

**FIDUCIARY MANAGEMENT FOR COMMUNITY-DRIVEN  
DEVELOPMENT PROJECTS**

**A Reference Guide**

# FIDUCIARY MANAGEMENT FOR COMMUNITY-DRIVEN DEVELOPMENT PROJECTS

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## PREFACE

The Financial Management and the Procurement Sector Boards are pleased to introduce this Reference Guide prepared for Bank staff and clients that are contemplating, designing, or implementing projects that involve community driven development (CDD). This work is the product of many interested staff who were willing to provide comments, intellectual input and support in order to give others the benefit of their experiences, lessons learned and practical suggestions to facilitate the increased use of community driven development in Bank-financed projects. Procurement, financial management and disbursement are part of the fiduciary responsibilities undertaken by Bank staff to ensure that Bank funds are used for the purposes intended in the loan, credit or grant agreements. They are often seen as problem areas for Bank staff when designing a CDD project. We hope this Reference Guide will provide solutions for Bank staff and make these fiduciary requirements easier to address and implement.

This work could not have been completed without the support of many who worked with the FM and PR Sector Boards. Although staff in all the regions participated in the review of the document, Africa, South Asia and East Asia Pacific were particularly generous in providing both staff and consultant services to support the preparation of the Reference Guide. We would like to thank members of the CDD; Social Funds; and Rural and Water Sanitation Groups for reviewing the various drafts and providing guidance to the work

There are also many other individuals who contributed their time and effort. We wish to thank and acknowledge their support on producing this document. Unfortunately, we cannot name all without the risk of missing a few. This product truly was a team effort.



# FIDUCIARY MANAGEMENT FOR COMMUNITY-DRIVEN DEVELOPMENT PROJECTS

## I. INTRODUCTION

1. Community-driven development (CDD) gives control of decisions and resources to community groups. These groups often work in partnership with demand-responsive support organizations and service providers including elected local governments, the private sector, nongovernmental organizations (NGOs), and central government agencies. CDD is a way to provide social and infrastructure services, to organize economic activity and resource management, to empower poor people, improve governance, and enhance security of the poorest. CDD is relevant across many sectors. The potential for CDD is greatest for goods and services that are small in scale and not complex and that require local cooperation, such as common pool goods (e.g., management of common pasture and surface water irrigation systems), public goods (e.g., local road maintenance), and civil goods (e.g., public advocacy and social monitoring). But not all goods and services are best managed through collective action at the community level. Public goods that span many communities or that require large and complex systems are often better provided by local or central government. Similarly, private goods or toll goods are often better provided using a market-based approach, relying more on individual enterprises than on collective action. CDD can, however, fill gaps where markets are missing or imperfect, or where public institutions or local governments fail to fulfill their mandates.

2. ***CDD Fiduciary Challenges.*** Fiduciary management in CDD projects presents special challenges because:

- CDD embraces a range of projects, methodologies, and rules, and CDD projects often have a multiplicity of actors, including government agencies (starting with the borrower agency, sector ministries, down to district level administrations) and affiliated units (such as village political and administrative committees, Social Funds, and so forth), nongovernmental organizations (NGOs), the private sector, and communities themselves.<sup>1</sup>
- Communities and subprojects are scattered, sometimes in remote locations with poor communications, no access to banking facilities, and low literacy levels.
- Bank policies and procedures are typically constructed to respond to larger-scale initiatives than those undertaken at the community level. CDD project procedures thus need to be tailored to project-specific situations while consistent with Bank procedures.

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<sup>1</sup> Many Social Fund projects fit into the CDD definition, as do many that have been called Community Development, Community-Based Rural Development, and Participatory Development. Project methodologies vary widely as well. Some projects use carefully defined “menus,” whereas others are more open. Some projects have minimum requirements for community contributions at each stage; others let the communities set their own targets. Some projects have a degree of competition for the funds; others use a fixed standard funding system.

3. ***CDD Fiduciary Principles.*** Although the high degree of variation among CDD projects precludes universally applicable rules and procedures, some general principles and working procedures apply:

- Bank rules and guidelines apply to CDD projects in the same way that they do for any other project; however, their application has to be scaled to the project and the community's capacity.
- The objective of Bank guidelines for procurement are efficiency and cost-effectiveness, quality of goods and services, transparency, and competition among qualified suppliers. Fiduciary procedures developed for larger institutions, firms, and transactions do not always mesh well with the CDD environment, especially at the community level where the transactions may be too frequent and small to warrant the methods (and attendant costs) usually considered to be good practice for larger, less frequent transactions.
- CDD projects should take local culture, norms, and capacity into account, and procedures should be kept simple, with a high degree of transparency and accountability, and with many of the decision making and management responsibilities delegated to communities.
- To achieve project ownership and sustainability, communities must be involved in preparing and implementing subprojects. The parameters of this involvement should be specified in project documents, including the degree to which fiduciary matters are to be planned and managed by community representatives and how these representatives are to be chosen.
- CDD aims to empower beneficiary communities, including in the selection, design, implementation, and fiduciary control of subprojects. This can only be achieved if they are fully aware of what the project aims to do, its rules, its sanctions, and so on. In relation to procurement, for example, communities need to know the rules and methods for paying local labor, buying materials, and hiring equipment. Communities also need to know how money has been spent, and the financial management system needs to include methods that promote full local accountability.
- Horizontal and downward accountability are essential features in many CDD projects. This means that the people managing the subproject activities must report to their communities (and that members of the subproject committees monitor each other), and ideally the communities should also get routine, simple consolidated reports from the project management unit (PMU) level, so that they can compare their progress with other communities.
- There may be constraints in some countries to giving full responsibility for a subproject to a community (for instance, lack of community-level capacity, legal/institutional impediments to decentralization), and hence the use of

intermediaries (NGOs, private sector entities, and/or government agencies) may be necessary. There may also be technical constraints that necessitate more elaborate project designs and procurement processes (including competitive bidding procedures), such as in urban water supply or power generation/distribution systems, than those described in this note.

4. ***Purpose of this Note.*** This note clarifies rather than supersedes prevailing Bank rules and guidelines. The note focuses on issues related to CDD project activities at the community level, where the community, or some agency acting on its behalf, undertakes fiduciary responsibilities. It is intended to help Bank staff<sup>2</sup> meet the Bank’s fiduciary requirements while building local management capabilities.<sup>3</sup> This note can also be used to facilitate understanding among donors in cofinanced CDD projects, and should facilitate the design of common fiduciary arrangements in such projects.

## II. FRAMEWORK FOR FIDUCIARY MANAGEMENT IN CDD PROJECTS

### Bank Policy

5. Bank policies regarding financial management (OP 10.02), procurement (OP 11.00), and disbursement (OP 12.00) apply to CDD projects.

6. ***Financial Management and Disbursement Policies.*** Bank policies regarding financial management and disbursement require that the borrower and the project implementing entities maintain financial management systems—including accounting, financial reporting, and auditing systems—adequate to ensure that they can provide the Bank with accurate and timely information regarding project resources and expenditures.

7. ***Procurement Policy.*** The Bank’s procurement policy (OP 11.00) is designed to (a) ensure economy and efficiency in the procurement of goods, works, and services, as mandated by the Bank’s Articles; (b) provide for transparency in the procurement process; (c) encourage the development of domestic contracting, manufacturing, and consulting

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<sup>2</sup> The unique aspects of CDD projects require specific orientation for Bank specialists. Financial management and procurement specialists should regularly visit and review CDD projects, particularly at the community level. Task team leaders would benefit from training focused on the relevant sections of the guidelines to be more familiar with the Bank’s requirements and with the fiduciary implications of CDD implementation arrangement choices.

<sup>3</sup> Although this reference guide is meant for Bank staff and Borrowers, and not for communities or local government bodies that are involved in implementing CDD projects, they may assist these groups to better understand World Bank requirements, and can be used as a basis for creating the relevant sections of Operational Manuals. This note does not directly apply to activities that resemble “on-lending” or “revolving funds” projects. Revolving funds may be driven by communities, but they do not involve the same kinds of procurement or financial management as those that focus on development grants for small infrastructures of communal facilities. The bookkeeping is likely to resemble that of a savings and loans scheme, with funds being revolved at the group or community level, and the procurement that takes place tends to be at the household level rather than the community level.

industries in borrowing countries; and (d) ensure eligible bidders from developed and developing countries a fair opportunity to compete in providing goods, works, and services financed by the Bank.

## **Principles and Aims**

8. Fiduciary management in CDD should be guided by the principles of simplicity, efficiency, accountability, transparency, sustainability, and cost effectiveness. Similarly, procurement procedures in CDD projects should be fair and transparent, efficient, and transparent, and should allow all capable suppliers interested in providing goods and services for such projects to participate.

