Independent Verification in Results-Based Financing

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With pressure for greater accountability and value for money in public budgets, widening the use of results-based financing (RBF) and setting up adequate independent mechanisms to verify results is becoming increasingly important. In January 2012, the World Bank launched the Program-for-Results (PforR), an innovative financing instrument that disburses funds upon delivery of verified results in developing country programs. Until now, the use of independent verification has been limited to output-based aid (OBA), which is one of the RBF modalities; however, there is potential for more widespread use of independent verification. This note highlights lessons from projects funded by the Global Partnership on Output-Based Aid (GPOBA) and the World Bank, and discusses elements that can best ensure the independence and effectiveness of a verification system.

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Results-based financing (RBF) proposes radical changes in development financing paradigms, shifting the focus of development work from inputs to outputs or results. RBF commonly refers to a range of mechanisms designed to enhance delivery of services or operations, through the use of performance-based incentives, rewards, or subsidies. In output-based aid (OBA) schemes, typically, service delivery is delegated or contracted out by a funding entity—a government or an international development agency—to a service provider. Payment depends on the achievement of pre-agreed and independently verified results.

Independent verification is a key mechanism to enhance the performance of service providers. For the funding entity, it mitigates the risk of misuse of funds, providing assurance and evidence that funds have been used for the intended purpose. In OBA projects, for example, verification is conducted by an independent verification agent (IVA). Its function is to ensure that only verified outputs are reimbursed, through a) certifying that the contractual outputs, as reported by the service provider, have been physically delivered and that pre-agreed standards of service have been achieved, and b) validating the service provider's reimbursement request (performing cost reconciliation by multiplying the quantity of outputs achieved by their unit cost), and recommending to the funding entity to honor payment. Figure 1 illustrates the typical verification cycle in OBA operations.

Verification protocols

Verification protocols are the procedures used to certify that a service meets agreed specifications. The more detailed the verification protocol and methodology is—specifying results/outputs, indicators, reporting frequency, and verification system—the less likelihood of conflicts later.

Results should be achievable—it is important that they are under the control of the service provider—and directly linked to the rewards or incentives. Indicators must be specific, measurable, and verifiable. Too many indicators may make verification complex. Attribution and regular measurement should be easy. In some cases, the actual suitability of indicators can only be tested once operationalized. In addition to technical considerations, results and indicators must be aligned with the stakeholders' objectives, priorities, and interests. Setting appropriate indicators thus often requires an inclusive, iterative process.

In OBA projects, which focus on access and sustainable service for poor users, outputs are defined as close to the desired development outcome as possible. For instance, in the infrastructure sectors (e.g. water, electricity supply), having working connections to the network installed triggers payment of a portion of the subsidy. The remaining part is withheld until after several months of verified service, which entails a review of billing and collection records. Further quality parameters can be verified, such as the timeframe for delivery, coverage and sustainability conditions, and anti-corruption

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standards. These are illustrated in RBF schemes, such as the São Paulo Water Recovery Project (REAGUA) in Brazil, a state government subsidy scheme that aims at increasing the quantity and quality of water in São Paolo's watersheds.

Effective verification protocols also rely on available data sources, the capacity to measure indicators on a regular basis, and baseline data. In OBA projects, baseline data typically includes current access to services, levels of service, and development indicators.

In most sectors, verification includes physical inspection in the field, which is also subject to specific quality requirements. In health and education, subsidies are reimbursed for ongoing service. Schemes rely on routine service delivery data collection at facility level and cross-checked against facility registers. When feasible, patients follow-up (through spot-checks of a sample of households, or household surveys) allows to better assess use, coverage, and perceived quality of care. Third-party agents are also used to carry direct observation of care provision and health facility assessment, which include interviews with health staff and patients, and audits of management practices, equipment and supplies. Ultimately, the size of the program influences the choice of verification systems and methods. Nationwide programs may require control enhancements. For instance, the national performance-based financing health program in Burundi incorporates several layers of verification, from the community to the provincial level.

Finally, reporting arrangements are important as they can affect speed of disbursement. In the GPOBA-funded health project in Uganda, disbursements were delayed due to the complex cycle of approval of the IVA report.

Scope of verification

Independent verification is expected to provide reasonable assurance that the statements claimed by the service provider are free from material error. Clearly, factors including logistical capacity, governance, and geographic distribution of the output influence the scope of verification. Since seeking 100 percent verification of each agreed output or result is not feasible, statistical sampling is often considered most economical and effective, with precision (how closely the sample represents the universe) and reliability (confidence level) taking into account factors such as available resources, and trust in implementing agencies.

