner.systems@dfat.gov.au) for further information.

- › a credible national poverty reduction or development plan is in place (to be separately assessed by the program area, as this is not covered by the ANS);
- › credible programs are in place to address weaknesses in PFM and governance (including corruption), and the trajectory of change is not negative; and
- › the risks of using country downstream components of PGS are ones that DFAT judges to be acceptable.

The report and the detailed knowledge acquired by DFAT staff who participate in preparing it can be used to inform policy dialogue with the partner government over systems reform, and to guide aid programming, but should not be the sole basis for dialogue, since its focus is primarily on identifying and managing risk.⁴ Advice on choice and sequencing of reforms can be obtained from PFM staff in the Environment Safeguards, Public Finance Management and Aid Risk Section (partner.systems@dfat.gov.au).

If the ANS report concludes that use of downstream components of PGS should be considered, additional assessment will be needed of the sector/s or agency/ies that will receive funds. This assessment is outlined in Section 4. If the ANS report only proposes that use of upstream components of PGS (On Plan, On Budget, On Parliament) be considered, then further assessment will not be required.

3.3 A special case: general budget support

Where general budget support⁵ is being considered, additional sector or agency assessments are not required. This is because general budget support may flow through any part of a country's PGS, not any particular sector or agency. Much of the risk assessment work relevant to general budget support will therefore have been completed as part of the ANS.

If general budget support is being considered, an assessment is needed of the benefits of general budget support undertaken in accordance with the Guideline: *Assessing the Potential Benefits of General Budget Support*. This tool is used to evaluate the prospects of general budget support achieving the potential benefits associated with using PGS in a particular country context. It is designed as an 'add-on' to the Guideline and template: *Conducting an Assessment of National Systems*. It is also important to ensure that any risk treatments recommended in the ANS are set out in sufficient detail to enable implementation. Please contact PFM staff in Environment Safeguards, Public Finance Management and Aid Risk Section on partner.systems@dfat.gov.au for further information.

3.4 Endorsement of assessment of national systems reports

Once completed, the ANS report must be submitted to the relevant Assistant Secretary for endorsement, accompanied by a completed Endorsement Minute.

⁴ While the ANS is primarily focused on assessing risks, it is developed by consulting standard diagnostic assessments, such as PEFA and MAPS that consider overall system performance. Information about overall system performance is also relevant to the choice and sequencing of systems reform.

⁵ General budget support typically uses all components of the partner government's PFM and procurement systems.

If the relevant Assistant Secretary does not endorse the ANS report, it must be revised accordingly and then resubmitted.

Once the ANS report has been endorsed by the relevant Assistant Secretary and any consequent changes made, it must then be emailed to PFM staff in the Environment Safeguards, Public Finance Management and Aid Risk Section (at partner.systems@dfat.gov.au) for information, together with a copy of the signed Endorsement Minute.

PFM staff in the Environment Safeguards, Public Finance Management and Aid Risk Section retains copies of all ANS reports and Endorsement Minutes, and may refer to them when participating in quality assurance processes for activities that involve use of PGS.

4. Sector or agency assessments

Sector or agency assessments cover fiduciary risks associated with using the PFM and procurement systems of a sector or agency. Assessments are needed for each sector or agency through which Australian aid funds may flow. For assessments in devolved country contexts, or where DFAT is considering providing funding to sub-national government, assessments should include relevant sub-national entities.⁶ For a small island country with a highly centralised PFM system the scope of sector assessment work could be very narrow. To discuss the scoping of assessment work, appropriate for your country context, please contact PFM staff in the Environment Safeguards, Public Finance Management and Aid Risk Section (partner.systems@dfat.gov.au).

Since the quality of a sector or agency's procurement system can be different from the quality of its PFM system, separate assessments of PFM systems and performance, and procurement systems and performance, are required. Assessments of both PFM and procurement systems must be undertaken by qualified professionals, and clearly documented. Terms of reference for conducting and documenting assessments can be obtained by contacting PFM staff in the Environment Safeguard, Public Finance Management and Aid Risk Section.

