BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Administrator Agency For International Development

Financial Management Problems In Developing Countries Reduce The Impact Of Assistance

The major bilateral and multilateral development assistance agencies provide billions of dollars annually to help developing countries improve their economic conditions. However, the lack of personnel trained in basic accounting and related financial management functions has adversely affected development program performance in many of these countries.

This report describes the financial management problems being encountered in the developing world and the need for more systematic donor agency attention to related training and technical assistance. GAO recommends that the Agency for International Development encourage formal donor cooperation to address these needs and that, as a part of such efforts, the Agency establish a clearly defined commitment to financial management training and technical assistance.

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

B-165093

The Honorable M. Peter McPherson
Administrator, Agency for
International Development

Dear Mr. McPherson:

This report presents the results of our review of financial management problems in developing countries and their impact on development assistance efforts.

The report contains recommendations to you on pages 40 and 41. As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of the report to the Director, Office of Management and Budget, and to appropriate congressional committees.

Sincerely yours,

Frank C. Conahan

Frank C. Conahan
Director

GENERAL ACCOUNTING OFFICE
REPORT TO THE ADMINISTRATOR
AGENCY FOR INTERNATIONAL
DEVELOPMENT

FINANCIAL MANAGEMENT PROBLEMS IN DEVELOPING COUNTRIES REDUCE THE IMPACT OF ASSISTANCE

DIGEST

Poor accounting, budgeting, and auditing capability in developing countries is eroding the performance of development programs.

GAO made this review to determine how the Agency for International Development (AID), in coordination with other major donor assistance agencies, can better meet the financial management training and technical assistance needs of developing countries. GAO discussed the problem with major donors and, through a questionnaire, obtained the views of 30 developing countries' national audit agencies concerning the scope of the financial management problem and their training needs. (See pp. 3 through 5.)

GAO found that AID and the other donors have not adopted policies or developed well-articulated and coordinated programs of assistance to improve host-countries' financial management systems. The donors have not (1) analyzed the constraints of financial management as they affect the main sectors of development or (2) formulated specific policies and programs to address major problem areas.

NEED FOR FINANCIAL MANAGEMENT IMPROVEMENTS

The experiences of the major donors have demonstrated the need to improve developing country financial management systems as an important element in the development process. Examples are:

--Lack of accounting capability in the Sahelian countries of sub-Saharan Africa resulted in a misuse of donor assistance funds and a legislative requirement that AID certify the adequacy of accounting systems for development assistance projects in that region. (See p. 3.)

--World Bank reports which indicate that public sector agencies in many developing countries cannot establish and maintain records in accordance with sound accounting principles. Financial control in development programs is inadequate and data is insufficient for formulating realistic development policies and strategies. (See pp. 8 through 10.)

DEVELOPING COUNTRY VIEWS

In responding to GAO's questionnaire, many developing countries stated that improved financial management capability would significantly benefit the performance of development programs. Several countries believed such improvements are important because

--their government accounting systems do not have the ability to meet the accounting and auditing requirements of donor loan and project agreements;

--their accounting and budgeting systems do not have the capability to identify and control the costs of development projects; and

--there is little or no capability to audit development projects, particularly for economy, efficiency, and effectiveness.

Many respondents indicated that donors provide some training and technical assistance to help improve their financial management systems, but they believed there is a need for greater donor assistance. (See pp. 6 through 8.)

AID SHOULD ESTABLISH A FINANCIAL MANAGEMENT TRAINING AND TECHNICAL ASSISTANCE PROGRAM

AID has not developed a systematic approach to long-term training and technical assistance to help improve the financial management capabilities of developing countries or regions other than the Sahel.

Its attention to the problem area has been limited to considering financial management as only one of many public administration needs, without the necessary focus on financial accounting problems affecting development program performance. It has also been limited to providing assistance as a component of development projects which, while helpful, does not adequately address institutional development problems that limit financial controls on a sectoral and countrywide basis.

AID officials agreed that improving host-country systems should have a higher priority and suggested that such efforts should build on

--the ongoing Regional Financial Management Project in the Sahel which includes training of both host-country and AID project staff, the use of minimum accounting standards for certifying the adequacy of host-country systems, and improved monitoring of development project financial controls;

--actions by the Africa Bureau to encourage greater overseas mission use of private accounting firms to improve project performance and host-country financial systems (see pp. 26 and 27); and

--the development of a Payment Verification Policy by AID's Office of Financial Management to strengthen overseas mission controls, which requires assessments of host-country accounting capability in selected assistance programs (see pp. 27 and 28).

GAO also found that, except in the Sahel, there are no minimum standards for overseas AID missions to use in their approval of host-country accounting capability.

DONOR COOPERATION NEEDED

GAO believes that successful institutional development in the area of host-country financial management requires coordinated donor strategy and action.

No effective consideration of the financial management issue has taken place in established donor forums. The Club Du Sahel, which includes 20 donor nations as participants and was established to focus both donor and recipient interest on factors essential to development in the Sahel, has not addressed the financial management problem. As a result, the AID regional project is the only major donor assistance activity that addresses improved financial management as an important element of the recipients' abilities to efficiently use assistance.

Similarly, the financial management assistance needs of developing countries have not been addressed in the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD) or in the group called Cooperation for Development in Africa. (See pp. 28 and 34.)

U.N. organizational programs have financial management improvement objectives and can provide an important point of reference for donor policy formulation. (See pp. 35 through 37.)

CONCLUSIONS AND RECOMMENDATIONS

As a matter of institutional development strategy, AID has not systematically addressed the financial management training and technical assistance needs of developing countries.

GAO recommends that the Administrator of AID establish a long-term program for financial management assistance. GAO believes that the long-term program should

1. begin with a complete documentation of financial management training and technical assistance provided by AID and other donors and the identification of developing countries not yet receiving adequate assistance and

2. include for those countries identified as having major financial management shortcomings an assistance strategy as part of the Agency's overall country development plan. To promote recipient interest, each development assistance project approved as part of the country plan should require as a condition for disbursement of project funds a program agreed to by host-country implementing agencies for establishing improved and standardized financial planning, accounting, and reporting systems. (See pp. 40 and 41.)

In developing the AID program, GAO recommends that the Administrator of AID initiate formal donor discussions of the financial management issue in OECD's Development Assistance Committee. The discussions should focus on the implications of financial management weaknesses in developing countries, their effect on the major sectors of development assistance programs, and the options for donors to systematically emphasize improving host-country systems.

To facilitate multilateral donor interest, GAO recommends that the Administrator of AID, in conjunction with the Secretary of Treasury, also encourage the regional development banks to develop financial management training and technical assistance strategies that complement AID initiatives and emerging World Bank policy.

AGENCY COMMENTS

AID stated that it agreed with the basic recommendation of the report, that financial management be given greater attention in the Agency. Seven specific Agency actions were identified for the near future to improve financial management by host-country institutions. These included developing minimum accounting standards for application worldwide in reviewing host-country institutions, developing a data base for reviewing host-country needs and training received, and establishing an AID working group to develop financial management policy and assistance plans. AID believed that its regional project in the Sahel and Payment Verification Policy also represent important efforts in the area.

AID believed, however, that high-level policy discussions with other donors on the financial management issue would be premature until successful implementation of these actions is complete. GAO believes that policy-level discussions with other donors should be encouraged to complement the stated AID actions for improving host-country institutions. AID stated that although in some projects it does require a host-country plan for improved financial management systems as a condition precedent to development assistance, this requirement is generally limited to institutions having responsibilities for individual projects. GAO believes that implementation of this requirement as a part of the Agency's overall country development plans would be more effective than a project-by-project approach in generating host-country commitment to improved accountability in development programs. (See app. II.)

C o n t e n t s

ABBREVIATIONS

AID	Agency for International Development
GAO	General Accounting Office
OECD	Organization for Economic Cooperation and Development

CHAPTER 1

INTRODUCTION

The lack of capability for financial management has been linked to the difficulties of developing countries (1) in meeting the audit requirements of donor assistance, (2) controlling assistance funds, (3) avoiding cost overruns, and (4) in some instances, misusing public funds. The lack of financial management controls in the Sahelian countries of Africa--Senegal, Mauritania, Cape Verde, Mali, Gambia, Niger, Upper Volta, and Chad--led to a 1981 legislative requirement that the Agency for International Development (AID) certify the adequacy of Sahelian governments' accounting for AID funds. However, developing countries in all regions face financial management problems with their development programs.

The financial management problems present a dilemma to the development assistance agencies (donors) which must maintain a reasonable level of accountability in their programs and yet, for humanitarian, economic, and political reasons, must maintain a high level of resource transfers to the Third World. A key question is how can assistance funds, as well as the substantial resources provided by the developing countries themselves, be better managed to improve the overall effectiveness of development programs?

FINANCIAL MANAGEMENT NEEDS

The flow of resources which includes several billion dollars annually, from donors to developing countries, requires effective financial management systems in developing country institutions. World Bank lending in fiscal year 1983, for example, included $11 billion, representing 136 loans to 43 countries. Asian Development Bank loans have increased to well over $1 billion annually. The other principal regional donors--the Inter-American Development Bank, African Development Bank, and Caribbean Development Bank--are making large loan commitments.

Bilateral donor assistance programs are also substantial. The Organization for Economic Cooperation and Development (OECD) reports that the members of its Development Assistance Committee[1] provided $27.8 billion in official development assistance in 1982, and AID had approximately $3.4 billion in authorized but unliquidated development assistance funds in fiscal year 1983. On a regional basis, official development assistance to the Sahel has grown from $817 million annually in 1975 to approximately $2 billion beginning in the early 1980s. The

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[1]The Committee has 18 members: Australia, Austria, Belgium, Canada, Denmark, Finland, France, West Germany, Italy, Japan, Netherlands, New Zealand, Norway, Sweden, Switzerland, the United Kingdom, the United States, and the Commission of the European Communities.

magnitude of such commitments underscores the importance of efficient management in the development process.

Limitations in financial management capability affect both the public and private sectors in developing countries. As discussed in chapter 2, these limitations include

--shortages of trained staff,

--inadequate accounting and auditing standards and a lack of policy for developing financial management capability as a part of overall development strategies, and

--accounting systems that are outdated and unable to keep pace with the cost and control requirements of development efforts.

