PN-AAX-656

DPMC

Development Project Management Center

An international cooperation and resource center that supports project design and management in developing countries.

AN APPROACH TO THE EVALUATION OF FINANCIAL MANAGEMENT PERFORMANCE AND IMPROVEMENT OF HOST COUNTRY INSTITUTIONS ON AID FINANCED DEVELOPMENT PROJECTS

WORKING PAPER

PREPARED FOR AID/PPC/CDIE
DEVELOPMENT MANAGEMENT EVALUATION WORKSHOP
SEPTEMBER, 1984

By
Merlyn H. Kettering
and
Frank Lusby

Development Program Management Center
Technical Assistance Division
Office of International Cooperation and Development
U.S. Department of Agriculture
and
International Development Management Center
Office of International Programs
Division of Agricultural and Life Sciences
University of Maryland, College Park

U.S. Department of Agriculture

Office of International Cooperation and Development

Technical Assistance Division

In cooperation with the

U.S. Agency for International Development

Bureau for Science and Technology

Office of Multisectoral Development

AN APPROACH TO THE EVALUATION OF FINANCIAL MANAGEMENT PERFORMANCE AND IMPROVEMENT OF HOST COUNTRY INSTITUTIONS ON AID FINANCED DEVELOPMENT PROJECTS

WORKING PAPER

PREPARED FOR AID/PPC/CDIE
DEVELOPMENT MANAGEMENT EVALUATION WORKSHOP
SEPTEMBER, 1984

By
Merlyn Kettering
and
Frank Lusby

Development Project Management Center
Technical Assistance Division
Office of International Cooperation and Development
U.S. Department of Agriculture
and
International Development Management Center
Office of International Programs
Division of Agricultural and Life Sciences
University of Maryland, College Park

TABLE OF CONTENTS

Section 1: INTRODUCTION TO FINANCIAL MANAGEMENT OF PROJECTS

1.1 PURPOSE AND ORGANIZATION OF PAPER

The purpose of this paper is to orient development professionals who are not financial management experts to the evaluation of financial management and enhancement of financial management capabilities on AID-financed development projects. This paper is written in preparation of a series of evaluations to be carried out throughout Africa. Although illustrations of financial management problems are presented from projects across the continent, the discussion is based largely upon experiences from the Sahel, where financial management problems and improvement strategies have been highly visible and intense over the past few years. The AID financial management improvement activities in the Sahel will be referenced throughout the paper and can be looked upon as models for comparison with other efforts.

This paper focuses primarily on the financial management systems and practices of Host Country Institutions (HCIs) that have responsibility for AID project funds This differs from looking at the financial management of HCIs "internal" resources or at other funds that are "managed" more of less directly by AID. AID and other donors require distinct accountability for their project funds; this sometimes implies a separate or modified accounting system which may vary somewhat from the HCI internal systems and practices. At a minimum, it requires that the funds can be traced, reported and audited in an isolated form.

It is difficult to view the financial management of development funds provided for projects by donors from a purely "institution-building" point of view. The fact that AID and other donors put compliance requirements on their funds brings donor systems and procedures into play in relation to HCIs systems and procedures. Although it is not possible to completely isolate the HCI financial management practices and systems from external factors, such as AID systems and requirements, this paper highlights management of AID provided finances handled through the HCI systems.

Section 1, Introduction to Financial Management of Projects, attempts to "de-mystify" financial management and put the issues and concepts in easily understood terms, followed by a review of AID financing mechanisms which give rise to financial management responsibility on the part of HCIs. Section 2 presents the general situation of financial management and examples of financial management problems in AID projects, followed by a discussion of causes and related factors. Section 3 presents a discussion of financial management improvement strategies, review of the experience of financial management in the Sahel and a summary of "lessons learned". Finally Section 4 is a proposed analytical framework for evaluation of financial management and financial management improvement on development projects.

1.2 DE-MYSTIFYING FINANCIAL MANAGEMENT

From an obscure and routine position in development management, financial management has recently become highlighted as a key to the successful discharge of managerial responsibilities on development projects. Specific financial management procedures and applications vary according to nations, organizations, systems, purposes and needs; Never-the-less, general principles are adhered to and practiced by financial management in almost all types of organizations and situations (Spiro, 1976)

Often many organizations, such as several HCIs or donors, are involved in the same development projects or programs. Finance impacts on all aspects of an organization's activity and is particularly important on development projects which represent a cooperative activity between at least two organizations (e.g., AID and HCI). The control and coordination of finances to maintain accountability for funds and objectives is a major concern.

Financial management is the set of activities involving the acquiring of funds, allocating of financial resources and the tracking of performance. Financial records represent perhaps the most concise statement of managerial performance and are the focal point for managerial attention, decision-making and accountability. Accountability is the assurance that resources (finances) are properly used for a agreed upon purpose. Accountability is particularly important when several organizations with broad constituencies, such as AID, collaborate on a project.

The purpose of financial management is to ensure that finances are properly allocated and expanded so that organization (project) objectives are pursued to reap intended benefits. Financial management involves (i) interface between organizations to obtain or distribute funds, and monitor funding agreements, and (ii) recording, monitoring and controlling financial operations (or stated in another way, the financial consequences of past, current and future operations).

Two primary functions of financial management are financial accounting and managerial accounting. Financial accounting provides answers to the question of "what happened". The orientation of financial accounting is historical i.e., a portrayal of financial events that have occurred according to generally accepted accounting principles (GAAP). The emphasis is on accuracy, consistency and reasonableness. Financial accountability can be narrowly defined in terms of expenditure control and audit trails. This serves, on projects, to meet the interests of the legal requirements imposed by external and cooperating/sponsoring agencies.

Managerial accounting, on the other hand, is the term used to described the "direction and control" of finances toward meeting objectives. It includes the preparation of financial forecasts, the development and monitoring of performance budgets and activity/output costing. This requires, at a minimum, considerable reliance on the historical data provided by financial accounting. But managerial accounting is, by contrast, primarily oriented towards the future.

The distinction between financial accounting and managerial accounting can best be understood as differences in perspective and orientation -- but they are interdependent, as noted above. Financial accounting is traditionally dominant. Accounts and reports record events historically for project managers and external agencies as an assurance that plans and control are maintained. A sophisticated scorekeeping system identifies deviations and responsibility for deviations attributed appropriately to project components and/or personnel.

This is the foundation for audits. Scorekeeping, as the minimal financial management requirement on projects, is often written (although vaguely) into project agreements. Effective financial accounting solicits organization compliance to agreements and regulations.

Although scorekeeping (financial accounting) is an important function for effective project and program management, it must always be viewed as a tool, not an end in itself. If the emphasis on scorekeeping becomes overly rigid and loses sight of its overall objectives, countermeasures and subterfuges (in terms of organizational and personal behaviors) will destroy its effectiveness. The ability of entrenched bureaucracies to subvert is boundless--in the public and the private sectors.

Managerial accounting is broader, encompassing the accounting functions but emphasizing the use of accounting information for decision-making. By providing timely data, financial management can be used by donors and project managers to assess: 1) how resources are being committed; 2) whether they are being allocated to the most critical phases of the program; 3) whether they are being used efficiently, and; 4) to what extent they are needed in the future.

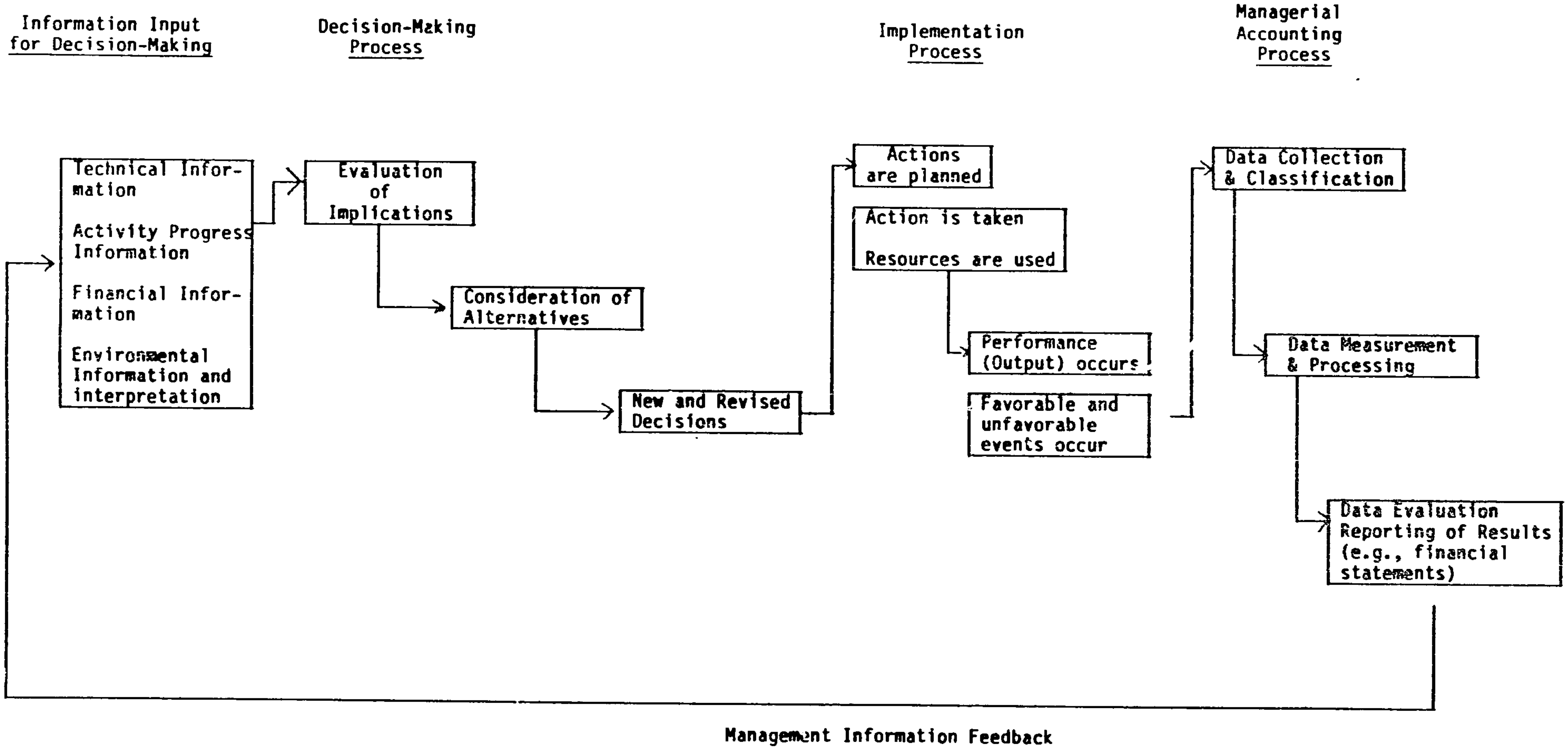
Both financial and managerial accounting are the basis for good management. Basically, they provide information system to measure, record, and report, in monetary terms, the flow of resources into and out of an organization, as well as the claims against those resources. This serves decision makers in important ways: 1) providing a basis upon which to weigh alternatives in terms of their financial implications, 2) measuring the financial effect of decisions already made, and 3) tracking the organizations resources including; how much cash is available for use; how much is owed the organization and how much the organization owes; what items are owned, and; inventory levels on hand.