If the value of procurement to be undertaken is low then please contact PFM staff in the Environment Safeguards, Public Finance Management and Aid Risk Section (partner.systems@dfat.gov.au) to discuss the scope for conducting a combined assessment of PFM and Procurement.

Where sector or agency assessments are undertaken jointly or in partnership with government and other donors, and where DFAT is not in a leading role, DFAT looks for an assessment with coverage that is broadly consistent with that used by DFAT, rather than a specific format.

⁶ Sub-national PEFA assessments may provide valuable information (see Background note: Analytical tools for assessing partner government systems more information). When assessing a sector that includes a large number of separate entities, a sampling methodology may be appropriate. The Terms of Reference for sector or agency PFM and procurement assessments make provision for assessing a representative sample of entities, rather than assessing all entities.

4.1 Identifying risk controls and treatments

As part of sector or agency assessments, consultants must recommend measures to control and treat identified fiduciary risks. While there is no definitive list of risk treatments, there are three key ways to mitigate risks, which are described in 4.1.1 to 4.1.3 below.

4.1.1 Choice of type of aid

The choice of type or types of aid can be effective in spreading and managing risk. For example, DFAT might provide sector budget support to sectors where PFM and procurement systems are assessed as relatively strong (rather than providing general budget support), to avoid risks associated with weaker sector agencies. If risks are high across all sectors, DFAT might spend funds outside of government systems, such as through a project managed by a contractor or a non-government organisation. In all cases, DFAT may continue to reduce risk over the medium to long term by providing capacity development activities that support ongoing reform of PFM and procurement systems. DFAT may also provide complementary forms of assistance through, for example, supporting civil society and Parliament to improve accountability to citizens.

However, the choice of type of aid also depends on other factors in addition to fiduciary risk concerns. These include the partner government's level of commitment to use aid funds for poverty reduction at national and sector levels, other donor practices in the country or sector, Australia's relationship with the partner government, and the level and timing of funding. For example, if other donors are already providing budget support in a country, and managing the associated risks, then DFAT may choose to delegate funds to one of these donors, to facilitate harmonisation and reduce transaction costs. For more information on different types of aid and their strengths and weaknesses, see the Guideline: *Choosing Approaches and Types of Aid for Working in Partner Systems*.

4.1.2 Capacity development measures

The most sustainable way to treat and control the risks of using PGS is to work with the partner government to strengthen its systems. Complementary capacity development activities can support a partner government's reform program and strengthen PFM and procurement systems in the medium to long term. Capacity development can be for national systems and/or systems within a sector or agency. Capacity development measures include long-term technical assistance or training targeting the PFM and/or procurement systems, or support to civil society organisations to improve transparency of the budget process. Such measures can focus on developing the competencies of individuals, groups, organisations, sectors or countries. For advice on designing activities to support procurement reform, contact PFM staff in the Environment Safeguards, Public Finance Management and Aid Risk Section.

Agreed capacity development measures should be specified in aid investment design. The investment design document or investment design summary should also identify performance benchmarks and monitoring arrangements, preferably taken from the government's own reform strategies and development plans, to assess progress towards better PFM and procurement practices. Box 4 overleaf identifies some lessons learned on strengthening partner government systems:

Box 4

Lessons learned on strengthening PGS

- › Donor support for strengthening a PGS is more likely to be effective if linked to donor funding that supports the achievement of development outcomes (for example, funding support for improved delivery of the partner government's health service measures) rather than by way of stand-alone capacity development activities.
- › Sustainable reform of a PGS takes many years. Diagnoses of the scope for strengthening a PGS should address the basics first and then target incremental improvements. A realistic assessment of the political (or non-technical) constraints to reform should also be undertaken, including whether the partner government is genuinely committed to PGS reforms. An incremental approach that is sustained over a period of years will generally be more successful than a 'big bang' approach seeking to achieve 'best practice' quickly.