9. ***CDD Fiduciary Aims.*** The fiduciary management of a CDD project should aim to ensure that

- funds flow smoothly, adequately, regularly, and predictably from those providing them (donors, central/local governments, etc.) to communities, NGOs, or local government bodies implementing project activities;
- funds are managed properly and efficiently by the bodies receiving funds, and applied only to their intended purposes;
- sufficient and accurate information on project activities including usage of funds flows smoothly and regularly among communities, local governments, and stakeholders, including project beneficiaries and financiers, without placing too large a burden on any layer;
- accountability is stimulated through a strong flow of information among all concerned levels of government and the public on public investments and on the performance of relevant local governments, NGOs, and communities; and
- the capacity of the community and local institutions to own and manage their activities is strengthened.

## **Framework**

10. The priority of task teams working on CDD fiduciary management arrangements should be to build on and improve existing systems rather than to develop parallel ones. This requires a reasonably comprehensive understanding of the related systems in place at all levels where project activities will be implemented.

### *1. Levels of Accountability in CDD Projects*

11. Misuse of or failure to properly account for funds can erode political commitment to decentralization and local empowerment. Each level of government may raise concerns about devolving resources to the level below it, while lower levels may doubt the ability of higher-level governments to effectively manage resources on their behalf.

12. **CDD Accountabilities.** Depending on the project design, a CDD project will need to address accountability at the following levels:

- within the community’s development committee and from the community’s development committee to non-committee members of the community (i.e., beneficiaries);
- from intermediary groups (e.g., NGOs) to the community and to the government implementing entity (PMU);
- from local interested groups or civil servants to their constituents;
- from project staff to interested groups or civil servants;
- from the local government to the central government, and vice versa; and
- from the central government to external donors.

Accountability requires a management system that provides accurate and timely information.

## 2. *CDD Models*

13. CDD project arrangements depend on the specific activities and implementation needs of each project and on the national and local context and culture. Although projects and countries vary greatly, three basic CDD models can be distinguished according to the locus of primary responsibility for project implementation:

- Central or local government—possibly including the PMU or sub-PMU (Model 1);
- Communities (Model 2); or
- An intermediary entity that fulfills a fiduciary role, such as an NGO or a private company (Model 3).

14. **Hybrid Model.** A hybrid model can also be used. For instance, communities or local governments might be responsible for technical implementation but procurement and financial management might be entrusted to an NGO.

15. **Model Suitability.** The model chosen for any project depends on a range of factors, including the purpose of the project; the perceived and potential capacity of the local community; the capacity of the various implementing agencies; the level of decentralization; logistics; national laws and regulations, and established procedures dealing with procurement and financial management; and other factors defined in the project logframe.

- (a) **Model 1.** In general, fiduciary control by government bodies is suitable for strategic infrastructure development, through:

- funding mechanisms that give local authorities access to resources for infrastructure investments benefiting several communities (for example, roads between villages and primary irrigation schemes); and
  - methods to build the capacity of local governments to better plan and maintain this infrastructure.
- (b) **Model 2.** Often it is more appropriate for communities themselves to take responsibility for goods and services within the reach of the communities and for support to economic activities,<sup>4</sup> through:
- funding mechanisms that encourage local private investment (improving the private sector environment, providing funding for income-generating activities, and so forth); and
  - capacity-building assistance to local common-interest groups to promote local economic development. Examples include community roads and water supply schemes, and secondary or tertiary irrigation systems. Some CDD projects allow schools and health clinics to be built and/or maintained by communities. In these cases, a range of small activities may be involved, and these may be widely scattered geographically. In such circumstances it would be difficult for more centralized approaches to succeed.
- (c) **Model 3.** The use of NGOs or other intermediaries may be appropriate where there is limited capacity at the local level and it might take time to build these capacities, and for emergency projects. There may also be specific CDD-type projects whose aim is to strengthen local NGO capacity or enable them to operate as contracting agents on behalf of local government.

16. **Model/Fiduciary Management Relation.** Task teams should identify the model that best fits the project and the local context. Although most arrangements are the same regardless of who implements the project, the choice of a specific model will guide at least some of the fiduciary management aspects of the CDD project.<sup>5</sup> It is important, whenever possible, to field test a CDD project during its preparation (e.g. in a district where the project is likely to take place). All the necessary forms and tools should be tested and finalized, as well as training programs (definition, organization, logistic, costs) during this field test. Scaling up to the wider geographic area becomes then more reliable. Such field testing/development can be financed from project preparation funds or other suitable sources.

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<sup>4</sup> See paragraph 42 for a description of the two ways in which communities can be engaged to carry out these activities.

<sup>5</sup> The Bank also issues guidelines to staff. See, for example, “Assessment of Financial Management Arrangements in World Bank-Financed Projects,” issued by the Financial Management Sector Board, and “Assessment of Agency’s Capacity to Implement Procurement.” Task teams need to be able to identify which aspects of these standard guidelines apply to the specific needs and context of each project.

### 3. *Legislative Framework and Environment*

17. Most countries have a legislative framework and, usually, administrative and financial regulations governing community development and the institutions and the flow and management of funds involved in it. In many countries, for example, public funds targeted to community development are incorporated in the national budget and have to be accounted for in a strict national format determined by the central government; such countries may also make a sharp distinction between the responsibility for approval of expenditure and the responsibility for their disbursements. In most countries, the supreme audit institution has an obligation to audit all government expenditures, including funding for community development.

18. ***Legislative Framework Sources.*** The legislative framework is usually described in the country financial accountability assessment (CFAA) or country profile of financial accountability (CPFA). Likewise, the country procurement assessment report (CPAR) should have salient information related to procurement issues as viewed from the national level. The task team should study these assessments, but be aware that they may not fully cover issues that directly relate to CDD projects. For example, the task team will need to ensure that the targeted beneficiary groups and/or their representatives have the appropriate legal status to enable them to receive, use, and account for project funds.

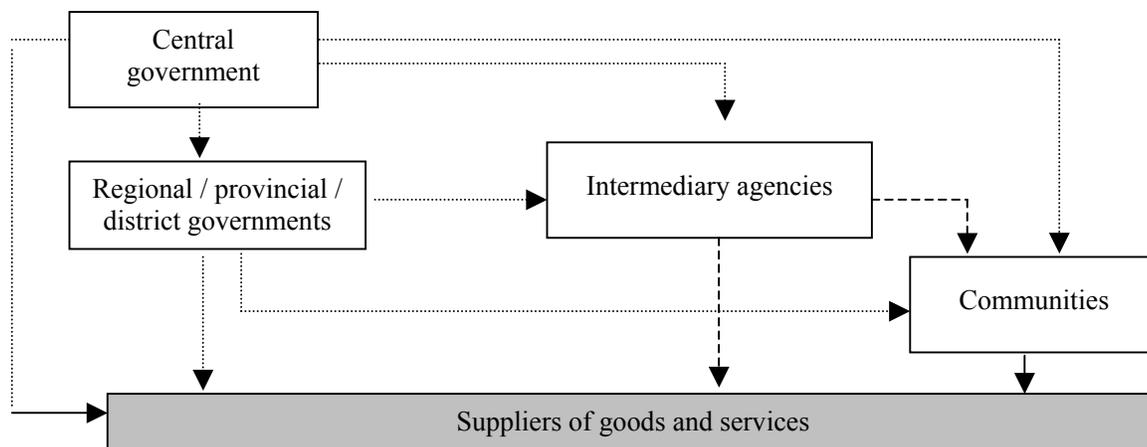
## **III. ELEMENTS OF A SOUND CDD FIDUCIARY MANAGEMENT SYSTEM**

19. It bears repeating that, to the extent possible, in CDD projects it is important to devolve responsibility to the community, ensure that procedures are fully accountable to the government apparatus and the communities concerned, introduce a high level of transparency, and simplify procedures and processes (especially by minimizing paperwork).

### **Flow of Funds**

20. Typically, the large number of small-value transactions (usually by the communities themselves) require supporting documents to be kept at the community level, and the use of simple, consolidated reports to document disbursement requests from the subproject implementation team to the PMU. Ideally, a simple financial report and milestones (for instance, assessments of subproject progress) defined in the financing agreement between the PMU and the beneficiary community serve as the basis for the disbursement of funds.

21. ***Fund Flow Factors.*** Task teams must pay close attention to the flow of funds, especially in relation to the number of tiers before the funds reach the end users, and the size and number of payments that will be made. Factors to be taken into account include the geographic coverage of the project, the location of financial management entities, the local government's financial and accounting regulations, and the country's banking network. Based on these factors, funds can be channeled through a variety of mechanisms, as depicted in Figure 1.



22. **Types of Channels.** These mechanisms may be grouped under the following main headings:

#### *Government channels*

- Block and/or discretionary funds can pass through a ministry to provincial, district, municipal, or rural councils, and onward to communities.
- Funds can be allocated directly to a community by a line ministry carrying out specific projects in that community.
- In some countries, the Treasury Department or the Ministry of Finance has provincial or district treasuries through which the central government channels funds to local governments and communities.

