

AusGuideline

Activity design

3.8 Designing and using Flexible Funding Accounts

Associated guidance on 'Activity design'

Part 3A *Identification & assessment of initiatives*

Part 3B *Preparing activity designs*

Part 3C *Appraisal and Approval*

AusGuideline 3.1 *Principles of activity design*

AusGuideline 3.2 *Selecting forms of aid*

AusGuideline 3.3 *The logical framework approach*

AusGuideline 3.4 *Undertaking a prefeasibility study*

AusGuideline 3.5 *Undertaking a feasibility and design study*

AusGuideline 3.6 *Preparing draft scope of services and basis of payment*

AusGuideline 3.7 *Preparing activity schedules*

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Abbreviations

AusAID	Australian Agency for International Development
CFO	Chief Financial Officer (AusAID)
FFA	flexible funding account
FMA	<i>Financial Management and Accountability Act 1997 (Cwlth)</i>
MOU	memorandum of understanding
NGO	non-government organisation
ROU	record of understanding
SPF	specific-purpose fund
UFU	unconditional financial undertaking
VAT	value-added tax

Glossary

Community development fund	A specific-purpose fund (SPF) which provides monies to members of a local community or to community-based organisations for development purposes, other than as a private business enterprise. This excludes schemes such as Small Activity Scheme and Australian Community Assistant Schemes as funds provided to these are ultimately, accountable directly to AusAID.
Counterpart agency	An agency that is part of the partner government, whether at the central, provincial or local level.
Imprest account	An account holding funds under an imprest mechanism. Includes funds contributed by counterpart agencies.
Imprest mechanism	A mechanism to reimburse the SPF, either to the maximum limit or by a set amount, upon the receipt of evidence of expenditure when either a minimum limit or a given period of time is reached. Used where the partner government agency controls the bank account and thus is governed by the partner government's legislation.
Specific Purpose Account	Bank account established for a specific purpose, eg community development fund or revolving credit account. The bank account is governed by the contractual arrangements (ie contract, funding agreement, memorandum of understanding or record of understanding).
Non Specific Purpose Account	The delivery organisation's own normal operating bank account. The bank account is governed by the contractual arrangements (ie contract or funding agreement).
Delivery organisation	An organisation that is under an agreement to deliver Australian Government overseas aid. It includes Australian contractors and other organisations, such as Australian Government departments and institutions, both in-Australia and in-country non-government organisations, community based organisations and multilateral organisations.
Revolving credit account	A bank account from which loans are made and to which repayments are made.
Trust fund/account	A bank account holding funds in trust for a particular beneficiary, or purpose (for charitable purposes). Used for stand-alone arrangements and operates under a trust – a legal device where legal title of property

(eg finances) is vested in a trustee on behalf of another person, or purpose (for charitable purposes). Trust funds/accounts are governed by trust law.

1 Purpose of a FFA

Flexible funding accounts (FFAs) are an integral part of the Australian aid program. A FFA is one funding arrangement available to support the effective delivery of an aid activity that can be a project, a financial transfer (but not budgetary support) or, in some circumstances, a program, a sector-wide approach or a facility.

In simple terms a FFA is a banking arrangement established to make funds available for local expenditure as part of an AusAID-supported development initiative. The overarching definition of a FFA is

... any funding arrangement, whether with a private bank or a counterpart account established specifically to facilitate the expenditure of funds for an AusAID activity ...

The types of FFAs are imprest accounts, trust accounts, specific purpose accounts and non-specific purpose accounts. Facilitating revolving credit accounts and community development grants are examples of the reasons for establishing a FFA.

A FFA is held separately from the partner government's consolidated revenue or the working accounts of the delivery organisation so that the expenditure can be accounted for and transparently managed to meet the specific purposes of the activity. FFAs are not held by AusAID. If an area in AusAID wishes to establish such an account, they must discuss and gain approval from the Chief Finance Officer (CFO).

2 Risks and benefits of a FFA

An AusAID-funded activity does not have to have a FFA. It is important to consider the risks and costs as well as the benefits of establishing a FFA when addressing how an activity can be most effectively managed.

The risks of establishing a FFA include

- possible failure to achieve the activity's objectives due to AusAID's loss of control over funds used for day-to-day development work
- loss/misuse of financial and other assets
- increased costs associated with managing and monitoring the activity as a result of using a contractor to meet, for example, extra financial management and reporting requirements associated with a FFA, and

- possible confusion in roles and responsibilities and failure to achieve activity objectives due to increased complexity if both the counterpart agency and the implementation contractor are involved in managing the FFA.

For more detail on risks with FFAs see Section 4.1, 'Risk assessment and management'.

The benefits of establishing a FFA may be in some instances

- increased control of funds by the delivery organisation/counterpart agency, thereby facilitating activity effectiveness
- shared activity risks between the counterpart agency, the delivery organisation and AusAID, and
- increased continuity and flexibility of funding.

If the activity manager decides not to use a FFA the opposite applies – the risks and benefits stemming from a FFA are removed.

3 Deciding whether to use a FFA and choosing its management model

3.1 The decision process

Chart 1 illustrates the process involved in deciding whether to use a FFA and, if one is to be used, who should manage it, taking into account AusAID policies on transparency and accountability. Advice must be sought from an appropriate sector advisor, CFO and AUSP during the decision process below or by writing terms of reference to obtain advice from a specialist financial advisor.

The first decision is whether to use a FFA. In order to decide this activity designers need to consider

- is the proposed aid mechanism (eg project, program, sector-wide approach) appropriate for a FFA?
- are the Activity Objectives better served by a FFA?
- does the activity need to procure goods and services (for example raw materials for construction, but not administrative goods such as office supplies)? Such procurement must be substantial.
- does the activity provide grants to Community-Based Organisations?

- is the timing and frequency of payments, and the counterpart's or delivery organisation's cash resources and access to cost efficient finance important? (That is, does the FFA meet value-for-money requirements under FMA legislation?)
- does the legal system allow the use of a FFA? (For example, are trust accounts a legal instrument in the partner country?)
- do the benefits of establishing and managing a FFA outweigh the administrative costs in managing the associated risks?

To assist further in these considerations, FFAs are not appropriate when

- the aid mechanism is budget support
- the counterpart does not have cash resources or access to cost effective finance, and/or
- the legislative requirements or the risks to the FFA's operation will lead to financial costs that are considered prohibitive.