4.1.3 Supplementary treatments

The timeframe for reducing risk through capacity development is typically medium to long term (at least five to 10 years), longer than a typical DFAT funding program. It may therefore be necessary to consider using supplementary treatments in high-risk areas until capacity development has effectively lowered risk levels.

Supplementary treatments can include direct support to government processes through technical assistance with agreed control duties, or oversight steps taken directly by DFAT, such as earmarking funds to specific agreed expenditures in the partner government's budget, and ensuring that funds are traceable to those expenditures within the PGS. Some examples of treatments are listed in Annex 1.

If supplementary treatments are used, they must be agreed with the partner government. Ideally they are short term only, and phased out once risk has reduced. However, in some cases, such as where capacity is very limited, supplementary measures may be medium- or long-term in practice. All measures must be described in the investment design document or investment design summary, and in the funding arrangement with the partner government, to ensure implementation and allow for ongoing monitoring. See Box 5 overleaf.

In some contexts, such as Pacific island countries, binding capacity constraints may call for other alternatives such as long term capacity substitution, where in-line advisers perform key PFM roles over a number of years.

Box 5

Selecting the most effective risk treatments and controls

Research indicates that supplementary risk treatments imposed by donors can be fragmented and ineffective in protecting them from fiduciary risk⁷, and can undermine the potential benefits of using PGS.⁸ In light of this the following considerations should guide the choice of controls:

- › Risk treatments and controls should prioritise capacity development, which is usually a medium to long-term endeavour: Ideally, safeguards should support the progressive and sustainable reduction of fiduciary risk through ongoing capacity development measures aligned with the government's own PFM reform plan.
- › Supplementary treatments should be non-intrusive if possible: Controls should interact in a non-intrusive way with the underlying system and ongoing reform programs. Well-designed supplementary treatments should lower risks in a way that does not substitute for the partner government's own procedures and/or policies, or remove responsibility from national actors or systems.
- › Intrusive supplementary treatments should ideally be short term and have an exit strategy: There should be a time limit on their use, and a plan for system strengthening that allows a move to less intrusive measures.

If no short-term, non-intrusive treatments can be mobilised for a key risk, but the risk is too high to wait for a solution through capacity development, use of downstream components of PGS may not be appropriate at this time.

Source: Adapted from Danida (2009), 'Technical note on programme support preparation'.

5. Reaching and justifying a final decision

Deciding whether to use PGS involves judging whether the risks are manageable and worth taking given the likely benefits (as described in Section 2.3.1). This judgment is informed by analysis and assessment, but is ultimately a qualitative rather than a quantitative decision.

The final decision should be based on the ANS and sector and/or agency assessments (though other assessments and documents may also be consulted). If it is clear from these assessments that PGS cannot be used in full, decision-making should focus on whether PGS could be used in part. This should be done with reference to the specific risk controls and treatments identified in the assessment process, and to the different components of PGS that may be used (see Table 2 and Background Note: *Using Components of Partner Government Systems*).

Where the number and severity of risks are substantial, a decision not to use downstream components of PGS may be justified in the short to medium term. In such cases, DFAT funds could still be aligned with the upstream components of PGS (On Plan, On Budget and On Parliament) without exposing funds to significant fiduciary risk. Thought should still be given,

⁷ United Kingdom, Department for International Development (DFID) (2006), 'Study of measures used to address weakness in PFM systems in the context of policy based support'. This is available at the [World Bank](#) website.

⁸ Through, for example, over-reliance on technical advisers, creation of parallel systems that undermine those of government, and poaching skilled staff away from essential government positions (DFID).

however, to funding activities to support reform of PGS through other types of aid (for example, projects or technical assistance).