Financial management systems are adequately designed dependable and relevant histo[illegible] data is provided through financial statements. The donors and managers, if they have a reasonable understanding of the financial considerations, can utilize these data as important inputs into the decision-making process. Exhibit 1 shows how accounting information feeds into the project decision making and implementation cycles.

Good management is built on managerial accounting; managerial accounting, in turn, is built on financial accounting. The allocation of existing resources to derive future benefits is one of the key responsibilities of the management. Determining the financial feasibility/desirability of financial commitments, directing commitments, monitoring performance and redirecting commitments requires not only scorekeeping (a historical, verifiable record) but also future-oriented management practices. In other words, strict financial accounting must be complemented by the budgeting and control process. Any manager who lacks an appreciation of the purpose, underlying assumptions and interpretation of budgeting is at a disadvantage. The ability to present a case for a budget, to discuss issues in financial terms is a requisite for good management. A related skill is the ability to develop and provide information (developed from accounting data) for decision-making.

The language and tools of financial management impose a desirable discipline on management and decision-making. It forces the expression of project/organization plans in quantifiable terms, even if the assumptions underlying plans are sometime tenuous. The specificity of these expressions contributes to a more fruitful dialogue between managers and organizations and thereby improves overall management. (Spiro, 1976)

Exhibit 1: Decision-Making and Implemenation Cycle for Project Management



(Adapted from Welsh and Anthony, 1981:2-8)

1.3 AID PROJECT FINANCING MECHANISMS FOR HCIs

An HCI incurs financial management responsibility for project funds under different circumstances. First, AID may directly appropriate local currency to a HCI so that it may implement the local cost components (goods and services) of a project. In this case, reliance is placed on the financial management practices of the HCI to ensure that the funds are used for the purposes for which they were programmed and budgeted.

AID encourages less developed countries (LDCs) to defray these local costs and, in fact, there is a general rule that at least 25% of project costs must be financed by the LDC (generally identified as local costs). However, many LDCs face serious economic difficulties and thus are unable to cover these expenses. In these cases, the 25% rule can be waived and AID will help finance local costs. In the Sahel, as of December 31, 1979, AID had appropriated $41.7 million in local currency to HCI's. (Audit 81-35, 1981:2)

A second type of "assistance" comes in the form of PL480 and Commodity Import Program (CIP) generated funds. Under these arrangements U.S. commodities are sold in an LDC and local currency is generated. The conditions attached to the use of these funds differs according to the program (PL480, Title III, for example, has different conditions from Title I). The financial accountability requirements of the HCI to AID also vary. In many programs, however, the LDC must use the funds for economic development projects, and must account for their expenditure to AID. This gives rise to the need for financial management and reporting capability on the part of the HCI.

A third situation which may call for HCI accountability arises under the Fixed Amount Reimbursement (FAR) method of financing. Under this arrangement the HCI is reimbursed by AID upon completion of an agreed upon project or sub-project. The FAR was originally designed for capital projects such as roads, schools, or bridges as these are easy to quantify by AID inspectors. It is now used, however, for certain non-capital projects in which case HCI has to show financial reports in order to be reimbursed. Financial records may also be necessary under an alternative FAR procedure whereby AID makes a preliminary advance to the HCI to start the work. In each case the HCI must have the capacity to collect, evaluate, and record financial accounting data.

For most of the above situations, the responsibilities of the HCI can be summarized in three major categories. First, there is the responsibility to maintain accounting and control systems which record the receipt and application of monies so there is an audit trail accessible to the donors. Second, there is the production of reports which document the uses of funds against their intended purposes on systematic, periodic basis. Finally, there is the responsibility for management to use the reports for evaluation and decision-making to ensure progress and that resources are being used properly and efficiently.

Section 2: FINANCIAL MANAGEMENT PROBLEMS ON AID PROJECTS

2.1 THE EMERGENCE OF FINANCIAL MANAGEMENT PROBLEMS ON AID PROJECTS

Problems with the financial management of AID project funds have recently become more visible in the light of audit reports from throughout Africa, and especially in the Sahel, where estimates of waste and misuse are in the $ millions. Although subsequent on-site consultation and training proved these estimates to be excessive, the lack of a clear audit trail presents a problem to AID in carrying out its mandate and responsibilities.

The major problem areas can be conceptually divided into two areas: 1) those dealing with managerial accounting and 2) those dealing with financial or compliance accounting. As discussed earlier, managerial accounting involves the development of accounting information and procedures specifically intended for HCI management to carry out their implementation responsibilities (planning, coordinating and controlling project activities). It is for internal purposes. Financial/compliance accounting information is intended both for management and for the use of external parties, in this case the donor, or AID.

2.2 PROBLEMS IN MANAGERIAL ACCOUNTING

The perceived role of accounting and accountants is often distorted in HCI's. These entities generally regard reporting as an AID requirement for obtaining additional funds and not as an important managerial tool for monitoring financial performance. (Audit 81-35; 1981:6) There is also a tendency for host country project directors (PDs) to view accounting personnel as simple technicians performing a bookkeeping function and not being part of the management team. In many instances reports that would be of value to management are not produced, or when produced are ignored, thereby reinforcing this perception (SFMIE, 1983:11). In the Sahel, investigators felt that a fundamental weakness of HCIs was their failure to produce and use financial information for effective management (SPP; 1982:1).

Because the accounting unit is not seen as a necessary or important element of management, internal controls are often overlooked. In many cases, cash is given to the same individual who procures the goods and services, pays the payroll and makes loans to the small farmer. More often than not, no receipts are retained to document the authenticity of each transactions. Writing checks and making disbursements is often done outside of the accounting unit and checks are frequently cashed with only one signature (Audit 81-35; 1981:10). By failing to separate responsibilities and control cash, possibilities for misusing project funds are increased.

Other problems exist as well. Sometimes functions are split between units and there is no central point where financial information is found. This creates difficulties for managers as they must go to more than one place for the data they need. Additional difficulty arises when checkbooks and journals are not posted up-to-date. This leads to liquidity problems and overdraws since no one knows the amount of funds available.

2.3 FINANCIAL ACCOUNTING PROBLEMS

The problems in this area generally stem from the lack of necessary records, reports, and procedures which would allow the HCI to monitor the cash flow of project funds and provide an audit trail for donors. The following items were identified as the basic set of accounting records for compliance with AID requirements. (Kettering and Matthews, 1981) Often they are either non-existent or inadequate within the HCI:

1) Encumbrance Journal - this journal records the amount of AID funds allocated to each project activity, the amount spent, and the amount remaining, or available. It allows HCI management to avoid exceeding agreed upon budget limits.

2) Separate bank accounts for AID funds and a cash receipt and disbursement control ledger - AID Missions generally require HCI's to deposit local currency funds into a separate bank account. To record withdrawals and disbursements from the account the HCI should maintain a cash receipt and disbursement ledger. This ledger serves as a checkbook does to monitor the amount of funds available for use. It also separates disbursements by budget category (salaries, equipment, services, etc.) so that a running tab can be kept on each.

3) Financial Report - basic financial reports are necessary for the HCI to coordinate and control the project as well as to meet AID compliance regulations. They are also required as pre-conditions for replenishing advances made in prior periods. Such reports would be produced for example, using the aforementioned encumbrances journal and cash receipt and disbursement ledger.

4) Bank reconciliation - a project bank account reconciliation is important just as it is for someone to reconcile their checkbook with a bank statement. It serves as a check on calculations as well as project liquidity.

5) Commodity sale proceeds ledger - generally such a ledger is necessary when PL480 or CIP counterpart funds are involved. It records sale proceeds for HCI management purposes and provides information for AID when required.

2.4 CASE-EXAMPLES FROM AFRICA

Examples of the aforementioned problems are seen in audit reports and evaluations from all of Africa. A few of the cases include:

Upper Volta - "The Eastern ORD Integrated Rural Development Project" Although the implementation letter stated that financial reports would be prepared biannually only one report was prepared from April 1, 1974 to March 31, 1979. Audit reports showed that $153,000 had been diverted from the funds for non-authorized expenses. This could have been prevented had reports been produced. (Audit 81-35; 1981:5)

Burundi - "Pest II Project"
One of the expected outputs of this project was strengthened financial management within the HCI responsible for implementation. However, the HCI failed to submit timely reports and advance requests thereby forcing the contract management team (theoretically the financial management advisor to the HCI) to borrow more than $54,000 for daily operational needs. (Audit 3-695, 1984:16)

Zaire - "Basic Rural Health Project"
Under this project approximately $2.2 million in counterpart funds were previewed to flow through the host country implementation agency. Audit reports revealed that records relative to project funds did not provide adequate cash management and control. Auditors emphasized the need for improved cash control and recordkeeping procedures in order to strengthen project management and facilitate the accomplishment of project objective. (Audit #3-660, 1984)

Uganda - "Food Production Support Project"
Progress made using the funds generated by sale of AID-funded commodities were not reported as required. (Audit 3-617; 1984:3)

Tanzania - "National Foods Credit Program"
AID funds contributed to this program were not separately accounted for. Rather, they went directly to the Treasury, then to a general bank account in the Rural Development Bank, and then to the project. Due to the considerable float periods there were many possibilities for these funds to be used for other than agreed upon purposes.

Tanzania - "PL480 Program"
There was no verification that PL480 sale proceeds were being used for the economic development priorities agreed upon in the sales negotiation. (Review of AID program; 1980:21-22)

Senegal - "Cereals Production Project"
Several instances have been noted where advances are repeatedly made to HCI's who never submit adequate reports accounting for the expenditure of funds.

Senegal - "Rural Health Project"
Five revolving funds (where loans are made to small farmers and repayed with interest into the same account) were examined equalling over $2.7 million in AID funds. Almost without exception, little or no documentation was found supporting the loans and repayments. Without controls, there was no way of knowing where the money went. (Audit 81-35: 1981:6,10)

Mali - "Livestock I Project"
The equivalent of $72,000 was withdrawn from the Credit Fund to buy 2017 sheep. None could account for the sheep or the funds. (Audit 81-35; 1981:10)

As one can see from these examples financial management problems are not limited to any one region of Africa. There is a degree of variability, however, depending on the economic condition of a country and their ability to contribute local costs. The more local costs a government can contribute for a project, the less potential there is for misuse of donor funds. This does not mean the HCI will not have problems with its own resources. It does mean, however, that project financial management becomes less of a concern for the donor, unless there is a donor-financed component to address financial management improvement.

The causes of financial management problems are numerous and do not lie solely with individuals (i.e. accountants) or with existing systems. They range from the institutional and environmental constraints of the host country, to the institutional "tendencies" of AID, to the communication (or lack of) between the two. As we see in the case of the Sahel, initial audit reports in the Sahel recommended that a training course for accountants be held to address financial management problems (Audit 81-52, 1981:29). After additional reconnaissance and study however, it became clear that the problem was more complicated then just a lack of accounting expertise. (Kettering and Matthews, 1981) This comes out in the following description of causes and supports the comprehensive improvement strategies that will be discussed later in the paper.

