

THE EFFECTIVE OF WORLD BANK PROJECT/ FINANCIAL MANAGEMENT REPORTING IN REDUCING RISKS

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Abstract- The study seeks to clarify why donors such as the World Bank still insist on the use of their financial management system rather than the recipient country's financial management system, despite the intention under the Paris Declaration 2005 to use the respective government's systems. The study then explores the reasons why the financial management system such as the Project/Financial Management Reporting (PMR/FRM) used by the World Bank is more effective in managing risks related to public financial management and aid as compared to the Government of Malaysia approach. The quality of reporting is based on the criteria by a study by Drebin, Chan & Ferguson (1981) on "Objectives of Accounting and Financial Reporting for Government Unit". Findings are based on evidence from its documentation and direct observations. The study demonstrates the significant roles in reducing risks played in the World Bank approach by the better financial management and procurement procedures using the PMR/FMR. The implication is that more effective risk management in financial management were needed by all implementers not in Malaysia but also will benefits other countries in managing risk such as fraud and corruption.

Keywords- Financial Management System, Financial Reporting, Procurement Procedures, Risk Anagement

I. INTRODUCTION

Managing public financial management system in an effective manner is the key in public finance. This is because it involves major sums of money collected from various sources through taxation incomes, grants and loans either from the public or even external sources such as donors like the World Bank and DFID. The funds collected will then need to be spent wisely and accordingly based on what has been planned in the budgetary processes. Campos, and Phadhan (1996), stated that a good public expenditure management should consists of three key objectives namely, fiscal discipline (expenditure control); allocation of resources consistent with policy priorities ("strategic" allocation); and good operational management. Unfortunately, there are many issues and problems related to public funds such as over-spending, underutilized and unauthorized expenditures which have been raised while contributing to the risks of public funds. The risks that had lead to the mismanagement of fund influenced the service delivery while it failed to achieve its main objectives by the government entities or bodies accountable for it. The issues were seriously discussed at both national and international level that had shown how weak the implementations of the financial management systems for government bodies or countries were. The condition will even get worse when it leads to the practicing of fraud and corruption without realizing it.

The weaknesses that had been identified by the World Bank (1998) in resource allocation and had been used that undermine public sector performance included poor expenditure controls; inadequate funding for operations and maintenance; little relationship between the budget as formulated and the budget as executed; poor cash management; inadequate

reporting for financial performance; and poor cash management. All the weaknesses were in relation to the financial management systems of the country. Furthermore, according to Schick (World Bank, 1998), the central budget agencies have to take the lead in putting the basics in places to support all three functions of the budget which are control of public resources, plan for future resource allocation and management of resources. For instance, in the case for Aid Effectiveness, as in a study by Brooke (2003) confirmed that most countries that requested for funding from international organizations were countries that had poor financial management systems. Brooke (2003) added that in order to overcome the weaknesses in the country's financial management systems, the development agencies typically require governments to take measures to reduce the likelihood of fund being wasted or misappropriated in both the short and long terms. This also included the additional measures or parallel systems that may only apply to donor funds. This is supported by Caiden (1980) that stated, not surprisingly, countries heavily dependent on aid are more likely to have weak PEM. Caiden added that major problems emerge from priorities (not only between a donor and a country, but between donors and the poor coverage of aid funding in the budget. The weaknesses are not newly discovered. In 1980, Caiden wrote: "If ever there was a subject who has been overwritten, overanalyzed and overtheorized with so little practical result to show for the effort, it is budgeting in poor countries."

II. MOTIVATION OF THE STUDY

The issues on poor management of public fund have been discussed earlier by the international bodies has also been brought up to the attention of the general

public in Malaysia. For instance, the Auditor General Office of Malaysia keep on highlighting the bad cash management and reporting among government ministries and agencies despite warning year by year. Subsequently, this development had caused a lack of public confidence towards the management of public funds. For instance, in project management most of the setback were due to shortage of funds, delay in payments to the contractors and suppliers, cost overruns of certain projects, and also delays and failures in supplying quality equipment to the respective schools and institutions even though the personnel involved in managing the projects were selected staffs appointed through the Department of Public Services of the Prime Minister Department.

III. STUDY OBJECTIVES, RESEARCH QUESTIONS AND HYPOTHESES

3.1 Objectives of the study

The objective of this study is to explore and analyze the effectiveness of financial management systems particularly the World Bank Project/Financial Management Reporting (PMR/FMR) in managing risks such as fraud and corruption using in the ESSP. This study is also trying to proof the effectiveness of the reports as been claimed by the World Bank.