World Bank studies have concluded that substantial initiatives are needed to improve host-country financial management. The Bank is concerned that without such improvements, many borrowing countries will not be able to comply with accountability and auditing provisions in its loan agreements. The Bank has acknowledged that there is an urgent need, both within the Bank and among its borrowers, for a clear understanding that financial performance is a necessary condition, not only for effective Bank operations but for sustained economic development generally.

In 1981 the World Bank issued its report on development requirements in sub-Saharan Africa. A central theme of the report was that more efficient use of scarce resources--human and capital, managerial and technical, domestic and foreign--is essential for improving economic conditions in most African countries. In terms of training, the report concluded that:

> "One of the most crucial and pervasive weaknesses in development administration in Africa is in the area of financial management, and a sustained effort is required across the board to improve budgeting, accounting, and auditing standards, to augment the supply of qualified accountants, and to develop effective national systems of financial control."

Limited financial management capabilities are apparent in both the public and private sectors in other regions of the developing world. Such problems are not insurmountable, but they are long-term in nature and require long-term approaches to their solutions.

THE SAHEL: FOREIGN ASSISTANCE LEGISLATION REQUIRES AID CERTIFICATION OF ACCOUNTING SYSTEMS

In 1981, the Congress enacted Section 121(d) of the Foreign Assistance Act, which requires a determination by the AID Administrator that Sahelian countries have adequate accounts and controls over AID assistance funds. This legislation was enacted in response to an AID Inspector General report which concluded that host-country controls over AID and other donor-financed local currency were seriously deficient, resulting in the waste, misuse, or diversion of millions of dollars in AID and other donor-generated funds. Other Inspector General reports concluded that the governments of the region must be made aware of the importance of improving financial management and that unless such improvements were forthcoming, donors cannot be assured that their financial aid is not wasted. In 1982, AID authorized a $5-million Sahel Regional Financial Management Project, which is designed to consider financial management training needs on a country-by-country basis in terms of

--financial accountability for AID project funds;

--financial controls and integration of development resources, including the funds of other donors under basic accounting and management systems; and

--comprehensive financial management for improved organizational management in key Sahelian institutions.

Each objective addresses an important element in the institution-building process and represents a major AID initiative for dealing with financial management issues.

OBJECTIVES, SCOPE, AND METHODOLOGY

We made this review to determine how the major donor assistance agencies can better help to identify and meet the financial management training and technical assistance needs of aid recipients. The review focused on problems and training needs in accounting, budgeting, and auditing systems of developing countries.

To present a comprehensive picture of financial management issues from a donor's perspective, we

--documented the major donors' experiences with host-countries' financial management problems and the extent to which these experiences indicate a seriously limited institutional capacity for managing development programs,

--compared the strengths and weaknesses of donors' technical cooperation programs as they relate to improving the financial management capability of aid recipients,

--identified mechanisms for formal donor coordination in formulating more complementary approaches to the financial management problem, and

--determined whether AID should take a greater role in financial management assistance.

We talked with officials of the major bilateral and multilateral donors. The bilateral donors included AID, the Canadian International Development Agency and British Overseas Development Administration, and the principal West German and French bilateral assistance agencies, whose official development assistance programs totaled $18 billion in 1982, representing nearly two-thirds of the OECD Development Assistance Committee total.

The multilateral donors included the following U.N. organizations which sponsor training and technical assistance programs and the multilateral and regional development banks.

--U.N. Department of Technical Cooperation for Development

--U.N. Regional Economic Commission for Africa

--The International Labor Organization

--The World Bank

--The Asian Development Bank

--The African Development Bank

--The Inter-American Development Bank

--The Caribbean Development Bank

We also talked with personnel of the Development Assistance Committee of OECD, the Club Du Sahel, and the Cooperation for Development in Africa, which were established to encourage better cooperation among aid donors.

The AID Sahel Regional Financial Management Project design indicated that effective donor coordination would contribute to meeting the long-term training needs of Sahelian institutions through (1) mutual in-country training efforts, (2) established donor coordinating groups, and (3) the Permanent Inter-State Committee for Drought Control in the Sahel which represents the interests of recipients in the region. We visited the Inter-State Committee's headquarters in Upper Volta to obtain the views of Sahelian country officials concerning the extent to which financial management weaknesses continue to affect the performance of development efforts and the extent to which they believe additional training and technical assistance will be needed beyond the scope of the current AID regional project.

To complement our work at the donors and to obtain the greatest practical coverage of developing country views on financial management problems and training needs, we sent a questionnaire--prepared in English, French, and Spanish as appropriate--to developing countries' national audit agencies. Responses were received from 30 audit organizations and have been incorporated into our report as appropriate.

We made our study in accordance with generally accepted government auditing standards. It was conducted during January 1983 through April 1984.

CHAPTER 2

INDICATORS OF SERIOUS FINANCIAL MANAGEMENT WEAKNESSES IN DEVELOPMENT PROGRAMS

From our analyses of donor evaluations, studies, and related experiences in development assistance programs, we found the most important financial management weaknesses were inadequate accounting system design and standards and lack of trained developing country personnel to meet the accounting, budgeting, and auditing requirements for current levels of donor lending and resource transfers. The underlying causes of these deficiencies appear to be (1) insufficient attention to management of development as an important element of the development process and (2) cultural differences in the developing world.

In our discussions with donor officials, it was apparent that financial management is a sensitive issue in the relationships between Western donors and Third World countries. Donors opinions varied sharply concerning appropriate policies for dealing with the limited host-country financial management capability. Some donors rely on expatriate staff to manage and monitor development project performance and, in the belief that developing countries are not receptive to donors' interests in better financial management, provide little or no training and technical assistance. In only a few instances have donors (1) analyzed the constraints of financial management as they affect the main sectors of development in each country, (2) formulated specific policies and mechanisms to address major problem areas on a country basis, and (3) given special attention to the needs of the least developed countries, where management inefficiencies can have the most serious impact on targeted beneficiaries of development efforts.

DEVELOPING COUNTRY VIEWS

National audit organizations of the following 30 developing countries responded to our questionnaire concerning their financial management capabilities and training needs:

Bahamas	India	Philippines
Bangladesh	Jamaica	Sierra Leone
Botswana	Kenya	Sri Lanka
Burma	Lesotho	St. Lucia
Costa Rica	Mauritius	St. Vincent and the Grenadines
Dominican Republic	Nepal	Swaziland
Egypt	Oman	Tanzania
Equador	Pakistan	Thailand
Gambia	Panama	Tunisia
Honduras	Peru	Zimbabwe

Most of the audit organizations indicated that their development programs need improved financial management and that financial management capability would benefit the overall development process. Many of these organizations indicated that they do not have sufficient trained financial management staff or ability to audit development project economy, efficiency, and effectiveness. They believe that a higher priority should be placed on financial management training in the future.

For development program purposes, 16 countries reported insufficient numbers of trained accountants and staff for budgeting functions, 21 countries reported insufficient staff for auditing functions, and 15 countries reported little if any capability to audit development program economy, efficiency, and effectiveness (impact). In terms of their future needs and in relation to other institutional development priorities, 23 countries reported that either a high or very high priority should be placed on improving financial management. To meet the audit requirements for control of project funds, 17 countries believed improved financial accountability was needed to either a great extent or very great extent. In terms of higher level program needs, 16 countries reported that substantial improvements were needed in the financial control and integration of development resources under basic accounting and management systems and 21 countries reported that substantial improvements were needed in the development of comprehensive financial management, to get beyond auditing and resource control to managerial accounting that would be useful in higher level decision making.

Many of the developing countries identified specific areas for financial management assistance, including

--technical assistance to their universities to increase their training capacity;

--on-the-job instruction for mid-level program staff;

--academic training for high-level officials;

--statistical sampling, data processing, and system design; and

--techniques for economy, efficiency, and effectiveness audits.

The following responses are not necessarily representative of all the countries surveyed, but they provide additional insight into developing countries' views. One English-speaking African country reported that mid-level training of accounting and auditing staff cannot be overemphasized. Another African country stated that donor countries should clearly specify their financial requirements and ensure that the recipient country has the capacity to meet such requirements. One Eastern Caribbean country raised a more sensitive issue by stating that "vast leakages of public funds . . . are attributed to insufficient numbers of trained staff in all aspects of financial management, particularly in the area of budgeting."

Many of the respondents indicated that donors may provide some training and technical assistance to help meet the accounting and financial control requirements of development lending. However, they added that greater donor commitment to long-term training and technical assistance is needed to increase aid-recipients' capacity for development.

Most of the French-speaking countries of Africa did not respond to our questionnaire.[1] The principal French bilateral assistance agencies attributed this to (1) the financial management capabilities in many French-speaking African countries are so limited that they cannot respond to specific accounting, budgeting, and auditing questions and (2) the subject of financial management is particularly sensitive in African relationships with Western donor countries. The World Bank and other donors, however, have developed considerable information on African financial management capabilities. This information is presented in the following sections, complementing the analysis of country conditions in other regions.

WORLD BANK ASSESSMENTS OF ACCOUNTING SYSTEMS

The World Bank has addressed the financial management problem as it has affected the Bank's assistance programs and, in view of the serious host-country weaknesses, has proposed changes in Bank policies and procedures. Studies have indicated that few of the Bank's projects could meet audit requirements because of basic and significant weaknesses in host-country accounting systems. Selected information on the public and private sector accounting and auditing capabilities of developing countries indicates that:

--The Bank, similar to other donors, has recognized the need for effective accounting in its dealings with developing countries; consequently, it has sought assurances that borrowers will establish and maintain adequate records in accordance with sound accounting principles.

--Public sector accounting capabilities in several countries are inadequate in relation to modern concepts of accountability, so outputs from such systems are ill-suited to provide data for formulating development policies and strategies and for monitoring the performance of complex sector activities.

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[1]GAO mailed its questionnaire to 17 French-speaking countries, but only two responses were received.

--Even though the Bank has adapted accounting, auditing, and reporting requirements to meet local circumstances, accounts and financial reports from projects are frequently late, erroneous, or incomplete and audit reports often contain qualifications and reservations.