2.5 HOST COUNTRY INSTITUTIONAL/ENVIRONMENTAL CONSTRAINTS

As mentioned earlier, HCI's project management processes do not provide timely and accurate financial accounting information that feeds effectively into the decision-making process. This is evidenced by the fact that few HCI's use financial reports as a means of measuring project performance and that they generally view such reports as AID requirements for obtaining additional funds. (Audit 81-35, 981:6) This is due, in part, to the institutional arrangements between AID and HCI which generally provide for an initial advance and then require accountability before new advance are allocated. It may also be due to certain colonial influences which put less emphasis on the managerial role of accounting. Perhaps the major reason, however, is the lack of experience and training in financial management. This weakness has been brought out frequently in audit reports and studies as a major cause of poor financial management (Audit 81-35, 81-52, FMIE, and others). One audit stated that "in most cases it appeared that the government entities simply did not know how to establish and maintain an accounting system." (Audit 81-35, 1981:7) Thus, although not the sole cause of the problem lack of training certainly ranks as one of the highest. This is particularly the case when good technicians are promoted to project and/or program management without the experience or education to prepare them for their expanded roles.

The budgetary problems of African countries also contributes to the misuse of project funds. Faced with no internal means of financing their deficits the HCI's must look to outside sources to cover recurrent costs (salaries, rents, etc.). Auditors felt that when budgetary funds are not immediately available donor project funds are diverted to cover the HCI's normally recurring expenses. (Audit 81-52, 1981:28)

Also due to budget constraints many managers in HCI's have difficulty in securing adequate operational funds to "make things happen" in their organization. There may be resistance to accounting control as this might further restrict their freedom to manage. The fact that many AID projects only appropriate local currency for recurrent expenses like salary and rent does not help the situation. In such cases it is difficult (within the project) to show how accounting information can improve management decisions. (SRFMP interviews: 1984)

A multitude of donors within the same project can place heavy burdens upon a HCI accounting unit and staff, and can contribute to poor financial management. This is especially true if each donor requires a different system of accountability. Field reports have downplayed this problem, however, citing the presence of many donors within one project as rare (SRFMP interviews, 1984). It seems to occur more often at top ministry levels because many donors sponsor different projects within the same programs. Nontheless, it is a potential cause of difficulty.

Certain cultural patterns may also be inhibiting financial management in HCI's. These have not been studied or documented and would vary from country to country, but might include: 1) a resistance from the project director to consult a subordinate (i.e. the accountant), 2) difficulty in achieving "upward" information flow in a "pyramidal" system and 3) unwillingness or inability to confront the misuse of funds. It is important to have an understanding of at least the possibilities of such barriers in order to design effective improvement strategies.

Other characteristics of the development context also impact heavily upon financial management. There is a shallow pool of highly qualified professional in a broad range of disciplines. Consequently, project and program managers are often technical specialists who move rapidly up through the bureaucracy and assume managerial responsibilities with very limited training and/or experience. Consequently, they are highly dependent upon external assistance and often focus to exclusively upon the technical components with which they are most familiar and overlook the broader perspectives required of management.

To counter the limits of management, donors often give technical assistance teams on projects, major management responsibilities or even assume some of the key management functions to be performed themselves. This results in a very limited arena of actual management for the HCI manger. In financial management, the amount of funds actually under the direction and control of the HCI manager may be quite small. Financial management is dispersed between the HCI, the contractors and AID with no clear agreements on the coordination of financial management or even financial accounting to ensure consistency or mutual accountability.

Finally, the issue of "absorptive capacity" in an HCI for development projects cannot be ignored. HCIs are often saturated with a variety of development activities, all requiring special management attention and resources, further straining already weak technical and management systems.

2.6 AID INSTITUTIONAL TENDENCIES

One of the major factors that cannot be overlooked as a cause of financial management problems is the institutional tendency of AID to emphasize and reward the obligation of funding for projects versus rewarding the efficient management of funds for project implementation. This tendency contributes to: 1) little or no pre-project research into a HCI's financial management capacity,

2) little emphasis on financial management in project design and 3) lack of financial monitoring during implementation. The same audit reports which exposed deficient HCI accounting systems in the Sahel pointed out this tendency and emphasized that AID "Takes the accounting capabilities of the Sahelian governments too much for granted." (Audited 81-35, 981:9)

This lack of attention to implementation results in cash or resources being turned over to HCI's who are not prepared. Consequently, financial management problems are produced. Audit reports and studies from Africa evidence this argument. Observations include: "Project Papers (PPs) contain assessments of the host governments administrative capacity to undertake projects - but little or nothing is said about the government entities financial management capabilities," (Audit 81-35, 1981:16) "A selective review of PPs, Project Agreements (PROAGS) and Project Implementation Letters (PILs) indicate that inadequate attention has often been devoted to the financial implications of projects and therefore to the need for project resources to be devoted to host country project management," (Sahel PP, 1982:6-35) and "Project Papers ... notably ignore financial management. Host country financial management capability has not usually been a criterion of project feasibility." (Sahel, 1982:6-3-2).

As the AID institution does, not generally reward Project Officers for ensuring successful project financial management, nor reprimand them for financial management problems, there seems to be little incentive for them to monitor projects in this area. Observations regarding this include: "AID project offices are not monitoring the financial management aspects of the projects to the extent required." (Audit 81-35, 1982:17) "The ability and inclination of many Project Officers ... to take the lead in supervising and appraising host country financial management of projects is lacking." (Sahel PP, 1982: G-3-4) Recent innovations in this area have yet to permeate the organization to operational levels to the degree that there are standards or norms established in this area.

2.7 COMMUNICATION

The lack of communication between HCIs and AID also adds to financial management problems. HCI's often fail to produce timely reports and do not seek clarification when requirements are not clear. On the other hand, with no clear idea of what is expected of them, the HCI is at a loss in terms of producing and communicating financial reports. In general, there seems to be a lack of structured communication channels whereby the two positions can exchange pertinent information regarding financial management.

Project documents often do not spell out the requirements for financial reporting or the divisions of responsibilities between HCI management and that of the Mission. (Sahel PP, 1982:6-3-1) An example of a project agreement statement is "Financial records shall be kept in accordance with [the government's] usual accounting procedures which shall follow generally accepted accounting practices." (Audit 81-35, 1981:6) In reality, "usual accounting procedures" are ill-defined and subject to wide interpretation. No one is clear as to what accepted accounting practices are. Thus, there seems to be a general ambiguity and confusion with both parties in the use of required documentation to communicate financial management procedure.

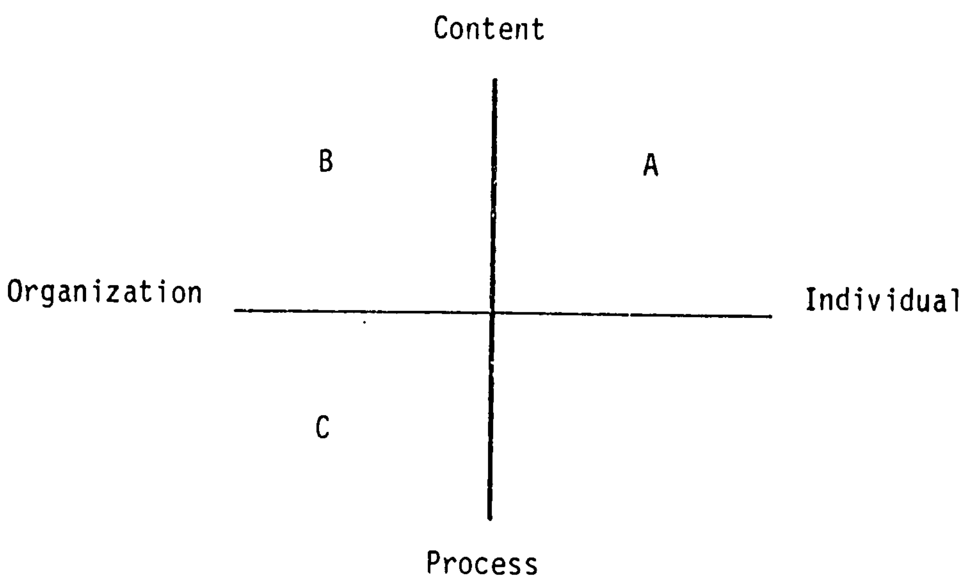
The lack of project financial management monitoring and control does not help the communication problem. With no surveillance or auditing, HCI accountants and project directors are not up-to-date on AID compliance requirements and do not receive guidance or training. This problem stems back to the "institutional tendency" mentioned earlier but is also due to: 1) constraints on Mission Staff, especially controllers, 2) confusion over the responsibility for financial management monitoring between the Project Officer and Controller and 3) the Project Officers lack of financial management experience and training (Audit 81-35, 1981:18).

Section 3: FINANCIAL MANAGEMENT IMPROVEMENT - STRATEGIES, THE EXPERIENCE OF THE SAHEL AND LESSONS LEARNED

3.1 ALTERNATIVE STRATEGIES FOR FINANCIAL MANAGEMENT IMPROVEMENT

These are alternative strategies AID can pursue in enhancing project and HCI financial management practices. In Exhibit 2, there are two continuums which show extremes which may be emphasized in any financial management improvement effort. One set of extremes is between "content" and "process", and the other between the "organization" and the "individual."

Exhibit 2



"Content" here refers to specific designs for accounting and financial management systems. "Process" refers to the extent that the system is adapted by taking the needs and circumstances of an organization into consideration. At the content extreme, one has standardized concepts and systems applicable to all projects. At the other one is willing to be very flexible and adaptable focussing upon how a particular kind of system is to be developed, i.e., the process.

The variables on the second continuum regard the "organization" and the "individual." On the purely individual side one targets the strategy to an individual, for example, the accountant. The concern is to impart skills to that individual so that he/she can accomplish specific tasks. On the other side one looks not at an individual but at all the interrelated people and systems which together make up an organization. The idea is to work with the entire organization such that new practices become institutionalized.

These can be various points along the two continuums representing various financial management strategies. No one strategy is necessarily best for all situations. Depending upon the specific situation and circumstances one strategy will be more appropriate than another. Three distinct strategies that may be identified, seen in Exhibit 2, may emphasize these dimensions in distinctly different ways.

Some projects, for example, merely want to insure the accountability of USAID funds through a separate accounting system. Such projects might pursue a strategy at point A, where a specific system is required (content) along with specific skills to use it (individual). At point B, the strategy goes beyond accountability for the AID contribution to a wider concern for the financial management of all development resources in the HCI's operating budget. Here, the system (content) is being integrated into the HCI (organization). At point C, financial management systems are fully integrated into the higher levels of HCI management. Here, concern is expanded beyond accountability and resource control to using financial management in top level decision making. In this strategy one must consider the HCI (organization) and integrate the new system (process) into the existing systems and procedures.