3.3 Research Questions:

In order to achieve the above, the following research questions are relevant to this study as guidelines to the researcher. The research questions is 1. The criteria used proof the effectiveness of World Bank approach in managing risks.

IV. RESEARCH METHODOLOGY

The evaluation is carried out with reference to the study by Drebin, Chan & Ferguson (1981) on "Objectives of Accounting and Financial Reporting for Government Unit".

The purpose of using the two various studies between the study by Drebin, Chan & Ferguson (1981) on "Objectives of Accounting and Financial Reporting for Government Unit" is because it provide a better overall view for the researcher to use them as the basis for effective financial management system related to public financial management and aid in the public sector. The effectiveness is based on the PMR/FMR used in the ESSP in the 8th Malaysian Plan.

V. KEY FINDINGS

The results related to how effective the World Bank financial management system were compared to the Government of Malaysia approach in reducing risks in the ESSP. The financial management system in this study focuses on the procurement procedures which were highlighted and debated in the Paris Declaration 2005 are based on the hypothesis set for

this study that the project financial management systems. The study found that the procurement procedures were more effective in reducing risks in the World Bank approach as compared to the Government of Malaysia are as followings:

In analyzing the effectiveness of the reports in reducing risks, 5 criteria been used from the study by Drebin, Chan & Ferguson above. The results revealed the followings:

Short-term financial resources

he short-term financial resources aims to provide financial information that are useful for determining and predicting the flows, balances and requirements of short-term financial resources of the governmental unit involved in the ESSP (1981: pg 126)

The 'Opening Cash' and 'Closing Cash' Balances in the Sources and Applications of Funds by Activities (Report 1-A) is very useful as a basis for ensuring the amount of 'cash in hand'. This serves as an important indicator in monitoring flows as sufficient amount of cash helps to fulfil short-term demand situations.

In addition, Report 1-A also disclosed the actual and planned expenditure amount for the current project with the variance analysis column if any. This is very useful in assisting the user in predicting the outflow of funds more accurately. The content of Report 1-A is also applicable in Annex 1 and Annex 2 as prepared by the sub-implementers. In addition, Report 1-A is also coordinated with Report 1-C known as the 'Special Account'. The 'Special Account' showed the amount of 'Cash in hand or bank'. This is to ensure that the amount of cash can be easily monitored and made available in anticipation of over-spending and meeting any future shortage of fund of future obligations especially in the short-term aspects. Therefore, expenditures were to be disbursed based on cash requirements rather than a result of uncontrolled spending.

The 'Special Account' also assisted the implementers especially the project accountant to prepare the Report 1-D of the PMR, known as the 'Project Cash Forecast for cash requirement' for the next two quarters. The 'Project Cash Forecast for cash requirement' is part of a financial management tool in ensuring that the funds are available on requests which may help to avoid other impacts such as project delays and poor quality workmanship of buildings. The delay in payment as a result of the shortage of funds will also adversely affect service delivery planned earlier.

The effectiveness of the above reports in the World Bank approach is supported with the evidence from the interview with 8 respondents who prepared the Annex 1 and Annex 2 in managing cash flow for short-term requirement. The respondents stated that the reports Annex 1 and 2 were very useful in assisting them to predict the needed amount for short-term obligations. This is because the reports themselves are very detailed containing the opening balance, allocation amount, the expenditure incurred

and planned as well as closing balances. The reports were also fruitful as a management tool for project cash requirement for any expenditure incurred. They also agreed that the reports assist them in monitoring the progress of their respective projects or programs both financially and non-financially (Source: Appendix A – Interview Session).

Economic condition

Can the PMR provide financial information useful for determining and predicting the economic conditions of the governmental unit and changes therein (1981: pg. 127)

As the project life will take more than a year, it should have a long term economic value. Likewise, a full disclosure of the projects through reporting will be helpful in determining the value and predicting the potential resources for future outflows which results from existing commitments.

Can the PMR provide financial information that are useful for monitoring performance under terms of legal, contractual and fiduciary requirements? (1981: pg.127)

This objective refers to the need of the project by programs or activities which are paid according to the terms of agreement in the contract. It ensures that the report is useful for monitoring the progress payment made to the respective project in accordance with the legal or contractual requirement.

The comprehensiveness of the main PMR/FMR is useful for project monitoring that only authorized projects or programmes will be paid for when demanded. For example, The Progress Report for Procurement of Works (Report 2-A), Progress Report for Procurement of Goods (Report 2-B) and Progress Report for Procurement of Consultants (Report 2-C) showed the name of the contractors/suppliers and contract references. In addition, as it was complemented with the other reports, i.e. in the case where any charges for payments would also be noted in the Project Cash Withdrawals (Report 1-B) and on the allocated projects or programs or activities (Report 1-A). Any unauthorized charges can be detected when the balance of the reports did not match each other. This also applies to the expenditure in the Annex 1 prepared by the implementers of the World Bank financing.

