



Schweizerische Eidgenossenschaft  
Confédération suisse  
Confederazione Svizzera  
Confederaziun svizra

**Direktion für Entwicklung  
und Zusammenarbeit DEZA**

**Current issues and future challenges in health SWAps:  
Fiduciary Risk Assessment & Financial Man-  
agement – Issues Note**

**By Jean-Luc Bernasconi and Fabrizio Tediosi**

**Supported through the 2007 Backstopping Mandate  
of the Social Development Division's Health Desk**



**SCIH** Swiss Centre for  
International Health  
A department of the Swiss Tropical Institute

## Table of contents

1. Defining fiduciary risk .....	4
2. The importance .....	5
3. Measuring Fiduciary Risk .....	6
4. Managing fiduciary risk.....	8
5. Some fiduciary and governance risk issues specific to the health sector.....	10
6. Conclusions.....	12
8. Useful Resources .....	13

## Contacts

<b>Swiss Agency for Development and Cooperation</b> <b>Franziska Freiburghaus</b> <a href="mailto:franziska.freiburghaus@deza.admin.ch">franziska.freiburghaus@deza.admin.ch</a>	<b>Swiss Centre for International Health</b> <b>Swiss Tropical Institute</b> <b>Claudia Kessler</b> <a href="mailto:claudia.kessler@unibas.ch">claudia.kessler@unibas.ch</a>
--	---

## Disclaimer

This paper was commissioned by the Swiss Agency for Development and Cooperation (SDC). The views and ideas expressed herein are those of the author and do not necessarily imply or reflect the opinion of the Agency.

## Abbreviations and Acronyms

Coof	Cooperation offices
CS	Civil Society
DFID	Department for International Development
DP	Development Partner
GBS	General Budget Support
GFATM	Global Fund to Fight AIDS, TB and Malaria
GHI	Global Health Initiatives
H&A	Harmonisation and Alignment
HSR	Health Sector Reform
MDGs	Millennium Development Goals
M&E	Monitoring and Evaluation
MoF	Ministry of Finance
MoH	Ministry of Health
MTEF	Medium Term Expenditure Framework
NGO	Non-governmental Organisation
PAF	Performance Assessment Framework
PEFA	Public Accountability and Fiduciary Assessment Framework
PETS	Public expenditure tracking studies
PFM	Public Financial Management
PRSP	Poverty Reduction Strategy Paper
SBS	Sector Budget Support
SDC	Swiss Agency for Development and Cooperation
seco	State Secretariat for Economic Affairs
SWAp	Sector Wide Approach

## 1. Defining fiduciary risk

**The concept** Strictly defined, the notion of "fiduciary risk" is borrowed from the financial sector industry and refers to the risk that funds entrusted to a financial institution through trusts or agency accounts are not properly managed. Applied to the case of Sectoral or General Budget Support (SBS/GBS), the definition would cover the funds entrusted to the partner government's treasury by the taxpayers of the donor country, in support of public spending programmes and related reform measures. In this context, fiduciary risk can be defined as the risk that funds: (i) are not used for the intended purposes; (ii) are not properly recorded and accounted for; and (iii) do not achieve the value-for-money objectives of the programmes they finance<sup>1</sup>.

If funds are not used for the intended purposes this means that resources are effectively diverted from the agreed use - i.e. the budget as voted by the country's Parliament and presented to the donors at the time of the funds being committed. Proper accounting means that units within the ministry of finance or the sectoral ministry, depending on the degree of financial management devolution, as well as being designated and held accountable for recording adequately and transparently the budgetary transactions. It also means that mechanisms for ex-ante control, internal audit and external audit are in place. Finally, the value-for-money objective refers to the well-known "3 e's": economy (procuring inputs at a reasonable price), efficiency (link between input and output, i.e. service provision) and effectiveness (achieving development outcomes of the service provision).