Various factors will help determine what strategy is needed in a specific project. These include the objectives of AID, the scope of the project, the size of the AID contribution and the host country commitment. For example, sometimes institution building is a priority concern for AID in which a strategy on the organization side of the graph is desirable. In other cases, there may be little concern in which case a type A strategy would be appropriate. Type A might also be adequate for small projects. Projects where AID provides significant funding may call for strategies following the organization or institutionalization side (B&C). This would also be the case where the host country has a strong commitment to improved financial management. Where this commitment is lacking and the HCI is only meeting AID compliance regulations to gain additional funds, a type A strategy would be adequate. (Kettering, 1982:2-5)

3.2 A STRATEGY FOR FINANCIAL MANAGEMENT IMPROVEMENT IN THE SAHEL

The development of financial management improvement strategies is a recent phenomenon. In order to study them it is useful to look at the Sahel, where a comprehensive improvement effort was launched in 1980. This will provide a basis on which to compare future efforts.

The Sahel case study presents a historical perspective of how, financial management problems are created. The story begins in 1974 when large amounts of relief aid were supplied in response to the drought that had crippled the Sahelian nations. This was handled by AID central and regional facilities (as there were no country missions at the time) and was mainly in the form of goods and services. AID then began to shift from relief activities to development programs projects. During these years there was a strong emphasis to obligate funds as all the world was watching assistance activities in the region. This forced implementation issues, such as management and accountability of funds, to become secondary considerations. Large amounts of aid were distributed without an analysis and strengthening of HCI management capabilities ("Improving Financial Accountability," 1981:9). This contributed to the financial management problems that are being confronted today.

Improvement strategies were initiated in the Sahel in response to audit reports from the AID Inspector General (IG) and Africa Bureau which disclosed serious problems with HCI financial practices. They increased as financial management problems became highly visible in the light of numerous reports to Congress on the issue. Congressional concern for the accountability of funds derived from U.S. taxpayers was then reflected in the passage of legislation signed by President Reagan on December 29, 1981. Section 308(B) of the International Security and Development Cooperation Act of 1981 (relating to the Sahel Program) added a new subsection 121(d) to the Foreign Assistance Act of 1961 as follows:

> "(d) Funds available to carry out this Section, including foreign currencies acquired with funds appropriated to carry out this Section may not be made available to any foreign government for disbursement unless the Administrator for the Agency for International Development determines that the foreign government will maintain system of accounts with respect to those funds which will provide adequate identification of and control over the receipt and expenditure of those funds."

This statute prompted action which further intensified the financial management improvement effort (FMIE) that had been put into motion by IG reports. Offices involved in these efforts included: 1) the Development Project Management Center (DPMC) of the Office of International Cooperation and Development (OICD) of the USDA, 2) AIDs Office of Financial Management (AID/M/FM), 3) AID's Office of Sahel and West Africa (AFR/SWA) and 4) USAID Missions. Their strategies included: 1) reconnaissance, 2) the design of a fundamental accounting system, 3) workshops for HCI and Mission personnel, 4) direct technical assistance to projects in an attempt to "certify" financial management systems, 5) policy guidance to Missions and 6) the initiation of a regional financial Management project. Those various strategies can be broken down conceptually into: administrative actions and program actions, primarily the Sahel Financial Management Improvement Program

3.3 ADMINISTRATIVE ACTION TO SUPPORT IMPROVED FINANCIAL MANAGEMENT IN THE SAHEL

In the summer of 1981, following upon audit reports from earlier in the year, AID management initiated a process of "Certification Review" and "Certification" of field project accounting systems. The Sahelian AID Missions were given until December 31, 1981 to determine which accounting systems meet AID standards and which were deficient. After that time disbursements for local cost financing were to be halted on projects which did not meet requirements. AID/M/FM established the following minimum standards which HCI's must meet:

- -document the receipt and expenditure of AID funds
- -ensure that approved budget/budget categories do not become over committed by maintaining a procedure for identification of commitments/encumbrances and funds due/receivable by budget categories;
- -ensure that accounting entries will refer to supporting documentation which can be readily located;
- -generate prompt and accurate financial reporting information; including periodic bank reconciliations

-include appropriate internal controls which assure usefulness of financial data, accuracy and integrity by separation of function, pre-number checks, two separate signatures on checks, etc.

-enable an auditor to trace each accounting transaction from accounting reports to source documents to determine the validity of project expenditures.

This policy corresponded with Section 121(d) which was authorized on December 29, 1981. The "Certification" process therefore became the basis for measuring compliance with the new legislation.

The Mission Directors were responsible for certification of projects in the countries and depended heavily on the Mission controller for recommendations. In order to aid the Controllers in their review (and frequent re-construction) of project accounting systems, outside experts were called in including: retired French speaking AID Controllers, accounting firms, TDY Controller personnel from Washington, French expatriates and Sahelians with accounting capabilities. (Report to Congress, 1983:8,9) AID project officers were then used for follow-up to monitor procedures.

Other administrative actions were taken in order to enforce the certification process. First, several AID Sahelian Missions underwent a reorganization, adopted new management and accounting procedures and hired new staff with financial management experience. Second, training courses for AID staff were instituted. These included an in-service "Project Implementation Course" directed primarily at direct hire Project Officers and a "Financial Management Training Program" directed at upgrading the skills of Controllers Officer personnel (Report to Congress, 1983:11). These were in addition to the programmatic workshops which will be discussed later.

On December 30, 1983 the AID Administration approved 16 policy statements on financial and administrative management. These were directed to all Mission directors and included the following: (Payment Verification Policy Implementation Guidance, 1983:2-12)

5) If local currency is to be made available to HCI responsible for controlling reporting on the use of such funds, the mission should first assess the organizations's financial management procedures and related internal controls (the assessment should be included in the PP.)

6) PP's are to include an evaluation of the need for audit coverage in light of potential risks and are to describe planned contract and audit coverage by the host government, AID, and/or independent public accountants. Project funds should be budgeted for independent audit unless adequate audit coverage by the host country is reasonably assured.

9) Mission Controllers are to provide annual assessments of the adequacy of the monitoring and invoice examination procedures followed by host country contracting agencies.

#10) USAID Controllers are encouraged to utilize the services of competent public accounting firms to a greater degree in providing accounting and financial management consulting services within project design, as a post of program funding, and in auditing host country contracts.

3.4 SAHEL REGIONAL FINANCIAL MANAGEMENT IMPROVEMENT PROGRAM

The 1981 audit reports also prompted program actions. The Africa Bureau in response to the reports, has done a great deal to increase awareness of and attention to improved financial management. These include systematic attention at conferences of Mission Directors and Controller, use of consultants and firms for training and systems improvement, clearer policy statements, and guidelines for project officers. Perhaps the most intensive effort comes from the recommendations of a reconnaissance sent to the Sahel to analyze the underlying causes and nature of the problem and to develop a strategy for addressing the issues raised in the audits.

The report of the team included models for an on-the-job training approach and a basic accounting/financial control system which would meet AID and Sahelian HCI needs. (Kettering and Matthews, 1981) Their recommendations were accepted and the models were tested by experts from DPMC, Controllers Office, and AFR/SWA. As a result a training manual was developed based on a fundamental accounting system which included all accounting functions required to meet AID standards.

This manual (called the "User's Manual") was based upon an elementary fund accounting system which provides adequate control but is simpler to maintain than a double-entry system. (Raleigh, et d, 1983) It illustrated, but did not prescribe, the system recognizing that "accountability requirements can be satisfied by somewhat different systems and that the system for a given project may need to be tailored to meet the management needs of that particular project, as well as meeting formal AID requirements. The illustrated system in the Users Manual can serve as a basis for examining needed changes in existing systems rather than as a blueprint for all AID Projects." (Introduction to FMIE, 1982:6)

The manual and training program were tested in September 1981 by bringing 13 Sahelian graduate students (from U.S. universities), with no accounting background to Washington for a 5-day workshop. The test was evaluated as successful and the program was deemed ready for field trials.

Under the coordination of DPMC, "Financial Management Improvement Teams" (FMITS) carried out the following management improvement (FMI) activities in the Sahelian countries: 1) orientation visits, 2) training workshops, and 3) follow-up visits. During the orientation FMIT members met with key Mission and host country officials to explain the FMI as well as to learn as much as possible about existing accounting practices at the project level. (Sahel FMIE, 1983:5) An important objective of orientation visit was to encourage participation in the effort to improve financial management practices and to create a sense of ownership and commitment to it among Mission and host government officials. The orientation visits also gave the FMITS the opportunity to adopt training materials that had been developed.

Workshops were held in each country two to four months after orientation. These were composed of three phases: Phase I lasted two-three days and focussed on managerial accounting. Participants included host country project directors and Ministry officials as well as USAID project officers. The emphasis was on the value of financial information in management decision-making. They facilitated discussion on the value of financial information in management decision-making and presented an overview of the Basic Accounting System and how it could be used to provide management with the information they need. Phase II was aimed primarily at project accounting personnel and USAID project officers. It was six days long and focussed on technical aspects of accounting. The Basic Accounting System, as outlined in the Users Manual, was used as a tool for comparison and discussion to encourage project director and accountants to incorporate needed elements into their existing systems. (Report to Congress, 1983:15) Phase III brought all participants together to: 1) jointly examine the features of the basic fund accounting system, 2) note the extent to which existing systems were already sufficient, 3) generate recommendations/strategies by which project practices would meet AID minimum levels of accountability and 4) make general recommendations for improved financial and project management. (Sahel FMIE, 1983:5)

The FMITs pursued a strategy which included: 1) acting in a facilitative, third party role (i.e. neither representing AID nor the HCI), 2) viewing their interventions and technical assistance as a "starting point" where the object was not to jump in and solve the problems overnight, but to get a solid understanding of problems and then begin to address them systematically, and 3) approaching problems from an "organizational perspective" and playing down the idea that by changing individuals or by installing new systems problems would be solved.

Building upon the experiences and efforts of the Certification Review and FMITS, AID designed a regional project to address the needs that had been identified. In September 1982, the Sahel Regional Financial Management Project (SRFMP) was launched. The purpose of the project is to "improve financial management of Sahelian development institutions that directly handle funds provided by AID and encourage institutionalization of improved management practices." (Sahel PP; 1982:6) The project tries to balance two objectives. First, it strives to ensure accountability of AID funds through "hands-on" technical assistance. Second, it tries to institutionalize financial management in HCI's through action training. The four basic elements of the project are: 1) long-term technical assistance, 2) short-term technical assistance, 3) specific short courses and workshops, and 4) materials development and dissemination. These elements have been elaborated into a country-specific strategy for each of the seven countries in the Sahel.

AID contractor USDA/OICD/DPMC to carry out the project beginning in September, 1982. USDA entered into a Cooperative Agreement with Virginia Polytechnic Institute and State University (VPI&SU) to implement the project through its Extension Division and Office of International Agriculture. SRFMP has financial management teams, consisting of USDA/VPI staff and Sahelian experts in six countries. Through intensive, in-country and on-site action training and consultation, the SRFMP ensures that systems are in place to account for AID funds, that Sahelian are properly trained in accounting and financial management of development projects, and that commitment to improved financial and program management is effectively enhanced.

In most of the countries, technical assistance takes the form of a resident team composed of one expatriate financial management expert and one Sahelian accountant/financial manager. These teams work with institutions which host AID projects providing technical assistance to improve accountability. Short term assistance is made available through U.S. technicians with specialized financial management training, and workshop development skills. Specific short term courses are provided based on training needs identified in the field. Regional workshops also take place which allow project personnel from different countries to exchange ideas and information. Finally, a central management unit in Washington provides overall direction and coordination, develops training programs and materials and provides logistic support. (Sahel PP, 1982:7, Report to Congress, 1983:21).