The final decision on whether to use PGS should take into account DFAT capacity. Managing and monitoring activities that use PGS requires a thorough understanding of those systems, and capacity for ongoing policy engagement with the partner government. Program areas and Posts that lack this understanding and capacity may expose DFAT to additional risk by choosing to use PGS, particularly the downstream components.

The decision to use PGS, and the justification for same—particularly downstream components—should be appropriately documented, for example in the relevant aid investment plan and investment design document or investment design summary. The final decision and justification should also be referenced in relevant submission to the PGPA Act s(23) and FFPS Act s(32B) delegate/s.

Where the decision is made not to use PGS, or not to use downstream components, this should also be documented. Program areas should be prepared to explain the decision to partner governments. In such cases, DFAT may still wish to support the strengthening of PGS, with a view to using them in future.

6. Next steps

6.1 Prepare the investment design document or investment design summary

The final decision on use of PGS should be clearly documented and justified in the investment design document or investment design summary, and in the submission to the PGPA Act s(23) and FFPS Act s(32B) delegate/s, as should the proposed policy engagement strategy where use of PGS is proposed. Detailed implementation arrangements for activities that use PGS should be included as part of the investment design document or investment design summary. These should summarise the key risks and specify the risk treatments and controls and other practical details of implementation that will be employed, such as how funds will flow and what types of financial and progress reporting are required. These should draw as appropriate on the recommended program implementation arrangements and detailed Risk Mitigation Resourcing Plan set out in the assessment of sector/agency level PFM systems completed during investment design.

When DFAT funds are to use downstream components of PGS, the grant agreement with the partner government needs to be carefully drafted in parallel with the investment design document or investment design summary. It needs to detail the risk treatments and controls agreed with the partner government (as per Section 4.1) and specify any conditions for disbursing tranches of DFAT funds to the partner government. Additionally, the grant agreement needs to clarify any sanctions that could be imposed by DFAT for serious violations by the partner government of the terms and conditions in the instrument. Advice on drafting the grant agreement and details of templates can be obtained from PFM staff in the Environment Safeguards Public Finance Management and Aid Risk Section. See also the [Guideline: Content and Format of Financial Acquittals for Programs that Use Partner Government Systems](#).

A separate agreement (typically a commercial contract) may be needed if providing technical assistance, for example to support PFM system reform through capacity

development (as per Section 4.1.2) or to implement control measures. A tender process may also be needed.

Investment design documents and investment design summaries are subject to a quality assurance process prior to approval. Contact PFM staff in the Environment Safeguards, Public Finance Management and Aid Risk Section (partner.systems@dfat.gov.au) in advance of the quality process for assistance.

6.2 Monitoring and updating assessments

Ongoing monitoring of PGS is important for effective risk management and to adjust delivery arrangements in response to changing risk profiles. Assessments of national systems should be updated every three years, but if there are genuine reasons to do so program areas may delay an update beyond the three year mark, in consultation with PFM staff in the Environment Safeguards, Public Finance Management and Aid Risk Section, and subject to close oversight by Posts and in line with the level of risk. Guidelines and templates for updating an ANS and ANS update are included in the Guideline and Template: *Conducting an Assessment of National Systems*. Sector/agency assessments need to be updated every three years, unless programs demonstrate they are monitoring risk controls and treatments and have a credible mechanism to identify emerging risks which can replace the formal three-yearly sector assessment update. Terms of reference for updating sector or agency PFM or procurement assessments should be discussed with PFM staff in the Environment Safeguards, Public Finance Management and Aid Risk Section.

Exceptional updates should be undertaken as required (for example, if a change has occurred that may increase the level of risk). An exceptional update may be a full or partial reassessment, depending on the nature of the change.

7. Operational considerations

7.1 Application of this guideline to performance-linked aid funding

Performance-linked aid (PLA) may be provided in the form of sector budget support, or as projects that use PGS. In these cases, the steps set out in this guideline should be followed. DFAT has the same fiduciary responsibility for funds provided to partner governments, whether through PLA or other mechanisms, and needs to assess PGS and manage and monitor the risks associated with using them. So long as a current ANS (or ANS Update) and sector assessments (less than three years old) are available, new assessments are not needed.

