

MINISTRY OF FOREIGN AFFAIRS OF DENMARK
Danida



GUIDELINES FOR FINANCIAL MANAGEMENT OF DECENTRALISED UNITS

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1 Introduction

These guidelines describe the requirements concerning financial management of decentralised units, i.e. units where the Ministry of Foreign Affairs (MFA) is the implementing agency¹. They are part of and shall be used in conjunction with the Aid Management Guidelines (AMG) for Danish bilateral development cooperation.

The MFA is the implementing agency for a programme or development engagement where there is no external public or private institution responsible for the overall implementation of the activities, i.e. there is no external partner for the MFA to make an agreement with on implementation or accounting. The decentralised unit is directly accountable to MFA but keeps a separate set of accounts.

The full financial responsibility for all aspects of the implementation of the activities rests with the MFA, including the responsibility for ensuring a robust financial management set-up to reduce the risk of fraud cases, breach of contracts, lack of value for money, etc.

There are several types of decentralised units. A decentralised unit may generally be described as:

- an office staffed with one or several long term Danida advisors (and possibly local staff),
- placed inside a ministry or operating as an 'independent' (programme steering) office,
- a component of a thematic- or country programme or separate activity,
- providing advisory support to a ministry and/or working with programme coordination, -implementation, -monitoring and -administration,
- accounting for all project office expenditure (and possibly for payments to other implementing partners)

The agreement covering a decentralised unit may be a government-, country- or development engagement agreement or an 'Allocation note for special finance law appropriations'. In case the decentralised unit handles payments to other implementing partners these partners must be covered by separate programme- or development engagement agreements between MFA and implementing partner.

It should be noted that this modality does not necessarily live up to the intentions in the Paris Declaration on Aid Effectiveness and the Accra Agenda for Action and the Strategy for Denmark's development policy². A justification will have to be presented in connection with approval of the grant appropriation.

For details on procedures for approval of appropriations for grants please refer to the ['Guidelines for Presentations to the Programme Committee, Danida Grant Committees, and Council for Development Policy'](#)

¹ The MFA may refer to Representation or Head Quarters in Copenhagen

² In the Paris Declaration, developing countries committed to strengthen their systems and donors committed to use those systems to the maximum extent possible and to reduce the stock of parallel project implementation units (PIUs).

1.1 Purpose of the guidelines

The management of Danish funds shall be based on sound financial management procedures and international accepted accounting standards.

The main purposes of the guidelines are:

- to give guidance to MFA staff regarding roles and responsibilities and administrative procedures when organising a decentralised unit,
- to state the basic accounting principles and rules for decentralised units and
- to provide guidelines for the overall financial management.

The primary users of the guidelines are MFA staff, the management of the decentralised unit, the Steering Committee and the auditors.

1.2 Recent changes

The revision of these guidelines is primarily to ensure a more lean and aligned administration in the MFA's accounts system. The major changes are the abolishment of balance (interim) accounts and monthly reconciliations (i.e. registration of monthly expenditure to reflect in detail the accounts of the decentralised unit). The decentralised units will provide MFA with quarterly reporting. Advance disbursements to the decentralised units will be booked directly as disbursements on standard specification code 65 and will appear on one job ID only.

2 Responsibilities

2.1 Responsibility of the MFA staff

The MFA (department or Embassy) staff members are responsible for the overall financial management monitoring and implementation of the development activities. The responsibilities include, but are not limited to:

- Ensuring the development and maintenance of the accounts manual (see Annex 1).
- Receiving quarterly financial reports and taking prompt action on issues and problems identified.
- Appointing the auditor (from the beginning of the project).
- Ensuring independent external annual audit of the accounts according to international accepted standards.
- Ensuring that an unannounced cash check is performed at least once a year.
- Ensuring a final audit at the end of the project.
- Ensuring the constitution of a Steering Committee.
- Ensuring that action is taken promptly on issues and problems raised in Steering Committee meetings, in progress reports or identified by the auditor.
- Approving annual work plans, budget and procurement plans according to the MFA procedures or according to agreed local procurement rules with thresholds that are tighter than the MFA requirements.
- Making regular inspection visits according to the Financial Monitoring Visit Plan of the relevant MFA unit (see Guidelines for Financial Monitoring, Representations), and to coordinate these visits with monitoring of the progress of activities and achievements of planned results.

- Signing contracts with international advisors, international consultants and for international procurement.
- Giving ‘no objection’ to or signing contracts with local consultants to ensure agreed procurement guidelines are followed.
- Providing the decentralised unit with information about project-related payments made directly by the MFA (excluding payments for international advisors).
- Participating as member of Steering Committee.
- Receiving annual audit reports and preparing and finalising Cover Note in PDB.
- Finalising and signing of project completion report.
- Completion of grant in PDB, including reversal of provision in FMI.