If it is decided that a FFA is appropriate for the aid mechanism, then the activity designers need to consider the prospective delivery mechanism – for example contractor, NGO, multilateral. FFAs can be managed by

- the counterpart agency, or
- an NGO or community-based organisation, or
- the delivery organisation (contractor, Australian Government department and institution, and in some circumstances a non-government organisation (NGO) in Australia or multilateral organisation) if the legal system prohibits the use of FFAs by the counterpart agency or the counterpart is considered too high risk, or
- jointly by the counterpart agency and the delivery organisation.

Note, not all counterpart agencies, NGOs and multilateral organisations have the legal framework to establish and/or operate every type of FFA. Where this is the case, the delivery organisation will be a contractor, or Australian Government department and institution, or a NGO or multilateral organisation that has a legal charter that allows the establishment and operation of FFAs.

Included in the decision of the appropriate delivery organisation is whether funds ownership by the counterpart agency is preferred. For this the activity designers need to consider the risk and activity objectives. Other considerations are

- do the benefits of counterpart involvement outweigh the costs?
- do the financial and legal systems allow the use of FFAs by the counterpart? and
- does the counterpart agency have the capacity – that is resources, appropriate financial systems or skills required to operate a FFA?

Where funds ownership by the counterpart is not preferred, the choice of delivery organisations will be as listed above. **The contract must clearly allocate full responsibility for the financial management and control of the FFA to the delivery organisation** and the fees payable to the contractor should reflect the costs of management.

The counterpart agencies may not be involved for the following reasons

- the country's financial and legal systems may not allow a FFA to be established and managed by a counterpart agency, or
- the counterpart agency does not have the resources even though it may have appropriate financial systems and skills.

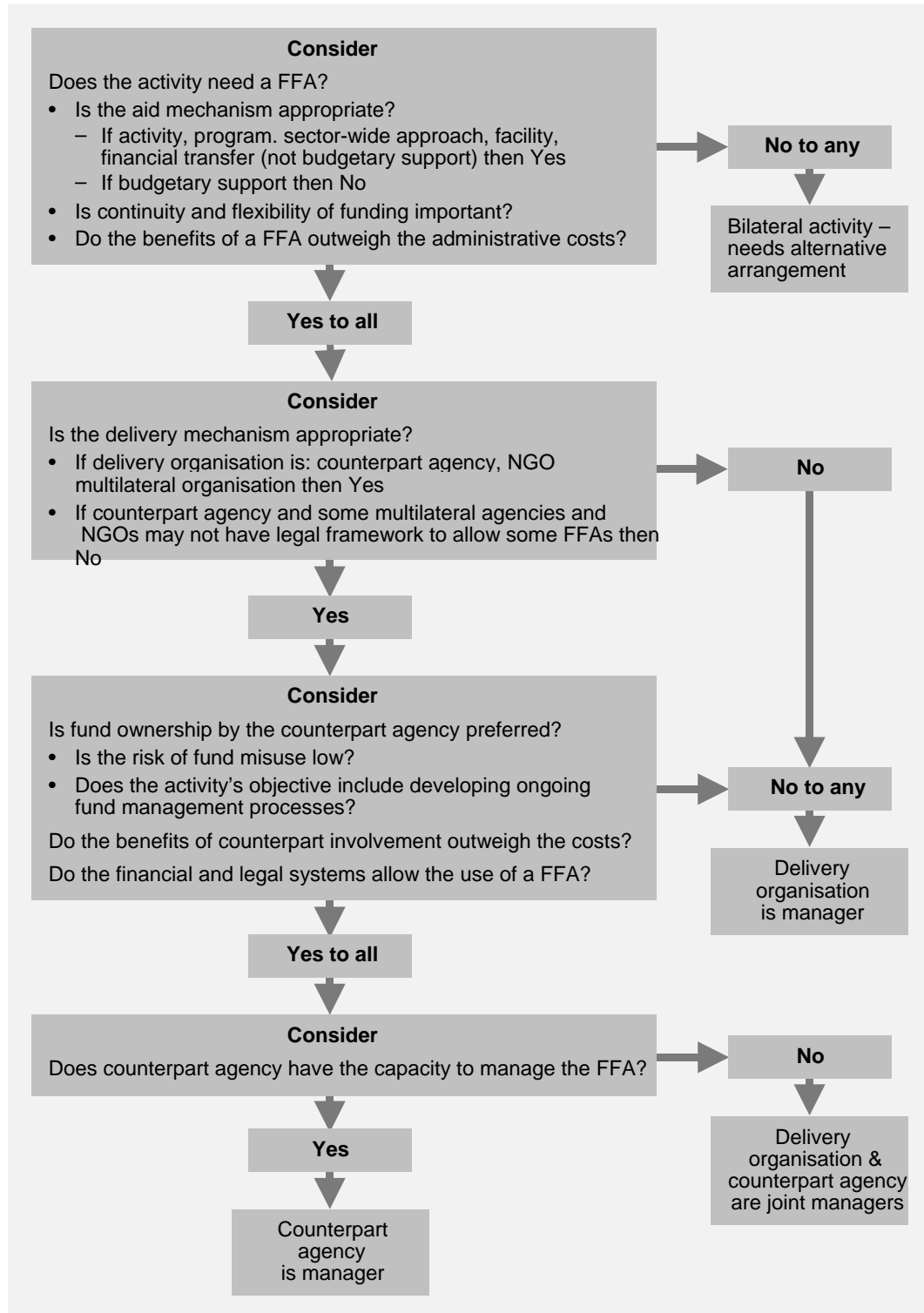
If counterpart involvement is preferred then whether the activity/FFA is managed by the counterpart solely or jointly with another delivery organisation will depend on (and in the case of joint managed division of responsibilities, depend on)

- the size and complexity of the activity
- the counterpart agency's resources
- the counterpart agency's financial and accounting systems and processes, and
- the risk management strategy for the activity.

Where the counterpart assumes full responsibility **the agreement, which is the Memorandum of Understanding (MOU), must detail the risks and outline the controls that are considered necessary for effective and responsible management of the funds.** If the counterpart agency is not to be involved, then AusAID should engage a delivery organisation, such as an implementation contractor, and not have the counterpart agency involved.

Finally, if a FFA is appropriate, the activity designers need to consider which type of FFA would be best for the circumstances – for example, a trust fund or imprest account. Each type of FFA has different purposes and different operational features with their advantages and disadvantages. Appendix A, 'When to use types of FFAs', summarises situations when to use or not use the different types of FFAs.

Chart 1 Process for deciding whether to use a FFA and who should manage it



3.2 Key features of FFA management

Whatever the FFA management model chosen, it must include the following features

- management effort that is appropriate to the risk profile and the management costs
- well-defined management roles and responsibilities for the delivery organisation and/or the counterpart agency, and for the AusAID post and desk
- strict criteria for using the funds
- sound planning systems linked to the overall activity design
- clear financial management processes, particularly for approving the use of the funds, and
- simple and appropriate reporting requirements to monitor and acquit funds.