#### *Private sector channels*

- In a country with a good network of commercial, agricultural, rural, or cooperative banks, the branches of such banks could be used to channel funds to communities.
- Government and donors may also choose to pass funds to communities through charitable institutions and other NGOs with a track record of success in community development.

#### *Combination of public and private sector channels*

- In some CDD projects, funds originate in a government account, and are then channeled through NGOs. For example, some projects hire NGOs to manage government-funded funds or projects (or aspects thereof) on behalf of communities.<sup>6</sup>

<sup>6</sup> Funds may be held in local government-managed accounts according to statutory procedures, assuming that the central and local governments' financial and accounting regulations are appropriate and that the systems in place are functional. If this is not the case, then the government's budgetary and public expenditure system should be considered for the short to medium term. Until local government financial management, monitoring, and auditing capacities are enhanced, funds may go directly to communities or through intermediary entities.

23. **Channel Selection.** Designers of CDD projects must identify the most appropriate channel in consultation with community members and other stakeholders, ensuring that the chosen channel is compatible with other attributes of good management identified in this document. Using channels that have proved successful in the past rather than creating new ones may reduce the risk of funds failing to arrive in the proper place and in a timely fashion, and strengthens the community's capacity to plan and carry out their own development.

24. **Channeling Funds.** The general rule is that funds should be channeled to the level where the activities are actually carried out. Funds should therefore be transferred to the bank account of the entity in charge of the implementation (the community, NGO, or local government), except in the absence of adequate banking facilities or capacity for implementation, when they may be managed by an intermediary agency.

### **Financing Agreements**

25. The approval process for community projects includes the need for the community to plan, program, and budget its subprojects. The forms of the plan and budget for subprojects are usually documented in the financing agreement between the beneficiary community and the PMU, and should be quite simple:

- a comprehensive list of activities, their approximate timing, their estimated costs and sources of financing (including community contributions), and estimated benefits; and
- a listing of responsibilities for each aspect of the subproject before, during, and after implementation.

26. **Subproject Appraisal.** Subproject plans, complete with basic specifications and budget estimates, would be appraised before they are approved for funding approval. These plans should identify the actions needed to complete the subproject, their approximate cost and timing, as well as potential sources of finance and how this will be obtained or provided. This simple procurement planning can help identify which goods, works, and services the community can procure for itself, and which will require additional assistance.

27. **Fiduciary Aspects to Subproject Appraisal.** The subproject appraisal process should include all pertinent fiduciary aspects. For example, does the team designated to manage the process on behalf of the community include a trained bookkeeper and/or treasurer? If not, who can be quickly trained to undertake these responsibilities and how will this training be given?

28. **PMU Contribution.** The financing agreement between the PMU and the community should ideally specify a lump-sum contribution from the PMU for specified deliverables, and define payment terms/tranches. Disbursement of a given tranche can then be made against the attainment of a specified milestone, progress report, or certificate.

29. **Good Practice.** In most cases, project funding is set, so shortfalls in budget can be met only by increasing community contributions or reducing subproject scope. Where there are budget savings, it is usually good practice to allow the community to use these to finance eligible expenditures under the project without having to undergo a process of formal approvals.

30. **Financing Agreement Topics.** From a fiduciary management perspective, the financing agreement with the community should address the following topics:

- legal status of the community;
- scope of activities covered, including timeframe;
- amount of the funding;
- Contributions of the community;
- reporting requirements (financial and progress);
- terms and conditions of payments to the community group; including:
  - lump-sum payments (i.e., a set amount will be paid to the community based on output) or
  - actual costs payments (i.e., the community group will be reimbursed for the actual costs of the subproject);
- timing of payments to community groups;
- financial management requirements (e.g., staffing) of the community group;
- Simple procurement plan;
- roles and responsibilities of all parties, including supervision and monitoring, through implementation and including the operation and maintenance of the investment after completion of the subproject;
- statement that if the financing is on a lump-sum basis, the community accepts responsibility for the agreed-on output, bearing the cost of overruns and accounting for the use of any surplus funds;
- dispute resolution/termination procedures;
- remedial actions, sanctions; and
- simple procedures for amending the agreement.

### **Releases or Tranches Paid to Community Groups**

31. The financing agreement or MOU signed with the community group typically calls for the funds to be disbursed in tranches, depending on the size of the funding, the length of the implementation period, and the capacity of the community.

32. **Initial Tranche.** The initial tranche is usually based on the approved subprojects' proposals and subsequent payments are based on progress reports (physical and financial). In some projects, a small up-front transfer is made to communities to cover the costs of preparing their proposals. In some cases, for example where the total cost of a subproject is minimal or where materials need to be bought in bulk at the outset, financing may be disbursed at once. In these cases, a more detailed completion report will be required.

33. ***Agreements with Intermediary Agency.*** In almost every case it is better for Bank staff and the national-level PMU to establish the basic agreements with the channeling agency (or agencies), including such aspects as the expected minimum and maximum amounts of time required to transfer funds between each level, payment of fees *to* the channeling agency, and payment of interest *by* the channeling agency on funds held. These agreements must be transparent and should be adequately explained in the project operational manual. It may also be necessary to field test these arrangements before scaling up (para. 16).

34. ***Vouchers.*** In some circumstances vouchers may be used rather than (or in addition to) funds. As with funds, the use of vouchers should be carefully explained in the Operational Manual.

## **Community Contributions**

### *1. Types of Community Contribution*

35. Community contributions reduce overall project costs and are essential to sustain CDD subproject achievements in the long term, especially as regards operation and maintenance (see J below). Most CDD projects require communities to contribute a proportion of the total cost of their subproject. Such contributions should be established as an element in the subproject financing plan and the subproject contract.

36. ***Community Contribution: Design Stage.*** Agreement must be reached at the design stage regarding the level and nature of the community contribution, which could be in cash, in kind, or a mixture of the two. It is important to establish who should contribute and to whom, and when, how, and where the contribution should be given. If the contribution is in kind, it is usually necessary to establish how it will be valued, focusing on an output-based valuation approach rather than an input-based approach, since the costs of measuring the latter may exceed the benefits.

### *2. Tracking Community Contributions*

37. When developing or assessing systems for tracking cash and in-kind community contributions, it is important to distinguish between the considerably greater level of detail needed for the community's own use and that needed for project reporting purposes. Tracking of community contributions by the project depends on the overall project design and justification. In most cases a rough approximation can be used, based on initial proposals or a comparison between estimated total value of the subproject and the amount of funding received from the project.

38. ***Tracking: Cash vs. In-Kind.*** The community's system of tracking contributions will vary based on the type of contribution. Systems for cash contributions should monitor cash received, cash balances, and payments made. Systems for in-kind contributions will vary depending on whether the contribution is measured by input (e.g., number of days of labor) or output (e.g., a trench is dug).

## Procurement

39. The borrower is responsible for ensuring that project procurement is carried out in accordance with the Loan Agreement and the procurement schedule. The schedule—that is, the procurement procedures acceptable to the Bank, as described in the Project Operational Manual (POM)—defines the project procurement arrangements, including the organization, procedures, and review thresholds at all levels (government, local government, and communities). Procedures at the PMU and sub-PMU levels (whether for the purchase of equipment or selection of consultants for centralized tasks, or for purchases of large quantities of imported items that are needed by beneficiary communities) are similar to those of any other project, and follow normal Bank procedures and guidelines.

40. Although international competitive bidding (ICB), national competitive bidding (NCB), and international shopping (IS) may be used by central/local governments and the PMU, they are seldom used by communities under CDD projects. Procurement methods commonly used by the community are highlighted in paragraphs Annex B.

41. The thrust of a CDD project is the involvement of communities in the formulation, design, and implementation of their subprojects. Typically, a CDD project includes many small, simple subprojects that are geographically dispersed and that are implemented by communities that have various degrees of procurement expertise. At the project preparation stage of a CDD project, a global procurement capacity assessment is required and should focus on the following:

- CDD procurement experience in the country (especially if the project involves the same or a similar group of communities and PMU);
- The proposed project implementation roles and institutional arrangements of the PMU and the community given the nature and complexities of likely sub-projects; and
- Local regulations concerning community involvement.

42. ***Payments for Community Subprojects.*** Subproject beneficiary communities should be empowered to carry out their procurement according to project-specific procedures contained in the financing agreement between the PMU and the community that must be consistent with those described in the project operational manual. There are essentially two methods of payment used for community subprojects. The financing agreement should identify the method to be used and once agreed, this method should not be changed for that sub-project during implementation. In a given CDD project, the two method may be used for different types of subprojects.