The MFA will appoint a Desk Officer, who will be responsible for actively monitoring the implementation of the project in accordance with the appropriation note, the programme document, the development engagement document, the government-to-government agreement or other binding agreements, in consultation with the Chief Financial Officer.

2.2 Responsibility of the management of the decentralised unit

It is the responsibility of the management of the decentralised unit to ensure that:

- Detailed annual work plans and quarterly budgets are prepared.
- The Danish grant is appropriately accounted for (using computerized, double entry accounting software).
- Appropriate internal guidelines for financial management and accounting as well as control procedures are prepared and followed.
- An accounts manual based on a template (Annex 1) is developed and approved by the Steering Committee and continuously maintained (joint responsibility with the MFA).
- The funds are used in accordance with the activities, planned results and outcome set out in the project agreement and supporting documents.
- Funds are used in accordance with the budget. Deviations on budget lines above 10% must be reported to the MFA for approval. (A lower threshold may be negotiated).
- Timely, reliable and relevant financial reporting is provided (quarterly) to the MFA and the Steering Committee (or other relevant body overseeing the implementation).
- Annual accounts, outlining the use of available funds during the accounting period, are prepared and ready for audit no later than 3 months after the end of the financial year.
- TOR for the annual audits are prepared (to be approved by the MFA).
- Annual audit reports, including management letter (both signed by management) is provided to the MFA no later than six months after the end of the accounting period.
- Capacity assessment of external partners is carried out prior to entering agreements and initiating the first disbursement.
- Transfers (if applicable) from the decentralised unit to external implementing partners are specified in the audit report.
- The decentralised unit follows the MFA rules and thresholds on procurement. Local rules may be followed only if these have similar requirements and similar or lower thresholds.
- Contracts with local consultants as well as local and international suppliers are prepared and negotiated according to the MFA rules on procurement or according to agreed

procurement rules with thresholds that are tighter than the MFA requirements. (MFA must provide ‘no objection’ or sign the contracts).

- Project related payments made directly by the MFA are specified as “in kind” in the audit report.
- Financial monitoring of external implementing partners is carried out (joint responsibility with the MFA).
- Annual progress reports from external partners are submitted in due time.
- MFA policy on anti-corruption is followed.
- When closing down the decentralised unit, make a financial exit plan at least 6 months in advance (must be presented to Steering Committee for regular follow-up)
- When closing down the decentralised unit, prepare an agreement on returning or handing over of assets.
- When closing down the decentralised unit or ending a phase of the project, a draft project completion report is prepared.

2.3 Responsibilities of the steering committee

It is the responsibility of the Steering Committee to meet at least twice a year to:

- Approve the budget and work plan, at least on annual basis.
- Approve the audit arrangements. (The auditor must be appointed from beginning of the project).
- Approve the annual audit report and management letter.
- Approve financial and progress reports for all financial funds handled by the decentralised unit.
- Monitor that funds are used in accordance with objectives.
- Keep minutes of the meetings.
- Approve the final report
- Approve agreements where the decentralised unit shall administer or handle separate project or programme funding.

3 The Principles of Decentralised Unit Accounting

3.1 Definition

In MFA terms, decentralised unit accounting means that a unit, which is directly accountable to MFA, maintains a separate set of accounts. All accounts vouchers and other supporting documents remain with the decentralised unit. An external auditor shall audit the decentralised unit accounts and make unannounced check of cash holdings and other assets. The MFA appoints the auditor. The appointment of the auditor shall be in consultation with the Steering Committee.

The decentralised unit accounts must be organised in such a way that it is possible to report on the use of funds as per budget lines in the project document. The budget responsibility must be clearly divided between the MFA and the decentralised unit. Any expenditure paid by the MFA on behalf of the unit must be communicated to the unit and included in its accounts as an “in kind” entry (excluding payments for international advisors).

The decentralised unit accounts must be organised in such a way that it is possible to distinguish between funds from the MFA for the decentralised unit and cost paid for a service by the MFA.

Also in FMI³ it must be possible to distinguish between funds paid as advance disbursements to the decentralised unit and cost covered by direct payment from the MFA to the creditor. One action card with two unique job IDs will be designated for

- i) the advance transfers from the MFA to the decentralised unit (using standard specification 65), and
- ii) cost paid for a service by the MFA (mainly using standard specification 33).

The organisation linked to this action card⁴ must be 'Danida'.

The MFA will be responsible for signing contracts with international advisors, international consultancy contracts and for international procurement. Payment in relation to these expenditures must be booked directly in FMI on separate job ID under separate action cards. The MFA will also in most cases be responsible for transfers to external organisations; these transfers should be booked directly in FMI on separate job ID under separate action cards using standard account 62 (to ensure audit follow up).