It may be worth highlighting three issues at this stage. First, from the definition above, it is evident that fiduciary risk applies to any type of aid, whether delivered through programmatic or project modalities, and whether implemented by the host government or non-governmental organisations. Second, in the case of Sector Budget Support (SBS), General Budget Support (GBS), or SWAp arrangements whereby the national financial management system is used for all budgetary resources, the agents subject to fiduciary risk are ultimately foreign and domestic taxpayers. Third, it should be noted that fiduciary risk forms only part of a **broader governance risk framework**, which would in addition also covers aspects of corruption that are not related to the management of the State budget

---

<sup>1</sup> This is now a broadly accepted definition initially developed by DFID. A more theoretical definition covering essentially the same concept would be the expected (i.e. probability weighted) loss that would result from gaps between generally accepted financial management standards and actual practices in the subject country. A few donors (e.g. the EC) do not consider the value-for-money dimension as part of fiduciary risk, but rather as part of a broader development risk framework (i.e. risk of a programme not achieving its development objectives).

(e.g. petty corruption, parallel funds, state capture, influence peddling, etc.). Conversely, high fiduciary risk does not necessarily mean high corruption, but may "simply" result from organisational inefficiencies or capacity weaknesses.

## **2. The importance**

### **Why does fiduciary risk matter?**

Fiduciary risk covers the partner country's Public Finance Management (PFM) systems, i.e. all stages of the budgetary process: formulation, execution, accounting and reporting, as well as control and audit. **Besides management systems, fiduciary risk also covers accountability mechanisms**, i.e. institutional arrangements through which the partner institution can report on the use of public funds (externally or domestically financed) for public programmes and public service delivery. In the results framework of a S/Wap (or a GBS) operation, PFM is a key element in the transformation system from inputs to outputs. PFM in itself will not necessarily deliver the development results aimed at (e.g. paying teachers on time does not ensure quality teaching in itself), but can be a key bottleneck or constraint even if all other things are taken care of (e.g. even if teacher recruitment or training system is state-of-the-art, performance will most certainly be affected by negative incentives stemming from late pay or procurement of supplies).

Therefore, it is self-evident that fiduciary risk management is not only important as a means to bring "comfort" about limiting mismanagement of funds. There is also a wider development agenda stemming from mitigating fiduciary risk, with potentially very positive externalities for other sectors and over time.

### **Donor approaches to fiduciary risk**

Donors have traditionally put a lot of emphasis on mitigating fiduciary risk in bilateral projects by ring-fencing financial management systems and adopting stringent procedures that are regularly subject to external audits. The understandable risk aversion over the use of taxpayer resources has also characterized more programmatic interventions (GBS, SBS, SWAs,...). Such programmes are typically preceded by diagnosis assessment of the PFM systems. On the basis of the assessment, a principle decision is taken as to whether the level of risk is acceptable for engaging into programmatic support. Even if the decision is positive, the diagnosis will have unveiled weaknesses in the PFM system that donors and partner governments will agree to tackle as part of the programme. These processes are not without problems however, as they have led in some countries to a proliferation of fiduciary risk assessments, that have put excessive strains on the counterparts and therefore undermined reform capacity.

In this context, most donors interested to some extent in fiduciary

risk mitigation agree that:

- fiduciary risk is only one type of risk faced by donors when providing aid and should be considered in a broader governance and development effectiveness context;
- strengthening country systems is the best strategy to mitigate fiduciary risk in the medium and long term;
- risk assessments, monitoring and policy dialogue on reforms should be harmonized to minimize transaction costs and reform fatigue;

This latter objective is not unproblematic in practice as the definition of fiduciary risk may differ slightly between donors and some donors may not be ready to "delegate" the responsibility of the assessment to another agency. A lot of progress, however, has been achieved in harmonization over the past 5 years or so, and the emergence of common diagnostic tools such as Public Accountability and Fiduciary Assessment PEFA (see below) has proven instrumental in that regard. Switzerland has been an early sponsor of common approaches at the country and global level by supporting PEFA from the outset.