- (a) ***Payments for Actual Costs Incurred*** by the Community. This method should only be applied when (a) the subprojects are few and of large value (e.g., water supply in cities), and are identified during project preparation, or (b) the cost cannot be satisfactorily estimated, but it has been determined that the community has the requisite capacity to implement the appropriate procurement procedures. (The formal procurement procedures associated with this method require a high level of technical knowledge; if the community

does not have sufficient capacity, technical assistance from the PMU, a local government agency, an NGO, or a consultant would be a prerequisite). In either case, the community acts like an arm of the PMU when this method is used to finance subprojects. The procurement procedures to be applied should be reviewed to determine their consistency with the Loan Agreement and the project operational manual. Disbursements to the community are made on the basis of eligible expenditures incurred or to be incurred by the community; hence the implementation of such subprojects involves a significant amount of paperwork, expenditure reporting, and fiduciary controls by the PMU.

- (b) ***Payments on a Lump-Sum Basis.*** This is the preferred method for subprojects that are large in number, small in scope, and technically simple. Most of the sub-projects are not identified during project preparation. The PMU agrees on this method of payment on the basis of the following criteria: subproject eligibility, method of implementation, cost estimates, along with a defined outcome or delivery of an end product. The financing agreement is a contract between the PMU and the community, against which disbursements will be made, usually in one or several tranches, and on the basis of physical progress. The review of the subproject will focus on the delivery of the end product described in the financing agreement. This financing method involves direct community participation, and often will include in-kind labor or materials contributed by the community, or subcontracting or procurement of goods and skilled labor. Such subcontracting must comply with the financing agreement, and thus with the procurement procedures and financial management requirements set forth in the project operational manual. Such subprojects are relatively simple to administer, as documentation and reporting is kept to a minimum, and the PMU receives progress and completion reports as well as technical inspection certificates from its staff and from consultants that the PMU hired. Another advantage is that the community has a built-in incentive for economy and efficiency, which allows for fewer and less onerous process controls by the PMU.

43. ***Provision 3.15: “Community Participation in Procurement.”*** This provision of the Bank’s Procurement Guidelines has been specifically designed to address procurement in CDD projects.<sup>7</sup> It stipulates that procedures shall be “*suitably adapted*” to reflect the conditions and capacity of the community, provided they are “*efficient.*” This provision allows flexibility in defining acceptable procedures at the community level. As a general rule, procurement should be designed to:

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<sup>7</sup> Provision 3.15 reads: “Where, in the interest of project sustainability, or to achieve certain specific social objectives of the project, it is desirable in selected project components to (i) call for the participation of local communities and/or nongovernmental organizations, or (ii) increase the utilization of local know-how and materials, or (iii) employ labor intensive and other appropriate technologies, the procurement procedures, specifications, and contract packaging shall be suitably adapted to reflect these considerations, provided these are efficient. The procedures proposed shall be outlined in the staff appraisal report, and the Loan Agreement.”

- Be simple enough as to be understood and implemented by local staff and the community;
- Be sufficiently transparent to permit real competition among suppliers and to facilitate control in the selection of contractors and use of funds;
- Use simple, standardized documentation; and
- Balance risk versus control/management with efficiency considerations.

44. **Publicity.** Publicity is an important feature in CDD projects, to inform community members and potential providers of goods, works and services about project development and activities, and to enhance transparency and competition in procurement processes. Publicity may take the form of information campaigns notices or billboards placed in appropriate locations (e.g., local newspapers, village councils), and community meetings.

45. **Community Procurement Challenges.** Many community-level expenditures will be payments of local wages or for the purchase of materials. Under the lump-sum payment procedure, the valuation of these goods, labor, or services is predetermined, usually based on a database that reflects local market prices, and funds are included in the fixed-amount provided for the subproject. This enables a community representative (for instance, the implementation team treasurer) to make payments to individuals in the same community for goods or services. The actual amount paid becomes the decision of the community and can produce efficiencies and savings for the community, allowing the saved funds to be applied against expenditures eligible under the project.

46. **Community Procurement Requirements.** Communities typically use the following four methods of procurement that are derived from the procurement guidelines and are consistent with the provision 3.15 of said guidelines. These procedures are detailed in the Project Operational Manual (POM).

- Local Shopping.** Local shopping—a simple version of national shopping—is the most commonly used procurement method. In this process, communities should solicit at least three price quotations for the purchase of goods, materials or services (other than consulting services), in order to make a cost comparison. It is important that factors such as quality, availability, and transportation costs are taken into account when comparing the potential suppliers. Sometimes, in relation to works, contractors can be hired to carry out a particular part of an activity that is technically or physically beyond the community's capacity; again, at least three quotations are required.
- Local Bidding.** Local bidding—a simplified version of national competitive bidding (with local or regional competition, and simplified contracts and bidding documents)—is used for larger contracts. This process requires a level of procurement expertise on the part of the community
- Direct Contracting.** Direct contracting or sole sourcing may be used when the cost to the community of another procedure would be disproportionately

high relative to the value of the procurement itself, and where only one supplier/contractor is available locally. The supplier can thus be chosen without going through either the bidding or shopping procedures outlined above, provided the costs are in line with local market rates.<sup>8</sup>

- (d) **Community Force Account.** Under a community force account, the community implements the subproject using its own resources (skilled and unskilled labor, materials, equipment), and may subcontract part of the subproject. This approach offers several advantages. It is community driven and cost effective (inputs can be provided by the community at below-market costs), and it injects funds into the community (e.g., through the payment of wages and materials). Its major drawbacks are the potential for abuse (misallocation of funds) and the difficulty of estimating and controlling costs.

47. **Consultant Guidelines.** Communities may need assistance in preparing and implementing their subprojects. Such assistance is usually provided by consultants (individuals or firms) or NGOs. The Bank's Consultant Guidelines<sup>9</sup> apply to both individuals and firms, and the three pillars of the selection process are competence of the incumbent, transparency of the process, and simplicity of the process. Suitable and efficient selection processes should be designed on an ad hoc basis keeping these principles in mind. It may be useful for the PMU to prepare a roster of qualified consultants and NGOs, and even to enter into indefinite delivery contracts with them; communities can then contact the consultant or NGO of their choice from such lists.

48. **Prior Review Thresholds.** Prior-review thresholds should be set at levels commensurate with the expected contract amounts or lump-sum financing agreement, and should aim at reviewing only the larger contracts (e.g., those in the upper decile). Post review is made on a sample basis.

49. **Peer Control.** In CDD projects, the beneficiaries' representatives (and the beneficiaries themselves) participate directly and closely in the management of the funds allocated to the community subproject. This provides a unique assurance that these funds will serve useful purposes: one can assume that the beneficiaries will be inclined to exercise peer control over the use of funds. Such control is important, and should be facilitated by making the internal control system procedures as transparent as possible.

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<sup>8</sup> Many projects use a Unit Cost Database (UCD) to help create reasonable cost estimates. These databases are created and maintained by the PMU or sub-PMUs. The UCDs should be kept updated and valid, and should be regularly checked by the PMU. UCDs can be useful for communities in the preparation of proposals and in assessing whether a specific supplier is offering a "fair" price for a given commodity. They can also be used by project staff engaged in supervision. Some projects also develop a database of approved contractors, suppliers, and consultants and/or a database of those that have been barred from participating due to malpractice. The specific circumstances of the project will dictate whether such databases are appropriate.

<sup>9</sup> See Guidelines: Selection and Employment of Consultants by World Bank Borrowers (January 1997; Revised September 1997 and January 1999).

## Risks and Internal Controls

50. As in every project, a good system of internal controls is indispensable for the proper fiduciary management of CDD. The internal controls and audits at the PMU and sub-PMU levels follow normal fiduciary procedures. It is at the community level that special measures are necessary, as outlined in the following paragraphs.

51. **Risk Factors.** Risk factors that need to be addressed include:

- The large number of parties and transactions involved, the small value and multiplicity of contracts, and the scattered locations of the subprojects that render problematical ex-ante controls across all individual sub-projects;
- Disbursement to the beneficiaries' bank accounts or to regional/subregional accounts is based on progress reports while the supporting documents are best kept at the level where the expenses are incurred;
- Community groups may lack the necessary capacity;
- Community representatives may not be truly representative of the community (i.e., elite capture of institutions and political interference).

52. **Mitigating Risks; Internal Controls.** Task teams should ensure that the risks associated with CDD projects are mitigated by clear transparency rules and other methods for empowering and training communities to exercise fiduciary control over their leaders, as well as by suitable internal control procedures. The mitigation system should be simple but effective. Key controls points to consider include:

- no individual should be able to initiate, authorize, execute, or record a transaction without the active involvement of someone else (for example, all withdrawals and transactions should be witnessed and countersigned);
- risks of loss, leakage, fraud, inaccuracy, or mistake should be identified at all levels, carefully assessed, and measures put in place to eliminate or minimize them;
- measures should normally not cost more than the possible loss that could result from their absence;
- the measures should not *unduly* slow the flow of funds or project implementation;
- fiduciary management supervision at the community level should be integrated with monitoring and evaluation to ensure a close link between technical/progress reporting and financial reporting, as a way to support the validity of the expenditures;
- accountability should be built into the local governance system and at the community level using the many accountability mechanisms already being piloted in a large number of projects (participation, public announcement of community

activities and funds received and spent, use of local languages for all community records and their communication to the next higher level, election of subproject management committees, putting all information into the public domain in open meetings and posting salient information in public places in the most common local language(s)—even in communities where illiteracy levels are high); and

- Internal audits/ex-post audits (paras 54,55) of community organizations should be encouraged.

