Assessing Risks Associated with Funding Development Initiatives Through Host Country Systems:

The USAID Public Financial Management Risk Assessment Framework (PFMRAF) and the Case of Honduras

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President and CEO, IBI International

- Ownership
- Alignment
- Harmonisation
- Managing for Results
- Mutual Accountability
Context: USAID Forward

- Objective 1: Strengthen partner country capacity to improve aid effectiveness and sustainability
- Aim is to avoid creating parallel service delivery structures and instead focus on improving those that exist.
- Direct funding conditional on PFMRAF (see ADS 220)
PFMRAF

- **Stage 1:** Rapid Appraisal (country level)
- **Stage 2:** Risk Assessment (institution level), Analysis, Mitigation, and the Approval for Use of Partner Country Systems
- **Stage 3:** Project Design, Approval, Designation of Responsibilities and Selection of the Funding Mechanism
- **Stage 4:** Negotiating and Preparing the Bilateral Project Agreement with the Partner Country Government
- **Stage 5:** Implementation, Monitoring, and Evaluation
PFMRAF (cont’d)

Current Status (as of Oct. 2013):

- 36 Stage 1 country-level assessments completed.
- 80 Stage 2 institution-level assessments at some stage of activity
- 69 awards made to host government institutions, by 30 USAID Missions (in FY12)
Related Indicators

USAID OVERSEAS MISSION FUNDING TO LOCAL GOVERNMENTS/INSTITUTIONS

<table>
<thead>
<tr>
<th>Year</th>
<th>Host Govt</th>
<th>Other Local Institutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY10</td>
<td>4.03</td>
<td>5.68</td>
</tr>
<tr>
<td>FY11</td>
<td>6.5</td>
<td>6.44</td>
</tr>
<tr>
<td>FY12</td>
<td>7.51</td>
<td>6.79</td>
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</tbody>
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Source: USAID Forward Progress Report 2013
Stage 2 Risk Assessments

Objective: identify fiduciary risks at the institutional level and develop mitigation measures

Usually done with a program design already in mind.

Positive Outcome = Approval of Use of Partner Country Systems
Stage 2 Case Study: MCA Honduras

- Unique situation of an institution already set up for purpose of receiving, programming, accounting for USG funds (some $389m)
- PEFA report on overall PFM system completed in early 2013.
Scope of Work

- IBI approach extended well beyond the application of the PFMRAF questionnaire to encompass a validation of the 2013 PEFA Report on the GoH PFM, and a capacity assessment of the MCA-H.
- Work performed included extensive testing of governance, control environment, transaction cycles, internal control, procurement and operational procedures of the MCA-H.
- Key point: institutions can’t be assessed in isolation. They exist within a system.
Analysis of six PEFA dimensions related to GoH PFM capacity:

1. Budget Credibility
2. Budget Comprehensiveness and Transparency
3. Policy-Based Budgeting
4. Predictability and Control in Budget Execution
5. Accounting, Recording and Reporting
6. External Scrutiny and Audit
Analysis of 10 components related to MCA-H capacity

1. Governance, control environment, and organizational structure
2. Budgetary Systems
3. Budget Execution
4. External/Internal Audit Function
5. Internal Controls
6. Procurement
7. Human Resources
8. Revenues, Accounts Payable, and Expenses
9. Information Technology
10. Donor Relations
Risk Assessment

<table>
<thead>
<tr>
<th>#</th>
<th>Relevant Component</th>
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<tbody>
<tr>
<td>1</td>
<td>Credibility of the budget</td>
</tr>
<tr>
<td>2</td>
<td>Comprehensiveness and transparency</td>
</tr>
<tr>
<td>3</td>
<td>Policy-based budgeting</td>
</tr>
<tr>
<td>4</td>
<td>Predictability and control in execution</td>
</tr>
<tr>
<td>5</td>
<td>Accounting, Recording and Reporting</td>
</tr>
<tr>
<td>6</td>
<td>External scrutiny and auditing</td>
</tr>
<tr>
<td>7</td>
<td>Governance, control env., and structure</td>
</tr>
<tr>
<td>8</td>
<td>Budgetary systems</td>
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<tr>
<td>9</td>
<td>Budget execution</td>
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<td>10</td>
<td>External/internal audit</td>
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<td>11</td>
<td>Internal controls</td>
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<td>12</td>
<td>Procurement</td>
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<td>13</td>
<td>Human resources</td>
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<td>14</td>
<td>Revenues, A/P, and expenses</td>
</tr>
<tr>
<td>15</td>
<td>Information technology</td>
</tr>
<tr>
<td>16</td>
<td>Donor relations</td>
</tr>
</tbody>
</table>

GoH

Impact Scale

- Serious: 50 - 75
- Catastrophic: 76 - 100

Likelihood Scale

- Probable: 51 - 75%
- Frequent: 76 - 99%

MCA-H

Impact Scale

- Negligible: 1 - 10
- Marginal: 11 - 49

Likelihood Scale

- Remote: 0 - 25%
- Occasional: 26 - 50%

GoH/MCA-H
Illustrative Findings Matrix

The matrix categorizes findings based on impact and probability. The impact categories are Catastrophic, Serious, Marginal, and Negligible, with corresponding probability levels of Remote, Occasional, Probable, and Frequent.
Flowcharts encompassing budget, procurement, accounts payable, revenues and expenditures
Assessment Results

- Included an assessment of the MCA-H “residual risk” - i.e. risk remaining after mitigation measures are in place — e.g. audited semiannual progress reports, annual or project-end financial audits, etc.

- Our conclusion is that MCA-H relatively strong capacity effectively reduces risks posed by the larger PFM system in which MCA-H operates to a resultant level of risk ranging from medium to low
Discussion Topics

- Does the USAID Forward objective of funding development through host country systems represent a shift to the MCC Compact model?
- Is it advisable/sustainable to use a Millennium Challenge Account organization as an implementing partner for USAID – if it succeeds in Honduras, should USAID seek to replicate the model in other MCC countries?
- What happens if risk assessment shows unacceptable risks and lack of capacity? What does the development community do then?