The overall responsibility for monitoring and budget follow-up remains with MFA and the decentralised unit management must submit quarterly financial statement showing the units total expenditure against the budget and the balance of the cash, bank, and current account holdings. The details of the expenditures will be found in the decentralised unit accounts only.

3.2 Modified cash basis of accounting

The modified cash basis principle for accounting must be followed, which means that in general expenditures are accounted for at the time of payment, but allowing for some exceptions; e.g. cash advance settlements, income tax and insurance settlement. This means that the accounting system does not operate with depreciation of fixed assets, stock of materials or accrued expenses. However, fixed assets and any stock of supplies of significant value must be registered in separate lists.

3.3 Financial years

The MFA financial year follows the calendar year. The financial year of the government of the recipient country and the counterpart organization can be different from the calendar year, e.g. July/June and for annual reporting purpose this calendar year can be used.

3.4 Budgets

The decentralised unit must prepare quarterly budgets, to be used for quarterly reporting and by the MFA staff for frame management and for updating disbursement budgets in FMI.

3.5 Currency

The decentralised unit shall keep its accounts in local currency and report to MFA in local currency.

³ FMI is the Ministry's system (interface) for financial management of development assistance.

⁴ See FMI User Guides for details on commitment registration and FMI action cards.

If more than one currency is used, the decentralised unit must convert it to one currency in its account. Procedures must be described in the accounting manual.

3.6 Interest

Interest from bank holdings cannot be used as part of the funding of the project. Interest earned shall be booked on a separate account in the accounting system. At the end of each accounting period (or by end of project), the decentralised unit will transfer interest earned during the accounting period to the MFA for onward transfer to the Danish Ministry of Finance.

3.7 Transfer of funds

The decentralised unit will forward a quarterly transfer request to MFA. The request must contain a budget for the relevant quarter(s) minus the balance of holdings (cash and bank) = needed liquidity.

The MFA transfer the funds through FMI (local or central disbursement depending on currency) and the advance transfer is booked on the relevant job id for the decentralised unit using standard specification code 65.

The decentralised unit has to be created as a creditor in FMI and attached to the relevant organisation which is Danida.

3.8 Monitoring and review of the accounting

At least quarterly the decentralised unit must report its expenditure to the MFA. The decentralised unit shall as a minimum submit a trial balance for the period and bank and cash reconciliations. MFA will scrutinize the reports for errors and anomalies.

3.9 Agreements and onwards transfers of funds to external partners

In case the decentralised unit enter into a project agreement with an external organisation for the implementation of activities, then it is the responsibility of the decentralised unit to ensure that accounts are received timely and that they are appropriately audited. Procedures for approval of the external organisations' work-plans and budgets, transfer of funds, accounts, and audit shall be described in the accounting manual of the decentralised unit (see chapter 5).

Funds for external partners should where possible be transferred directly from the MFA (on a separate action card and job ID in FMI). In this case the MFA has entered into a contract with the external organisation and the standard specification code will be 62.

If the decentralised unit transfers funds to an external implementing partners as an advance or grant then a system must be established in the decentralised unit to assure audits are received in due time. The advance payments and outstanding advances must be specified in the audit report of the decentralised unit.

The responsibility to ensure that accounts are received timely and that they are appropriately audited must be clearly divided between the MFA and the decentralised unit.

3.10 Review of audit arrangement and annual audit report

The MFA shall receive the annual audit report including the management letter, and prepare the relevant cover note in PDB. The MFA shall ensure that any material issues raised in the auditor's report is appropriately and timely followed up and appropriate actions taken.

The desk officer must finalise and the CFO will review and approve the Cover Note in PDB. In those cases where there is no CFO at a Representation, the CFO in KVA approves the audited accounts and the Cover Note. This also applies to the MFA units with service agreement between KVA and the unit. Documentation for completion of the Cover Note and actions taken for follow up on the audit report must be filed in PDB.

4 Establishment of the Decentralised Unit Accounts System

4.1 Introduction

A computerised, double entry accounting system must be procured. The accounts system should as far as possible be operating from the start. A manual cashbook should be used for recording expenses until the computerised system is in place. When the computerised system is in place all transactions from the beginning of the project shall be recorded in the system.

4.2 The project document

The project document must include a detailed description of the decentralised unit and should in particular include the following issues:

- The responsibility for implementation and financial management of the project.
- The flow of funds from MFA to the decentralised unit shall be described.
- Job descriptions for any expatriate adviser(s) responsible for the project including description of the responsibilities related to the accounts functions.
- Job descriptions for local senior accounts staff.
- The budget lines according to which will be reported.