53. **Community Involvement.** Successful internal control and financial management of a CDD project require that beneficiaries and other stakeholders be kept well informed at all times and at all levels about their entitlements, rights, obligations, and the project's costs and benefits. This information should be provided in a manner understandable to all interested parties. Where any of the beneficiaries are illiterate, it may even have to be presented in pictures or other appropriate media. It is also good practice that summaries of local project expenditures and procurement information be posted in a public place (for example, outside of a village hall or meeting place), since this literally places the information in the public domain.

54. **Internal Audits.** Internal audit by central government, local government, or simply by trained members of the community should also be encouraged as an integral part of the internal control system.

55. **Ex-Post Audit.** A simple, inexpensive internal ex-post audit of community subprojects designed to confirm that funds have been spent on the intended purpose and that the community has received value for money can be a valuable addition to the quality and internal control framework. This ex-post audit is often linked to the overall monitoring and evaluation of the community subproject.

### **Community Record-Keeping and Accounting**

56. Successful record-keeping and accounting systems can range from a very simple hand-written record of receipts and payments up to a full accrual basis accounting system. At the community level, it is important to keep simplicity as a primary objective. Key principles to apply to the community accounting system include:

- use of local language,
- all transactions (cash and bank) should be recorded in simple formats,
- supporting documents should be retained, and
- as few forms as possible should be used, focusing on the needs of the community (including tracking use of funds and stores and community contributions when required).

## **Project and Community Monitoring and Reporting**

57. As under any Bank-financed project, borrowers prepare the documents normally required by the Bank for CDD projects. At a very early stage of the project, the Bank and the PMU should decide on the minimum data needs, and agree to collect only these, notably at the community level. Data should be fed back down the administrative system to community level. The focus should be on gathering, processing, and using data in a manner that brings benefits to the project and helps national-level planners develop better programs.

58. ***Designing Reports.*** Designers of CDD financial management reports should consider either (a) adopting the existing or mandated government reporting formats and requirements; or (b) adapting the government reporting system to conform to Bank standards. The objective is to avoid reporting essentially the same project data in several different formats to satisfy different stakeholders.

59. ***Simplifying Reporting.*** In most projects, physical progress reports and financial reports from the subproject level are combined to enable the PMU to compare expenditures against targets. This process can be simplified by linking the reporting with project tranches rather than requiring periodic (e.g., quarterly) reports, such that unless an agreed level of progress has been achieved then the subsequent tranche cannot be approved. Funds for small subprojects with a short duration, may be disbursed to the community group in one payment, with only a final report required. In such cases, additional funding to the same group would depend on its having adequately reported on the previous funding.

60. ***Subproject Reporting Format.*** Simple reporting formats should be created, as follows:

- *Financial.* The format of the financial reports may be either summary sources and uses of funds, or cash and bank balances.
- *Physical.* The physical progress reports may be equally simple in format and content, and should be received together with the financial reports.
- *Link with the Financing Agreement.* Report formats should be clearly specified in the financing agreement, preferably by attaching a copy of the agreed format. The timing for submission of the reports should also be specified in the financing agreement.

61. ***Implementation Team Review.*** It is often useful for the subproject implementation team to regularly (for instance, monthly or quarterly) review subproject progress and budget, to monitor and adjust them as necessary. This review can be an excellent chance for the team to make a public statement of progress, including a public reading of a simple statement of accounts and clarifications of any issues raised. Some projects link such activities to tranches, so that no tranche can be released until a public review meeting concerning the preceding stage has been held.

62. **Reporting System Linkages.** The reporting system should be clearly linked to the funds flow mechanism (thus in many respects the reporting flow is the reverse of the funds flow) and the reports should be directed to the approvers of additional tranches or new funds.

63. **Disseminating Reporting Information.** Information from such reports should be widely disseminated, including through radio broadcasts, bulletins, and workshops. Bank staff should ensure that matters related to good fiduciary management practices are included in the project information and education campaign (IEC). It is also important to document and disseminate anecdotes and stories of how communities have overcome problems. Furthermore, the project should publicize cases where effective sanctions have been employed, so as to discourage new cases of fiduciary mismanagement. This information exchange needs to be two-way, with messages from concerned members of the community also being acknowledged and acted on appropriately by PMU staff.

### **External Audit Arrangements**

64. To ensure accountability, it is important to have a person (or persons) independent of the CDD project verify internal controls and transactions. Auditing principles and techniques do not change with the nature of the project, but the kind of evidence used by the auditor for vouching purposes does: methods must be adapted to suit the conditions found in each location that is audited. Audit reports should take account of the needs of the various stakeholders. Like the financial statement, the audit report may need to be translated into a local language and presented in a form recipients can understand.

65. **Audit Scope.** The audit arrangements should be adapted to the model used for the project and should clearly define the scope of the audit of the project accounts and of other audits at the subproject level. The scope of the project audit can then extend from central and local governments to accounts maintained by communities, depending on the nature of the relationship between the project and the communities (see paragraph 37). These may include a sampling of receipts, archiving systems, and management information systems. If the project is financing the actual expenditures of the community, then these expenditures may be consolidated into the project accounts and, therefore, be covered by the scope of the audit. If payments are made on a lump sum (through tranches) basis, then the payment to the community is in the project accounts and is audited; the community's own expenditures are outside the scope of the audit. The audit may be a multiyear contract so that it can proceed on a rolling basis (this is of particular relevance to projects that provide multiyear support, as the majority of CDD projects do).

66. **Audit Dilemma.** The auditing of CDD projects presents a dilemma. On the one hand, it is prohibitively expensive for an external auditor (public or private) to produce individual audit reports on small investments; on the other hand, it is critical to ensure that communities receive value for every dollar that is purported to be spent for their benefit.

67. **Audit Approach.** It is useful for CDD projects to have a two-stage audit. Following an internal ex-post audit at the community level as outlined in paragraph 54, an external audit of the project as a whole by a qualified auditor should be prepared. It should comply in

all respects with OP/BP 10.02, and yield a standard audit report—with opinions on the overall project financial statements, the overall project internal controls, the Special Account, the Statements of Expenditure (or Project Management Reports and/or Financial Monitoring Reports, where used)—accompanied by a Management Letter. Normally, only one such annual external audit report would be prepared for each CDD project, regardless of how many subprojects, communities, or institutions were involved.

68. ***Subproject Audits.*** As part of the project’s overall monitoring system, subprojects implemented by local governments, intermediary entities, or community groups are typically audited on the following basis: a random sample of low-amount subprojects and all high-amount subprojects would be audited. The threshold should be based on the level of risk determined as an outcome of the financial management and procurement assessments. In addition, the auditor should be required to report on compliance with the internal control mechanisms mentioned above (Section F). Linking expenditures to physical progress and examining value for money may be integral components of the subproject audit.

69. ***Auditing Community Organizations.*** Community organizations should be encouraged to be audited for their own purposes as part of the project reporting systems as documented in the financing agreements (but not as part of the Bank’s audit requirements). This audit may be a simple, internal ex-post audit (paras 54-55) undertaken by a trained community members who is independent of project staff and the subproject implementation committee. Larger organizations may be required to submit audit reports to the project to enhance fiduciary supervision of individual fundings. If the organization is legally registered, such audits are typically required by law. Encouraging community organizations to be audited fosters sustainable accountability systems.

70. ***Auditing Local Government Accounts.*** An audit of local government accounts may be required if it is critical to the success of the project. It may also be necessary to audit intermediary groups if they play a key role in the fiduciary management process. Such an audit may be conducted by the Auditor General or similar public audit institutions if their capacity has been rated satisfactory in the financial management assessment. Otherwise, a private independent auditor may audit the project’s related accounts. Though communities should be involved in supervision (and social audits), the strict legal financial audit functions are usually beyond their capacity. Technical and financial audits should include an indication of whether communities are able to sustain the results of subprojects.

### **Sustainability and Provision for Operation, Repairs, and Maintenance**

71. The design and implementation of the fiduciary system at the local level should consider the sustainability of the investment and the need to account for operation and maintenance. Examples of such costs might include contractual salaries of dispensers or nurses, as well as medicines, for village clinics; teachers’ pay and school materials for community schools; fuel, repairs, and maintenance for the pump in a village borehole; and so forth.