World Bank officials believe that if these conditions exist in projects exposed to the scrutiny of a major lender, the question must arise as to the quality of accounting and auditing arrangements in the day-to-day operations of governments and parastatal bodies in the developing countries concerned. Parastatals are institutions responsible for managing development programs in such critical areas as airlines and railways, agricultural, small industrial, trading, and service institutions.

World Bank lending and assistance for accounting and auditing development has been project-oriented and has included, for example, strengthening government audit (Guinea, Senegal, and Yugoslavia), studies of accounting and financial problems of parastatals (Uganda), reorganization of government accounting and auditing (Indonesia), and studies of the accounting sector (Ethiopia). Nevertheless, the Bank believes that its efforts to improve accountability may be piecemeal and haphazard. The degree of success achieved is viewed as being uneven, and Bank projects in the traditional sectors (agriculture, transportation, utilities, etc.) with accounting or auditing components designed to improve institutional performance generally do not provide the intended "demonstration effect" either at the country or the sector level.

Information provided to the Bank by major accounting firms also suggests that when donor participation in development assistance projects ceases, the local implementing agency typically abandons the donor-installed financial management control system for less stringent controls favored by local customs. This further substantiates the Bank's view that to improve the developing countries' institutional capacity for financial controls, assistance must be on a scale larger than is currently provided.

The Bank provided us with descriptions of accounting and auditing capabilities in eight West African countries, which it assessed as almost universally inadequate, particularly for the public sector, which is responsible for managing most development programs.

Four of eight West African countries do not have a single indigenous accountant or auditor qualified in terms of internationally accepted standards. The accounting profession was viewed as being particularly undeveloped in the French-speaking countries. Each country has a severe shortage of accountants at all skill levels compared to the needs of economic development. In one of the more severe cases, Bank studies noted that:

"the country has no law or act requiring preparation and maintenance of books of account by either public or private institutions. No audit requirements exist either. As a result of the lack of regulation, there are no public institutional structures directly linked to accounting and auditing in the country. Also, no standards exist for either accounting or auditing and the country has no minimum education or relevant experience requirements for employment into accounting positions. On the public side, there is no Government Accounting or Auditing Office, and no Accountant-General or Auditor-General. Government departments and ministries usually keep some form of single entry books, but these are for convenience only and are not subjected to regular audits."

The World Bank is considering possible approaches to the host-country deficiencies in accounting capability as they have affected the performance of development projects. The studies in Africa suggested several possible approaches, including:

--If accountability within the Bank's projects is to be the primary focus, the continued use of expatriates for accounting and budgeting functions may be more appropriate than investing in training programs for developing country officials.

--If the Bank decides to endorse financial management training on a larger scale, the focus must be on countrywide deficiencies that affect overall development performance.

--Numerous donors are providing training in a number of financial management fields, so any Bank approach needs to ensure cooperation with key donor programs.

OTHER DONOR EXPERIENCES IN AFRICA

Our discussions with the other donor organizations working in Africa confirmed the views of the World Bank that the financial management assistance needs of several countries are massive and need immediate attention.

African Development Bank

According to African Development Bank officials, financial management capability throughout Africa is generally weak. The most pronounced weaknesses are (1) the overall lack of adequately trained personnel for most management functions and (2) systems which cannot adequately account for certain program funds. These weaknesses contributed to the Bank's problems in receiving timely repayment of its loans as well as with poor development project performance.

The U.N. Economic Commission for Africa

Commission studies identified serious weaknesses in the accounting, auditing, and budgeting capabilities of African governments and indicated that these weaknesses have led to poor budgeting practices in development programs and, in some instances, to the misuse of funds by public officials. Studies by other donors have confirmed that, with few exceptions, standards of accounting and financial control in the African public sector fall far short of requirements for effective development program management. These studies have further indicated that often there is no proper control over development expenditures, which in turn leads to waste, often on a considerable scale.

The International Labor Organization

As part of its overall international training program, the Organization has surveyed accounting sector training needs in a number of Southern African countries. The findings of the surveys closely parallel those of studies by the World Bank. For example, a 1983 study on accounting needs in five countries indicated a number of weaknesses, including the lack of well-defined and coordinated government policies for developing an accounting capability and training that tends to be piecemeal and developed independently of efforts made in other institutions in the same country, resulting in duplication or overlapping efforts.

Club du Sahel and the Canadian International Development Agency

Analyses by these organizations concluded that special attention should be given to the African parastatal system to improve development program management. Club reports concluded that the Sahelian parastatals, which are often responsible for managing development programs, are largely inefficient, draining the already limited resources of central governments and operating perpetually from donor subsidies. A recent Canadian survey in one East African country describes in detail the problem of financial management in parastatals, including:

1. Poor overall management. This included operating without accounting records; improper management of properties; poor feasibility studies, leading to bad decisions and resource losses; poor budgetary control; poor organizational structure; and management's lack of awareness of the importance of up-to-date accounting and financial information for planning and decision making.

2. Lack of accounting personnel. Most parastatals were inadequately staffed with accounting personnel; the books of accounts of many parastatals were poorly maintained and generally inadequate.

3. Lack of standard accounting procedures. There were no standards or guidelines for accountants; consequently, standards of accounts were as diverse as the different professional backgrounds of accountants practicing in the country.

4. Lack of internal audit. Internal accountability and verification of performance was inadequate and poorly performed.

Overall, it was concluded that the shortages of managerial skills at all levels constituted a major obstacle to effective development programs in the East African country surveyed.

AID

Host-country financial management deficiencies have been identified by AID as significantly limiting the impact of development projects and, in some cases, affecting overall development strategies in specific countries. For example, the AID Controller's Office in Egypt described that country's budgetary guidelines and accounts structure as grossly inadequate. A major rural development project was redesigned in the Sudan to address the inadequate financial management and budgetary procedures in Sudan's regional governments. Surveys of accounting systems in some African countries showed only minimal adequacies for controlling AID-financed local costs, and a survey of the Public Law 480 Title III program in one country concluded that its accounting capability for food sales proceeds was inadequate. An assessment of seven food production projects in four Sahel countries showed that AID project planners had consistently overstated host-country capabilities to manage development assistance projects. Many of the food credit sales programs had been either suspended or delayed because of mismanagement and none of the projects reviewed had a credit sales program which would have been able to meet the minimum accounting standards established by AID to comply with Section 121(d) of the Foreign Assistance Act. (See app. I.)

Developing country view

In response to our questionnaire, one of the countries in English-speaking Africa, a major recipient of AID funds, indicated that its governmental accounting systems do not have the ability to meet the accounting requirements of donor loan and project agreements. It was stated that donors have not provided the necessary training and technical assistance to meet such requirements and that shortages of trained manpower have resulted in costly mistakes and delays in project implementation.

The sensitivities of the subject should not be understated. Club Du Sahel officials told us European donors have been reluctant to encourage host-country accountability because such positions may be viewed as infringing on the sovereignty of recipient governments. Our discussions with Canadian bilateral assistance officials indicated that, as a matter of policy, they have not been enthusiastic about promoting improved host-country management capability because of the serious cultural obstacles to the concept of accountability in development, particularly in Africa. World Bank studies suggest that efforts to upgrade the standards of accounting, auditing, and financial management will be difficult and will meet resistance from host-country officials who have a vested interest in maintaining current management traditions. Private contractor officials said their studies suggest that in certain African countries entire public financial systems are on the verge of collapse, suggesting that mismanagement is becoming institutionalized and growing.

We believe that successful financial management assistance programs in Third World countries will require long-term donor strategies for dealing with country-specific needs, instead of the current practice of institution building as a component of individual, short-term development assistance projects.

EXPANDED ASSISTANCE TO LATIN AMERICA AND THE CARIBBEAN REQUIRES ATTENTION TO MANAGEMENT CAPABILITY

In recent years, U.S. development assistance programs to Latin America and the Caribbean have increased significantly with no commensurate increase in host-country financial management capability to use the expanded assistance. For example, in responding to our questionnaire, two Central American countries indicated that they have had great difficulty in developing financial accounting systems to keep pace with the overall growth of their public sectors. It was stated by one country that their governmental accounting systems have little capability to meet the accounting and auditing requirements of donor loan and project agreements and are inadequate for identifying the financial costs of development projects.

Both countries also indicated little or no capability, or only some capability, to audit development programs, either for the adequacy of internal project controls or for project economy and efficiency. In relation to other institutional development priorities, they believed that the major donors should place a "very high priority" on helping to improve accounting and auditing systems.

A major recipient of AID funds in the Caribbean indicated that it has had great difficulty in developing financial accounting systems able to keep pace with either the growing financial demands of national development strategies or the lending levels of donors and that:

--Current government accounting systems probably do not have the ability to meet the accounting and auditing requirements of donor loan and project agreements.

--Improvements are needed in financial accountability for project funds and for overall institutional capability in terms of developing comprehensive financial systems, beyond auditing and resource control, to managerial accounting for higher level decision making.

--There are insufficient numbers of trained staff for accounting and auditing functions in development programs.

--In relation to other institutional development priorities, "a very high priority" should be placed on improving financial management in the areas of general ledger accounting, assets management, budgetary controls, and computer auditing.

Donor experiences in Latin American and the Caribbean also indicate major institutional weaknesses in the financial management area. For example, in 1983 Bolivia requested a World Bank/Inter-American Development Bank mission to assess opportunities for improving its national auditing capacity in response to growing concerns of limited accountability for the use of public resources and a lack of past government support for the audit function. World Bank interest in providing technical assistance to Bolivia is apparently linked to (1) concern over accountability of development project funds, (2) the country's precarious economic condition and its history of economic instability, and (3) the need to improve governmentwide financial management to maximize the utilization of scarce financial resources generated both internally and from external sources.

Canadian officials said that, in general terms, their operations in the Caribbean and Latin America accept as a statement of condition the limited financial management capabilities of their aid recipients. One official described Bolivia as well as Honduras and Haiti as having the most serious financial management problems, with Jamaica, Peru, and Nicaragua considered as relatively more skilled in managing their development efforts. No specific examples of country conditions were provided.

