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Executive Board of the United Nations Development Programme, the United Nations Population Fund and the United Nations Office for Project Services

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Report on direct budget support, 2008-2014

Summary

This report responds to Executive Board decision 2013/3, which in paragraph five requested "UNDP to provide a report, prior to the first regular session 2015 of the Executive Board, on the UNDP approach to assessing, prior to allocating funds, the full range of risks associated with the provision of direct budget support and pooled funding, and on the actions taken to continuously monitor and review those risks, with recommendations on the most appropriate approach to assessing the associated risks".

The report also responds in summary form to paragraphs four and six, through which the Executive Board requested "UNDP to submit the evaluations and audits", as well as any "refinement of the rules and regulations, for the consideration of the Executive Board at its first regular session 2015, in order for the Board to adopt a decision on continued UNDP engagement in direct budget support and pooled funding".

Elements of a decision

The Executive Board may wish to: (a) take note of approach adopted by UNDP to manage risk before and during allocation of funds; (b) take note of the current and anticipated demand for UNDP engagement in sector budget support; and (c) recommend continuation of this policy as part of the options available to UNDP in programme and project management.

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I. Introduction

1. Governments and international partners use direct budget support and pooled funds in development and in post-conflict and humanitarian situations to enhance available resources for national priorities. The two funding mechanisms combine resources from different sources with the intention of promoting coherence, coordination and cost effectiveness while responding to specific development needs.

2. Direct budget support can take the form of financial transfers to national treasuries that help to improve fiscal stability and reduce budget deficits (so-called ‘general budget support’) or it can take the form of sector budget support comprising earmarked contributions to specific national programmes, transferred through government-administered financial management systems. Direct budget support, as defined by the Organisation for Economic Co-operation and Development (OECD), consists of combined financial instruments and capacity development assistance to national and local authorities in support of a proper institutional response to certain critical needs and development challenges. Direct budget support instruments use country-specific public finance management mechanisms and are meant to strengthen the financial and administrative capabilities of governments to fund reforms and programmes that are essential to recovery, resilience and development. A pooled fund is administered by a third party on behalf of the government and is also aligned to a national programme. UNDP involvement in pooled funding is limited to management services in the Multi-Partner Trust Fund (MPTF), which is a financing mechanism that mobilizes resources for use in sector budget support.

3. Sector budget support and pooled funds are funding modalities that shift resource allocation policies from incremental budgeting to *programme budgeting* for more strategic, results-oriented use of public revenues. Incremental budgeting has the advantage of being informed by the previous budget cycle but, in the absence of a programmatic dimension, can lead to fragmentation of strategic intent and achievement of outcomes. Interest in programme budgeting is at least 100 years old and is partly responsible for historical and large-scale investments in reconstruction and development. This includes the Marshall Plan and the idea of a ‘Big Push’ that was revived in the early 2000s in relation to the Millennium Development Goals (MDGs). Modalities such as sector budget support and pooled funds are part of this tradition, motivated to harmonize and align contributions to shared development priorities.

4. In 2008, the Executive Board adopted decisions that enabled UNDP to adopt sector budget support for a pilot period. The pilot period ran from 2008 to 2012. It was extended to include 2013 and 2014. This report summarizes the approach that UNDP has taken to: (a) assess risk prior to allocation of funds during the implementation of the pilot policy on direct budget support; and (b) undertake continuous monitoring of performance. It makes recommendations on managing associated risks, and provides options for the continuation of this policy beyond the current pilot period, incorporating lessons from evaluations and audits of practices to date.

II. Executive Board decisions

5. UNDP engagement in direct budget support and pooled funds is framed by decisions DP/2008/24 and DP/2008/29. The former decision “requests UNDP to give preference to engagement in direct budget support, in the form of sector budget support, as a signatory, without fiduciary obligation, taking into account the views of programme countries”. The Executive Board decisions emphasize the heterogeneity of country-led approaches and experiences, stressing national ownership as the basis for the configuration of UNDP support.[1]

6. Decision DP/2013/3, on the review of UNDP engagement in direct budget support, includes the following provisions:

[1] http://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/5809.pdf.

- 4. *Agrees* to maintain the changes in the rules and regulations, as contained in document DP/2008/36, for a subsequent pilot period, 2013 to 2014, in order to continue to provide country offices with the needed flexibility in a direct budget support environment, and for UNDP to gain different experiences from this work, recognizing that these rules and regulations may be further refined, with a view to strengthening transparency and accountability in the context of the harmonized regulations and rules currently under consideration at the United Nations;
- 5. *Requests* UNDP to provide a report, prior to the first regular session 2015 of the Executive Board, on the UNDP approach to assessing, prior to allocating funds, the full range of risks associated with the provision of direct budget support and pooled funding, and on the actions taken to continuously monitor and review those risks, with recommendations on the most appropriate approach to assessing the associated risks;
- 6. *Requests* UNDP to submit the evaluations and audits, as well as any refinement of the rules and regulations, for the consideration of the Executive Board at its first regular session 2015, in order for the Board to adopt a decision on continued UNDP engagement in direct budget support and pooled funding.