The regional and country-specific activities of the SRFMP program are built upon a "Financial Management Improvement Cycle" which embraces the following steps:

1. Agreement on needs (HC/USAID/FMT) based on solid data.

2. Agreement on plan to address needs (technical assistance, materials, and training.

3. Procedures, manuals, and training materials are developed to address systems adequacy based on actual needs.

4. Group training for systems refinement, skills development, and implementation planning.

5. Follow up training/implementation assistance.

6. Materials revision and refinement to meet user criteria based on pilot use of proposed improvements.

7. Evaluation, analysis of performance and needs, and recommendations for replication and adaptation.

Finally strategies inherent to achieving SRFMP objectives include the following:

- Build on more successful efforts of financial management improvement for future amplification.

- Use multi-action/organizational HCI involvement for systems development/change and training activities.

- Build Host Country and USAID commitment and ownership on performance improvement to suggest the use of collaborative and facilitative rather than directive consulting strategies.

- Clarify understanding and acceptance of individual and organizational responsibility for successful financial management improvement.

- Achieve cross-country transfers of materials and methodologies with sound documentation that enhances communications, training and institutionalization.

- Use all points in the Financial Management Improvement Cycle to enhance the professional role of accountants.

- Focus on practical systems and procedures as the basis for all activities and materials development in the Financial Management Improvement Cycle.

Following are some of the most important results of the SRFMP to date, quoted from the recent draft AID evaluation report on the project:

o "Detailed financial and training needs assessments have been conducted concerning all projects involving AID-financed local currency in Senegal, Mauritania, Mali, Niger and Upper Volta, resulting in generally well-organized and effective financial management training programs.

o "Project specific workshops have been held in Senegal, Mauritania, Mali, Upper Volta and Niger to train project accountants and in some cases to develop a pool of local accounting personnel for future use. These workshops were usually one to five days in length, frequently conducted at the project site and used materials tailored to the needs of individual projects as determined by the financial/training needs assessment visits.

o "Workshops exclusively for project officers have been conducted in Senegal and Upper Volta concerning financial management problems in general and providing specific status reports on each officer's project. All FMTs have incorporated project officers into their training workshops aimed primarily at host country personnel.

o "Detailed country-specific accounting manuals have been prepared by FMTs in Mali and Upper Volta and are being used in AID projects. The Upper Volta manual was determined to be so appropriate that its installation is a prerequisite for Mission certification of projects. FMTs in Senegal and Niger have installed several project-specific accounting systems.

o "The Banjul FMT has conducted detailed training courses for mid-level government managers and has developed the textbook for these courses. SRFMP activities in The Gambia have been institutionalized into the framework of the Management Development Institute, a government-sponsored training entity.

o "Relevant newsletters are being produced by FMTs to highlight issues of interest to accountants as well as enhance the professionalism of accounting in the Sahel.

o "The Niamey FMT conducts monthly day-long meetings of all accountants for USAID projects in addition to regular training workshops as a means of promoting better project accountability and enhancing accounting as a profession."

As the SRFMP moves into its second full year of in-field implementation, its primary objectives are to continue support of financial management improvement and to strengthen the institutionalization of financial management improvement in host countries. The SRFMP program is now design to:

- Help countries adopt and implement systems that assure basic accountability for funds provided by AID.

- Complete a successful FM Improvement Cycle on a given technical issue in each host country and train trainers on-site to do follow-through and future training.

- Assure the development and implementation of a routinized needs assessment model on a periodic basis, e.g., annually.

- Involved Project Directors and Project Officers in the needs assessment data analysis, priority setting, and development of a national FM improvement plan.

- Assure that Project Directors and Project Officers have experienced satisfactory/useful consulting and training experiences and have useful materials in hand.

- Lay the foundation of systems, records, and skills to institutionalize improved financial management.

- Identify host country entities for institutionalizing FM improvement and ensure that they have an opportunity to observe and participate in consulting and action training.

- Initiate the process of institutionalizing improved financial management in organizations above the project levels.

- Developing institutional involvement in long-term improvement efforts that go beyond individual players and individual institutions to assure long-term continuity e.g., increase Project Director and Project Officer involvement in FMT activities; look for several host country entities for institutionalization to diversify the investment).

3.5 LESSONS LEARNED

This section will review "lessons learned" from financial management improvement efforts. Most of these lessons are based on experience in the Sahel. It is nonetheless felt that they have relevance throughout Africa as cross-continental audit reports have shown financial management problems to be very similar. The lessons will be broken down into the following categories: 1)technical assistance/intervention; 2) training; 3) motivation; 4) project design/conception; 5) communication; and 6) need for parallel AID improvements.

Technical Assistance/Intervention

Often times both HCI's and Missions feel threatened by a FMIE. Common misperceptions are that the objective is to install or impose a new accounting system or to perform an auditing function. Project personnel may therefore be unwilling to open their books and Mission staff may be uncooperative (especially if they feel that activities have been initiated in Washington). In order to overcome these obstacles, emphasis must be put on the methodology of intervention especially when introducing improved or changed accounting systems. A proper orientation is required followed by assistance which reflects the needs and characteristics of the client institution. A key lesson, therefore, is that a climate of acceptance must exist both in USAID's and HCI's for financial management improvement strategies to succeed.

Playing a third-party, facilitative role is effective in introducing improvements. Without taking sides with either HCIs or AID Missions consultants can help both parties reach common goals, purposes, and outputs. They can facilitate joint examination of existing systems and the generation of recommendation and strategies.

Carrying out systematic needs assessment and ensuring agreement on the needs and priorities is a critical first step in financial management improvement. The creation of a data base, systematic analysis of that base and discussion of the implications of the findings are the foundation for cooperation and commitment required for the effort to be successful.

Approaching financial management improvement from an organization perspective is more effective than targeting assistance to individuals (i.e. accountants) or concentrating on installing new systems. This is due to finding which revealed that HCI mangers pay little attention to the accounting function. Thus, it is futile to develop new systems and skilled accountants if management is not going to use them. Such skills and systems must be complemented by management training which teaches this usefulness.

A valid accounting system is a prerequisite for sound financial management, for training and for long-term institutionalization of financial management improvement. This means that the overall strategy for improvement must embrace all stages of the financial management improvement cycle including needs assessment, systems development, training and consultation.

It has been found that success is most ensured when existing systems can somehow be used on modified rather than introducing a totally new system. This is especially true in francophone countries where many HCIs are accustomed to "French systems" which, although not significantly different, are identified with by those who use them.

It is important to be aware of other donors who may be involved in AID funded projects or who may be providing parallel technical assistance in financial management. Unless communication takes place there is a risk of promoting incompatible systems and of creating confusion on the part of HCIs.

Measuring and enforcing "Certification" can be an opportunity for creating project specific plans for improved accounting and management. In the Sahel it was a motivation and a basis for initiating improvements. Both Missions and HCIs rallied around the requirement and this facilitated collaboration and commit-

Training

The basic accounting System, as a model for examining needed changes in existing systems, has been an effective improvement tool. Properly presented it allows an accountant to examine a system and modify it so that the systems includes required functions. It has also been found, contrary to speculation, that the systems is basically compatible with existing "French" systems (SRFMP interview, 1984)

The use of an "action training" methodology has also proven effective. By encouraging participation and the expression of real needs it allows training to adapt to different organizational and cultural climates. Because this advice and insight is solicited, participants feel that they "own" new ideas and hence are more apt to implement them. By giving participants simulation exercises which reflect typical operations their can immediately apply this new skills after training.

Workshops were also shown to be useful in stimulating the discussion of problems and in providing management training and technical skills. They are especially helpful in fostering the link between accounting information and management decision making and in enhancing the professional role of accountants. Workshops can also be used effectively to overcome communication barriers and clarify relationships: 1) between AID Washington, Missions, and HCIs, 2) within Missions, 3) between HCIs, and 4) within projects (between project branches and field offices and between general managers and accounting staff).

Motivation

FMIEs can be successful if there is a shift in the perception of host country project directors from viewing accounting as a "compliance measure for donors" to seeing it as a management tool that can have payoffs to them in terms of higher project success and associated public esteem. It has been found however, that inducing this "perception shift" maybe difficult when the project director is only responsible for redundant project costs (i.e. salaries, rent, utilities) and has no control over local procurement of goods and services or larger project budget.

Project Design/Conception

Project Papers, Financial and Monitoring Plans should take financial management issues into account. To ensure this, project design terms should contain some expertise on financial management. (Sahel PP, 1982:6-3-7) It is clear that financial management deficiencies cannot be corrected by writing requirements into grant agreements such as, "adequate books and records will be monitored." AID must assess each HCI's accounting system and practices during the design stage to determine whether they are adequate. Appropriate actions can then be taken, at that stage, to provide training and assistance where required (Audit

81-35, 1981:9). AID must strive to include precise financial management requirements and models in project documents. These requirements can prevent ambiguities and improve communication.

Project design should also include resources to allow outside accounting firms or consultants to provide auditing and financial management assistance to projects when Mission staff or the host country are unable to provide the services. Ways must be found to finance such activities.

Communication

Financial Management communication between AID and HCI's can be improved by creating structured channels for the exchange of up-to-date information concerning their respective objectives, requirements and procedures. Informal relationships can then be utilized to support the formal channels.

Cultural sensitivity and empathy are also needed to prevent misunderstanding and conflict. Failing to pay attention to these factors can result in the "polarization" of individuals as was sometimes the case between Mission Controllers and host country project directors during the "Certification Review" in the Sahel. Each blamed the other while neither took time to understand the others situation.

It is also important to have clear financial management guidelines from AID Washington to avoid the re-interpretation of requirements by Mission each time there is a personnel turnover. This would reduce the "mixed messages" that flow from Mission to project director and then from project director to accounting personnel.

At the same time Mission Directors can set guidelines for their staff which would result in more consistent and unified management within USAIDs. For example the "Certification Policy Statement" issued by certain Mission Directors in the Sahel provided a basis for clarifying and communicating policy on financial management requirements. It facilitated the process of planning and implementation by reducing ambiguity and limiting individual interpretation (FMITS, 1982:15)

Need for Parallel AID Improvements

The success of efforts to improve financial and project management by HCIs depends, to a degree, on parallel improvement in AIDs procedures and staff. (Sahel PP, 1982). Responsibilities for monitoring project financial management must be delineated between Project Officers and Controllers, and Project Officers need to receive the training that will enable them to perform their monitoring task. There is a need for guidance from AID Washington in these areas.

AID must reassess its institutional tendency to concentrate on design and to reward funding of projects rather than efficient management of projects. Otherwise project staff will continue to operate in a "fire-fighting, crises management mode" which results from inadequate attention to implementation issues. Along these lines AID Washington must decide if it is serious about making project financial management a priority. If so, they must exhibit this in practice as.

was done in the Sahel when funding was cut off to projects that did not meet Certification requirements, and recently with the issuance of Payment Verification Guideline (see p. 6). To be effective, such actions cannot be temporary in nature but need to be institutionalized over the long-run. Also, motivation schemes must be developed to reward the efficient allocation and management of resources.