In a February 1982 report[2] on the U.S. assistance program to Haiti, we reported that many AID projects suffered delays, implementation problems, and, in some instances, failures due in part to the limited institutional capability of the Haitian government. Although we did not focus specifically on accounting, budgeting, and auditing systems in that review, AID officials stated that development in all sectors and all levels in Haiti is hampered by a lack of trained personnel.

Inter-American Development Bank evaluations identified serious weaknesses in the management capability of Bank member countries. In some instances, these weaknesses are so significant that the Bank is investigating alternative ways of channeling funds to achieve development program objectives in a more efficient manner. The Inter-American Development Bank has not formally assessed the accounting and auditing capabilities of its member countries, but its officials believe that the World Bank's assessments are generally consistent with Inter-American Development Bank experiences at the project level--member countries have had trouble in maintaining accountability due to inadequate accounting systems.

Analysis of private sector training requirements in the Eastern Caribbean have also shown that accounting and related financial management areas need special attention of donor agencies. Canadian and AID analyses of conditions in Eastern Caribbean countries stated that:

> "A study of accounting needs conducted in 1976 for the Canadian International Development Agency revealed a widespread shortfall in trained accountants throughout the islands. The current survey reveals that this need still exists and extends throughout the area of financial management generally. Training of small businessmen and manufacturers in accounting and financial management is badly needed throughout the islands."

Major donors in the Eastern Caribbean recognize that inadequacies in financial management capability are a limiting factor in the success of development programs. We were not able to identify any donor projects dealing exclusively with financial management problems, but current AID, Caribbean Development Bank, and Canadian training projects included financial management improvement components. Our work in the Eastern Caribbean confirmed that the financial management improvement process is long-term in nature, requiring substantial and complementary donor attention to problems on a country and sectoral basis.

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[2]<u>Assistance to Haiti: Barriers, Recent Program Changes, and Future Options</u> (ID-82-13).

MANAGEMENT CAPABILITIES
VARY AMONG ASIAN COUNTRIES

According to Asian Development Bank officials, the least developed countries of Asia (e.g., Nepal, Bangladesh, Pakistan, and the island countries of the Pacific) have the most elementary accounting, budgeting, and auditing systems. Even in the more economically advanced countries such as the Philippines, improved financial management would strengthen the performance of development programs. Asian Development Bank officials also noted that countries such as Indonesia are in need of financial management training in terms of setting development priorities and linking the budgeting and planning process to those priorities.

In response to our questionnaire, one of the least developed Asian countries discussed its financial management capabilities as follows:

--There has been great difficulty in developing financial accounting systems that are able to keep pace with the growing demands of national development strategies.

--Current accounting systems probably do not have the ability to meet the accounting and auditing requirements of donor loan and project agreements.

--There are insufficient numbers of trained staff for accounting functions in development programs and very insufficient numbers of staff for budgeting and auditing purposes.

--Shortages of trained staff have reduced the efficiency/effectiveness of development projects to a great extent, as evidenced by the lack of data and records for program evaluation purposes.

The same country noted that it has received both AID and U.N. Development Program help in the past in establishing an accounting system. However, the growing needs of public fiscal administration have outstripped the capability of its academic institutions to provide the necessary follow-on training. Additional donor assistance is believed to be needed.

Another of the least developed Asian countries also indicated that it has had great difficulty in developing financial accounting systems able to keep pace with the growing demands of national development strategies. In responding to our questionnaire, that country indicated that donors have not provided the necessary training and technical assistance to help meet the accounting and financial control requirements of development assistance programs. In the long-term, it was believed that improvements are needed to a great extent to strengthen the country's institutional capacity for comprehensive financial management. It was also believed that shortages of trained accounting and auditing staff have significantly reduced the efficiency and effectiveness of development projects.

Asian Development Bank officials described their experiences in general terms. Host-country problem areas appear to be concentrated in the soft sectors of Bank assistance--health, agriculture, and social programs. Sectors such as public utilities which have received repeat loans, including assistance to upgrade accounting systems, have the strongest financial management capabilities. One official suggested that part of the problem may be attributed to host governments' lack of attention to the need for internal controls and to overall staffing deficiencies in the financial management area.

The Asian Development Bank has addressed host-country financial management problems primarily on a project-by-project basis. However, the Bank's study of operational priorities and plans for the 1980s stresses further promotion of institutional development as a high priority and concludes that ". . . the Bank's approach in the past has been reactive and unsystematic . . . institutional development has been treated largely as incidental to the preparation or implementation of specific projects." The study also recommends that the Bank " . . . go beyond mere project-specific activities in helping developing member countries strengthen their institutional capabilities." This conclusion would hold true for many other donor programs in Asia as well as in other regions.

AID and Asian Development Bank experiences in the Philippines illustrate some of the issues that are encountered in addressing the financial management training needs of the more advanced developing countries. These issues involve national-level budgeting and development program planning, government decentralization, and financial accountability in development projects. For example, the AID mission concluded in 1980 that the Philippine government needed external assistance to help improve its overall budgeting process as it affected the planning, management, and accountability of the entire foreign assistance portfolio. A 1982 Asian Development Bank assessment concluded that the Philippine government still needs to streamline its procedures for development budget allocations, budget releases, and contract approvals.

The AID Regional Inspector General has on several occasions questioned the level of financial accountability exercised by Philippine agencies in AID's development projects. In reviewing Regional Inspector General reports for 1981-83, we found numerous references to financial management deficiencies in Philippine development agencies, including inadequate internal controls and accounting procedures. However, mission officials considered most of these findings as narrow and insignificant in relation to the scope of development efforts underway. We did not follow up in detail on the issue of project-level accountability in the Philippines.

The Philippine government is trying to improve its development programs by decentralizing responsibilities for development program management to regional and local institutions. However, successful decentralization will require substantial improvements in financial management capability at these levels. The AID mission is trying to support the decentralization through such projects as the Rural Service Center Project, which began in 1978, and the Local Resource Management Project. The ultimate goal of the multiphase, 10-year Local Resource Management project is to promote greater self-reliance, productive employment, and increased income among disadvantaged people in rural areas. Financial management assistance, we were told, will be a major component of the project beginning in 1985.

Recurring costs and budgeting problems

Our August 1983 report[3] on irrigation assistance programs noted the lack of adequate budgeting or reporting systems for operation and maintenance costs in developing countries. As an example, we referred to statements by an Indonesia Ministry of Finance official who told us that there were no consolidated figures of funds actually used for operation and maintenance. There were at least 11 different government sources for funds and no single source responsible for collecting and disbursing them.

We concluded that such situations illustrated opportunities for donors to help developing countries document operation and maintenance requirements and to establish standard budget classifications for local programs. In response to our work in Indonesia, the AID Mission in Jakarta is planning a small-scale irrigation operation and maintenance project that will include objectives of helping to consolidate and rationalize operation and maintenance financing at provincial and lower levels of the Indonesian government so that they can provide adequate and more timely funds to existing irrigation investments, including those of AID, the World Bank, and the Asian Development Bank.

CONCLUSIONS

The magnitude of the financial management problem demonstrates that donors need to seriously consider it when planning assistance levels and types of resource transfers. In the least developed countries, there is a serious question as to whether long-term development can be achieved without substantially improved financial management.

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[3] Irrigation Assistance to Developing Countries Should Require Stronger Commitments to Operation and Maintenance (NSIAD-83-31).

Host countries have problems with accounting procedures and controls, basic information systems for decision making, budget planning and allocation, and auditing. Each of these interrelated management requirements entail the need to process large quantities of data for development program planning and control purposes. Computerization may eventually be the answer to some of these inefficiencies, but the effective use of such systems will require a strong financial accounting system base, which will take substantial resources and time to develop.

Many of the developing countries which responded to our survey questionnaire indicated that they would encourage donor help in strengthening financial management systems in their institutions. They recognized that financial management is an increasingly important and distinct element of the institution-building process and, as such, should receive donor attention.

Experiences of some donors indicated that assistance programs which do not adequately consider the financial management requirements for control and use of resources may not meet expectations and in some instances may result in serious failures, cost overruns, and waste. Donor experiences and the responses to our questionnaire also suggest that many developing countries' accounting systems would have great difficulty in meeting the minimum standards now required for AID project certification in the Sahel. This condition suggests that financial accountability needs to be a more important part of assistance considerations.

In planning allocations of development assistance funds, donors should recognize host-country financial management capability and plan related training and technical assistance accordingly. To develop financial assistance strategies, donors should consider that

--substantial improvements in host-country capability will require a long-term commitment by both the donor community and the recipient and

--needed improvements include not only better development assistance project financial controls, but also strengthened national accounting system capacity and related improvements at local and provincial levels as development program responsibilities are decentralized.

Our overall recommendations on these issues are presented at the end of chapter 3.

CHAPTER 3

FINANCIAL MANAGEMENT TRAINING REQUIREMENTS AND AID DEVELOPMENT ASSISTANCE PROGRAMS

Except in the Sahel, AID has not systematically addressed the financial management training needs of aid recipients. AID generally plans development assistance programs without adequate consideration of host-country financial management capability. Section 121(d) of the Foreign Assistance Act was enacted because AID had not addressed host-country financial management capabilities in planning its assistance strategy for the Sahel. Although AID's fiscal year 1985 Congressional Presentation identifies financial and program management as a distinct part of development assistance in the Sahel, it does not do so in other regional/country presentations.

This chapter provides a historical perspective of AID's approach to the financial management issue and discusses some of the factors which have influenced the Agency's approach to dealing with host-country problems. This chapter also discusses (1) elements of the AID development assistance program which we believe can provide a basis for developing a systematic U.S. approach to providing financial management training and technical assistance and (2) the interests of other bilateral donors and U.N. organizations in improving financial systems which can provide a point of reference for formal donor discussions of the financial management issue.

HISTORICAL PERSPECTIVE OF AID TRAINING PROGRAMS

In the 1960s AID made substantial efforts to strengthen the "public administration" capability of selected developing countries. Based on computerized information in AID's Development Information System, these efforts included

--improving budget and fiscal management in Brazil,

--improving government management in El Salvador,

--setting up public administration (fiscal management) in Honduras,

--financial management in Paraguay,

--government budget practices in Ethiopia, and

--government organization training and management in Liberia.