### **3. *Measuring Fiduciary Risk***

Measuring fiduciary risk is not an exact science. By definition, risk involves uncertainty and hence, ultimately, a portion of subjective judgement. Generally, fiduciary risk assessments consider whether fundamental principles of sound public finance management are in place. These core principles can be summarized in the following questions:

- Is a clear set of rules governing the budget process?
- Is the budget comprehensive (i.e. are there public funds, including aid, being managed outside the budget)?
- Is the budget aligned with the poverty reduction programme (or the sector development strategy)?
- Is the budget a reliable guide to actual expenditure?
- Is the expenditure within year subject to adequate control?<sup>2</sup>
- Are government procurement procedures in line with principles of value-for-money (in particular economy) and trans-

---

<sup>2</sup> Adequate should not necessarily mean excessive control. Too many control layers in a PFM system may actually weaken it, as they provide an incentive to short-circuit procedures which are perceived as sources of delay.

parency?

- Is the expenditure (and revenue) reported in a timely and accurate fashion?
- Is there independent and effective scrutiny of public spending?

A fiduciary assessment will provide a diagnosis of two sets of issues. First it will make **an explicit judgement on how fiduciary risk is impacting the performance of PFM systems**, based on the set of principles outlined above. In doing so, the assessment will examine the formal system (rules, laws, procedures,...) governing PFM as well as the actual operation of the systems and their institutional context. Second it will assess the risk mitigation strategies that are in place or should be established, in the form of (i) a credible and nationally owned programme of PFM reforms, (ii) a system to monitor progress and (iii) if needed, the recourse to short-term safeguards to limit fiduciary risk that would be perceived as excessive for complete devolution to country systems.

### **Public Accountability and Fiduciary Assessment (PEFA) framework**

As mentioned above, donors have realized that engaging into multiple assessment and mitigation processes could defeat the purpose, and are making efforts to apply good principles of harmonization and coordination also in the area of fiduciary risk assessments. With this objective a leading group of donors, including Switzerland, has supported the development of a comprehensive assessment framework, the PEFA assessment framework, over the past few years. The PEFA assessment includes a set of [28] indicators, covering the whole budget cycle and respond to the fundamental questions raised above. The PEFA assessment also includes 2 indicators on domestic revenue mobilization, as donors are weary about the moral hazard risk brought about by providing programmatic support.<sup>3</sup> In line with points made above, a PEFA assessment may not only serve the purpose of providing comfort to risk averse donors that they can trust national systems to an acceptable level. These assessments can **potentially** be a very useful tool to guide the formulation or the implementation of a reform programme in PFM, and hence the priorities for related technical assistance and institutional strengthening.

The word "potentially" is used here with an intention. A reform programme can only be effective if it owned. Logically, the findings of the diagnosis or assessment should also be owned. There is a tension here between the need for taking an objective external look of systems that lay in the heart of the functioning of a sovereign state, and the objective of finding a common ground in following up the

---

<sup>3</sup> By moral hazard risk, we mean the disincentive to collect domestic revenues in the face of steady (or even growing) aid flows to the budget.

assessment. Unlike other diagnosis tools, the PEFA process is addressing this tension by putting a lot of emphasis on dialogue, including have a self-assessment preceding the external assessment. Also, in order to avoid the natural tendency to jump to conclusions, the PEFA assessment will not include recommendations for improvement in the early stage. The dialogue should first focus on agreement over the findings and the priorities needing action. Once these priorities are defined, the PEFA assessment may not prove detailed enough to guide a reform plan. Some further (although limited) "drill-down" analysis may be needed to design reforms (e.g. detailed assessments of procurement systems, expenditure tracking surveys, public expenditure reviews, etc.).

We make the case for privileging a systemic approach to fiduciary risk. Undertaking a fiduciary risk assessment for a sector only, makes little sense. That being said, it can be very useful to "drill down" the measurement of certain indicators in a particular sector (e.g. budget vs. outturns). Some PFM or governance-related issues may also be sector-specific (see below for the case of health).