Cooperation and Commitment

Often times both HCIs and Missions resist FMI. Project personnel are sometimes hesitant to open their books and Mission staff may be uncooperative. This behavior is seldom due to technical deficiencies in proposed financial management systems but is rather due to the psychology of how human beings respond to change.

Generally, people will resist changes that are perceived to be imposed from outside sources. On the other hard, when they are part of the change process they are committed to making it work. Thus, in terms of FMIEs, as much attention must be given to the human dynamics of systems operations as to the rational mechanics of the system itself. Those who will operate the system must see a benefit to themselves. If they see the benefit as someone else's (i.e. Mission staff seeing it as AID Washington or project staff seeing as the Missions) the response will be lip service to recommendations without a willingness to implement them.

Commitment is best achieved when the participants feel that their ideas and perspectives are reflected in the financial management system design. Therefore, involvement of participants should be stressed, their opinions solicited, and the needs and characteristics of their institutions reflected in all forms of assistance. This will insure a climate of acceptance and participation which is essential for financial management strategies to succeed. (Kettering and Schmidt, December 1981:8-11)

Section 4: AN ANALYTIC FRAMEWORK FOR THE EVALUATION OF FINANCIAL MANAGEMENT IMPROVEMENT OF DEVELOPMENT PROJECTS

4.1 INTRODUCTION TO THE ANALYTIC FRAMEWORK

The previous discussion provides the background for an analytical framework which can be used to evaluate financial management improvements on development projects and programs. Financial management problems which plague development projects and host country institutional/environmental constraints have been discussed to illustrate the nature and context of financial management effort in the Sahel has been used to demonstrate lessons learned regarding approaches to changes in this particularly sensitive area. An understanding of these areas should prove valuable to evaluators in their investigations by giving them points of reference and comparison. In addition, the theoretical and operational distinctions between financial accounting and managerial accounting provide a skeleton for differentiating between levels of impact and change. This background can help evaluators use their time more efficiently to focus in on known problem areas, explore practical approaches and systems and categories their findings in a comparative manner across projects and programs.

To illustrate, an understanding of financing mechanisms (Section 1.3) permits an analysis of the nature of financial responsibility resting with the host country institution and consequently the accountability requirements to meet AID regulations. This is important since the method of financing influences the improvement and the strategy required. The alternative approaches to financial management improvement Section (3.1) provides a framework for analyzing the implicit or explicit strategy in the project design (or developed during implementation) to ensure proper financial accounting and management. Finally, the experience of financial management improvement in the Sahel should be useful for evaluators to compare (1) where problems are similar, what strategies, if any, have been developed to address problems, and (3) which of the approaches taken in the Sahel, if any, would be applicable, given the project circumstances and environment.

One of the most difficult aspects of assessing financial management impact on development projects is that there is seldom an explicit, well-articulated strategy to improve (or to carry out) financial management. The neglect of this area in project design has led to many of the difficulties experienced in project implementation, and consequently in the confusion nd complexity encountered in management development programs from the host country perspective. It is, therefore, quite difficult to isolate financial management improvement from the total project, expect in cases where there are intentional efforts, and identified resources, for improving the management of credit, rolling funds or similar financing mechanisms as part of the technical package in the project design. This is not uncommon in agricultural service delivery projects, but even in these instances, the financial management improvement aspects are usually limited narrowly to a particular office or program handling credit funds, rather than emphasizing the improved management of all project funds within the development program context.

Following is an "analytical framework" which can be used to evaluate project/HCI financial management and its improvement. An underlying premise of this framework is that the development project provides an accurate entree to observing and analyzing how HCI development finances are managed. This is a legitimate premise when assistance programs provide substantial resources in proportion to the development program being analyzed and when the programs do, in fact, encompass the development projects (as opposed to having projects which are programmatically and managerially isolated and insulated from ongoing development program operation in the HCI.)

The analytical framework is based upon three analytical dimensions. First, there is the distinction of functions between financial accounting and managerial accounting (Section 1.2). This permits analysis of the level of improvement and the focus of improvement efforts. Second, there is a distinction of levels between financial management improvement in terms of project performance, program impact and viability. This permits analysis of the impact on the project, on its encompassing program, and its sustainability beyond the life of the project. Third, there is the identification of the key sets of determining variables affecting financial management improvements, focussing particularly upon those variables which can be influenced by project design and implementation. These variables are illustrated in four major categories -- Structures, Systems, Institutional Arrangements, and Personnel. It is necessary to collect objective data upon these variables as the first step toward analysis of performance, impact and viability.

Figure 4-A illustrates this analytical framework, and suggests analytical focus for the various areas of inquiry. The questions suggested by the framework are designed to expose financial management strengths and weaknesses, as well as possible related characteristics and/or causes. This allows evaluators to determine factors that have contributed to success or improvement and/or which have contributed to problems or failures. In general, the framework will provide information that contributes to insights on financial management improvement. As noted below, the hypotheses in this area are still in development and it is hoped that this study will contributed to a better understanding of what should be further explored in the future. At this stage of development, the evaluators are searching for insights more than confirmation of clearly defined hypotheses. However, it is clear that there are definite hypotheses which determine the structure of this analytical framework, and these are suggested below.

PROJECT PERFORMANCE

Development projects undertaken by AID in African nations are, by definition, cooperative efforts. The structure of the projects determine the extent to which they can be successful separate from the organizational context of the HCI or to which they are dependent upon the HCI for success. Typically, designs attempt to reduce dependence when there is a great deal of uncertainty or anticipated change. The evaluators will need to explore to what extent the determining variables as designed and implemented on the project contributed to immediate success in achieving project outputs and end-of-project status.

Illustrative Hypotheses:

Highly independent structures and systems with adequate resources for hiring and training project-specific personnel contribute to project successes.

Figure 4-A: A Conceptual Framework for Evaluating Financial Management Improvement

FINANCIAL MANAGEMENT FUNCTIONS

	FINANCIAL ACCOUNTING	MANAGERIAL ACCOUNTING
PROJECT PERFORMANCE Structure Systems Personnel Institutional Arrangements	Did the project get into financial problems? Were systems and practices appropriate and adequate? Degree of and rationale for dependence or independence of financial systems? Clarity of requirements from point of project initiation? Use of audits and other tests of accountability? Selection of personnel? Deliberate strategy for financial accountability, financial management or improvement?	Degree to involvement of HCI in the management and decision-making? To what extent financial reporting was oriented toward AID vs. HCI needs? Proportion of financial resources managed by HCI? Flow of financial information between HCI and AID--sharing of total/partial information, mutual analysis, feedback? Flexibility and changes in financial resources/applications during implementation.
PROGRAM IMPACT Structure Systems Personnel Institutional Arrangements	Proportion of finances handled by HCI? Proportion of project relative to larger program? Integration with HCI financial systems? Introduction of innovations and changes with program implications? Use of HCI program personnel, their tenure and subsequent assignments?	Management links to larger program and use of collaborative management? Use of donor or HCI reporting formats and practices? Inter-department/program coordination introduced by project and follow-through support for changed practices? Sharing of financial information in complete and analytic ways between units?
VIABILITY & SUSTAINABILITY Structure Systems Personnel Institutional Arrangements	Recurrent costs generated by the project? Extent to which project costs generated systems requiring different practices and systems from traditional HCI approaches? Follow-up support from AID or others to reinforce and sustain momentum?	Extent to which complementary projects are funded by AID or others? Awareness of recurrent costs during project design, approval and implementation so that costs assumption is effective? Disruptions during transition periods?

Highly centralized project management based upon technical assistance teams and donor-supplied personnel (local and expatriate) facilitative speedy project implementation and high accountability of funds and activities.

Clarity and detail in project documentation and institutional communications, such as PILS, help improve accountability and success for development projects.

Lack of continuity of personnel at the project level increases the probability of financial and managerial accounting problems and crises. Lack of continuity of personnel at the program level in both the HCI and AID also increase the probability of accountability problems and crises.

Project accountability emphasizes the needs and concerns of the donor agency to the neglect of local institutional needs.

Reports and use of financial information is primarily oriented toward the donor agency. The flow of information is generally from the HCI to AID, and there is little flow of financial information of feedback from AID to HCI.

PROGRAM IMPACT

Many development programs are a collection of development projects with a minimal base of ongoing activities. Projects are normally oriented toward technical innovation and change without corresponding attention to the program and financial management implications of the changes or the designs of projects. Administrative requirements are usually assumed and not explicitly addressed through a change strategy. The program impact of development projects can focus upon the proportion of the development program comprised of the project(s), the integration between projects and between project and program context, the continuity and tenure of personnel at the project and program levels who are the primary sources of institutional memory and learning, the extent to which systems and practices introduced were accepted and adopted by the program, and the extent of follow-up or subsequent phases in the program area.

Illustrative Hypotheses:

When development projects have a low profile in the total HCI program, their impact is not high, particularly with respect to management functions.

If financial management systems are linked to existing HCI systems, these systems are likely to use innovations or changes introduced to meet donor needs and still be acceptable for the HCI program.

Use of HCI personnel on projects ensures that the training and learning from the project will remain in the HCI and be used on future projects and programs for development.

Lack of follow-up or subsequent phases of projects reduces the impact and the probability that any improvements will be adopted by the HCI.

VIABILITY AND SUSTAINABILITY

One of the biggest challenges to development programs is the need to introduce technologies, systems and practices which are viable and self-sustaining after the departure of the donor. This is particularly difficult in the nations which are poor and resource-deficient where it is anticipated that donor/aid assistance will be a major part of the development for the foreseeable future. Information on the determining variables provide a basis for insights into sustainability. The most important question is often that of recurrent costs and demands upon ongoing structures which are generated by the project. Is there the financial base to assume recurrent costs? Are the financial systems and structures to handle increased demands, larger programs, more complex transactions as a result of the project? As pressures increase during implementation to get a project done, many of the sustainability issues are neglected in the rush to achieve project outputs. The result is often a vacuum at the end of the project which requires further dependence upon similar external assistance or a neglect which reduces the long-term results expected from the project's original design.

Illustrative Hypotheses:

The greater the increase of demands for services generated by the project, the more attention which must be given to financial management concerns.

The higher the proportion of HC funding in the project, the more sustainable the program will be in the future.

The closer the project is linked to other donor funds, the more viable the program which its supports.

The less linked the project is to existing structures and systems, the sooner momentum is lost following the project and impact or change is difficult to track.

4.2 APPLYING THE FRAMEWORK TO DEVELOPMENT PROJECTS AND PROGRAMS

In the preceeding discussions, we have outlined financial management problems and causes in the areas of host country institutional/environmental constraints, AID institutional tendencies, and communication. An understanding of these areas should prove valuable to evaluators in their investigation of financial management as it will give them points of reference. Using these reference points they can pose questions such as "does the manager use accounting information for management decisions?," "was the project pushed through quickly without attention to implementation issues?" or "were their open channels of communication between Mission and project/HCI?," which will allow them to get at the heart of major problem areas. The problems discussed in this paper arose out of extensive evaluations themselves. It is therefore not necessary to rediscover them - evaluators can use their time more efficiently to focus in on known problem areas and to expand their discoveries from there.