4.3 Establishment and organisation of the accounting unit and system

The management of the decentralised unit shall at an early stage and within the frame of the project document, prepare a plan for the detailed organization of the accounts functions and the establishment of the accounts system. Some main issues are:

Organisation

The organisation and staffing of the accounts section should be outlined in the Project Document. Attention should, inter alias, be given to: a) how shall the accounts functions be organized, b) what functions will be carried out, and c) where shall the staff be placed, and to whom do they report. If the project requires accounts staff in the field, the considerations should also be given to issues related to available office facilities, communication and reporting to head quarter, etc.

Staffing

Job descriptions shall be prepared for all the accounting staff. In cases where staff is seconded from e.g. a local ministry, further training and capacity building may be included in the project support. Employment contract and remuneration should be according to local rules and

regulation. Contracts must be on fixed-term not exceeding the project period. Contracts must be approved by the Steering Committee after consultation with a local lawyer.

Chart of accounts

A chart of accounts shall be prepared, which can fulfil the requirements for reporting. Control of funds is essential. Management information and the possibility of monitoring use of funds are equally important. The chart of accounts must allow for monitoring expenses according to activities in the annual work plan and budget, and must enable reporting to MFA according to the budget lines in the project document.

Design of reports

Reports to MFA, the Steering Committee and national authorities, as well as internal accounts reports shall be designed. The decentralised unit shall where applicable get approval from relevant national authorities with regard to reporting as appropriate.

Procedures

Procedures regarding cash handling, approval of expenditures, reporting, budget control and other internal control, including control of assets (fixed assets, stores, debtors and cash) shall be established and documented in the accounting manual and in accordance with international acknowledged standards (see chapter 5).

Filing

All bookkeeping material shall be filed so it is easy to retrieve, and it must be stored safely. Vouchers and other records must be kept until five years after the end of the financial year, in which the project is finalised. After completion of the project, the management ensures that a list of accounting documents is made and delivered together with all the documents to the MFA.

The accounting documentation shall at any time be available for scrutiny by the MFA and the Danish Auditor General.

Please see Chapter 5 for more details and see Annex 1 for an accounts manual template.

5 Accounting Manual

5.1 Introduction

All MFA units using decentralised unit accounting shall have an accounting manual describing the specific accounting procedures. The management of the MFA unit is responsible for developing the manual. The manual shall give an explicit description of the project's accounting procedures and of the organisation of the accounting function and the accounting system and related systems. The manual shall stress the management's responsibility to maintain a sound record-keeping system, and to control the use of funds in relation to project results.

5.2 Preparation and maintenance of the project's accounting manual

The auditor or other external consultants may be requested to assist in the preparation of the manual as found feasible.

The manual shall be prepared as an integrated part of the process of establishing the accounts section and setting up the accounts system. The manual shall be prepared at the outset of the project. The manual will serve as a reference-guide for the project management and staff, members of the Steering Committee, auditors, and MFA representatives.

During the implementation the manual shall be reviewed and updated at least once a year following the annual audit incorporating the auditor's recommendations regarding accounting and control procedures. An updated version shall be forwarded to all holders of the manual, including MFA and the auditor.

Please see Annex 1 for an accounts manual template.

5.3 Approvals

The accounts manual shall be forwarded to the auditor, as soon as possible after the auditor has been appointed, for comments and recommendations before the Steering Committee approval. After approval the finalised accounts manual shall be distributed to the MFA, members of the Steering Committee, to the auditors and to all relevant staff of decentralised unit.

6 Audit Arrangement

An annual audit of decentralised unit expenditures in accordance with International Standards of Auditing (ISA) shall be performed by an external auditor. The auditor shall be a certified public accountant. The selection of the auditor will be made by the MFA at the beginning of the project, and where applicable, in consultation with the Steering Committee. As a reference, when selecting the auditor and preparing the terms of reference for the audit, it is recommended to use DAC's technical guidance notes on selection of a private sector audit firm and specimen terms of reference for external auditors for donor-supported projects and sector programmes. DAC's technical guidance notes are available from the book on '*Harmonising Donor Practices for Effective Aid Delivery*' and can be downloaded from www.oecd.org/dac/effectiveness/harmonisingdonorpracticesforeffectiveaiddeliverythreevolumes.htm , (see volume 1, chapter 5).

The procurement of auditor must be done in accordance with MFA procurement guidelines or according to agreed procurement rules with thresholds that are tighter than the MFA requirements.

In cases where a comprehensive compliance or value for money audit is found relevant, terms of reference should be prepared according to ISA standards. The MFA, in consultation with the Steering Committee shall approve the specific terms of reference. The audit agreement, signed by the auditor and the MFA, shall be distributed to the project's management.

The audit report shall include a financial statement (signed by management) for the fiscal period audited and a management letter including recommendations and follow-up on previous recommendations. The audit report, together with the management's comments to the report and replies to all questions raised in it shall be presented to MFA and the Steering Committee not later than six months after the end of the accounting period. One original copy of the audit report shall be forwarded to MFA immediately after completion.