4 Key considerations for FFA arrangements

4.1 Risk assessment and management

For detailed information on AusAID's risk management principles and practices, see AusGuideline 6.3 *Managing risk*.

The most important considerations in establishing FFA arrangements are the risk assessment and the appropriate processes for managing the identified risks. The risk assessment, undertaken by the team designing the activity, should include a comprehensive analysis of the proposed activity's objectives, size and complexity and the counterpart agency's capacity (its resources, processes and procedures). If the risk assessment indicates that a FFA is not practical or that its risks would exceed its benefits, alternative funding arrangements would need to be assessed.

After the risks have been identified they are documented in a risk management plan in the format of a risk matrix (see AusGuideline 6.3). This plan requires ongoing monitoring and updating as the activity progresses. This is to ensure that the risks identified at the design stage, and any new risks identified during the activity implementation, are managed in an appropriate way.

Significant risks require sound and robust controls in the activity design. Controls are features, such as policies and procedures, that proactively ensure objectives are achieved and that risks are detected and/or prevented. Appendix B, 'B Design and implementation risks to be considered', summarises the control or design features that can be put in place to manage risks affecting a FFA. The risk management plan should consider these features.

At the strategic level **AusAID must consider the type and level of risk it is willing to accept** and, therefore, the level of detail needed in specifying the controls. The level of detail included in the activity design documentation influences the management effort and therefore the costs associated in administering a FFA.

Not all risks need to be actively managed. Strategic-level risks require consideration of the overall political environment in the partner country and any experience there with the financial management of aid activities. **The risk assessment must identify not only the risks that may affect the activity, but also the likelihood and consequence of a particular risk occurring.** The management effort then focuses on significant risks with a higher probability of occurrence.

When determining FFA arrangements at the design stage, attention is focused on the more practical decisions to be made in response to the risks identified in setting up and managing the activity's funds – for example, which processes and procedures need to be documented and what they should include. The risk management plan will allocate responsibility for the operational risks to the implementation contractor and/or the counterpart agency, as appropriate.

4.2 Review of counterpart capacity

The counterpart agency's capacity to manage a FFA is initially assessed as part of the risk assessment process when an activity is being designed.

If the activity's design assigns management or a lead role in joint management of the FFA to the counterpart agency, if the activity's funding is considered significant and if the political environment carries a perceived risk, the design appraiser should consider a due diligence review of the counterpart agency. AusAID can undertake the review using in-house resources or contract consultants with financial expertise.

Such a review should identify the agency's technical, logistical and financial management strengths and weaknesses and its recommendations should be taken into account in the risk management plan.

If the counterpart agency is assessed as rigorous enough to allow AusAID to meet its accountability requirements, the agency should use its own accounting system, codes and procedures. If improving the counterpart agency's accounting practices is a stated aim of the activity, the activity design must explicitly incorporate institutional strengthening components and financial management training. In this way, the activity provides the opportunity to promote the sustainability of activity benefits.

4.3 Roles and responsibilities

The roles and responsibilities of FFA managers depend on the initial risk assessment for the activity and the fund ownership and management structures specified in the activity design documentation and confirmed in the contract/MOU. Appendix C, 'C Roles and responsibilities in FFA management', summarises the roles and responsibilities of FFA managers and AusAID.

If the **delivery organisation** is fully responsible for managing the FFA it may be required to provide an unconditional financial undertaking (UFU). The necessity for and level of any UFU should be determined giving due consideration to the average and maximum amount of funding in the account at any point of time; the level of controls established and the risk profile of the FFA; the cost of the UFU; the terms and conditions in the contract and the adequacy of the delivery organisations financial systems and controls. If the contractor plays a lead role in jointly managing the FFA, in practice the contractor still carries most of the responsibility. See Table C1 for a list of the delivery organisation's key responsibilities.

For details on contractual responsibilities, see AusGuideline 3.6, Preparing draft scope of services and basis of payment. The desk officer should refer to this guideline when preparing the scope of services for the contract. The Australian Partners Branch of AusAID is responsible for writing the basis of payments in the contract.

Generally funds ownership is a function of the type of FFA used – for example, trust accounts transfers legal ownership to trustee and eventually the beneficiaries. If the **counterpart agency** is manager of the FFA, it would normally control the funds. Its key responsibilities are listed in Table C2. **If there is more than one counterpart agency, the MOU must clearly articulate which agency has responsibility for what** to avoid any risk of loss or incorrect expectations. This may mean specifying which agency is responsible for a particular set of activity components or for a particular dollar amount.

If the funds are jointly managed by the **delivery organisation and the counterpart agency** the activity design documentation should clearly set out the operating procedures for the FFA and detail the responsibilities of each stakeholder. These details should be confirmed in the contract and MOU. Table C3 lists their key responsibilities.

If an activity has multiple donors and sources of counterpart funding, which is common in a devolved political environment, **the delivery organisation/counterpart agency must maintain records that indicate the funding source and how those particular funds have been expended.** The contract/MOU will need to specify consistent reporting formats to allow the activity's funds and the progress of its components to be tracked. To report on multiple sources of funding, it is not necessary to establish a separate bank account for each source. A

subledger account in the delivery organisation/counterpart's system or even a separate cashbook is sufficient.

AusAID's role in FFA management is to address strategic activity issues and to monitor progress against the objectives of the activity and compliance with contractual requirements. AusAID's key responsibilities are summarised in Tables C1 to C3 and include

- allocating and disbursing the activity's funding
- managing the contract/MOU
- monitoring compliance with contract provisions regarding the *Financial Management and Accountability Act 1997 (FMA)* and its regulations, as well as adherence to procurement guidelines and to governance and risk management principles
- monitoring the physical progress of the activity
- liaising with the delivery organisation/counterpart agency, as required, to ensure appropriate management to facilitate the disbursement of funds
- monitoring the activity and financial reporting to ascertain whether it is adequate and conforms to contract/MOU requirements, in order to facilitate the release of Commonwealth funds to the FFA
- providing adequate hand-over of documentation between AusAID activity managers when an activity is transferred within AusAID from one activity manager to another; and
- undertake audits as required, to facilitate compliance with Commonwealth legislation and regulations.

4.4 Funding options

Funds can be disbursed from a FFA in one of three ways

- reimbursement based on proof of valid expenditure prior to subsequent fund releases
- periodic/progressive funding for a clearly defined activity or its components as defined in the contract, funding agreement, ROU, MOU, or
- payment of invoices for goods and services procured by the counterpart/beneficiary.

