

# How to Note – Managing Fiduciary Risk when providing PRBS – Additional Guidance

## “Managing the Risk of Corruption”

June 2005

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### i) Introduction

1. This additional guidance note complements summary guidance on assessing and managing the risk of corruption contained in the current **How to Note 'Managing Fiduciary Risk when providing PRBS'** dated 22<sup>nd</sup> September 2004 and additional guidance **'When to perform Fiduciary Risk Assessments and Annual Statements of Progress'** dated June 2005. It responds to questions from country offices and lessons learnt in the course of reviewing fiduciary risk assessments (FRAs) in 2004 and early 2005. Examples cited from country FRAs are held in a library being developed on the Policy Division Financial Accountability and anti-Corruption Team (FACT) Insight webpage.
2. This note will be incorporated into a full update of the How to Note to be completed later this year. This update will also promote and integrate the PEFA PFM Performance Report<sup>1</sup> in to our approach for managing fiduciary risk. The PEFA performance report will not provide an explicit assessment of the risk of corruption of the scope required by DFID, therefore it is anticipated that an assessment of corruption risk will still be required.

**For further information please contact the Financial Accountability and Anti-Corruption team at [Fact-Team@dfid.gov.uk](mailto:Fact-Team@dfid.gov.uk)**

### What is required?

3. All fiduciary risk assessments must include an evaluation of how the risk of corruption impacts the performance of public financial management & accountability (PFMA) systems and related fiduciary risk. This should also include an explicit judgement on whether related reforms (including anti-corruption reforms) represent a credible programme of improvement.

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<sup>1</sup> The Public Expenditure and Financial Accountability (PEFA) Program is currently finalising a common performance management framework to enable a more harmonised and standardised mechanism for partner governments and donors to assess public financial management (PFM) performance and monitor progress over time.

## Why do we assess the risk of corruption?

4. The assessment of corruption risk provides additional information to enable DFID's Accounting Officer and Ministers to be accountable to Parliament for how UK taxpayers' funds are used when provided to partner governments as PRBS. Our evaluation of the risk of corruption aims to provide a clear, full and balanced picture of the real impact of corruption on all funds passing through partner government systems. Public perceptions of levels and types corruption in recipient countries may be informed by material which only provides a **partial** picture of the impact of corruption, for example by the well-known annual Corrupt Perceptions Index (CPI) produced by Transparency International (TI) or media reports.

## ii) How does DFID assess the risk of corruption?

### What should be in the statement of corruption risk?

5. The FRA should state the level of corruption risk based on assessment of the following key risk factors:

- How high is the likelihood of occurrence; and
- How material is the potential impact on PFMA systems; and
- How significant is the potential impact DFID or partners' reputation?

**See Zambia PRBS 2004 FRA for a comprehensive example of corruption risk assessment.**

### What types of risk should we cover?

6. Risks of corruption in relation to PFMA systems may include those related to:

- Formal budget, expenditure and internal control systems.** Annex 1 of the How to Note contains specific questions related to corruption to be asked when assessing the DFID good practice principles and benchmarks. Key areas of corruption risk identified in FRAs to date have tended to focus on weaknesses in procurement, audit, oversight and accountability.
- Real (actual) operation of these formal systems.** For example: How do ministers' political interests affect procurement decisions? What incentives do civil servants have to implement internal controls? Do procurement regulatory bodies or anti-corruption commissions have resources to fulfil formal functions? Will investigations of corruption, cases that affect senior government figures or associates, be halted? Do local communities have sufficient capacity to exercise formal functions of procurement or expenditure oversight?

- iii) **Wider governance and institutional context.** For example: Is corruption in the judiciary a significant factor - are cases of corruption likely to be prosecuted? Are there significant expenditure decisions or events (e.g. elections) forthcoming which will increase the risk of diversion of funds?

**See Pakistan PRBS 2004 FRA for risk assessment covering these 3 types of corruption risk.**

## **What kind of evidence should we use?**

7. The assessment of corruption risk should draw on:

- information from the regular information sources for evaluating PFMA systems and processes, such as PEFA PFM Performance Report, Country Financial Accountability Assessment (CFAA), Country Procurement Assessment Review (CPAR). This is most likely to provide evidence for risks to formal budget, expenditure and internal control systems
- governance and specific corruption diagnostic material (see below), including studies of the countries' political economy which may provide additional information about the way systems operate in practice (e.g. DFID drivers of change studies, Politics of the Budget studies).

## **Which corruption diagnostics are the most useful?**

8. **Transparency International Corrupt Perceptions Index (CPI)** - The CPI is a useful tool for broadly raising awareness, but it is a survey of surveys that reflects the perceptions of a range of international organisations. It is **not** useful for providing a clear view of the key risks to PFM systems on the ground. It may not show an accurate picture of progress in reducing corruption over time. However it is helpful for comparing risk ratings for corruption across countries in any one year.

9. We recommend using **Transparency International National Integrity System (NIS) country studies**, where these are available. NIS studies provide an assessment of a country's key institutions dealing with corruption, including the executive, legislature, judiciary, supreme legislature judiciary, supreme audit institutions, ombudsman, independent anti-corruption agencies, public service, local government, media, civil society, private sector, international institutions. Available at <http://www.transparency.org>.