72. ***Timing of Implementation Responsibilities.*** All important operations and maintenance issues, including delegation of responsibilities, should be agreed at the earliest

planning stage of the subproject, and should be clearly stated as an integral part of the financing agreement or subproject contract between the community and the PMU. Where inputs are required from line agencies of the government, or from non-government sources, these should be formally agreed at the relevant level before the subproject is approved.

### **Project Operational Manual**

73. Project operational manuals should contain such fiduciary policies and procedures as are needed to enable the project to efficiently use, account for, and report on expenditures, and should include agreed formats for procurement activities, accounting records, and reporting.

74. ***Timing of Operations Manual.*** A draft operational manual should be completed prior to appraisal, and an approved final draft should be completed prior to negotiations, in order to permit an objective evaluation of the financial management and procurement arrangements that will govern the project.

75. ***Field Testing.*** An operational manual is best developed as part of field testing of all the processes and procedures in a district where the project is likely to take place (para 16).

### **Capacity Building**

76. Capacity building—whether for communities or for intermediaries and government agencies—is an integral part of most CDD projects. It is essential to properly assess the need for capacity building activities and build a program that can address these needs. The peculiarities of CDD projects may require that they receive substantially more Bank support and supervision in their first year of operation than do other types of projects.

77. ***Community Capacity-Building Requirements.*** Typical community capacity-building requirements include an adequate number of people either trained or identified to be trained in basic bookkeeping and record-keeping procedures as well as in monitoring and evaluation. (These individuals may subsequently train people in other community groups.)

### **Disbursement Procedures and Eligibility**

78. The disbursement procedures under the subprojects match the two methods of payment described in paragraph 42. Typically, (a) small-scale financial contributions disbursed to the communities on a lump sum basis are covered under a disbursement category in Schedule 1 of the legal agreement entitled “Community Subproject” rather than being split among the civil works, goods, or consultant services categories. The legal agreement should document the criteria (para 42) for adopting the lump sum payment method to determine the eligible expenditures, and (b) if payments are made against specified sub-projects eligible expenditures, disbursements are made under the corresponding categories (e.g., goods, works, consultant services).

79. ***Disbursement Percentage and Accounting for Community Contributions.*** The disbursement percentage for subprojects should comply with standard Bank restrictions on

financing of taxes, and will be affected by how the project accounts for community contributions.

- *Including Community Contributions.* If the cash community contribution is recorded in the project's accounts as part of the project cost, then the Bank's disbursement percentage should take this into consideration. Withdrawal applications would include the total cost of the community subproject (that is, from all sources, including community cash contribution), and the Bank's disbursement percentage would then be applied to this total expenditure. However, this can be problematic since in-kind contributions are not eligible expenditures and are therefore not considered in the determination of the disbursement percentage or included as an eligible expenditure on a withdrawal application. Since in-kind contributions may be the only contribution possible from the poorest communities, this is a significant problem. It may be necessary to agree with the Borrower on a method which will be applied to evaluate in monetary terms the in-kind contribution of communities.
- *Excluding Community Contributions.* If the cash community contribution is not included in the project's accounts, it would not be factored into the disbursement percentage, and withdrawal applications would be prepared on the basis of the government's expenditure, to which the disbursement percentage would be applied.

80. ***Expenditure Eligibility.*** The following should be considered when determining the eligibility of expenditures for Bank financing:

- *Progress Payments*—if the funding is made on a lump-sum basis as described in paragraph 42, the periodic payments (tranches) to the community group are eligible expenditures. The initial payment could be an advance, but should be made in line with the provisions of the financing agreement; typically, a bank guarantee is not required. Progress payments are not considered advances since they are payments made against physical progress.
- *Advances*—if the funding provided to the community group is based on actual expenditures or a combination of lump-sum and actual expenditures as described in paragraph 42, then the initial advances to the community can be treated as an eligible expenditure as long as they are made in line with the provisions of the financing agreement. The final payment to the community would need to be based on the actual expenditures to ensure that advances to the community were not in excess of the actual cost and that actual expenditures are properly recorded.

The above are only eligible to the extent that the work of the community group will be completed by the closing date of the loan.

### **Legal Status of Community Groups**

81. Local laws, regulations, and customs should be the first factor when considering whether community groups should be legally registered entities. In addition, the nature of the

expectations and responsibilities placed on the community group (such as ownership of assets and the ability to enter into contracts) may affect the legal registration decision. Since project designs may include initiatives to work with the government on new models and legal frameworks for community organizations, the benefits and risks of registration must be assessed. As a matter of policy, the Bank does not normally support borrowers to mandate registration to participate under Bank-financed projects.

### 1. *Legally Registered Community Groups*

82. **Benefits.** Registered community groups may have enhanced legal rights and benefits (such as the ability to enter into contracts or take legal action against nonperformance of contract), usually can open their own bank accounts, and can own assets created by the project or contributed by the government. In addition, the reporting requirements imposed on legally registered community groups may increase transparency and accountability, and it may be easier to ensure that disadvantaged and marginalized people are fully incorporated into the group.

83. **Risks.** Legal registration could take significant time and effort. Communities may prefer to work informally and not be involved with government in such a formal way. Proliferation of specific-purpose groups within a community can be detrimental to coordinated development efforts.

84. **Project Design Considerations.** Reporting and accountability aspects of project design should reflect the legally mandated reporting requirements for registered groups rather than project-specific requirements.

### 2. *Non-Registered Community Groups*

85. **Benefits.** Non-registered community groups may mobilize and initiate project activities more quickly. If communities are familiar with working together in an informal manner, imposing registration may be neither necessary nor culturally appropriate. Indeed, project objectives may be better served through an informal grouping of people that comes together for a specific purpose rather than through a more formal, externally generated structure.

86. **Risks.** Government regulations may preclude transferring funds to non-registered groups, and ownership of any assets created by the project may be in question in cases of non-registered community groups. Such groups may be unable to open bank accounts as an entity, and thus may be required to open them in the name of an individual, increasing the risk of mismanagement of funds. Project benefits may be directed to individuals rather than to the community, and there may be constraints to legal action or other efforts to recover any misused funds. The informal group may be less likely to include disadvantaged or marginalized people and in other ways be non-inclusive.

87. **Project Design Considerations.** Project design must foster appropriate reporting and accountability since the organization will not be reporting to the government or other registration body. Ownership of assets and access to banking facilities will also need to be addressed in project design.

## ANNEX A. CDD FINANCIAL MANAGEMENT ASSESSMENT

The Financial Management Board has approved guidelines to staff on assessment of financial management arrangements of World Bank projects,<sup>10</sup> which are applicable to community-driven development (CDD) projects. This annex provides implementation ideas with an emphasis on CDD.

The coverage of the assessment depends on the design of the project. Before starting the assessment, those involved in project funds flow and reporting should be identified so that the Assessment is responsive to their roles and responsibilities.

### Local Governments Financial Management

The central government will continue to play a role in financial management; its extent will depend in part on the CDD model selected. At a minimum, central government funds would cover the resource transfer process. Consequently, the financial management arrangements and capacity assessment should cover the central government budgetary and public expenditure management systems with respect to funds and accountability requirements. Bank staff are not expected to conduct a full assessment of the local government financial management system. Existing reports such as Country Financial Accountability Assessment (CFAA), Country Profiles of Financial Accountability (CPFA), or other government/donor documentation are useful source documents for a broad assessment of the local systems.

Assessing the local institutional context and capacities is important because these determine the range of services that can be delivered and the capacity building and institutional support required. It may be useful to conduct an institutional analysis of potential local and central partner institutions to assess the scope for supporting decentralized planning and financing for services and investment. The financial management analysis should assess the mandate, responsibilities, and fiscal capacities of local government bodies. Elements to be considered are presented below.

#### *1. Local governments' financial and accounting regulations*

The assessment should determine (a) whether the legal framework is appropriate and (b) whether the financial and accounting regulations are actually implemented. The gaps between theory and practice must be identified and corrective measures proposed as part of the project' preparation or activities. Areas to be considered include:

- ♦ Existing laws, and administrative and financial regulations governing community development, and
- ♦ Institutions and the flow and management of funds involved therein.

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<sup>10</sup> See "Assessment of Financial Management Arrangements in World Bank-financed Projects|—Guidelines to Staff," dated June 30, 2001, World Bank Intranet <http://opcs/fm/>.

## 2. *Budgeting*

The assessment of the budgeting system should cover the following:

- Budget preparation, approval, implementation, and monitoring procedures, including timing;
- Comprehensiveness of the budget, including donor funds (unconditional and conditional fundings);
- Resource allocation criteria (in view of the need to finance operating and maintenance costs);
- Budget balance between expenditures and revenues;
- Link between the budget estimates and the policy which the local governments intend to pursue;
- Possibilities of tracking budget estimates and expenses by programs and subprograms, in addition the nature of the expenses (including contractual salaries and maintenance).