The option chosen should be linked to the requirements of the activity and the initial risk assessment. Generally, the amount of documentation required and the level of its detail are higher for full reimbursement than for periodic/progressive funding. Whichever option is chosen, **the FFA manager must demonstrate sound financial practices** to ensure accountability to AusAID for the money expended.

4.4.1 Reimbursement of funds

Generally speaking, the reimbursement of funds is the appropriate option for an activity that is well designed, has a defined total cost, is to be undertaken over an extended period and

requires tight control over the funds. If the implementation risks are high, the FFA would have to be closely monitored. The contract/MOU may also specify that the delivery organisation/counterpart agency submit a costed proposal of the work program.

4.4.2 Periodic/progressive funding

Periodic/progressive funding is appropriate for an activity that is managed by an NGO or a community-based organisation in the partner country. If funds are to be provided through multiple advances during the life of the activity on a periodic/progressive basis, **the activity design documentation and contract/MOU must set up a procedure that requires a satisfactory level of reporting and acquittal of advanced funds prior to further advances.**

4.5 Institutional arrangements

The institutional arrangements for a FFA vary from activity to activity and from sector to sector. The arrangements depend on the number of stakeholders and the levels of government involved.

A simple arrangement for a FFA would involve only one bank account and a fairly straightforward approval process. A complex arrangement would involve linked bank accounts. **If there is more than one account, the contract/MOU must clearly define the structure and relationship of the accounts.** All subsidiary accounts are subject to the same accountability requirements as the primary account.

5 Managing a FFA

Basic FFA management involves regular monitoring and reviewing of not only accounting systems and procedures, but also overall performance, including

- the progress of activity implementation against schedules
- the efficiency of the FFA in converting limited inputs to outputs
- the effectiveness of the FFA in achieving expected outcomes and objectives
- the development impacts of the FFA – positive and negative, expected and unexpected, direct and indirect
- important risks and assumptions associated with the FFA
- compliance with financial and audit requirements
- the management of funds and procurement, and
- the potential for fraud and the reporting of incidents of fraud.

A significant proportion of FFA management problems arise from poor risk assessment and design. Problems common to current FFAs can be attributed to some of the following failures

- the FFA's purpose and the work program it supports have been poorly defined
- the FFA's objectives and arrangements are outside the counterpart's core business
- the design has overestimated the counterpart agency's capacity to manage the funds
- for a FFA jointly managed by the delivery organisation and the counterpart agency, their respective roles and responsibilities have not been realistically defined or adequately specified in the activity design documentation and subsequent contract and MOU, and/or
- AusAID, or the delivery organisation, has 'overmanaged' the activity or its components that have a low risk profile.

5.1 Updating roles and responsibilities

As already made clear in Section 4.3, establishing and managing a FFA are the responsibilities of the delivery organisation and/or the counterpart agency.

The initial allocation of FFA management responsibilities based on the risk assessment undertaken during the activity's design stage needs to be re-evaluated throughout the activity's lifetime and may lead to changes in responsibilities as the activity's risks evolve during its implementation. Major implementation risks include the following

- the work program is completed but does not achieve the activity's objectives
- the work program is not completed
- activity funds are expended on non-activity items
- activity costs exceed the budget
- the activity extends beyond the envisaged finish date
- the perceived loss of control of activity funds that are managed by stakeholders, and
- the activity's financial transactions are inadequately documented.

Annex B, Table B2, includes examples of the controls and processes that can be put in place to manage such risks.

As part of the annual plan process the implementation contractor should be required to regularly review the risk matrix and adjust the risk matrix and the controls to manage risks to ensure that the management processes are appropriate over the lifetime of the activity. It is generally good practice to review the risk matrix at least twice a year or at key stages in the activity such as when major milestones are reached or the operating environment changes (for example, the partner country's political leader changes or an international event is relevant).

5.2 Developing financial operating procedures

When setting up a FFA, a manual that sets the minimum standard of operations for the FFA must be developed before any funds are provided by

- the delivery organisation if there is no counterpart agency involved or if the counterpart agency does not have the skills or resources to prepare the manual in a timely manner, or
- the counterpart agency if it has the skills and resources to undertake the task in a timely manner.

AusAID officers are not responsible for preparing the manual but, if required, should have the manual reviewed prior to commencement of the FFA by either an in-country auditor or one of AusAID's in-house contract panel auditors. However, they can assist the delivery organisation or counterpart agency by demonstrating the minimum standards expected in the operating procedures. Appendix D, 'D CHECKLIST for FFA financial procedures', indicates the important points the procedures should address.

5.2.1 Standardisation of procedures

The FFA procedures should be the same as, or at least similar to, those common to all (or most) activities in the sector in which the proposed activity will operate. If the FFA procedures are not congruent with mainstream financial management practices, they will contribute to weakening overall accountability.

5.2.2 Selection of the bank services

As when procuring any service, the delivery organisation/counterpart agency should ensure that the activity receives value for money and should seek competitive interest rates and charges. The contract/MOU should require the contractor/counterpart agency to

- ensure that the bank is reputable
- negotiate rates and charges prior to establishing the account(s)
- ensure that the FFA account(s) comply with any local legislative and regulatory requirements, and
- ensure that banking services are available with the same institution for any subsidiary accounts outside major centres, as transfers between different financial institutions can be difficult or costly.

5.2.3 Foreign exchange issues

Under Government policy, AusAID is not permitted to hedge foreign exchange risks. **If activity funds are owned/controlled by AusAID, approval of foreign exchange arrangements above**

AUD\$1 million must be sought from the Chief Finance Officer. If the funds are controlled by the contracted delivery organisation and/or the partner government, foreign exchange arrangements are the responsibility of the managing contract or partner government in accordance with the contract/MOU. **All foreign exchange transactions must be conducted in accordance with the FMA and any other relevant Commonwealth legislation.**

5.2.4 VAT and other tax issues

Value-added tax (VAT) is payable in many countries where AusAID-funded activities are undertaken. Without commenting on any specific taxation regime, normally an activity can reclaim VAT paid when local goods and services are purchased. Some countries may allow an AusAID activity to be exempt from VAT (commonly referred to as a zero-rated activity). This is determined in either the activity-specific MOU or the umbrella agreement for the aid program to each country.

If no exemption has been granted, the delivery organisation/counterpart agency must prepare and lodge VAT returns with the relevant taxation authority in order to claim a refund. If an activity has been costed at net costs (exclusive of VAT), failure to claim a refund can result in expenditure overruns, as costs will be greater than budgeted for.