#### **4. Managing fiduciary risk**

##### **A credible reform programme**

As mentioned earlier, the existence and scope of a PFM reform programme should also be part of the fiduciary assessment. Several aspects of mitigation strategies can be examined.

There is subjectivity again in assessing the "credibility" of a reform programme. Essentially, this means that there are national drivers for the programme at the political and technical level. Objectives should, as in any programme, be realistic and monitorable performance indicators assigned to them. The reforms have to be sequenced. Ideally, they should offer solutions for longer term capacity building rather than short-term fixes (although both types of solutions are not necessarily mutually exclusive). Reforming PFM systems can be a fundamental change for the work of people involved in the system. The "change management" aspect should therefore be fully integrated.

##### **Monitoring**

PEFA and other assessment methodologies not only serve the purpose of assessing risk ex ante, but should be used for monitoring progress over time. Again, an important issue here, is that assessments and monitoring should themselves be subject to the principles of effective aid management, in particular ownership, results-focus, alignment and harmonization. Being a cross-cutting issue, PFM reforms is often best addressed in policy dialogue and performance assessment (conditionality) related to General Budget Support. In the absence of a GBS platform, SBS or SWap-related

policy dialogue can offer solutions although not ideal as they involve one or two ministries only. The issue of strengthening domestic accountability should be absolutely central to the reform programme. This also includes involving a wider audience to policy dialogue and monitoring of PFM reforms. Getting the people interested and involved is the best guarantee for long-term sustainability of the reforms.

**Institutional strengthening, capacity development and technical assistance**

In order to support these processes, Switzerland is generally accompanying its programmatic support and implication in policy dialogue with capacity building or technical assistance projects. Examples include strengthening of budget programming (Nicaragua, Tanzania, and Mozambique), country procurement systems (Ghana), budget execution and treasury functions (Burkina Faso), strengthening tax reforms (Mozambique, Ghana), support to the non-government sector in budgetary oversight (Burkina Faso), etc. Support is also provided at the global level (PEFA initiative, International Public Sector Accounting Standards Board,...)

**Short term safeguards**

In some cases where fiduciary risk (or some aspects of it) is perceived as too high, and programmatic support needs nevertheless to be pursued (e.g. the country has a good sectoral development strategy with high potential for economies of scale and scope), donors limit the recourse to country systems by building in some parallel control functions. These may include ex ante control of procurement transactions, pooling funds in accounts governed by separate financial management arrangements, undertaking special external audits. These safeguards may well be justified, but attention should be paid to the fact that they should support, rather than undermine or delay, the strengthening of country systems (e.g. by involving national auditors in a special audit).

## **5. Some fiduciary and governance risk issues specific to the health sector**

In the health sector the fiduciary and governance risks are possibly even more challenging and hard to manage than in other parts of the public sector. In all three aspects of fiduciary risk, as defined above, the health sector has specificities deserving particular attention.

The resource allocation mechanisms in health care systems are often not transparent and there is little information on how resources are used. This is due, among other reasons, to the inherent complexity of setting up comprehensive health information systems, and of linking resource use to health interventions delivered.

In low and middle income countries the leakages in public health care funds are significant. The World Bank has been trying to measure the extent of leakage – the amount of the health care budget that reaches the intended health care facilities and ultimately the intended communities – through public expenditure tracking studies (PETS). PETS follow the flow of funds through the labyrinth of government bureaucracy to determine if funds reach each of the designated levels. Essentially high leakage means inadequate funding for non-salary spending, making service delivery difficult and shifting part of the costs of health care to patients (through financial or in-kind contributions). In fact, in the health sector in-kind supplies from patients – including patients bringing their own food, linens, purchasing drugs or medical supplies, etc. – are widespread.