These training programs reflected an early recognition in AID that public administration and financial management skills are essential if aid recipients are to have a stable fiscal situation and the capacity to support foreign assistance programs. For example, the Paraguay program, which was initiated in fiscal year 1964, included training and technical assistance for installing new accounting systems and revising national budget procedures to accommodate assistance needed for Paraguayan development.

In 1979, we assessed AID's role in financial management and concluded that the Agency should give it a higher priority to assure the effective use of development assistance.[1] AID's response to the report stated that:

> "There is no need to adduce evidence in support of the GAO Report's assertion of the important relationship of improved financial management in LDCs [less developed countries] to the optimum use of scarce resources. LDC capacity in this area is needed as clearly as it is in health, education, agricultural research, etc. In assessing the skills deficiencies of LDCs, the area of public administration and financial management cannot be ignored, and it may be true that in recent years the U.S. as well as other donors have tended to do so."

That report noted that, beginning in the early and mid 1970s, AID gave little emphasis to financial management programs, focusing instead on direct assistance to the rural poor in clearly defined sectors of assistance--food and nutrition, population and health, and human resources development. The issue of host-country financial management capability was not defined as a sector for AID concern. In response to our report, however, AID expected that specific actions would reflect increasing concern by the donor community in the subject area, including the design of a multi-regional AID financial management project to provide technical assistance to overseas missions and developing country institutions, and the adoption of guidelines in the Development Assistance Committee of OECD for donor use in considering aid recipient administrative capacity.

Proposed multi-region project not approved

The multi-regional financial management project referred to in AID's response to our 1979 report was not approved for implementation due to its overall poor design and emphasis on applied research and because it did not match available training and technical assistance resources to specific developing country problem areas. We found that the lack of success in developing this multi-regional approach represented, at that point in time, a lack of overall Agency focus and understanding of the issues

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[1] "Training and Related Efforts Needed To Improve Financial Management in the Third World" (ID-79-46) Sept. 20, 1979.

on a country-specific basis. For example, internal AID discussions of opportunities for assistance in the financial management area indicated:

--A recognition that financial management problems were both pervasive and entrenched in much of the developing world. Therefore, their solution would require patient, well-targeted, and carefully conceived efforts by a variety of institutions over an extended period of time. The proposed project did not satisfy this criteria.

--A lack of agreement as to what role AID should play in the area. Concern was expressed that (1) AID efforts in the past had sometimes resulted in failure, but the causes of failure had not been analyzed from a lessons learned perspective, (2) there was little or no knowledge of activities being sponsored by other donors, and (3) it was not clear whether the Agency should stress academic-level training of high-level host government officials or in-country, on-the-job training of project management staff. These issues were not satisfactorily addressed in the proposed project design.

The AID Office of Financial Management was particularly critical of the proposed project, noting that the project, with its emphasis on applied research and new approaches to financial management problems, did not recognize that most development institutions and host-country organizations need training and assistance in applying basic financial management policies and procedures that have been perfected and accepted for decades. AID documents indicated, at that time, little consensus among regional bureaus as to the proper focus of a financial management project.

--The Africa Bureau generally favored the overall purpose of the proposed project, asking for one-third of project resources with an emphasis on long-term consultant services.

--The Latin American and Caribbean Bureau were neutral on the proposed project; however, they indicated a need for work in the financial management area, which should be based on more specific analysis of mission and country requirements.

--The Asia Bureau was against the project despite apparent recognition of the utility of assistance in the general area.

AID's internal analysis had also suggested that improved financial management should be one of several performance indicators which would be of legitimate concern to the Congress in its deliberations on foreign assistance. As demonstrated in the following sections, AID's ad-hoc approach to the problem has resulted in a lack of such indicators for oversight purposes.

CURRENT TRAINING PROGRAMS ARE AD-HOC

Because of strong internal opposition to the proposed multi-region financial management project, AID decided not to pursue financial management improvement as one of its centrally funded technical assistance and training objectives. Selected multi-regional projects currently sponsored have components addressing related issues, such as local revenue generation and recurring costs. This effort does not, however, systematically address host-country financial control and accounting improvement needs.

AID officials referred to the following activities as representing regional Bureau involvement in the financial management area.

1. Academic training of foreign nationals in U.S. and third-country institutions as part of the Participant Training Program. However, we found no clearly defined objectives for this program in terms of improving host-country financial management systems.

2. Other training programs financed by a variety of technical service contracts and grants and as part of numerous development assistance projects. However, we found there is not an adequate data base for identifying the extent of such training activities in general or in terms of clearly stated country-specific financial management improvement objectives.

3. The use of private sector accounting firms to improve overseas mission project performance. We believe this effort represents recognition within the Africa Bureau that development assistance project performance can be improved through greater attention to financial accounting and related management systems.

4. New procedures by the Office of Financial Management for improving internal control systems in overseas mission programs. We also believe this effort represents a greater recognition within the Agency that host-country financial accounting capability should directly influence the level and mode of development assistance provided.

Participant training

The Participant Training Program was often referred to by AID officials as the major Agency training effort in the financial management area. It provides academic and technical training for several thousand foreign nationals each year in a variety of subject areas. According to AID officials, the subject area most related to financial management is the training category "Public Administration". A computer listing for participants in this category for fiscal year 1983 identified 697 participants, 412 in academic degree and 285 in technical programs. Degree participants were at all study levels in U.S. universities and represented a variety of countries, including, for example, Botswana (16), Cyprus (17), Indonesia (54), South Africa (12), and Zimbabwe (37). Technical participants were enrolled primarily at U.S. universities and included representatives from a wide variety of developing countries.

A major Participant Training Program activity has been carried out in conjunction with the Africa Bureau's African Manpower Development projects. According to recent Congressional Presentations, the projects have supported training in the United States and Africa for about 300 new students each year. According to an AID agreement with the African-American Institute, as many as 1,500 participants have been in AID-sponsored African graduate fellowship programs.

Our review did not identify any reliable analysis concerning requirements for academic training in the financial management area versus the requirements for in-country project-level training similar to that now being provided in the Sahel. Because AID has not defined its priorities and funding levels for financial management assistance, it is difficult to determine whether the current level of Public Administration training is consistent with host-country financial management needs or if it complements in-country training programs.

Other training

Except for the Sahel Regional Financial Management Project, AID's approach to providing financial management training and technical assistance in developing countries has been similar to that of the World Bank and other donors--unsystematic and largely incidental to the implementation of individual development assistance projects which results in insufficient attention being given to basic deficiencies in host-country financial controls that reduce the efficiency of overall development efforts. However, similar to the World Bank, AID sponsors a number of activities which, we believe, can provide an important element to building a systematic approach to the problem area. For example, AID entered into a cooperative agreement with the National Association of Schools of Public Affairs and Administration in 1979. Funding of Association training programs has since grown and includes a variety of financial management assistance, such as seminars and workshops in Rabat, Morocco, in 1982, to design and conduct workshops to train finance and budgeting trainers. During 1982 and 1983, 51 Moroccan trainers were trained, who in turn conducted short courses for more than 600 local officials.

Also the University of Pittsburgh has conducted training in countries such as Djibouti, Upper Volta, Congo-Brazzaville, and Mali. Over the past 5 years, approximately 369 officials from French-speaking African countries have been trained (182 in an 8-week course in Pittsburgh and others in short courses--about 2 weeks in length). Association officials believe that the overall impact of their programs has been positive, noting that many of the countries have requested follow-up sessions.

Our review of selected groupings of recent AID contracts and grants also identified the following Agency activities which have financial management improvement objectives.

Contractor or grant recipient	Amount	Purpose
American Consortium for International Public Administration	$17,000	Support of international information exchange activities
International Institute of Public Management	$63,240	Technical assistance to LDC's[2] in public management
Institute for Public Administration	$ 5.28 million	To help strengthen the Indonesian bureaucracy in areas including fiscal planning and budgeting

Other AID contracts and cooperative agreements may have financial management assistance components, but the lack of an adequate Agency data base for documenting in-country training and the often vaguely worded scopes of work for contractors precluded a more complete identification of such activities.

Although AID's Development Information System also lists a number of current development assistance projects as having financial management improvement components, its data base at the time of our review was limited to information on only two-thirds of AID's activities since 1974. For information purposes, some of the development projects identified were:

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[2]Less developed countries.

--Agrarian Reform Organization in El Salvador; includes training farm association members in the use of a standard accounting system.

--Agricultural Training in Zambia; training involving numerous management disciplines to be provided in the United States, Zambia, and third countries.

--Development Leadership Training in Mali; academic training to be provided for mid- and upper-level management in a number of areas.

--Development Decentralization and Development Industrial Bank in Egypt; training for village councils in several areas, including local government finance and financial management and training to meet improved operational and accounting needs of Egypt's Development Industrial Bank.

--Development Administration Training in Jordan; technical training in the United States in a number of areas, including financial analysis, government accounting, and budgeting.

--Professional Resources Development in Indonesia; training in the United States in a number of areas, including public administration and data processing.

We believe that these project components represent an important part of AID's traditional emphasis on institution building in general. They also further indicate that although AID is playing a role in the financial management area, the approach is fragmented even though the problem is pervasive throughout the developing world.

<u>Private sector accounting firms provide technical assistance</u>

The Africa Bureau has encouraged its overseas missions to use private CPA firms as a project management improvement tool as well as to perform financial compliance audits. According to documents provided to us, the use of such firms to improve host-country financial management has included the following activities.

Country	Firm	Objective
Sierra Leone	Arthur Young, Cassleton, Elliot & Co.	Assist the government to establish project monitoring systems, including financial controls
Zimbabwe	Price Waterhouse	Review of government systems for accounting of AID funds
Upper Volta	Deloitte, Haskins, and Sells	Design of financial management systems for the National Cereals Office
Somalia	Coopers and Lybrand Associates	Establish in the Ministry of Finance an accounting and control system for Public Law 480 and Commodity Import Programs

The most extensive use of CPA firms has focused on improving AID project management based on the audit of AID project activities. These have included, for example, an audit of project accounts in Uganda, private voluntary organizations in Sudan, host government contributions in Zaire, and project accounts in Kenya. Africa Bureau officials, however, were enthusiastic about the potential greater use of such firms for improved technical assistance to developing countries in the area of financial management.