As part of sound management practice

- the activity design documentation, and subsequent contract/MOU, should require the delivery organisation/ counterpart agency to register with the relevant taxation authority, and
- the FFA procedures manual should outline the necessary steps to regularly and accurately lodge VAT returns, and identify the responsible person.

5.3 Following management practices

AusAID policies and guidelines provide the framework for managing (and monitoring) a FFA.

5.3.1 Annual plans

The activity's annual plans are the basis of FFA funding and expenditure. Within one month of the start of an activity in the partner country (or as stated in the contract), the delivery organisation must develop and submit the first annual plan to AusAID. Thereafter, consistent with normal requirements, each annual plan must be submitted three months before the start of the next financial year. The activity design documentation, the activity-specific MOU and the contract (or other delivery agreement) are the basis for an annual plan, which is prepared in close consultation with the counterpart agency in the case of a joint activity. The activity

manager coordinates AusAID's review and assessment of each plan, addressing issues as they arise. The annual plan should report against, review and update the activity's risk management analysis, risk matrix and risk management plan.

In preparing an annual plan, the delivery organisation or counterpart agency must consider activity cash flows and specify the currency of the tranches, any other funding amounts and acquittal procedures.

For details on the preparation, consideration and approval of annual plans, see AusGuideline 4.4, *Preparing an annual plan*.

5.3.2 Procurement guidelines

When FFA funds are to be used to pay suppliers of goods and services, the tender process and the associated management of suppliers and contractors need to be carefully assessed by the delivery organisation/counterpart agency. The contract of the delivery organisation should include the need to adhere to the Commonwealth Procurement Guidelines. Similar advice may be included in the counterpart agency's MOU. Both the delivery organisation and the counterpart agency need to be aware that

- **any purchases made using FFA funds must conform to Commonwealth Procurement Guidelines**
- the procedures for managing the FFA should include relevant extracts from the Commonwealth Procurement Guidelines
- price ceilings (or other mechanisms) may need to be imposed to avoid the risk of excessive tender payments if there is weak competition for providing goods and services, and
- financial management reviews should include testing for compliance with the procurement guidelines.

5.3.3 Financial reviews/audits

Regular, external financial management reviews/audits are fundamental to managing financial risks. They can be scheduled as frequently as every three months during the first year of the activity and be gradually reduced to every six months or yearly if the management and operation of the FFA is proceeding smoothly. Alternatively, if the FFA is deemed to have low risk, annual reviews/audits may be appropriate unless circumstances change and an increase in risk indicates more frequent reviews/audits are required. If the activity design documentation, contract or MOU require an audit it should specify how often the audit is to be undertaken, by whom and to whom the results should be provided.

Frequent financial and compliance audits are recommended if, for example

- the FFA is going to operate in an environment that is politically unstable
- the funding is provided in two tranches, the annual total of which is a significant proportion of the activity's total financial limit, and
- the counterpart jointly manages the FFA with the delivery organisation but has had little or no previous experience with operating a FFA and is considered not to have the necessary skills or resources for managing the FFA.

An audit can be conducted by an in-country auditor or by an appointed international firm if local auditors do not satisfy the following requirements. The choice depends on a number of considerations, including the adequacy of the counterpart agency's auditors, the extent and depth of private auditing expertise in the partner country, and the cost of engaging expertise from Australia. **To be effective the auditor must be independent of the contractor/counterpart agency and be reputable and suitably qualified.** The auditor will be required to report to

- the delivery organisation/counterpart agency on the stewardship of funds in the FFA as well as the adequacy and accuracy of activity's financial records and reports, and
- AusAID on any significant issues that arise from the audit, especially any incidence of fraud found both by and outside the audit.

The auditor may also be required to report on performance, compliance and program evaluation issues if this is required. The activity design documentation, contract and MOU should also include a requirement and process for timely follow-up action on audit findings and clearly allocate responsibility for this to the party responsible for the managing the FFA.

The counterpart agency should agree to the timing and scope of any review/audit to minimise disruption to the activity. AusAID personnel involved in the activity should consult the relevant parts of AusGuide and staff of the Performance Review and Audit Section (AUDIT) in Canberra if they require further assistance in developing tasking notes for a review/audit mission.

The counterpart agency's auditor (usually drawn from the partner government's equivalent to the Australian National Audit Office) also has a role and responsibilities that need to be clearly stated in the activity design documentation and MOU. The auditor is responsible for conducting financial, compliance and often performance audits on government programs and activities, including the operation of bank accounts held and managed by the counterpart agency. The reports on these audits are held by the counterpart agency and should be made available to AusAID on request.

In addition, AusAID has a regular audit program of AusAID operations, which may include auditing FFAs as the need arises. This would have to be reflected in the MOU. Also AusAID

audits of Australian contractors and NGOs may review the outcomes of the in-country audits of the FFAs.

5.3.4 Tranche requests

If AusAID uses tranches to fund the FFA, **the amount of funding required for the next period must be clearly stated in a tranche request.** (Funds should already be on hand for the current period.) The delivery organisation/counterpart agency prepares such requests at regular intervals agreed to in the contract/MOU and should submit a request before the previous funding tranche is exhausted. The tranche request should include

- a certificate from a designated responsible officer of the delivery organisation/counterpart agency stating that expenditure from the FFA for the current period was in accordance with the activity expenditure requirements
- a certificate for the previous tranche
- a statement of all funds received to date from AusAID
- a statement of funds requested for the next period
- a statement of any funds received to date from the counterpart agency
- a statement of funds expected from the counterpart agency for the tranche request period
- any interest received to date from activity funds held in the bank and the use of the interest received
- a statement of funds received to date from any other source
- a statement of funds expected from any other sources for this tranche request period
- physical progress or the output delivered against planned (budgeted) output, and
- financial progress or actual expenditure against the planned (budgeted) expenditure.

Payments and obligations should not be incurred for

- any purpose that is unrelated to the activity, and
- any item of a corporate or overhead nature (including, but not limited to, salaries and wages, travel, transport, utilities, insurance premiums and rates or taxes) unless such an item has been clearly identified as an approved charge to be funded by the FFA in the annual plan or has explicitly been approved in advance by AusAID.

5.4 Reporting to AusAID

Reporting is important for the efficient and effective management of a FFA. Generally speaking, the delivery organisation/counterpart agency submits some combination of monthly, quarterly and six-monthly reports to AusAID as part of their contract/MOU obligations. Some

of these reports are in an electronic format (eg the simplified monitoring toolbox), while others are in traditional formats. These reports provide a range of information relating to the management and progress of the activity including activity achievements, problems or delays, and recommendations for action.