To support the development of coordinated incentives and conditions for partner governments, it is strongly recommended that a coordinated approach is taken to planning PLA and non-PLA funds.

7.2 Application of this guideline to regional and global programs

Regional and global programs, like country programs, need to assess the risks and benefits of using PGS before deciding whether to use them. The steps in this guideline therefore apply to regional and global programs, with due allowance for the approaches these programs take for strategy development and activity design.

This guideline does not cover the assessment of the financial management systems of regional organisations (for example, the APEC and ASEAN secretariats). When considering providing funding to regional organisations, appropriate due diligence should be conducted. Advice on due diligence assessment can be obtained from Due Diligence staff in the Environment Safeguards, Public Finance Management and Aid Risk Section (due.diligence@dfat.gov.au).

When applying this guideline to regional and global programs:

- › Staff may refer to ANS and sector/agency reports prepared by relevant bilateral programs, where available, rather than conducting separate assessments.
- › DFAT does not need its own assessments of PGS where a regional or global program will provide funds to a multilateral organisation or other donor partner that will be implementing a specific activity through PGS. However, in such cases DFAT should retain an appropriate level of policy engagement with the lead organisation's assessments of PGS to ensure risks associated with use of PGS are adequately assessed and managed (see Section 7.3 for further guidance).
- › Where a regional or global program provides core funding to a multilateral organisation or other donor which may channel funds through PGS, DFAT may not know whether or in which countries PGS will be used when funds are committed. In such cases, no independent assessments of PGS are needed, but DFAT should be satisfied that the organisation's systems for assessing and managing the risks associated with using PGS are robust before committing funds.

7.3 Providing funds to partner government systems through other development partners

In some cases DFAT provides funds to multilateral organisations or other donor partners that have their own robust financial management and procurement monitoring and control systems, and that then implement through PGS. In such situations DFAT delegates financial duty of care to the partner, and relies primarily on their fiduciary control systems (as with other funds provided through such partners).

However, DFAT should retain a high level of policy engagement even where financial management and risk management arrangements are delegated to a partner. For example, DFAT staff should expect to be given copies of risk assessments undertaken by the partner. DFAT can add value in the risk assessment process and/or during activity design, by raising questions about fiduciary risk, reviewing partner documents, and asking how they are applying their procedures to manage risks and maximise the prospect of realising benefits.

DFAT's quality requirements still apply to funds channelled through another donor and that use PGS. Further details on providing funds to partner governments through other partners can be found in the Guideline: *Managing Fiduciary Risks When Channelling Funding Through Other Development Partners*.

8. Further information and advice

Guidance that may assist in applying this guideline include:

- › Conducting an assessment of national systems
- › Template for submitting an ANS report for endorsement

- › Template for submitting an ANS update for endorsement
- › Terms of reference (ToRs) for assessing PFM at sector or agency level
- › Terms of reference (ToRs) for assessing procurement at sector or agency level

Advice and support on applying this guideline can be obtained from PFM staff in the Environment Safeguards, Public Finance Management and Aid Risk Section on partner.systems@dfat.gov.au. Support is available on a range of topics including on how to:

- › Scope assessments of PGS
- › coordinate an ANS or ANS update and source consultants to participate
- › source consultants to conduct sector or agency assessments
- › source consultants to assist with diagnostic assessments of PGS (such as PEFA or MAPS procurement assessments)
- › access training on PFM and procurement
- › prepare an investment design document or investment design summary that involves using PGS
- › design an investment to support systemic reform of a PFM or procurement system.