Improved internal mission controls

When AID enters into a development project agreement with a borrowing government, it does so on the precept that the borrower will manage the project. The borrower is responsible for establishing and operating a system of accounts for effective development project implementation. Except in the Sahel, AID does not prescribe the procedures to be used by borrowing governments as long as they meet typical project agreement provisions, which state that books and records are to be maintained "in accordance with generally accepted accounting principles and practices consistently applied".

In view of the seriousness and the scope of the financial management problem, we believe that current project agreement provisions are inadequate for many of those countries which are most in need of strengthening their accounting and budgeting capability. However, many of these countries either do not have or do not know what constitutes generally accepted accounting principles and practices.

Until recently, AID's Office of Financial Management had relied on each overseas mission to "approve" the host country's accounting capability for project implementation based on experiences in working with various host country institutions. Except in the Sahel, there are no minimum standards established for mission approval of host-country financial accounting capability as it affects development project implementation. This has resulted in a wide disparity of accounting procedures and agreements entered into with developing countries.

AID Controller officials believe that the Agency now recognizes the lack of standard procedures as a weakness and is beginning to give greater attention to the host-country financial management issue. They said that AID has recently approved a Payment Verification Policy for assessments of both mission and host-country internal controls. Part of this policy will require a documentation of the procedures being required by various missions for host-country accounting systems.

More specifically, the Payment Verification Policy provides general guidelines to the missions for assessing the

--most appropriate methods for implementing and financing of development assistance projects from the standpoint of host-country accountability;

--host-country capability for contracting, commodity procurement, and voucher review activities; and

--the need for greater AID audit coverage in light of potential accountability risks.

This policy guidance is an important step forward in documenting the financial accounting capabilities of developing countries. However, the missions are not required to submit a plan or approach for providing training and technical assistance to improve host-country systems which have serious financial management weaknesses.

DONOR COOPERATION IS NEEDED

In response to our 1979 report, AID stated that cooperation among the major donors would be necessary to strengthen host-country financial management and that as a part of such cooperation the Development Assistance Committee of OECD had begun to formulate guidelines to recognize the importance of considering the administrative needs of developing countries for receiving and handling development assistance funds. AID believed that the United States should stress in international forums the benefits of improved financial management and encourage the use of resources for such purposes. AID also stated that donor attention to developing countries' capacity in the area of financial management was needed as clearly as it is in the traditional sectors of development--e.g. health, education, and agricultural research.

Although AID envisioned that OECD's Development Assistance Committee would address opportunities for donor cooperation, we found that it has not specifically addressed financial management problems in developing countries nor has the U.S. delegation encouraged the subject as a topic for donor discussions. U.S. officials referred us to the Director of the Committee's Aid-Management Division, who told us that:

--Weaknesses in host-country financial management, particularly in Africa, are well recognized by bilateral donors; however, this is largely viewed as an operational problem beyond the policy dialogue of the Committee on the more traditional sectors of assistance programming.

--Aid recipients have strongly resisted donor interest in financial accounting because (1) they often lack the necessary expertise to meet even minimum accounting standards and (2) they would like to receive assistance with the fewest possible conditions attached.

The Committee, however, has prepared guidelines for donors to consider in efforts to help aid recipients strengthen their administrative capacity. As indicated in AID's response to our 1979 report, these guidelines are designed to encourage Committee members to recognize the importance of administrative capacity in recipient countries when planning development assistance programs. These guidelines encourage members to respond to recipient's requests for assistance in such areas as budgeting and accounting, but they state that:

> "Action to strengthen recipient's administrative capacity must be compatible with the principle of respect for the sovereignty of the recipient country. . . . Nevertheless, the decision to request external assistance to strengthen its own administrative capacity lies ultimately with the recipient."

These guidelines have apparently been insufficient for stimulating systematic bilateral donor interest in helping developing countries to improve their financial management capability. As discussed in the following sections, the low level of bilateral donor interest has

--resulted in an emphasis on high-level academic training of developing country personnel in European and North American countries without adequate attention to in-country technical assistance needs,

--contributed to a lack of (1) coordination in the Sahel where AID is funding its major in-country training initiatives and (2) attention to related issues in the donor group--Cooperation for Development in Africa, and

--resulted in a lack of bilateral donor cooperation with U.N. agency activities.

Donor emphasis on academic training

We found in our discussions with other bilateral donors that, similar to AID, they have not adequately addressed the financial management training and technical assistance needs of developing countries. Training programs for developing countries have often focused on general academic study for high-level government officials and included such things as:

--Training has been sponsored by the French Caisse Centrale for senior personnel from developing countries in its Paris-based Centre d' etudes financieres, economiques et bancaires. Between 1961 and 1982, the Centre has trained nearly 2,000 personnel in overall management functions related to their jobs in financial institutions, mostly development banks, and public service corporations.

--Training has been provided in the United Kingdom by the Overseas Development Administration. In broad categories of technical cooperation, approximately 5,000 students and trainees financed by aid-funds were studying in Britain at the end of 1982. Approximately 219 man-years of training were provided in 1982 in the general areas of public administration. Public administration and management development training is also sponsored for senior-level officials from recipient countries, much of it through the organization, Technical Education and Training for Overseas Countries. Approximately 180 participants had been placed in the program in the 1981-1982 period.

Other donors, including the Canadians, have provided a similar emphasis on high-level academic training in the sponsoring developed country. The West Germans, similar to the other bilateral donors, had difficulty in providing an accurate inventory of their financial management assistance efforts because they have not adopted specific policies for such assistance to host countries. They noted, however, that they have a general sectoral assistance effort called the Promotion of Administration which includes technical assistance defined as promoting the receipt capacity of state institutions (tax and financial administration, customs) and training of mid-and upper-level managers of government ministries, parastatals and private corporations. West German officials indicated, however, that the most significant financial management-related training is conducted for senior-level officials of developing countries and provided at institutions in Germany.

None of the bilateral donors have addressed the financial management problem as a distinct sector requiring long-term commitments to in-country training and technical assistance. We found among the donors, however, an apparent interest in giving the financial management issue greater attention.

British officials said that the deterioration of the quality of financial management in many countries has raised issues of accounting and auditing which should be considered collectively by the donor community. They believed there is justification for greater donor emphasis on training in the aid recipient country and for direct training of mid- and lower-level personnel in the major development sectors. They also believed that because of the unfavorable financial conditions of many African countries, donors need to consider treating financial management as a distinct sector of aid assistance in that region.

According to British officials, the major donors should begin coordinated efforts to develop more standard accounting and reporting requirements for assistance programs. The West Germans believed the donors should initiate coordination by reviewing the extent to which donors need to reconcile and streamline their accountability and reporting requirements and determining appropriate requirements consistent with recipient countries' management systems.

Canadian officials also believed that donors have contributed to financial management problems in developing countries by each donor having significantly different accounting and reporting requirements in assistance projects. Canadian officials added that, although they are considering accounting and related financial management assistance to one African country, their general policy has been to use their own staff for financial control functions. They also said that this, in effect, operates project management systems that parallel those of the aid recipient, which in the short-term avoids the problem of weak host-country management but in the long-term perpetuates such weaknesses.

However, as a major food and commodity assistance donor, the Canadians are beginning to consider the importance of accountability and control over the use of local funds generated by the sale of food, commodities, and equipment in developing countries. At present, their policy is that the management of such funds is entirely within the purview of the recipient. This policy may change, and if so, it will create additional requirements for aid recipient financial management. According to a consultant's report, the recommended accounting plan for local currency should require an in-country accounting framework which has the complexities of normal accounting operations and which provides budgetary information on the availability and commitment of donor-generated funds. This policy if adopted, will make approval for local fund programs dependent upon an assessment of the budgetary and administrative capacity of the recipient and provide an additional point of reference for donors to jointly consider in addressing the financial management systems of developing countries.

The French bilateral assistance agencies--the Ministry of Cooperation and Development and the Caisse Centrale--have no stated policy or program of providing assistance to deal with developing countries' financial management problems. French bilateral assistance recognizes there is a financial management problem at all levels of development administration in Africa but for both political and foreign policy purposes has concentrated on dealing primarily with national level financial deficiencies. The agencies' officials envision France as continuing to emphasize direct budget support of African country economies and providing related academic training to high-level government officials. Lower priority will be given to in-country training, such as that sponsored by AID at the project level in the Sahel.

French officials noted, however, that as of December 1982, 58 Caisse Centrale personnel were assigned temporarily to developing countries to help improve development program performance and short-term missions were provided to address needs in financial diagnosis, accounting organization in companies, and conditions for establishing new development organizations. It was also noted that the Ministry of Cooperation and Development funds financial advisors assigned to national ministries in French-speaking Africa and has formulated two accounting plans for African national-level needs, one for the private sector and parastatals in 10 countries and one for the public sector in countries such as the Cameroon, Zaire, and the Central African Republic.

Coordination in the Sahel

AID's financial management project in the Sahel, which began in fiscal year 1982, represents its major effort to train developing country personnel in financial accounting and other related aspects of development project management. In addition to meeting congressional requirements for certifying the adequacy of host-country accounting systems for the control and use of locally generated funds, the regional training program was expected to generate the interest of other donors in providing complementary training activities. Our discussions with AID and other donor officials indicated that the financial management training and technical assistance needs of Sahelian institutions are much beyond the scope of the current AID regional project which emphasizes accountability in individual assistance projects. Successful institutional development in this critical area of host-country management will require concerted donor strategy and action.

Other donors have not sponsored complementary programs. Our discussions at the Club Du Sahel, with the bilateral donors, and with representatives of the Permanent InterState Committee for Drought Control in the Sahel indicated that the following factors have weighed against such complementary action.

--The Club Du Sahel has not placed the subject on its agenda for donor discussions and there has been a reluctance by the Permanent Interstate Committee to address the subject of financial accountability.