This paper has provided the background for use of an "analytic framework" to evaluate project/HCI financial management performance and capacity. To use the framework we can suggest a methodology. Consisting of "yes-no"/short-answer questions which reflect the financial management of projects. The questions are broken down in the next sections, representing major financial management variable or indicators and include: the structure and systems of the project/HCI; the institutional arrangements and personnel of the HCI and AID Mission, and project performance and institutionalization.

The questions illustrated for the framework are designed to expose financial management strength and weaknesses as well as their causes. They will allow evaluators to determine what factors have contributed to success or improvement and which have contributed to failures. In general, the framework will provide information which will contribute to improved financial management insights. The evaluators will then be able to apply those insights towards improved financial management in future projects. (Sources for the Framework include: Management Information System, SRFMP, 1982. Kettering and Matthews, 1981: Appendix G, and Dakar Conference, SRFMP:1983).

4.3 ANALYZING FINANCIAL MANAGEMENT

Structures

	Yes	No	N/A	Answer/Comment
1. What structural category did the project fall under? (See Appendix A) [] .... Separate Organization [] .... Highly Independent Matrix [] .... Highly Dependent Matrix [] .... Fully Integrated [] .... Program Advisory Structures				
2. Were other donors involved in the project? - Did they have independent accounting system?				
3. Was the scope of project activities: - National? - Regional? - Local?				
4. Was there offices at each level of project activity?				
5. Is this a typical structure for projects projects in this area?				
6. Are structures closely linked to or integrated with the host country organization.				
7. Are the demands for structural support from the HCI high?				

4.4 ANALYZING FINANCIAL MANAGEMENT

Systems	Yes	No	N/A	Answer/Comment
1. Did the HCI have a separate accounting system for donor funds? or a. Were project funds mixed with HCI internal funds?				
2. Did the project have a financial system which included a (or the equivalent of):				
a. Donors Receivable Account? (a ledger listing total AID funds committed, amount of advanced to date and balances)				
b. Encumbrance Journal (see p. 7)?				
c. Cash Receipts and Disbursement Ledger (see p. 7)?				
3. Were project funds isolated in a separate bank account?				
a. Was more than one signature required for authorizing checks?				
b. Was the check book and disbursement maintained by different people?				
c. Who signed the checks?				
4. Were bank reconciliation statements prepared?				
a. How often? ____________________				
b. By who? ______________________				
5. Was there a petty cash fund?				
a. Was it maintained at a fixed amount (i.e. did the receipts on hand plus the cash equal the fixed amount)?				
b. Was there a strong box for the cash?				
c. Who approved petty cash vouchers?				
6. Was there an effective system for transmitting data from remote project sites to headquarters?				
7. Were budgets prepared for the project?				
a. What were the budget periods?				
b. Who prepared them?				
c. Who was the budget submitted to?				
d. Was the accountant involved in budget				

	Yes	No	N/A	Answer/Comment
8. Was there a central point where all accounting information could be found?				
9. Was all accounting done at headquarters? or				
a. Were field site expenditures accounted for at the field sites and sent to to headquarters?				
10. Was the accountant required to submit periodic financial reports to the Project Director?				
a. How often?				
11. Did the HCI have a separate purchasing department?				
a. Was the function of receiving materials performed by some independent of it?				
12. Were receiving reports filled out to verify that goods and services received correspond to those ordered?				
13. Were purchased materials reviewed at a central location?				
a. Were they counted and inspected?				
b. Were they controlled by pre-numbered receiving reports?				
c. Who was responsible for inventory control?				
14. Was the system similar to and built upon existing HCI practices?				
15. Are any similar practices or innovations in financial management from the project still being used by the HCI?				

4.5 ANALYZING FINANCIAL MANAGEMENT

Institutional Arrangements

	Yes	No	N/A	Answer/Comment

1. Did project documents (PILs, PIOs, PROAGs, PPs) clearly spell out required methods of financial accountability and reporting of local currency funds?

   a. Did they describe the type of report required?
   b. Did they say how often reports were required?
   c. Did they preview funds for auditing by outside parties?

2. Was there a local cost component in the project?

   a. What percentage of AID funded local costs were managed by the HCI?
   b. Was the HCI responsible for managing AID funds to pay for?

      -Salaries?
      -Rent?
      -Travel?
      -Procurement of local goods and services
      -Other?

   c. How much total AID financed local currency was the HCI responsible for?

      -annually?
      -over the life of the project?
      -what percentage of the HCIs internal budget did this amount to?

3. Was a pre-project assessment made of HCI financial management capacity?
   a. Were the HCI systems/practices deemed adequate?
   b. Was there any training prescribed?

4. Was the project accounting system audited?
   a. By whom?
   b. How often?
   c. To whom were audit reports issued?

5. Did Mission staff make on-site visits to monitor project activities?

	Yes	No	N/A	Answer/Comment
-Which staff position? -How often? -Was financial management discussed? -Were financial accounts reviewed?				
6. Were any accounting firms or financial management consultants hired for auditing or technical assistance?				
7. Were there any structured communication channels to facilitate the exchange of financial management information between HCI and AID (i.e. correspondence, meeting etc.)?				
a. Was the HCI clear as to what its financial management responsibilities were?				
8. Did the project include a management enhancement component?				
a. Did it encompass financial management?				
9. Has there been any project follow-up by AID or other donors which support, reinforce or are consistent with the project arrangements?				
10. Were there clear institutional arrangements for financing the project after donor aid termination (e.g., recurrent funds)?				
11. Does the HCI have the capacity to finance and carry out the project, e.g., recurrent funds, personnel, financial management systems?				
12. Are the signs that financing and financial management are institutionalized and self-sustaining?				

4.6 ANALYZING FINANCIAL MANAGEMENT

Personnel

	Yes	No	N/A	Answer/Comment
1. Was there an accountant(s) assigned to the project?				
a. Were they assigned full time to the project?				
b. Did they have responsibilities outside of the project?				
c. Who did they report to?				
d. How much money were they responsible for accounting for before the project? - During the project?				
e. What was their formal education level?				
f. Did they have any accounting training? - formal? - on-the-job?				
2. Was the project director part of the HCI staff?				
a. Was he assigned full-time to the project?				
b. What was his formal education level?				
c. Did he have training in financial management?				
d. Who did he report to?				
e. Did he have direct authority over the accounting unit?				
3. Were any other HCI personnel assigned to the project?				
4. Was there a USAID project officer assigned to the project?				
a. Did he have any background in financial management?				
b. Did he speak with spoken language?				
5. Was there a USAID Controller in the country?				
a. Did he have any responsibility for project financial management monitoring or control?				
6. Were there expatriate contract personnel working for the project?				
a. Did any have financial management expertise?				
b. Were any responsible for financial management technical assistance?				

4.7 ANALYZING FINANCIAL MANAGEMENT

Performance

	Yes	No	N/A	Answer/Comment
1. Were project financial reports prepared for (or the equivalent of):				
a. Donor Receivables account?				
b. Encumbrance Journal?				
c. Cash Receipts and Disbursements Ledger?				
d. With what frequency?				
e. Were they timely?				
f. Who prepared them?				
g. How long after the end of the accounting period were they prepared?				
h. Did they correspond to accounting records?				
i. To whom were they directed? -for what purposes?				
2. Did the Project Director use accounting information to monitor:				
a. Where resources were going?				
b. if resources were going to priority areas				
c. if resources were being used efficiently?				
d. estimates for future resource needs?				
3. Were checkbooks and journals posted up-to-data?				
4. Did the project suffer from liquidity (cash flow) problems?				
a. What problems did this indicate?				
5. Was the project accounting system audited?				
a. Were there any disallowances as a result?				
b. What problems did they indicate?				
6. Were disallowances made for advance or reimbursement requests?				
a. Why?				
7. Were HCI officials interested in accountability for performance issues related to their own organizations?				

	Yes	No	N/A	Answer/Comment
8. Did HCI officials use financial records for decision-making?				
9. Were donor and HCI funds and resources linked for overall program management in the HCI				
(The following questions will help the evaluator determine how conductive the working environment of the HCI was to good financial management performance. This is important as it may be the case that the HCI has decent financial management systems and procedures but that external factors prohibited them from achieving good performances.				
10. Was the HCI experiencing internal budgeting constraints?				
a. Was staff being paid on time?				
11. Was there strong pressure to make extra payments (bribes) to people in order to procure necessary goods and services?				
12. Were the accountants overburdened?				

4.8 ANALYZING INSTITUTIONALIZATION OF IMPROVED FINANCIAL MANAGEMENT PRACTICES

	Yes	No	N/A	Answer/Comment
1. Was there a financial management enhancement component in the project?				
2. Was the project successful in improving financial management for AID compliance purposes?				
3. Was the project successful in institutionalizing improved financial management practices in the HCI?				
a. What systems were changed?				
4. Were there opportunities to improve HCI managerial accounting (see p. 5 for definition) given the institutional arrangements of the project (i.e. was the project Director responsible for local currency financial management outside of recurrent expenses such as rent and salaries)?				
5. Were there recurrent costs in the project that were to be taken over by the HCI after the project?				
a. If so, how successful has the HCI been in meeting those costs since project termination?				

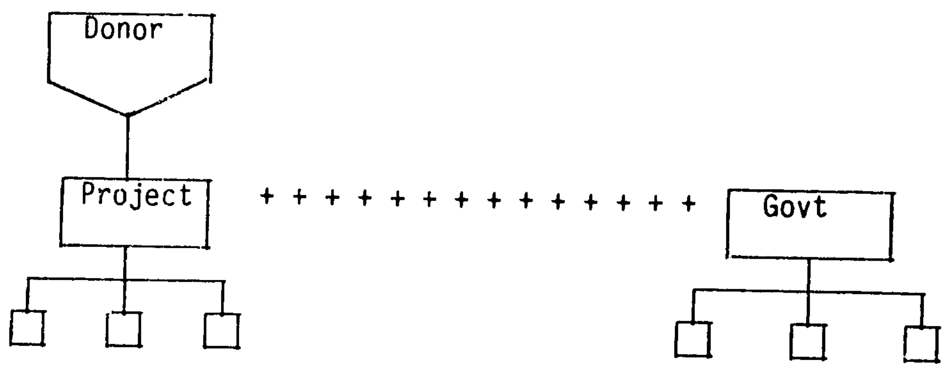
ATTACHMENT A

Structure

What "structural category" does the project fall under?