Annex 1: Supplementary risk treatments

1. Depending on the context, some or none of the measures outlined in this Annex may be proposed as supplementary risk treatments, ideally short term only, to manage fiduciary risks associated with using PGS. Some supplementary treatments are implemented by the partner government. In other cases the supplementary treatment needs to be implemented by an adviser or the donor.
2. Financial management and reporting
 - a. prior actions required on legislation and regulation relating to financial management
 - b. establish improved accounting and reporting systems within a defined timeframe, including provision of technical assistance to assist if needed
 - c. maintain identified systems, and minimum numbers and skills of financial management staff, including technical assistance if needed
 - d. agree on spending plans and compliance with previous plans as a basis for subsequent funds releases
 - e. certification by an agreed professional that expenditures are consistent with agreed criteria
 - f. strengthen public budget and expenditure reporting mechanisms within a defined timeframe
 - g. donor provides traceable, earmarked funds to identifiable expenditure lines or items
 - h. donor channels funds direct to implementing agency, bypassing weak central intermediaries.
3. Internal and external audit
 - a. financing arrangements define frequency, due dates, the organisation that will conduct audits, and arrangements for reporting to DFAT (including On Audit follow up)
 - b. agree on special audits (for example, procurement, performance, assets, value for money), and ensure adequate skills and experience for such audits
 - c. PETS may be considered as a potential form of control.
4. Procurement
 - a. inclusion of technical assistance to supervise and guide the procurement process (this would usually be by a specialist procurement adviser or advisers, but could be through in-line positions within government in countries in which this is accepted)
 - b. DFAT requirement for no-objection letters for selected procurement decisions (should be used sparingly, with clear criteria and involvement of procurement specialists)
 - c. independent annual post-execution review, to assess compliance with agreed procedures throughout the procurement cycle

Glossary

Term	Definition/description
Accra Agenda for Action	The agreement—reached at the 2008 3 rd High Level Forum on Aid Effectiveness—reaffirmed the Paris Declaration on Aid Effectiveness, and reinforced commitments on increasing country ownership, building more effective and inclusive partnerships and achieving development results.
Alignment	<p>When donors work in ways that are consistent with and support partner government policies and plans, and thereby support rather than undermine the sovereignty of the partner government.</p> <p>Its two main dimensions are the use of the partner government's:</p> <p>(a) <i>policies and plans</i> as the basis for support</p> <p>(b) <i>financial, procurement and other systems</i> to deliver assistance.</p>
Allocative efficiency	The extent to which a PFM system allocates resources to uses that reflect the government's policy priorities.
Busan Partnership for Effective Development Cooperation	The agreement reached at the 2011 4 th High Level Forum on Aid Effectiveness set the international standard on the principles of effective aid and good development. These principles include: country leadership and ownership of development strategies; a focus on results; inclusive partnerships among development actors; and transparency and accountability to one another.
Downstream components of partner government systems	Refers collectively to the elements of a country's PFM system that relate to budget execution, such as disbursement, procurement, accounting, reporting and audit.
Earmarked funds	<p>Donor funds linked to specific expenditures or activities. Can be:</p> <ul style="list-style-type: none"> • <i>Notional or virtual earmarking</i>: checks ex post that donor funds have been spent as agreed. The partner government receives the donor funds and reports back on expenditure against mutually agreed budget lines. • <i>Real financial earmarking</i>: the donor ensures its financial assistance can only be expended on specified budget line items. This can be achieved, for example, by only making disbursements after the partner government has shown that funds have been spent as agreed. <p>Real financial earmarking is sometimes supported by mechanisms to ensure that donor funds are <i>traceable</i> within the partner government's budget, disbursement and reporting systems. For example, some partner government budget codes can identify the sources and uses of funds, allowing donor funds to be traceable. If this were not possible, traceability would require the use of a parallel accounting system.</p>