Therefore, the consistency and the comprehensiveness of the reports will assist in ensuring that only authorized and approved programs or projects were accounted for the payments made. This measure assisted in avoiding any misleading of fund to unauthorized activities or programs. It avoids risks in mismanagement of fund such as in the case of 'virement' and non-authorized projects or activities as well. Furthermore, it will be very useful for the auditors to proceed with their auditing duties.

Planning and Budgeting

Can the PMR provide useful information for planning and budgeting, and for predicting the impact of the acquisition and allocation of resources on the achievement of operational objectives? (1981: pg. 128)

In achieving the above objective for planning and budgeting, the result showed that the reports in the main PMR consisting of Report on Project Sources and Uses of Funds by Activity (Report 1-A); Report on Project Cash Withdrawals (Report 1-B); Report on Special Account Statement (Report 1-C); Procurement and Progress Report on Execution of Works (Report 2-A); Procurement and Progress Report on Goods (Report 2-B); and Procurement and Progress Reports on Consultants Services (Report 2-C) provided very useful financial information for the Project Accountant to prepare the Project Cash Forecast (Report 1-D) for the purpose of financial planning and forecasting.

In the Project Cash Forecast (Report 1-D), the financial for cash requirement for the next two quarters is accounted for. The report also has the current closing balance as in the Report on Special Account Statement (Report 1-C), and is useful in determining the amount of additional cash required for the next two quarter based on the expected financial planning and forecasting. Through this mechanism the implementers can avoid mismanagement of cash in hand or in the bank especially at the end of the year.

In addition, the respondents recommended that the reports be used in other non-World Bank financing in the future. This is because the reports themselves provided critical information in determining the cost of programs, functions and activities in such a manner that they facilitated analysis and provided valid comparisons with established criteria, within specific time periods set, and with other governmental units.

Financial Reporting

The PMR in the World Bank approach was prepared and updated on a monthly basis even though the report needed to be submitted quarterly to the World Bank. The practice of monthly reporting was done and presented by the Project Accountant and sub-implementers in the PCC meeting. The report generated financial and non-financial information discussions on the current status or progress of the projects implemented.

VI. IMPLICATION

The issues on the weaknesses of a country's financial management system had raised concerns among funds donors and consequently this had affected their stand on aid contributions. These issues had been deliberated in the Paris Declaration 2005 and various strategies and recommendations were

proposed to tackle and overcome them such as, by strengthening a country's financial management system.

It is expected by the year 2010 that the objectives set and agreed upon in the Paris Declaration by participating countries will be achieved. In the review of related literature, the results on the Performance Evaluation by PEFA in 2008 had shown that indicators for efforts taken to enhance and to improve the financial management system of most countries were still weak and at a minimal level of improvements. The Performance Evaluation results reflected the weaknesses that still plagued most of the country's financial management system which continues to be of concern to the fund

donors. Is a country's financial management system in relations to project implementation and monitoring, financial reporting and procurements effective enough in reducing risks such as fraud and corruption?

As the role and importance of financial management system in managing risks became clearer, other approaches such as the „Financial Management Capacity Model“ by the Canadian Treasury had been introduced to strengthen the role played in improving the capability of countries to improve their own financial management systems. This is further correlated with the study by Brooke on aid management, the World Bank (2005) as well as the studies by Hallak and Poission (2006) and Ochse (2004) who agreed that the standardized financial procedures, procurements procedures, financial and management accounting, monitoring and auditing served as a practical basis of mitigating risks such as corruption in financing education.

CONCLUSION

The effectiveness of financial reporting in managing risks can be substantiate and evaluated through the standard and criteria in the study by Drebin, Chan & Ferguson on 'Objectives of Accounting and Financial Reporting for Government Units' (1981) Among the criteria met in the World Bank approach is that the PMR have disclosed useful information both from the financial and non-financial data gathered for short-term financial planning and forecasting, project or program monitoring, and performance evaluation.

They served as key performance indicators that proved useful for those involved especially the top management in decision-making purposes. This simultaneously reduces the risks of the fund being mismanaged and aid in the preparation of the annual financial statements or reports. The comprehensiveness and transparency of the reporting

was also useful for internal control systems and served as a good basis for a move to accrual accounting as it can reduced the risks in managing public funds such as shortage of funds, fraud and corruption.

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