--Reluctance of certain European donors to place accountability requirements on recipients because of their fears of infringing on the sovereignty of Third World governments.

--Lack of attention to the subject by the U.S. representatives to OECD's Development Assistance Committee.

Because of these factors, the AID project remains the only major donor project in the Sahel dealing specifically with financial management. This condition is particularly significant when considered in the context of the Club Du Sahel's mandate to (1) foster increased cooperation among donors and inform the international community about Sahelian development needs, (2) function as an informal and flexible discussion group, and (3) support the work of the Permanent InterState Committee for Drought Control in the Sahel.

Our discussions with representatives of the Permanent InterState Committee for Drought Control in the Sahel indicated that they believe the major effect of the AID Regional Financial Management Project will be in the accountability of AID project funds. Our discussions at the Committee suggested, however, that the project's higher level objectives of developing comprehensive financial management capability in key Sahelian institutions are not likely to be achieved without extending the project beyond its present scope and obtaining the complementary and material support of other donors in the region.

The U.S. representative to the Club Du Sahel believed that the AID Sahel project has a tough but needed message for all donor countries--to make development assistance more effective and longer lasting, the financial management practices of recipient countries must be substantially improved. He also believed that although Club participants may recognize the "hardcore" host-country financial accountability and management problem which the AID project addresses, improving financial management in the Sahel or in other African countries is not an issue they will pursue enthusiastically unless the United States provides much stronger encouragement and commitment. He believed that such cooperation should be encouraged in the Development Assistance Committee because of the Club's lack of leverage for encouraging recipient accountability as an element of effective regional coordination and because the financial management problem affects development performance in many developing countries.

The Director of the Club Secretariat agreed that the attitudes of the other donors will have to change. She believed that donors will have to give more attention to issues of recipient absorptive capacity and place special attention on recipient financial management because of pressures from their governments to reduce or only maintain existing levels of assistance budgets--which in her view, will require greater recipient responsibility for financial performance.

Cooperation For Development In Africa

To facilitate discussions in the Development Assistance Committee, the donor group--Cooperation for Development in Africa--would be an appropriate forum to address the host-country financial management problem. Cooperation for Development in Africa, which is an economic assistance coordinating group created by OECD's principal Western donors[3], has a permanent liaison group and a policy-level group which meets about once a year to discuss donor development program priorities in Africa. Technical working group discussions have focused on energy, forestry, transportation, agricultural research, irrigation, and health. Host-country training needs have been discussed in general terms, but specific issues such as financial management have not been addressed. The AID representative to the Group believed that the financial management issue may be appropriate for technical working group discussions. He also commented that as a former AID mission director in Senegal, he was familiar with the serious financial accounting deficiencies in assistance programs and the need for donors to systematically consider such issues.

It is apparent that the U.S. will have to provide leadership in placing the issue of financial management in development on the Group's agenda. We noted in our review of recent Group

[3]Current members include Belgium, Canada, France, the United Kingdom, the United States, Italy, and West Germany, who represent about 65 percent of bilateral assistance to Africa.

discussions that African countries have expressed concern about the donors' interest in improving the efficiency of foreign assistance. Such interests, we believe, should be translated into more concrete terms by focusing Group discussions on the question of recipients' financial management capabilities and related assistance needs.

We also noted that the African Development Bank has been a major contributor to the Group's discussion of development issues. Our discussions with Bank staff indicated that their assistance in the financial management area focuses on technical cooperation to improve overall management of assistance projects and includes management seminars at the Bank's training center. They indicated an interest in giving financial management training and technical assistance a higher priority, in coordination with other donors.

U.N. programs

In considering the opportunities for donor cooperation, we identified U.N. organization programs[4] that have financial management improvement objectives. These activities are limited in scope in relation to the magnitude of the problem, but they can provide an important point of reference for donors to consider in developing appropriate policy and assistance strategies.

International Labor Organization

Partly in response to the recent World Bank surveys which described weak financial management capabilities in many developing countries, the International Labor Organization has renewed its emphasis on accounting system training. It conducts training in both the private and public sectors, principally through programs for special public works and management development. The special public works program goal is to improve financial controls at all levels and it includes classes in elementary accounting principles for bookkeeping, cash and account books, and the payment of wages. The management development program assists countries in meeting their training requirements through field work, research, and periodicals. The degree of financial management training varies. At the time of our review, 12 projects in Africa had a significant financial accounting training component. Projects in Malawi, Botswana, and Benin focused exclusively on financial management.

Department of Technical Cooperation for Development

The U.N. Department of Technical Cooperation for Development has stressed the need to improve the financial management

[4]International Labor Organization accounting training programs in Africa, Department of Technical Cooperation for Development technical assistance, and U.N. Development Program.

capability of developing countries. The Department currently has two financial management advisors who provide training and technical assistance at the request of developing countries. The demand for such services have been extensive; for example, recent in-country missions have addressed the need to improve the

--budget systems in the Nigerian government,

--operations of the central organization for control and auditing in the Yemen Arab Republic,

--financial management operations of the government of Malta,

--government audit systems in the People's Republic of China,

--personnel training needs of Malawi's accounting service, and

--operations of the Auditor General in Nepal.

These advisory programs are often part of the much larger requirement to improve developing country financial performance. For example, an assistance mission to one African country was based on the results of a World Bank study of fiscal management issues which identified major budget system weaknesses in fiscal analysis and policy formulation, budget planning and preparation, and budget execution and financial control. It was concluded that the country's accounting system had been overloaded by the large increases in government development activities coupled with a shortage of qualified accountants and appropriate equipment for control functions. It was also concluded that development planners had given too little attention to recruiting, training, and retention of qualified financial management staff.

Similar efforts in Asia have only scratched the surface of countrywide problems. For example, a mission to a major AID recipient country noted that the efforts of that country's Department of Finance to improve existing reporting and accounting systems should be commended; however, it was also believed that additional external assistance would be needed in accounting system design and development and the related training of staff.

U.N. Development Program

The U.N. Development Program funds training and technical assistance through a number of U.N. agencies. Our analysis of a July 1983 computerized listing identified the following activities having financial management related objectives.

--Fellowships for study in the United States and other developed countries in support of related activities, including government accounting, manpower development, public administration, budget planning and processes, and local government finance.

--Several completed or in-process development assistance projects having financial management assistance components.

The financial management training and technical assistance is provided in a wide range of development sectors. For example, current projects identified in the computerized listing included industrial promotion in Burundi implemented by the U.N. Industrial Development Organization, regional cities development in Thailand, and computer center development in the Philippines. Completed projects have been funded and implemented through numerous U.N. organizations in addition to those of the International Labor Organization and the Industrial Development Organization, demonstrating the need as well as the opportunities for donor cooperation on a country basis.

AID BUREAU VIEWS ON FINANCIAL MANAGEMENT PROGRAMMING OPPORTUNITIES

Officials of the Africa Bureau that we talked with believed that, in coordination with other donors, AID should explore options for greater levels of financial management training and technical assistance. They indicated that based on our analysis, the Bureau will adjust its ongoing program of African Manpower Development to emphasize training in financial management skills. Bureau officials also indicated that they will hold discussions with the British and West German bilateral agencies and the World Bank to identify opportunities for program coordination.

Africa Bureau officials suggested, however, that our report should stress that host-country financial management weaknesses are not unique to Africa and that in fact they significantly affect development program performance in other regions. They also suggested that overall AID programs, in coordination with other donors, should build on Africa Bureau initiatives underway involving the use of private sector accounting firms for improving project management and design.

The AID Regional Mission staff in the Eastern Caribbean also believed that lack of financial management skills is generally a worldwide problem, so deficiencies in that region are not unique. They stated that deficiencies in financial management are hindering economic development efforts and that attention must be paid to (1) increasing the awareness of decision makers about the need for and the returns from sound financial management and (2) identifying possible approaches to improving the existing situation.

Officials in the Bureau for Science and Technology expressed only limited interest in financial management training and technical assistance--due in part to their difficulties in designing the multi-regional project in 1980. Their current reservations centered around the following issues.

--Should AID fund more training based on current information or is there a need for additional research to better identify priorities and training mechanisms?

--Would attention to host-country financial management weaknesses tax too greatly the resources of small AID missions?

--Would greater emphasis on financial management training programs be better handled by multilateral institutions, such as the World Bank?

We believe that the information developed during our review suggests that greater research is not the answer to addressing basic host-country deficiencies in accounting, budgeting, and auditing systems. The most significant requirement is for additional training and technical assistance designed to ensure that host-country systems are capable of managing development programs. Our analysis indicates that training and technical assistance is relatively inexpensive compared with other investment options, such as development infrastructure. Effective in-country and regional coordination with other donors would further reduce the costs of assistance to individual AID missions. We also believe that although the World Bank could be expected to play a greater, and in some instances, the lead role in providing assistance to specific countries, host-country needs are so pervasive that multi-donor commitment is necessary.

Officials in the Office of Financial Management agreed that AID has not paid sufficient attention to the host-country financial management problem and its effect on development assistance programs. They said that the missions' initial assessments of host-country capabilities as required by the newly initiated Payment Verification Policy have further substantiated the findings in our review that financial control systems, particularly in the lesser developed countries, are in need of serious attention.

CONCLUSIONS

Except for the Sahel, AID has not systematically addressed the financial management training and technical assistance needs of developing countries. AID has traditionally

--treated financial management as one of many public administration needs, without the necessary focus on accounting, budgeting, and auditing problems which limit the performance of development assistance programs and

--considered financial management development on a project-by-project basis, which provides insufficient attention to financial management problems that seriously limit sectoral and countrywide development programs.

The financial management weaknesses of certain developing countries are so pervasive that AID, in coordination with other donors, may have to consider assistance on a scale larger than just as a component of individual development assistance projects. This observation is important in terms of donor programs which recognize the need for institution building in developing countries but which generally emphasize training only as a component of development assistance projects. Project-by-project consideration of financial management development needs is inadequate for systematic improvements.

AID's training initiatives in the Sahel, the Africa Bureau's increased use of private accounting firms for improved project management, and the newly established Payment Verification Policy of the Office of Financial Management can provide key points of reference within the Agency for developing such a program. The magnitude of the financial management problem underscores the need for meaningful donor coordination, and our work at major donors demonstrates that there are areas for such cooperation.