Term	Definition/description
Fungibility	The substitution of domestic partner government funds by aid funds. Aid provided by a donor may substitute for spending that a partner government would have undertaken anyway. Since the partner government receives external aid funding, it may see its own (originally appropriated) money freed up and may use it for other purposes. In this case, aid money is fungible.
Harmonisation	Common arrangements between the partner government and donors, and among donors. Harmonisation can operate at program level, type of aid level or grant agreement level.
Medium-Term Expenditure Framework	A planning and budget formulation tool used by some governments to set medium-term fiscal targets and to allocate resources to strategic priorities within these targets.
Methodology for Assessing Procurement Systems	A tool, developed by the OECD-DAC, which developing countries and donors can use to assess the quality and effectiveness of procurement systems. The information resulting from an assessment supports the design of harmonised capacity development and reform initiatives intended to address weaknesses associated with the procurement system.
Paris Declaration on Aid Effectiveness	The agreement reached at the 2005 2 nd High Level Forum on Aid Effectiveness focusing on ownership, alignment, harmonisation, managing for results and mutual accountability.
Public Expenditure and Financial Accountability assessment	Assesses the strengths and weaknesses of a partner government's PFM system. It does not assess the risks associated with the system, or propose ways to strengthen it.
Public financial management	Refers collectively to the key elements of a country's budget process, including the key elements upstream from funds expenditure (such as budget planning, revenue and expenditure forecasting and annual budgeting) and those downstream (such as funds disbursement, procurement, accounting, reporting, and audit).
Partner government systems	Refers collectively to the components of the partner government's PFM and procurement systems.
Risk controls	Current processes, procedures, actions or other measures that are taken to reduce the likelihood of a risk occurring or minimise the impact if the risk were to occur. A control is something that is currently in use, as opposed to a treatment, which is a control not yet implemented.
Risk treatment	A strategy, process or procedure that aims to reduce the likelihood, share or mitigate the impact of risk. A risk treatment is something proposed or planned.

Term	Definition/description
Type of aid	The different ways donor funds are channelled to support development activities. This guideline refers to four key types of aid, and summary definitions of those four are provided in the next four rows (terms noted in <i>italics</i>).
<i>Budget support (a type of aid)</i>	Un-earmarked contributions to the government budget. Two types of budget support are recognised. For <i>general budget support</i> , dialogue is around the development outcomes that might be achieved through such additional government finance. For <i>sector budget support</i> , dialogue focuses on sector-specific concerns, rather than on wider policy and budget priorities.
<i>Pooled funds (a type of aid)</i>	The donor contributes funds to an autonomous account, managed jointly with other donors and/or the recipient. The account has specific purposes, modes of disbursement and accountability mechanisms, and a limited timeframe.
<i>Project (a type of aid)</i>	A set of inputs, activities and outputs, agreed to with the partner country, to reach specific objectives/outcomes within a defined timeframe, with a defined budget and a defined geographical area.
<i>Technical assistance (a type of aid)</i>	Covers the provision, outside of projects, of know-how in the form of personnel, training and research. Captures technical assistance not delivered through a standard project type of aid.
Upstream components of partner government systems	Refers collectively to those elements of a country's PFM system that relate to planning how funds will be expended (such as budget planning, revenue and expenditure forecasting and annual budgeting). Funds can be aligned with upstream components of PGS without using the downstream components.

Acronyms

Acronym	Definition
ANAO	Australian National Audit Office
ANS	assessment of national systems
CFAA	Country Financial and Accountability Assessment
CPAR	Country Procurement Assessment Review
CPIA	Country Policy and Institutional Assessment
DFID	United Kingdom Department for International Development
FRA	fiduciary risk assessment
IDA	International Development Assistance
IMF	International Monetary Fund
MAPS	Methodology for Assessing Procurement Systems
MTEF	Medium-Term Expenditure Framework
NGO	non-government organisation
OECD-DAC	Organisation for Economic Co-operation and Development's Development Assistance Committee
PEFA	Public Expenditure and Financial Accountability
PER	Public Expenditure Review
PETS	Public Expenditure Tracking Survey
PFM	public financial management
PGS	partner government systems
ROSC	Report of Observance of Standards and Codes