III. Assessing risk prior to allocating funds

7. Following the approval of DP/2008/36 and DP/2008/53, UNDP developed internal guidelines and procedures for country offices and headquarters units to steer and oversee engagement in sector budget support and pooled funding. These were reviewed and approved by senior management and published in 2009. The guidelines and procedures have been available in the public domain since January 2013.[2] This is part of the organization's commitment to transparency, a commitment that has been independently recognized for its overall excellence.[3]

8. The guidelines and procedures provide the basis for UNDP to ensure congruence with the approved policy and to manage risk before, during and after activity under the policy.

9. The guidelines explain what is and is not permitted in the following manner:

	UNDP can:		UNDP cannot:
A.	Support a standard project for policy advisory services and capacity development support	a.	Engage in general budget support, which is a general transfer of funds to the national budget to cover a fiscal gap
B.	Manage a pooled fund as a Managing Agent upon request by a government and thereby take full programmatic and fiduciary accountability in the interim (c.f. pooling funds for government.)	b.	Make financial contributions to direct budget support, be it a pooled fund or sector budget support fund that is not in its mandate areas
C.	Sign on to a sector budget support fund or a pooled fund as a non-fund provider or "signatory without fiduciary obligation", or becoming a non-signatory with observer status in the respective partnership group	c.	Transfer money into a pooled fund managed by others than a United Nations specialized agency, fund or programme
D.	Make a financial contribution to a sector budget support fund managed by a government entity (or Managing Agent per B above); or to a pooled fund managed by a United Nations specialized agency, fund or programme	d.	Engage as a financial contributor to a sector budget support or pooled fund, if the given conditions established by these corporate guidelines are not met

Source: (2009) UNDP engagement in sector budget support and pooled funding: guidelines and procedures for country offices and headquarters units, page 5.

10. The rest of this section highlights the main risk management features of UNDP participation in sector budget support. The report will *not* review the other three options available to UNDP country offices in detail.

2 https://info.undp.org/global/documents/ppm/SBS_and_pooled_funding.docx.

3 UNDP ranked first in the 2014 Aid Transparency Index with a score of 90.64 per cent: http://ati.publishwhatyoufund.org/donor/undp/.

Sector budget support

11. In accordance with the interest of the Executive Board, management draws specific attention to and places additional scrutiny on option D, in particular pages six and seven of the guidelines and procedures:

This option contains the most stringent terms of implementation:

1. Where it is not possible to become a "signatory without fiduciary obligation", UNDP may consider carefully the risks of transferring UNDP resources into a sector budget support fund managed by a government entity or a pooled fund managed by a United Nations fund, programme or specialized agency.

2. In addition to the principles stated [earlier in the guidance and procedures], the following must be present:

a. There is a strategic imperative, whereby the financial contribution can play a catalytic function and strengthen the advocacy, advisory and capacity development role of UNDP in this area;
b. There is certain demand for UNDP capacity development support through technical expertise or advocacy, or as trusted facilitator, rather than for our financial assistance alone;
c. There is clear indication that only a financial contribution will make it possible for UNDP to participate within the group of participating partners;
d. The results management, audit, monitoring and evaluation requirements, as agreed to by all the participating parties to the fund, do not contradict the principles and standards of UNDP;
e. Adequate capacity exists with the implementing partner to manage the fund; and
f. There is credible commitment to national capacity improvements in national systems for management, finance and oversight, where this may be lacking.

On page 37, the procedures specify the required documentation that must be submitted prior to any possible allocation of funds:

a. A cover letter summarizing the situation and justification for UNDP contribution;
b. An official government request;
c. A copy of the government programme for sector development or pooled fund;
d. Draft framework memorandum of understanding, if applicable;
e. Draft adapted cost-sharing agreement, if applicable;
f. Draft project document, which has been locally appraised;
g. Results of the systems-level financial management capacity assessment (the 'HACT [harmonized approach to cash transfers] macro assessment');
h. Results of the financial management capacity assessment of the implementing partner (the 'HACT micro assessment');
i. Minutes of local appraisal meeting signed by the Resident Representative.

12. Items d, e and f can only be submitted in draft form and are typically signed *after* headquarters clearances have been obtained and approved by the Associate Administrator. As per the guidelines, "*failure to provide all of the documentation detailed above will result in delay or even non-approval of a submission"* (emphasis added).

13. The UNDP approach is fully within the framework of the International Network on Conflict and Fragility (INCAF) of the OECD Development Assistance Committee (DAC), of which UNDP is a member. For these specific contexts, INCAF has defined the following framework that distinguishes between three types of risk:[4]

- **Contextual risk.** Risks of state failure, development failure, a humanitarian crisis.