Additionally, informal payments<sup>4</sup> are widespread in low and middle income countries, creating a parallel market for services within public health care systems. Informal payments in the health sector are even more challenging than in other sectors, due to the peculiar characteristics of health care services such as the asymmetry of information between patients and health professionals - i.e. patients have to rely on health professionals to act as their agents in diagnosing and treating ailments and they are ill-equipped to assess the adequacy and quality of physician decisions and actions – increasing the risks of the so-called supplier-induced demand.

Procurement of drugs and medical supplies is also particularly challenging in low and middle income countries where procurement and contracting rules are not established, there is a lack of performance monitoring, quality monitoring, and audits and there is

---

<sup>4</sup> Usually defined as “payments to individual and institutional providers, in kind or in cash, that are made outside official payment channels or are purchases meant to be covered by the health care system.

uncontrolled political interference. Deficiencies are also in distribution, inventory management, and security and information systems, lack of controls in prescribing and supplying drugs to patients.

Another important aspect to consider is the inherent difficulties in assessing the value for money of resources invested in the health care sector. Assessing the functioning and the performances of health care systems is complex and there is no single measure to do that. All countries have unique health care arrangements with a mix of public and private health financing, delivery and regulations and information. Comparable indicators on health outcomes are often limited or of questionable quality in low and middle income countries, as are those on other important measures of health systems performance such as staff output, medicine and medical supply availability, state of physical infrastructure, inventory and functioning of equipment, existence of patient records, or data on utilization of services and patient satisfaction.

Lastly, governance is also a key determinant of health systems effectiveness. However, the heterogeneous nature of health care, the highly variable and unpredictable nature of health care demand, the multiple actors involved in ensuring effective service delivery, and the limited choice of instruments for monitoring defining and measuring governance in the health sector, make health care systems governance assessment very hard.

## ***Conclusions of the SDC health SWAps workshop discussions:***

- The importance of addressing fiduciary risk is important for accountability to both the recipient and donor Governments and ultimately to the populations of both constituencies.
- When it comes to benchmarking it is important to clarify between absolute and relative milestones, the later serving to monitor change over time.
- The “acceptable” level of fiduciary risk can vary from donor to donor and within a single donor agency over time. It is important to communicate positions and potential sanctions clearly and in advance and to stick to them consistently.
- High fiduciary risk doesn’t automatically signify high levels of corruption, but more often limited systems and lacking capacity.
- The health sector in particular is vulnerable to fiduciary risk due to some of the inherent challenges it faces in resource-limited contexts – drug procurement, financial management in facilities, difficulty of measuring quality of services delivered.
- When a donor is involved in general budget support, addressing fiduciary issues within a line ministry can present a challenge. Here the Swiss can benefit from the collaboration and synergies between seco and SDC and could share experiences with other key donors in this area – World Bank, DFID.
- Through involvement in “project” and modalities which include field office work, SDC has a comparative advantage of being also able to assess the situation on the ground.

## **8. Useful Resources**

- **A guide to WHO's role in sector wide approaches to health development.** Department of Country Focus & Department of Health Policy, Development and Services, WHO, 2006.
- **Aid Effectiveness and Financing Modalities**, World Bank, September 2004
- **Alignment issues in the „Guidelines on EC support to Sector Programmes“**, Presentation of Agnes Lindemans-Maes, Europe Aid Cooperation Office, European Commission, Brussels.
- **Hintergrundmaterialien zu Programmorientierung und Gemeinschaftsfinanzierung**, 2. Entwurf, GTZ Arbeitskreis „Programmorientierte EZ“, Januar, 2007
- **OECD-DAC Report on Progress in Harmonisation and Alignment**, Chapter 13 Tanzania, 2005
- **OECD-DAC 2006 Survey on Monitoring the Paris Declaration**, Uganda Chapter, OECD, 2007
- **Paris Declaration on Aid Effectiveness, Ownership, Harmonization, Alignment, Results and Mutual Accountability**, High Level Forum, Paris March 2005.
- Walford, V (2007) **“A review of Health Sector Wide Approaches in Africa”**. Report.