A part of this standard reporting should be a 'monitoring/acquittal report' that tracks expenditure. The contract/MOU should specify who is required to provide this report to AusAID. The report should align with the annual plan, as its purpose is to convey the activity's current status (ahead or behind schedule) by detailing

- physical progress of output delivered against planned (budgeted) output, and
- financial progress or actual expenditure against the planned (budgeted) expenditure.

AusAID staff should monitor the delivery organisation's/counterpart agency's reporting, including the overall financial aspects of the activity. They should not undertake detailed financial monitoring of the FFA as this is the responsibility of the delivery organisation/counterpart agency. For a jointly managed FFA, training and a phased hand-over of reporting responsibilities from the delivery organisation to the counterpart agency should be factored into the schedule of activity implementation.

As part of AusAID's financial management responsibilities and reporting to Parliament, each FFA is to report as at 30 June of each year the cash balance in its nominated currency. The information is to be forwarded to the Chief Financial Officer by the 10th working day of July.

5.5 Winding up a FFA

When an activity is completed, the delivery organisation or counterpart agency winds up the FFA and closes all funding accounts. **The delivery organisation must allow sufficient time for all activity commitments to be paid** – usually 30 to 60 days. The delivery organisation returns any remaining cash balances to AusAID or transfers the balances to the partner government or other beneficiary.

The delivery organisation relinquishes all assets under the control of the activity according to its contract and the MOU. All activity and financial records are formally handed over to the counterpart agency if that agency is to assume responsibility for the ongoing management of the functions supported by the activity. The MOU may state where the records are to be stored. The contract for the delivery organisation will specify the period that **activity-related records must be retained**. This is normally six years.

A When to use types of FFAs

Type	Supporting Law and Agreements	When Use	When Not Use
Trust Account	Trust Law	<ul style="list-style-type: none"> • Aid mechanism is appropriate • Activity objectives best served by trust account • Substantial procurement for goods and services • Keep activity funds separate from counterpart's, or delivery organisation's, other funds • Greater control and transparency of use of funds is required • Share activity risks between counterpart agency, delivery organisation and AusAID • Require increased continuity and flexibility of funding 	<ul style="list-style-type: none"> • Partner country's legal system does not allow trusts (use contractor) • Delivery organisation not allowed to use trusts • Aid mechanism is budget support • Activity purpose is unclear • Risks and costs outweigh benefits
Imprest Account	Partner Government Legislative framework	<ul style="list-style-type: none"> • Aid mechanism is appropriate • Activity objectives best served by imprest account • Substantial procurement for goods and services • Want counterpart involvement • Share activity risks between counterpart agency, delivery organisation and AusAID • Require increased continuity and flexibility of funding 	<ul style="list-style-type: none"> • Counterpart does not have capacity (eg financial, systems, skills) • Aid mechanism is budget support • Activity purpose is unclear • Risks and costs outweigh benefits
Specific Purpose Account	Contract, funding agreement, MOU, ROU	<ul style="list-style-type: none"> • Aid mechanism is appropriate • Activity objectives best served by specific purpose account • Specific activities such as revolving credit accounts and community development grants • Shared activity risks between delivery organisation and AusAID • Require increased continuity and flexibility of funding 	<ul style="list-style-type: none"> • Activity purpose is unclear • Substantial procurement for goods and services • Risks and costs outweigh benefits
Non-Specific Purpose Account	Contract, funding agreement	<ul style="list-style-type: none"> • Limited occasions (eg pay consultant) 	<ul style="list-style-type: none"> • Risks and costs outweigh benefits

B Design and implementation risks to be considered

All design and implementation risks and management processes, controls or design features in this appendix are examples only and should be considered by AusAID personnel and design teams during both the design and implementation stages of an activity.

Table B1 **Design risks and their management**

Risk	Management process, control or design feature
<p>Aid objective</p> <p>The work program is undertaken successfully but the activity does not achieve its overall objective.</p> <p>The work program is not undertaken successfully and therefore the activity does not achieve its overall objective.</p>	<p>Activity objective is clear.</p> <p>Key stakeholders are consulted extensively on the activity objective and associated tasks.</p> <p>Activity objective and tasks are clearly linked in the contract/MOU.</p> <p>Design includes a comprehensive monitoring framework.</p> <p>Documentation of the design logic (eg logframe) is used to explain and improve cause and effect links.</p>
<p>Political environment</p> <p>Fund control is not clear.</p> <p>Partner government's funding for the activity is not guaranteed.</p> <p>Partner government's support for aid funding and objectives may cease.</p> <p>Funds may not be used for the designated activity objectives.</p>	<p>activity design documentation considers the political environment.</p> <p>Funding agreements between partners are documented.</p> <p>Key government representatives are consulted about the activity's objectives and involved at key decision points – at least annually as part of the annual plan process.</p> <p>FFA will be audited annually.</p>
<p>Legislative requirements</p> <p>Mandatory levels of financial accountability and reporting, and controls over opening and operating bank accounts are not established.</p>	<p>activity design documentation specifies who has financial responsibility.</p> <p>AusAID provides copies of relevant legislative requirements.</p> <p>activity design documentation specifies key account controls such as operating procedures.</p>
<p>Institutional capacity</p> <p>Capacity of the delivery organisation/counterpart agency to manage the FFA funds has not been adequately assessed, leading to over-reliance on the contractor/counterpart agency to achieve the activity's objective.</p>	<p>Where the delivery organisation solely controls funds, AusAID requests an unconditional financial undertaking to provide assurance of the financial capacity of the contractor and to protect the financial resources of the activity should the organisation fail to deliver. The undertaking is sought if the annual value of the activity is significant, the activity funding is in advance and the activity risks are considered high.</p>

(Continued on next page)

Table B1 **Design risks and their management** (continued)

Risk	Management process, control or design feature
Financial issues	
The FFA does not include all available activity funds, including interest revenue.	Design includes financial rules and regulations for operating bank accounts in the partner country.
Interest earned is withheld by the partner government.	Contract/MOU specifies that interest is deposited/credited to FFA or FFA is closed.
Funds are not released by the financial institution in a timely manner to coincide with the work program.	Contract/MOU states that the FFA financial procedures will specify how funds are released for the work program.
Exchange rates	
The conversion of Australian dollars to the currency of the partner country and vice versa materially affects actual funds available and therefore the achievement of the activity's objectives.	The Australian Government and the partner government agree on the funding amount in Australian dollars and the contract/MOU documents the process for converting funds as per the standard contract wording.
Reporting	
Reporting focuses on expenditure as a proportion of total activity funds rather than expenditure against physical progress, thereby failing to highlight progress issues.	AusAID and the delivery organisation/counterpart agency discuss, agree and document reporting formats and requirements in the contract/MOU and the activity design documentation. (Minimum reporting requirements are those mentioned in Section 5.4, 'Reporting to AusAID'.)
Timeliness of reporting	
Significant reporting delays affect management decision-making on funds disbursement.	Contract/MOU establishes regular reporting of activity outputs and outcomes, and actual costs against budgeted costs.
Delays in the work program are not reported in a timely manner to ensure they are considered appropriately.	
Conflicting interpretations of agreements	
Different understandings of requirements stipulated in the contract/MOU regarding the use of activity funds lead to the loss or misuse of funds.	Contract/MOU establishes and documents clear dispute resolution procedures, and FFA financial procedures indicate who is to be consulted, the time frame for resolution and the requirements for warnings, documentation and consultation.