We realize that developing effective financial management will be difficult in many of the least developed countries. However, we believe that because of AID's policy of encouraging developing countries to eventually take over the management responsibilities associated with successful development and its general policy emphasis on overall institutional development, AID should play a stronger role among the major donors in developing long-term financial management training and technical assistance programs.

AID should encourage the other donors to address the financial management training and technical assistance needs of developing countries as a part of formal coordination discussions in the Development Assistance Committee of OECD and Cooperation for Development in Africa. The World Bank attends Committee meetings as a regular observer and should be encouraged to present its views to the bilateral donors on possible joint donor approaches to specific country and sectoral problems. Donor approaches to the issue should build on the experiences and ongoing programs of U.N. agencies, emphasizing coordination with the accounting training programs of the International Labor Organization in Africa.

AID initiatives in the donor forums should include addressing specific policy concerns expressed by the Canadians, the West Germans, and the British in terms of the various donor requirements for host-country accountability in development assistance programs and the extent to which policy inconsistencies may contribute to poor host-country financial accounting and reporting performance.

RECOMMENDATIONS

We recommend that the Administrator of AID begin a program for financial management assistance that establishes training priorities and mechanisms on a country-by-country basis and in a regional context, if appropriate. We believe the program should include the following elements:

--Begin with a complete documentation of current financial management training and technical assistance sponsored by AID and other donors, in relation to problems defined on a country and functional basis.

--Identify countries requiring substantial levels of training and technical assistance and formulate long-term assistance strategies in cooperation with other donors. The strategies should be part of the overall AID country assistance plans. Development projects funded in support of the country plans should also be designed to encourage host-country commitment by having agreements that require, as a condition for disbursement of project funds, a plan agreed to by host-country implementing agencies for establishing improved and standardized financial planning, accounting, and reporting systems.

To encourage other bilateral donor interest in supporting assistance programs complementary to those of AID, we also recommend that the Administrator of AID, through the U.S. delegation to the Development Assistance Committee of OECD and in its participation in Cooperation for Development in Africa, initiate donor discussions of the constraints of financial management weaknesses and their effect on the main sectors of development assistance programming. Such discussions should also encourage the World Bank's involvement in working with bilateral donors to

--discuss the extent to which donors can systematically emphasize improving host-country financial management capability when designing development assistance projects.

--identify countries requiring major levels of donor training and technical assistance and formulate donor strategies accordingly.

--identify the elements of ongoing donor financial management assistance programs which offer potential for long-term replication.

To facilitate multilateral donor interest we further recommend that the AID Administrator, in his role as coordinator of U.S. assistance programs and in conjunction with the Secretary of the Treasury, encourage the regional development Banks to develop financial management training and technical assistance strategies that complement emerging World Bank policy and AID initiatives with bilateral donors.

AGENCY COMMENTS AND OUR EVALUATION

We received official comments from AID on this report. (See appendix II.) AID agreed that improved financial management in developing countries would improve the performance of development programs. It accepted the basic recommendation of the report, that focus on financial management should be elevated in the Agency. Seven specific Agency actions were identified to improve host-country financial management capability:

1. Review a mid-term evaluation of the Sahel Financial Management Project to extract the lessons learned.

2. Review as part of the Payment Verification Policy the first of the mission annual assessments to develop an inventory of the problems encountered in the accounting systems of the institutions assessed.

3. Develop additional guidance to assist missions in performing the second annual assessments.

4. Develop minimum acceptable accounting standards to be applied worldwide in reviewing host country institutions.

5. Initiate discussions with financial management leadership of major donors to reach a consensus on minimum accounting standards.

6. Develop a data base to monitor host-country institutions assessed, problems found, needs for training and/or technical assistance, funds provided, and indicators of successful resolution of problems.

7. Establish an AID working group to develop policy and specific training and technical assistance plans to improve financial management in host-country institutions.

AID believed that following successful implementation of these actions, consideration will be given to long-range programs. Concerning the need for donor coordination, the Agency believed it could increase the probability of success by initially working at the technical level with other donors. It was believed that high-level policy discussions with other donors would achieve little success without developing a significantly greater understanding of the problem.

We agree that the initial actions stated by AID are important steps toward giving more serious attention to the financial management problem. In particular, the development of minimum accounting standards for reviewing host-country institutions will represent a major step forward in focusing on the issue of accountability and the related need to strengthen accounting systems in developing countries. AID stated that although it does, in some projects, require as a condition precedent a host-country plan for improved financial management systems, this requirement is generally limited to institutions having responsibilities for individual projects. We continue to believe that such requirements should be developed as a part of the overall AID country development assistance plans, because financial management assistance would be more effective if planned on a scale larger than just as a component of individual development assistance projects.

We believe policy-level discussions with other donors in established forums are essential to underscoring a long-term AID commitment to improving financial management in developing countries. Policy-level discussions also would be important in documenting the training and technical assistance programs sponsored by various donors and in complementing AID's efforts to identify country organizations most in need of additional assistance. We also believe that the AID working group to be established for developing policy and training and technical assistance plans to improve financial management should (1) actively work with other donors through established coordinating forums and (2) be established as a clearly visible organizational entity within AID to assure both external and internal coordination.

MINIMUM STANDARDS FOR CERTIFICATION OF SAHEL HOST-COUNTRY ACCOUNTING SYSTEMS

AID has established the following minimum standards for use by its overseas missions to certify the adequacy of host-country accounting systems handling Sahel Development Program funds.

--The system must identify the receipt and expenditure of AID funds.

--The system must ensure that approved budgets/budget categories do not become oversubscribed; i.e., a system for identifying both commitments/encumbrances and funds due/ receivables by budget categories.

--Accounting entries will refer to documentation which supports the entry and is filed in such a way that it can be easily located.

--The system will generate accurate and current financial reporting information, including periodic bank reconciliations.

--The system will include appropriate internal controls which assure usefulness of financial data, accuracy, and integrity.

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

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

ASSISTANT TO THE ADMINISTRATOR
FOR MANAGEMENT

20 SEP 1984

Frank C. Conahan
Director
National Security and
International Affairs Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Conahan:

Thank you for the oppportunity to comment on the draft audit report titled "Financial Management Problems in Developing Countries Reduce the Impact of Development Assistance."

We share your view that improved accounting, budgeting and auditing capability in developing countries would improve the performance of development programs. For this reason, we believe two on-going Agency efforts mentioned in the draft report merit more emphasis. The first, the Sahel Regional Financial Management Project, is a pilot program in a geographic area where significant accounting deficiencies are known to exist. In this program, a contract team is working directly with host country institutions in the region which receives A.I.D. funds to develop and improve financial management systems and train accounting and management personnel. Extensive use is made of workshops and seminars in which institution and country specific problems are addressed. We are assessing the progress of this program for possible replication, although we recognize the conditions of the Sahel are not standard for the Agency worldwide.

Another significant undertaking involves implementation of the Agency's Payment Verification Policy. Implementation is in the early stages of evaluation by A.I.D./W. Individual country assessments are being reviewed and, where host country institutions are found to be deficient, we will address their problems through training and technical assistance as appropriate. These mission assessments represent an inventory of institutions which receive A.I.D. funds and are a starting point for assessing training requirements.

We consider both the Sahel Project and the Payment Verification Policy implementation to be important steps toward the development of A.I.D. policy on assisting host country governments in their efforts to improve financial

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management. Also, the Agency has been encouraging the use of CPA firms to assist host country governments to improve their systems. There has been a marked increase in project funded CPA contracts in such areas as:

1. designing and assisting in start-up implementation as well as training staff on accounting and reporting system for low-cost housing in Liberia;

2. establishing a financial control system and training personnel to implement the system for a rural development project in Sierra Leone;

3. designing a project planning, accounting and financial control system in the Ministry of Finance for Somalia.

In these and other related efforts, A.I.D. has opted to first improve financial management in those institutions which directly receive or manage A.I.D. funds, rather than attempting to develop and/or reform the total financial management of a host country. We believe this project-specific approach is more manageable and measurable. We are not limiting our efforts only to A.I.D. accounts at the institution. Rather, where an institution is found to be deficient, we will address financial management at the wider institutional level. This is distinct, however, from attempting to reform accounting in the government as a whole.

We accept the basic recommendation of the report, that focus on financial management should be elevated in the Agency. We believe, however, that the means for improving financial management should be demonstrated through experiment and trial and error before considering larger global assistance. With such limited resources, both in funds and personnel, A.I.D. should not commit itself to such an ambitious endeavor without first analyzing the high probability of frustration and failure.

A.I.D. is in the process of identifying countries and institutions requiring substantial levels of financial management training and technical assistance through the annual mission assessments. We will make this information available to the major donors and request like information from them. While we can and do, in some projects, require as a condition precedent a host country plan for improved financial management systems, this requirement is generally limited to the institutions which have implementing responsibility for the project.

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As to donor coordination, we believe we would increase the probability of success by initially working at the technical level with other donor agencies. Without developing a significantly greater understanding of the problem by donors, a high level policy discussion will likely achieve little success. Again, we prefer to approach donor coordination in this area on a pilot basis.

The following specific steps will be taken in the near future to improve financial management by host country institutions:

1. Review the mid-term evaluation of the Sahel Financial Management Project to extract the lessons learned.

2. Review the first of the Mission Annual Assessments to develop an inventory of the problems encountered in the accounting systems of the institutions assessed.

3. Develop additional guidance to assist missions in performing the second annual assessments.

4. Develop minimum acceptable accounting standards to be applied worldwide in reviewing host country institutions.

5. Initiate discussions with Financial Management leadership of major donors to reach a consensus on minimum accounting standards.

6. Develop a data base to monitor host country institutions assessed, problems found, needs for training and/or technical assistance, funds provided and indicators of successful resolution of problems.

7. Establish an A.I.D. working group to develop policy and specific training and technical assistance plans to improve financial management in host country institutions.

Following successful implemention of the above actions, we will consider whether more ambitious and longer range programs should be instituted.

Sincerely,

R. T. Rollis, Jr.

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