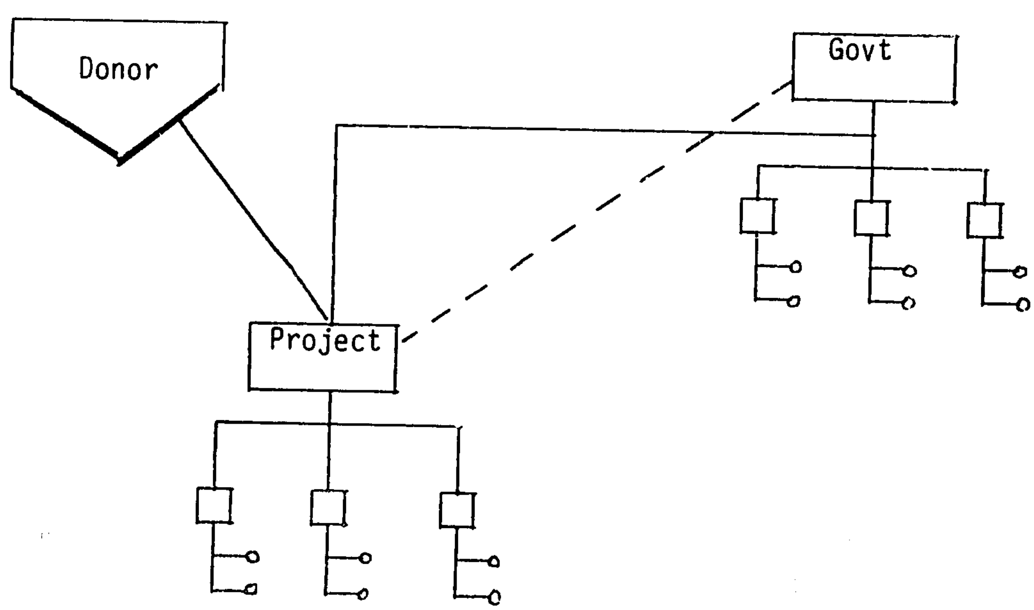
Type 1 - Separate Organization

An organization created specifically for the project. Characterised by high donor control, operation independence, and autonomy.



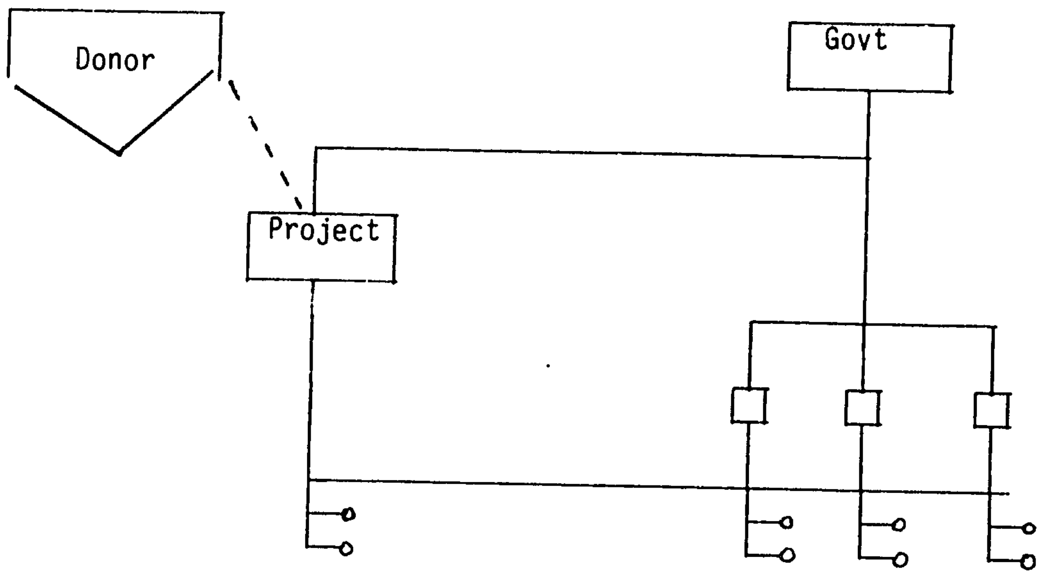
Type 2 - Highly Independent Matrix

A new unit within an existing HCI is created to carry out the project. It depends upon HCI for some of its support and functions. Donor usually retains high control of contracting and procurement.



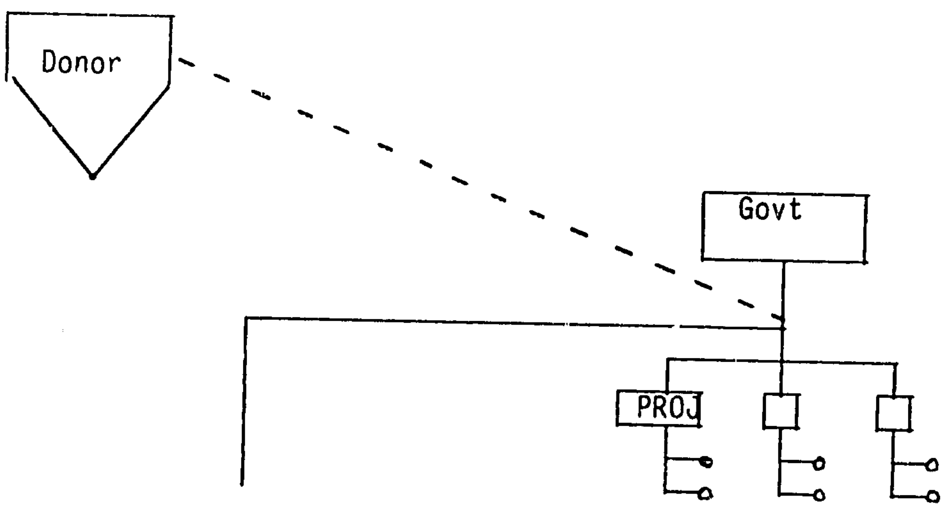
Type 3 - Highly Dependant Matrix

Project is organized to be highly integrated with a small project staff uniquely assigned to direct the project, but the HCI has a large responsibility for management, uses its people and resources to carry out the project.



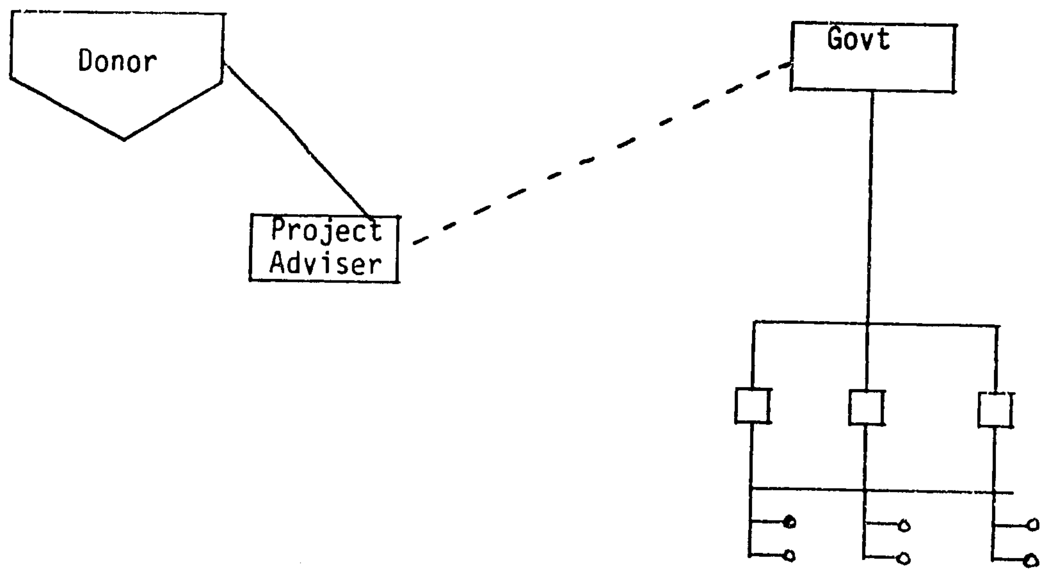
Type 4 - Fully integrated

Direct primary management responsibilities are within the parent organization, and subject to all the conditions and procedures of that organization. Assistance is provided through existing organizational position and programs.



Type 5 - Program Advisory Structure

Donor project provides guidance and influence on the program and helps direct it in ways that are agreed upon by the donor and HCI. Donor maintains high primary management responsibility for technical assistance. Usually oriented to program and policy objectives.



Key

______	=	Direct authority or control
------	=	Oversight and Monitoring only
+++++	=	Coordination only

(Adapted from M. Kettering, "A Framework for Analysis of Organization Structure and Management Patterns for Development Projects in Malawi." 1984)

47

BIBLIOGRAPHY

Kettering, M. Improving Financial and Program Management. USDA/OICD/DPMC. Washington, D.C. March, 1982.

U.S. Development Assistance to the Sahel-Progress and Problems. General Accounting Office - Report to the Congress, Washington, D.C. March 29, 1979.

AID Slow in Dealing with Project Planning and Implementation Problems. General Accounting Office - Report to the Congress, Washington, D.C. July 15, 1980.

"Use of Fixed Amount Reimbursement Method for Local Cost Financing," AID Handbook 3. Washington, D.C. September 30, 1982.

The SRFMP Management Information System. Virginia Tech and USDA/OICD. Washington, D.C. May, 1984.

Sahel Development Program - Annual Report to the Congress. AID. Washington, D.C., April, 1983.

PL480 and ESF Counterpart Funds. Proposal from Sahel Regional Financial Management Project, Washington, D.C., 1984.

Use of Public Accounting Firms, AAA/AFR/PMR. Washington, D.C. June 4, 1984.

Introduction to the Financial Management Improvement Effort in the Sahel. USDA/OICD/DPMC. Washington, D.C. February 22, 1982.

Problems in Host Country Accounting for Utilization of AID Funds in the Sahel. Audit Report 81-35, AID Inspector General, Washington, D.C. January 29, 1981.

Raleigh J., Kante M., Ritzert C. FMIT Report: Workshop in Niger. March 22 - April 2, 1982.

Improvements Must Be Made In The Sahel. Audit Report 81-52 - AID Inspector General. Washington, D.C. March 10, 1981

Kettering, M., Matthews, M., et. al. Improving Financial Accountability and Financial Management In the Sahel. Washington, D.C., May, 1981.

Raleigh, J., Ritzert, C. et. al. A Practical Manual For A Simplified Accounting System. Virginia Tech and OICD. Washington, D.C., 1983.

The Sahel Regional Financial Management Project Paper. AID, August 20, 1982.

Payment Verification Policy Implementation Guidance. AA/M, Washington, D.C. December 30, 1983.

Spiro, Herbert, Finances for the Non-Financial Manager, John Wiley & Sons, New York, 1977.

Lloyd, M., Financial Management Workshop for USAID Project Managers. Dakar, Senegal. February 3, 1984.

Kettering M., Schmidt, T. Improving Project Monitoring and Implementation Systems. USDA/OICD/DPMC. Washington, D.C. December, 1981.

Kettering, M., A Framework for Analysis of Organizational Structure And Management Patterns For Development Projects in Malawi. USAID/Malawi, Ministry of Finances/Malawi, USDA/OICD/DPMC. May, 1984.

The Sahel Financial Management Improvement Effort, 1981-1982. Development Project Management Center, USDA/OICD. Washington, D.C. May, 1983.

Uganda Food Production Support. Audit Report 84-09. AID Inspector General, Washington, D.C. March 8, 1984.

Pest II Project - Burundi. Audit Report 84-11. AID Inspector General, Washington, D.C. April 25, 1984.

Zaire Basic Rural Health Project. Audit Report 84-10. AID Inspector General, Washington, D.C. March 30, 1984.

Burundi Basic Food Crop Project. Audit Report 84-12. AID Inspector General. Washington, D.C. June 22, 1984

Review of the AID Program in Tanzania. AID. Washington, D.C. 1980.