## 3. *Accounting*

The assessment of the accounting system should indicate whether it is able to record and report on all expenditures that are the responsibility of the local government. This includes both recurrent and capital expenses financed from local government resources, transfers from the central government, and funds received from donors. The main aspects to be considered include:

- Type of accounting system (manual or computerized);
- Books of accounts maintained (cashbook, ledger, vote charge book, and so forth);
- Contents of the books of accounts; and
- Timelines of the accounting records.

## 4. *Audit arrangements*

In addition to local government financial statements, the audit should address compliance with tendering/contracting and financial management statutory requirements (such as final accounts, balanced budget). There should be specific audit reporting requirements to meet reporting conditions that may be defined in financing agreements with external donors. The assessment should identify whether there are any audit requirements, the scope of such audit, the capacity and independence of the auditor, and the regularity and timeliness of the audit.

## *5. Reporting*

Local governments should be able to prepare at least quarterly reports on funds received and spent, indicating the sector, type of investment in sector, and the amount of money spent. The following aspects should be considered when assessing reporting mechanisms:

- Format, comprehensiveness, and timeliness of the financial report; and
- Possibilities of linking the financial situation to budget forecasts.

### **Communities Financial Management**

Given the large number of communities that will be implementing the project and the possible disparities in management capacities among communities, it is unlikely that all communities will be individually assessed. Typically, not all participating communities are identified prior to project effectiveness. The unique issues to consider at the community level include:

- Mechanisms built into the project to first identify what financial management capacity needs to exist in a community groups and then to assess communities' financial management capacity and monitor their financial management during project implementation;
- Provision to strengthen communities' financial management capacity;
- Efficiency of internal control procedures (to ensure that funds are used for the purpose intended) and external audit arrangements (which would confirm compliance with these internal control procedures);
- Role and responsibilities of intermediary or facilitating organizations which may be working with community groups; and
- Systems adequate to monitor a large number of smaller value transactions.

#### *1. Payments on a lump sum basis*

If payments under a subproject are made on a lump sum basis, the financial management systems in the community are not required as part of the Bank's fiduciary financial management assessment, but will be important in determining the readiness and ability of the community groups' ability to handle funds. The results of such an assessment will be an input to the project design, including the use of intermediary organizations or training to build the capacity of the community organizations.

## 2. *Payments on the basis of actual expenditures*

If the actual expenditures of the community are paid by the project and consolidated into the project accounts), then the assessment will need to cover the financial management capacity of the community organizations to determine if they can account for a report on actual expenditures on a timely basis. Such an assessment would typically be performed on a sample basis and the determination of the adequacy of the financial management might include reliance on intermediary organizations and other compensating controls over the accounting and reporting of the community expenditures.

## 3. *Focus of the assessment*

- The assessment should focus on the mechanisms built in or to be developed under the project to ensure that the financial management arrangements at the community level are effective. These mechanisms might include the following:
- When preparing a subproject proposal, the need analysis should enable the identification of communities' financial management strengths and weaknesses, and such strengthening activities that could be financed by the project.
- The subproject proposal should include a clear financing plan identifying the activities to be financed as well as describing the financial management arrangements at the community level.
- The subproject selection criteria should include criteria on the feasibility of the financing plan and the soundness of the financial management arrangements at the community level. The financing plan should take into account communities' capacity to contribute.
- The project operational manual should define minimum financial reporting requirements, and the assessment of the community should help determine whether it is able to meet these requirements. If the community has a reporting format that satisfies these conditions, it should be maintained. Otherwise, a new format may be proposed.
- The assessment should also include a review of the memorandum of understanding and/or financing agreement to ensure that it properly addresses all financial management issues.
- Methods of monitoring and reporting on communities' contributions in kind.

The assessment should determine the minimum financial management conditions that are required to be in place before approval of financing. In cases where capacity building assistance is needed, the type of assistance and procedures should be defined.

In addition to the financial management capacity at the community level, the overall project financial management system in place should have effective procedures to monitor communities' compliance with the agreed financial management procedures. As suggested in

the guidelines, these procedures could be part of the monitoring and evaluation systems. The assessment should indicate whether the type and scope of financial controls envisaged as well as the qualifications of the monitoring and evaluation teams to perform these controls are satisfactory.

### **Intermediary Entities Financial Management**

The intermediary agency may be a government entity, a private sector firm, or a nongovernmental organization, which acts on behalf of local governments or communities. The assessment must therefore address not only the capacity of the intermediary entity but also the coordination and accountability mechanisms with the local governments and the communities to guarantee that technical implementation does not suffer from poor financial management, and vice versa. The intermediary entity's financial management system must be robust enough to cope with and report on a large number of communities and subprojects. The audit arrangements may have to cover the intermediary entity's own financial statements, depending on the amount of money it has to manage and the level of risk.

An assessment of the financial management capacity of intermediary entities is required when they are expected to manage funds on behalf of project beneficiaries.

report on the funds received and expenses incurred for a specific subproject. When the intermediary entity is expected to manage funds for several subprojects and communities, it should have a commensurate financial management system and be able to provide overall, as well as individual, financial situation reports.

Foreknowledge of all intermediary entities that will be involved in the project may not be possible; and hence it will be impossible to assess their capacity. In such cases, it will be important to assess the mechanisms used to select these entities and to include a clear method of ensuring reasonable fiduciary capacity in these mechanisms. A review of the known entities' audited financial statements should be a part of the assessment, following up on any significant relevant issues.

## ANNEX B: PROCUREMENT IN CDD PROJECTS

### *Capacity Assessment*

The Procurement Board has provided guidelines and format for procurement assessment of capacity available in procuring entities responsible for procurement under World Bank-financed projects. The guidelines are also used to assess parties responsible for oversight to ensure compliance. These guidelines are equally applicable to CDD projects. This annex provides additional guidance with more emphasis on CDD. The findings of the assessment should be summarized and documented in the PAD, identifying the actions required to be taken to make improvements, including training. Procuring entities to be assessed are described below.

#### 1. *Central Government Agency*

The central government as the Borrower of Bank funds assigns the responsibility for implementing the CDD project to a specific agency [referred to herein as a central Government agency], which can be a line Ministry, a para-state organization or a Social Fund. The capacity of the agency is assessed from a national perspective, as it would be expected to carry out any central procurement under the project, often including large and complex ICB contracts. The assessment should be on adequacy of the applicable procurement procedures and staffing. It should also include the adequacy of the agency's role in its oversight responsibility to ensure fiduciary compliance by participating local authorities, NGOs and beneficiary communities. Existing CPAR are useful source documents for a broad assessment of the national systems.

#### 2. *Local authorities/governments*

Very often local authorities are delegated project implementation because they are close to beneficiary communities. Local authorities may also be delegated the oversight responsibility to ensure fiduciary compliance by participating beneficiary communities and intermediaries such as NGOs and contracted private sector firms. Care must be taken to ensure that if local authorities are expected to follow central government procurement regulations, there is adequate legislation to allow them do so. The assessment should include analysis on the mandate, responsibilities, and financial capacities of local government authorities.

#### 3. *Intermediaries*

Intermediaries that assist Communities in procurement would be either a government entity, a private sector firm, or an NGO. Intermediaries are used where the community does not have adequate capacity to carry-out procurement. The assessment would cover the capacity of the intermediaries, as well as the coordination and accountability mechanisms with the local governments and the communities to guarantee that technical implementation does not suffer from poor procurement management, and vice versa. The intermediary's procurement management system must be robust enough to cope with and report on community's subprojects.

#### 4. *Communities*

It is not possible to assess the capacity of each one of the large number of communities that are to participate in a CDD project. Moreover not all participating communities are identified prior to project effectiveness. The assessment should be based on a sample of communities in order to have a general picture on how communities are organized and carry out their procurement, if any. The Project Operational Manual should define the minimum requirements that a beneficiary community should fulfill before it can be permitted to handle procurement; the assessment should determine whether communities would be able to meet these requirements. The requirements would include the communities' organizational and legal status. Communities that have a defined membership usually have an executive committee that facilitates collective decision making in contracting, while the community's legal status enable the community to enter into contracts and open Bank accounts. The assessment report should identify actions required to strengthen the communities' procurement capacity.

#### 5. *Supporting Documents*

The Project Operational Manual [POM] prepared by the PMU should contain the following supporting documents:

- (a) a sample format for submitting subproject proposals. The subproject proposal should identify the items [including cost estimates] that would be financed under the subproject. The format should require communities submitting subproject proposals to describe the procurement management arrangements that would be applicable at the community level, as well as the soundness of the such arrangements;
- (b) format for a simplified procurement plan for procurement under subprojects;
- (c) *appendix describing the procurement procedures* should be attached to the agreement. The procedures would be followed for procurement under the subproject. The simple procedures are described below. In cases where the community subproject involves large contracts, e.g. a small town water supply, reconstruction of a school, the procedures described in the legal agreement would apply. In such cases, the POM would provide guidance on the technical assistance required to assist communities process such contracts;
- (d) *simplified bid documents and forms of agreements* for works, goods and services that would be used by communities;
- (e) *draft financing agreement* to be signed between communities and the Project management [Social Fund or a central government agency. The agreement describes the obligations of the community and conditions for of use of project funds;

- (f) sample contract form to signed between the community and intermediaries; this agreement is a simplified form provision of services; and
- (g) format for reporting on procurement progress; the project operational manual should define minimum procurement reporting requirements. If the community has a reporting format that satisfies these conditions, it should be maintained; otherwise, a new format is proposed.