10. Other international tools which country offices have found useful include World Bank Country Policy and Institutional Assessments (CPIA) and World Bank Institute Governance and Corruption (GAC) diagnostics.

11. Country offices may also request the **helpdesk** of the **U4 anti-corruption resource centre** to source material, available at <http://partner.u4.no/>. There is a wide range of further surveys and diagnostic tools on anti-corruption, often performed at **local level**, which may provide relevant information (for example, national anti-corruption surveys, household and bribery

surveys). Mapping exercises for this information have been performed for a number of countries in Africa and Asia (including Central Asia and South Caucasus). The Africa study, "Local Corruption Diagnostics and Measurement Tools Mapping Study", February 2004, and the Asia report, "Mapping exercise of Corruption and Governance Tools in Asia and Caucasus countries" is available on the [Policy Division FACT webpage](#).

## What do we do where there is a shortage of "hard data"?

12. Material on corruption is often difficult to gather and verify. Evidence based on informed local opinion and academic or other professional observers can be useful. This may be used in the assessment of corruption risk where other reliable diagnostic material on a particular area of corruption risk is not available and a piece of such evidence is confirmed by more than one source.

13. Where hard evidence is limited and the assessment of corruption risk relies on anecdotal evidence, this should be **explicitly stated**. Similarly, where weaknesses in PFMA systems indicate that a risk of corruption would be expected in many circumstances, but evidence exists to contradict this assumption or evidence in this area is limited, this should be made clear in the risk assessment. This helps to ensure consistency in treatment of corruption risk across DFID.

14. In these circumstances, it is important to monitor the emergence of new corruption diagnostic material which may provide an improved evidence base.

**See examples of Ethiopia PRBS 2005 FRA and Vietnam P135 2005 FRA.**

## What is an appropriate mitigation strategy?

15. An appropriate mitigation strategy may encompass three types of measures, as necessary, to address different types of corruption risk over different timescales.

16. **A credible programme of improvement** that **specifically** addresses the key corruption risks to PFMA systems. There may be a number of reforms underway related specifically to corruption, PFMA and the wider governance and institutional context. The important question is how and whether the **content** of these reforms address weaknesses in the key risk areas identified. For example:

- A formal national anti-corruption strategy exists/is being produced – but is there political backing for implementation going forward and is this coordinated with other parts of government?
- Are related and relevant reform programmes underway? For example, will a judicial sector reform enable bidders disadvantaged in a non-transparent procurement process to seek redress through the courts? Does a civil service reform programme tackle the incentives or lack of effective controls and accountability that facilitate corruption?

17. **Mechanisms for monitoring** key corruption risks and related reforms, and mechanisms agreed in advance with partner governments and other donors (if appropriate) for **dialogue** and **response** when progress with reform is inadequate or new or increased risks arise. In these circumstances, the fiduciary risk assessment should summarise the relevant monitoring mechanisms for key corruption risks. For example, the timing of governance reviews, agreed conditionalities (such as PRSC prior actions and triggers), inclusion of corruption-related reforms in triggers for variable PRBS tranche disbursements.

18. Where corruption risk is high and not effectively addressed in the programme of improvement, specific **short term safeguards** should be considered through dialogue with partner government and the donor group; or the FRA should provide reasoned narrative as to why additional short-term safeguards are not deemed appropriate.

## How do we monitor corruption risk and programmes of improvement?

19. FRAs should state how the progress in implementing reforms to tackle key corruption risks will be monitored. Reviews of progress may take place as part of existing governance monitoring programmes in conjunction with other donors and/or partner governments. Existing corruption diagnostic methods are often of limited use in measuring progress in reducing corruption over time. Therefore it may be necessary to review a combination of factors including:

- **Process:** are reforms that address key corruption risks being implemented in a timely fashion?
- **Perceptions:** Are perceptions improving of efforts to tackle corruption from across a range of diagnostic sources, and in evidence from informed opinion and reliable observers?

20. DFID's requirements for monitoring fiduciary risk (including the risk of corruption) and reporting progress over time are detailed in section III of the additional guidance note '**When to perform FRAs and Annual Statements of Progress**'. The key requirements with respect to corruption risk are:

21. Every PRBS programme should have a completed FRA including an assessment of the risk of corruption, but this does not mean that an *updated FRA* is required for *every* submission related to multi-year programmes. However, whenever a **new or updated FRA** is required, this should include a full assessment of the risk of corruption.

22. Where there has been a **major change of circumstances** or overall negative trend in PFM performance, an updated FRA is required. Considerations of corruption (for example the credibility of anti-corruption reform, new anti-corruption diagnostic work or emergence of a significant corruption scandal) may impact the judgement as to whether there has been such a change in circumstances.

23. Where a full update of the FRA is not carried out, annual submissions for a multi-year PRBS programme should include an **annual statement of progress**. An annual statement of progress is intended to be a **targeted summary** to accompany annual DFID submissions, and should provide an assessment of progress against the main fiduciary risks identified in the most recent FRA, including the risk of corruption. Amongst other items detailed in the additional guidance, the annual statement should include a statement of progress in addressing the risk of corruption, an assessment of credibility of reform to address corruption and note how progress will be monitored going forward.

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