[4] OECD/DAC (2011) 'Managing risk in fragile and transition contexts' OECD: Paris.

- **Programmatic risk.** Risk of failure to achieve programme aims and objectives or causing harm through interventions.
- **Institutional risk.** Risk to the aid provider, including security, fiduciary failure, reputational risk, etc.

IV. Monitoring and evaluation

14. Monitoring and reporting requirements are spelled out on pages 15 to 17 of the guidelines and procedures. The section on reporting requires:

> As a minimum, the country office should ensure it receives an annual financial breakdown of expenditures modelled on the following expense categories. These categories are consistent with International Public Sector Accounting Standards (IPSAS). Good practice also entails receipt of interim data at the same level of detail.
>
> a. Wages, salaries and employee benefits
> b. Consultants
> c. Supplies, consumables and equipment
> d. Grants and transfers
> e. Other expenses

15. Due to senior management's additional scrutiny on option D, procedural requirements for reporting include the following additional requirements on page 35:

> - In addition to the standard project progress reporting requirements, all UNDP country offices are requested to submit to their respective regional bureaux the annual progress and financial review report of the fund to which they are financially contributing. This must include the results achieved and status of expenditures for any such funds in order to enable UNDP to report to the Executive Board, according to the decision 2008/29.

16. Arrangements for Burkina Faso demonstrate heightened monitoring of risk. In addition to quarterly monitoring and mid-term reviews, the country office contracts an independent external audit firm to verify that resources are used according to the standards of financial management and in accordance with the guidelines and procedures. The Office of Audit and Investigations conducted a desk review of this funding mechanism in May 2014 and found no major concern at either country office and headquarters levels. The Regional Bureau for Africa also monitors project performance through a 'business intelligence dashboard' that provides clear and accurate information in every area – delivery in programme and management, audit and evaluation – and ensures that appropriate measures are taken to make adjustments if required. UNDP intends to adopt a similar approach for the Nepal case, which is in its first year of implementation.

V. Lessons

17. To date, two country offices have requested to participate in sector budget support through financial contributions prescribed by the pilot policy. These are Burkina Faso (2009 to present) and Nepal (2014 to present). The Burkina Faso case is sufficiently mature to provide insights for the purpose of this report.

18. By 2007, 36 per cent of public development aid in Burkina Faso was provided in the form of general budget support (29 per cent) and common basket funds (7.3 per cent). This trend continued into the period when the current pilot policy came into effect. With UNDP regarded by the government as an important partner in specific national sectors, the country office was invited to play a part through financial contributions to sector budget

support. This involvement is circumscribed by the requirements of option D of the pilot policy, and has therefore remained strictly limited from the start. The scope of engagement is described as follows:

> "The recent decision of the Executive Board of UNDP to authorize a four-year pilot period to allow the testing of budget support has allowed the country office to experiment with new modalities (basket funds) stressing the importance of national ownership and harmonization. In spite of this, the rigidity and heaviness of some corporate institutional procedures of UNDP are a constraint to these efforts."[5]

19. All evaluation and audits conducted in Burkina Faso found that the national executing body and the country office have complied with the guidelines and procedures for the pilot policy. Two issues have been highlighted to date that have a bearing on its efficacy: (a) the lengthy approval process of the direct budget support fund (echoing the findings of the assessment of development results (ADR)); and (b) the flexibility in setting the threshold ceiling which is capped at 10 per cent of the annual authorized spending limit of regular resources.

VI. Demand and outlook

20. In decision 2013/3, which comprises the most recent guidance on the issue, the Executive Board "recognizes that the primary value-added contribution of UNDP lies in supporting national capacity and policy development". Since the approval of the pilot policy for 2008-2012 and extension for 2013-2014, UNDP has continued to support national capacities for national development planning and the pursuit of the MDGs, and to manage development finance in an inclusive manner. Much of this support has taken place through conventional programmes and projects. In a small number of cases, it has happened with UNDP operating as a non-fiduciary contributor to sector-based programmes.

21. In the six years since the approval of the pilot policy, only two country offices (Burkina Faso and Nepal) have been called upon to pursue this option. At the time of writing, there is one potential use of this mechanism in support of mounting challenges confronting governments in in West African Ebola-affected countries, where shortage of resources and capacities may further delay the containment of the crisis.

VII. Recommendations

22. UNDP believes that the approach to risk management introduced in 2009 is in full congruence with the explicit and specific requirements established by the Executive Board. Tight centralized controls provide the correct balance for oversight of this pilot policy, in particular option D. UNDP further maintains the view that, while involvement in sector budget support may not be a core competency, its availability as a policy option will help it approach emerging demands should they arise.

23. The Executive Board may wish to consider a continuation of this policy on this basis, incorporating lessons from evaluations and audits of practices to date.

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[5] From the foreword of the Assessment of Development Results for Burkina Faso, 2009: http://erc.undp.org/evaluationadmin/downloaddocument.html?docid=3759.