Sample documents are available in the OPCPR website under toolkits.

## 6. *Procurement Procedures*

Since CDD procurement at the community level is essentially governed by Provision 3.15 of the Guidelines, it is worth mentioning the flexibility and advantages that this provision present; it allows use of innovative approaches that may:

- (a) for sustainability of projects with future maintenance and operation, enable beneficiary communities to be contracted to implement their subprojects by community force account (para 46);
- (b) meet social objectives of the project by awarding small contracts to individuals and/or enterprises from beneficiary communities and grass-root NGOs, to enable the community to benefit from contracts for providing services, works and goods;
- (c) allow use of local know-how, technology and materials by employing local technicians, specifying materials and adopting technologies often used by communities; for examples schools could be of thatch roofs constructed by local artisans who know how to do it; and
- (d) adopt labor-intensive and other appropriate technologies so as to use community labor.

The procurement procedures to be described in the appendix to the financing agreement should be simplified selective tender procedures for works, shopping for goods and direct contracts. As a matter of principle, procurement of small contracts falling below the project's NCB threshold would follow the methods described below. It is important to assess whether communities especially registered ones are governed by Public Procurement Law of the borrower and required to follow certain procurement procedures, and how that fits well with the procedures and thresholds proposed under the POM. If it does not and national/local regulations are unsuitable, it is necessary to reach an agreement with the Borrower to follow POM procedures.

### 7. *Shopping for Goods*

By this procedure, quotations would be solicited from at least three qualified suppliers on basis of simplified documents. In order to enhance efficiency and remove the inherent risk of compromise, communities would be advised to ensure that request for and submission of quotations should be in writing. Quotations should be opened at the same time and to the extent possible in the presence of community members. As a general rule, the supplier who offers the lowest price should be awarded the contract.

### 8. *Shopping for works*

Just like in the case of shopping for goods, quotations would be obtained from at least three contractors who would be invited to submit quotations on basis of simplified quotation forms. The forms would describe the scope of the works, detail specifications and where possible include drawings. Quotations should be opened at the same time and to the extent possible in the presence of community members. As a general rule, the contractor who offers the lowest price should be awarded the contract.

### 9. *Local Bidding for goods and works*

Communities are often interested in open competition in order to enhance economy, perception of fairness and equal opportunity to suppliers and contractors. Open tendering procedures would be limited to local advertising using such media as local newspaper or radio, posting notices at strategic places, circulating such notices or reading them out in community meetings or other public gatherings. Essentially this is like NCB except that the advert it is not mandatory to advertise in a newspaper of national circulation and that bidding documents are simpler. Target suppliers and contractors are often those within the vicinity of the beneficiary community.

The request for bids spells out the work or goods needed, the criteria for selection, and the deadline for submission of bids. Bids are opened in a public ceremony. The bids are evaluated by a committee appointed by the community. Bids are examined to determine whether they meet the minimum specifications mentioned in the bidding documents (experience, quality of works, equipment, services offered, and delivery dates). Bids that meet the minimum requirements specified in the bid invitation are retained for further evaluation and the bidder who meets the minimum requirements and offers the lowest bid is selected. The award and amount of the contract should be announced to all bidders. A contract should be signed within five days of the announcement.

### 10 *Direct Contracting/Off the shelf purchases*

By this method a supplier or a contractor can be chosen without using any of the competitive methods described above. This method is used where there is only one source. Other reasons for direct contracting could be urgency, the need to adopt certain technology or a repeat order. To the extent possible the contract price agreed upon should be within local market rates or established estimates as shown in a Unit Cost Database. Direct contracting should be

one case that requires approval of the community committee in order to remove the inherent risk of compromise.

*11. Ensuring fiduciary compliance*

Procurement implementation arrangements under CDD should provide for a monitoring agent for ensuring that contracts under subprojects are procured in accordance with the agreed procedures and payments are made for performed contracts. One option is to have local governments or a frontline government agencies. Another option is to have an umbrella NGO carry out this function. In each case the objective is to monitor the activities of the communities on a regular basis and take corrective action in a timely manner. Communities can be required to obtain from the monitoring agent prior clearance of certain procurements.

The POM should provide for annual procurement audits (paras 67-68) so that issues raised in the audits would be corrected in follow-up procurement activities. The audit of procurement under subprojects should follow the arrangements described in the guidelines established for the project's overall procurement audit.

## ANNEX C. COMMUNITY-DRIVEN DEVELOPMENT PROJECT DESIGN AND PROJECT OPERATIONS MANUAL

Community-Driven Development (CDD) project designers should clearly state the guiding principles (for example, simplicity, efficiency, accountability, transparency, sustainability, and cost effectiveness) that underpin the project, its particular objectives (the overarching objective being increased empowerment and poverty reduction), and relevant current practices at the community level and in non-CDD projects.

***Simple, Transparent Implementation.*** Projects should be designed to keep paperwork and other administrative aspects to a bare minimum, and to ensure that project-relevant information is in the public domain. Complexity of paperwork and systems will slow implementation, diminish simplicity and transparency, and create opportunities for rent seeking.

***Legal Matters.*** Project designers should take into account two critical legal issues:

- Can the community groups or representatives and relevant government or non-government agencies envisaged as actors in the project and its subcomponents legally undertake the roles that the project expects them to?
- Who will retain ownership of purchased equipment or materials, and of the finished infrastructure, buildings, and so forth?

***Capacity Assessments.*** Project design should be predicated on assessments of the financial management, procurement, institutional, and social capacity of the community and of the country. At the community level, assessments would normally be on a sample basis and should not absorb too much effort. There may be specific issues that need particular attention, for example: Will communities need to rent heavy equipment from the Department of Public Works? Will communities need help in the purchasing of certain materials or equipment through bulk orders at the national level? On what terms will the project channel funds through local banks?

***Capacity Building.*** Project design should ensure that capacity-building activities (such as workshops, training, and exchange visits between villages) have sufficient funding to permit modifications to be made as the needs of the project unfold. At the community level, these activities should reflect the likelihood that most communities will not be managing many subprojects in the future--and those that they do manage should also be guided by the principle of simplicity.

**Audits.** Technical, procurement, and financial audits should be built into project design, and should reflect the imperative of Bank supervision including a review of such audits and sampling to verify accuracy and reliability.

**Community Audits.** Project design should incorporate methods to involve the community in auditing their own projects, as this is cheaper, more empowering, and sometimes more effective than top-down measures. Because of the inherent risk of local elite capture in CDD projects, and because it is important for the project management unit (PMU) to understand what is happening at the community level, the PMU should audit subprojects on a sample basis.

**Supervision.** Project designers should bear in mind that CDD projects may need more supervision than others, especially during the initial year, and that it will be necessary to make clear from the outset that supervision will need to be hands-on through frequent visits to the subproject levels. It is best if supervision aspects are discussed early on and included in project documentation.

**Procurement.** Project designers should bear in mind that it is difficult, if not impossible, to determine at the outset what communities will need to procure. Thus, in the community-level procurement arrangements and disbursement categories, the term “community subprojects” should be used instead of the categories of “goods, works, and services,” since the latter cannot normally be estimated with any accuracy. (N.B. This applies only to funds managed at the community level.) Rather than a procurement plan, a clear but brief description of the procurement methodology should be given in the project appraisal document. Although most projects dictate maximum amounts that can be used for any one purchase under each procurement procedure, uniquely as regards *community-level* fund management, it is best to avoid setting aggregate amounts as these may prove difficult to track.

**Subproject Design Process.** Subproject design should incorporate long-term sustainability issues, including the possible need for user-fee systems, and how fees would be calculated, used, and recuperated.

**Project Operations Manual.** The project operations manual (or manual of procedures) should cover all the principles and rules of the project—including menus (positive or negative), size and number of tranches, subproject design, verification and selection processes, establishment and management of implementation teams, fiduciary aspects, community contributions during and after implementation, sanctions, reporting requirements, and so forth. The manual, at least in draft form, should be reviewed by the Bank before project appraisal and should be completed before negotiations. The manual should give simple, clear guidance on all community-level procurement and financial management procedures. (In some projects, it may be useful to take these explanations and provide further clarifications and additional examples, in specific manuals for the subproject managers and/or treasurers.) It is important to maintain continuity between project documents, especially between the project appraisal document, the operations manual, and other community-level materials.