Table B2 **Implementation risks and their management**

Risk	Management process, control or design feature
Activity funds are expended on non-activity items.	<p>Authority limits are set for purchasing and payments.</p> <p>Purchasing, approvals and payments are segregated.</p> <p>Processes for expenditure approval and payment are clearly documented.</p> <p>Adequate training is given to responsible staff.</p> <p>An independent annual audit is undertaken.</p> <p>An appropriately trained staff member undertakes monthly bank reconciliations.</p> <p>An appropriately trained supervisor reviews the monthly bank reconciliations.</p>
Activity costs exceed the approved budget.	<p>Variations to the budget are regularly reported.</p> <p>Processes for expenditure approval and payment are clearly documented.</p> <p>Funding is released on approved acquittal.</p> <p>Adequate training is given to responsible staff.</p> <p>An appropriately trained staff member undertakes monthly bank reconciliations.</p> <p>An appropriately trained supervisor reviews the monthly bank reconciliations.</p> <p>An independent annual audit is undertaken.</p>
Activity extends beyond the planned time frame.	<p>AusAID/delivery organisation/counterpart agency monitor key activity deliverables, tasks and time frames specified in the activity design documentation and match them to the milestones and pay only on satisfactory completion.</p> <p>Annual reports of financial and performance information for the activity include time frames for the work program.</p>
Stakeholders feel they have lost control of activity funds.	<p>Key stakeholders are consulted about the procedures for operating the FFA to ensure accountability is maintained.</p> <p>FFA financial procedures include clear acquittal processes.</p>
Use of fund accounts for activity components leads to lack of control over fund disbursement and possible loss of funds.	<p>Operating procedures for the accounts of activity components are documented in the FFA procedures manual.</p>
Users of the FFA are unfairly accused of wrong doing and not following procedures.	<p>Adequate training is given to responsible staff.</p> <p>An appropriately trained staff member undertakes monthly bank reconciliations.</p> <p>A FFA procedures manual is available to users.</p> <p>An appropriately trained supervisor reviews the monthly bank reconciliations.</p>
Activity transactions are inadequately documented.	<p>The FFA procedures manual includes documentation requirements.</p>
Funds requested are not in accordance with the annual plan and do not reflect funds unspent from previous periods, thereby failing to highlight problems in physical progress.	<p>Delivery organisation/counterpart agency must submit tranche request that includes all statements of funds used and required for the next period. (For details see Section 5.3.4, Tranche requests.)</p>

C Roles and responsibilities in FFA management

Table C1 Contracted delivery organisation is FFA manager

AusAID	Delivery organisation
Identify strategic, financial and other risks associated with the activity.	Develop and present annual plan, including milestones and costings.
Assess risks and develop a risk management strategy, including any need for specialist assistance.	
Develop and agree to contract terms and provide activity funding as agreed in the contract.	Establish FFA and develop an instrument to specify account name, signatories and operating instructions.
Establish processes to manage overall strategic activity issues, including liaison processes with the contractor and reporting of outputs and outcomes.	Update the risk assessment and maintain the risk management plan to address key activity risks.
Identify timing of funds transfer based on exchange rate considerations. Request an unconditional financial undertaking if required.	Effectively and efficiently implement the activity, including the FFA and supporting systems and processes. Provide an unconditional financial undertaking if required.
Review reporting of expenditure and achievements to ensure satisfactory activity progress, and monitor financial and physical status in line with assessed risks.	Develop FFA procedures manual (as required) and maintain adequate processes and documentation, including cash books, bank reconciliations, payment vouchers and asset register (with the counterpart agency, if appropriate) in accordance with the contract.
Identify and follow up on activity problems in a timely manner.	Facilitate expenditure to support the activity's work program and provide adequate certification and verification of expenditure, funds transfers and acquittals.
Review activity results at closure, resolve any outstanding matters, including any significant audit findings, and finalise activity documentation for satisfactory record keeping.	Monitor and report in accordance with the contract and FFA procedures manual. Supplement financial reports with narrative comments that link the physical and financial progress of each component of the activity.
Undertake audits as required, to facilitate compliance with Commonwealth legislation and regulations.	Follow up on non-acquittals and audit findings.

Table C2 Counterpart agency is FFA manager

AusAID	Counterpart agency
Identify strategic, financial and other risks associated with the activity.	Develop and present annual plan, including milestones and costings.
Assess risks and develop a risk management strategy, including any need for specialist assistance.	
Develop and agree an MOU and provide activity funding as agreed in the MOU.	Establish FFA and develop an instrument to specify account name, signatories and operating instructions.
Establish processes to manage overall strategic activity issues, including liaison processes with the contractor and reporting of outputs and outcomes.	Update the risk assessment and maintain the risk management plan to address key activity risks.
Identify timing of funds transfer based on exchange rate considerations.	Effectively and efficiently manage the activity, including the FFA and supporting systems and processes.
Review reporting of expenditure and achievements to ensure satisfactory activity progress, and monitor financial and physical status in line with assessed risks.	Develop FFA procedures manual and maintain adequate processes, documentation and reporting, including cash books, bank reconciliations and payment vouchers to allow AusAID to meet its FMA obligations. Include any subledgers required for multiple donor funding and counterpart operation. Maintain an asset register if appropriate.
Identify and follow up on activity problems in a timely manner.	Facilitate expenditure to support the activity's work program and provide adequate certification and verification of expenditure, funds transfers and acquittals.
Review activity results at closure, resolve any outstanding matters, including any significant audit findings, and finalise activity documentation for satisfactory record keeping.	Monitor and report in accordance with the MOU and FFA procedures manual. Depending on the MOU, supplement financial reports with narrative comments that link the physical and financial progress of each component of the activity.
Undertake audits as required, to facilitate compliance with Commonwealth legislation and regulations.	Depending on the MOU, follow up on non-acquittals and audit findings.

Table C3 Delivery organisation and counterpart agency are joint FFA managers

AusAID	Delivery organisation	Counterpart agency
<p>Identify strategic, financial and other risks associated with the activity.</p> <p>Assess risks and develop a risk management strategy, including any need for specialist assistance.</p> <p>Develop and agree contract/MOU and provide activity funding as agreed in the contract/MOU.</p>	<p>Manage the activity, including its finances, reporting to AusAID, legislative compliance (FMA and regulations).</p> <p>Work jointly with the counterpart agency on accountability and reporting requirements, and jointly update the risk assessment and maintain the risk management plan to address key activity risks.</p>	<p>Establish FFA and develop an instrument to specify account name, signatories and operating instructions in consultation with the contractor.</p> <p>Work jointly with the contractor on accountability and reporting requirements, and jointly update the risk assessment and maintain the risk management plan to address key activity risks.</p>
<p>Establish processes to manage overall strategic activity issues, including liaison processes with the contractor and reporting of outputs and outcomes.</p>	<p>Build counterpart agency's capacity through development of the annual plan and implementation of sound controls over FFA receipts and payments.</p>	<p>Effectively and efficiently manage the activity, including the FFA and supporting systems and processes.</p>
<p>Identify timing of funds transfer based on exchange rate considerations.</p>	<p>Develop FFA procedures manual (as required) and maintain adequate processes and documentation, including cash books, bank reconciliations, payment vouchers and asset registers in accordance with the contract.</p>	<p>Develop FFA procedures manual (as required) and maintain adequate processes, documentation and reporting, including cash books, bank reconciliations and payment vouchers, to allow AusAID to meet its obligations under the FMA.</p>
<p>Review reporting of expenditure and achievements to ensure satisfactory activity progress, and monitor financial and physical status in line with assessed risks.</p>	<p>Maintain adequate documentation and reporting, including supplementing financial reports with narrative comments (current and future years) showing link between physical and financial progress of each task.</p>	<p>Facilitate expenditure to support the activity's work program and provide adequate certification and verification of expenditure, funds transfers and acquittals.</p>
<p>Identify and follow up on activity problems in a timely manner.</p>	<p>Establish the FFA and monitor its performance.</p>	<p>Monitor and report in accordance with the MOU and FFA procedures manual. Depending on the MOU, supplement financial reports with narrative comments that link the physical and financial progress of each component of the activity..</p>
<p>Review activity results at closure, resolve any outstanding matters, including significant audit findings, and finalise activity documentation for satisfactory record keeping.</p>		
<p>Undertake audits as required, to facilitate compliance with Commonwealth legislation and regulations.</p>	<p>Follow up on non-acquittals and audit findings.</p>	<p>Depending on the MOU, follow up on non-acquittals and audit findings.</p>

D Checklist for FFA financial procedures

Each activity with a FFA should have a financial management manual for the operation of the FFA. Some procedures described in the manual will be standard, while others will be activity-specific and tailored to the circumstances of implementation. The financial procedures should address the following

1. **Purpose of the FFA:** The purpose should be clearly stated and be consistent with the objectives of the activity's design.
2. **Funds use:** There should be very clear criteria for the use of funds that are agreed with partners and in writing.
3. **Draw-down policy:** There should be clear procedures for drawing money to the FFA, including who will approve the transaction, what documentation is required, and how the funds will be channelled to the FFA account(s).
4. **Accounting systems:** The procedures should state the ledgers to be used, including whether they will be existing or new systems and whether computerised or manual systems, as well as any special considerations for managing the requirements of different or multiple donors.
5. **FFA accounts:** The procedures should identify how many accounts there will be, where they will be held and how they will be titled to ensure clear identification of funds.
6. **Bank and cheque signatories:** The procedures should identify how many signatories and who they will be.
7. **Bank reconciliations:** The procedures should identify when bank reconciliations are to be done, who will do them and who will certify them.
8. **Bank interest rates and fees/charges:** The interest rates and charges should be specified, as should how they will be applied and how this may affect operating procedures for the activity.
9. **Purchase orders and expenditure authorisation or approval:** The procedures should state who has the authority, what documentation is required, where it will be held and what will be submitted to AusAID for review.
10. **Payments other than by cheque:** The procedures for cash payments should reflect consideration of security and access issues and include how cash payments will be dealt with (eg through cash books and petty cash accounts).
11. **Financial estimates and annual plans:** The procedures should specify the documentation required, when it will be required, who will prepare it, who will check the estimates and plans, and who will authorise them. This documentation should be clearly linked to milestones and provide adequate forward planning.

12. **The funds flow:** The funds flow and associated processes for the FFA should be identified and reflect the impact of using subsidiary accounts in remote regions.
13. **Financial reporting and monitoring:** The procedures should identify who will prepare financial progress reports, what is to be included in them and who will authorise them. The financial progress reports should clearly correspond to physical progress reports and include sufficient detail to support the responsibilities of the AusAID activity manager. As a minimum, the reports should include
 - total historical expenditure
 - previously reported period expenditure
 - anticipated expenditure for the current year
 - anticipated expenditure for future years
 - anticipated work program or its cost
 - variations to approved activity funding.
14. **Acquittals to AusAID:** The procedures should state what documentation is required, who will approve it and what should be provided to AusAID, and how funds should be transferred to subsidiary accounts.
15. **Acquittals and subsequent tranche payments:** The procedures should specify the timing and the documentation required for acquittals and payments, as well as who should prepare the documentation and who should approve the payments.
16. **Audit trails and records management:** The procedures should state how long documents should be retained, the requirements for accessing them, and the form of safe storage facilities required.
17. **Risk management responsibility:** The procedures should identify who is responsible for managing the risk of financial loss, fraud, misuse of funds and theft of assets by outsiders and personnel from implementation partners.
18. **Sanctions:** The procedures should specify the sanctions for failure to comply with operating procedures and include the requirements for warnings, documentation and consultation.
19. **Responsibility schedule:** The procedures should include a schedule of the key responsibilities of the implementation contractor/counterpart agency. The contractor/counterpart agency should develop this summary of no more than three pages of dot points and provide a copy to AusAID. It should be updated every six months.
20. **Audit and financial reviews:** The procedures should require audits be conducted by an independent/external audit firm at least once a year but more frequently if the assessed risk to the FFA warrants it. The requirement for audits and financial reviews should also be included in the activity design documentation and the contract/MOU.