In large government programs such as those supported by PforR, careful independent verification design is required because of the large number and geographic dispersion of outputs/results. An example is Indonesia's Local Government and Decentralization Project, which aims at improving the accountability and reporting of the central government's Specific Purpose Grants (DAK). Eligibility for loan reimbursement relies on reporting by participating local governments upon completion of pre-agreed outputs in roads, water and irrigation sectors, and independent verification.

One way to address the challenges related to geographic distribution is collecting data at the community level. The telecom sector offers examples of automated verification of outputs. In OBA projects aimed at installation of public phones in rural locations, often the regulatory authority demands the installation of an automated network management terminal in its offices, connected to the provider's own network management system, which provides instant alerts when a particular phone is out of service, and collects statistical information related to traffic and maintenance. This system can be used for initial verification of facilities installed and for recurrent verification that service is being delivered. There is scope for further community monitoring of service delivery, enhanced through the use of mobile phone applications (such as community monitoring of water supply), which can reduce verification costs.

Outsourcing or not

Verification of results can be carried out and by various parties, including government agencies, semi-autonomous

Figure 1. Typical OBA Verification Cycle
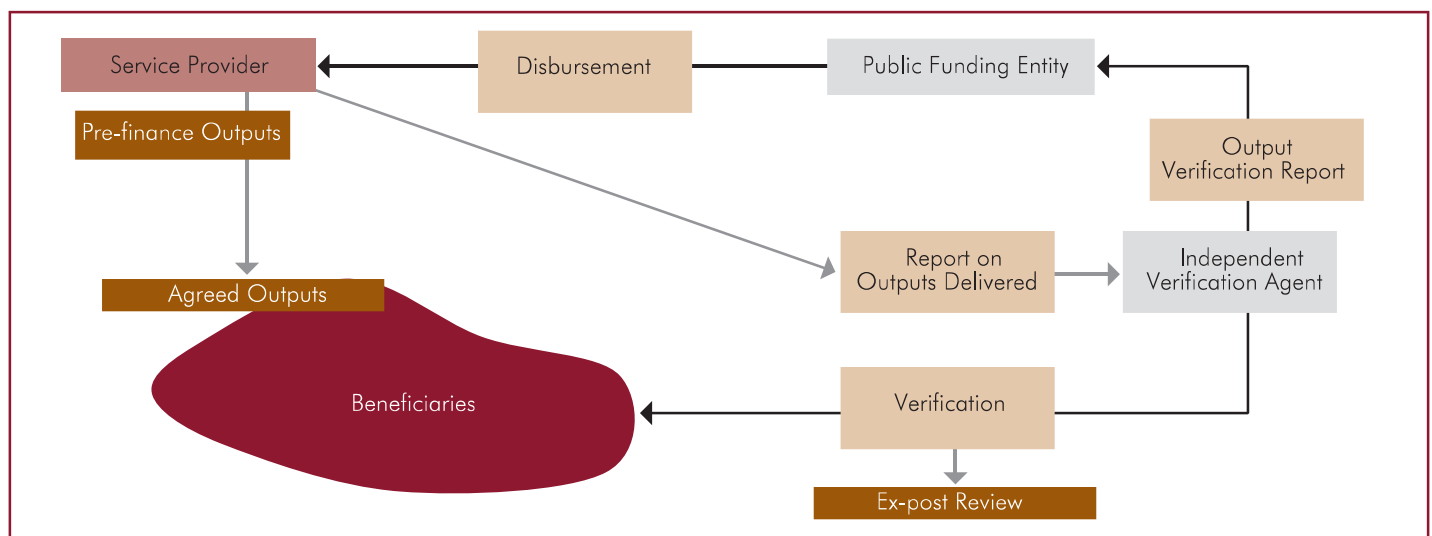
entities, statistical or audit entities (if they can demonstrate adequate capacity and independence), and third-party entities such as firms, nongovernmental organizations (NGOs), and civil society representatives. In determining which of these options is most suitable, the objective is to reduce the inherent risk of capture, primarily by the service provider, who is the main interested party; and protecting the funding entity against the potential manipulation of results. Conflict of interest issues need to be assessed when a government entity (such as the project's implementing agency) is responsible for both overseeing service providers and output verification; it may be motivated to inflate the results achieved, through political interference, to obtain payments.

The main institutional solution adopted by GPOBA and, in some cases, the World Bank, has been the use of external firms or consultants (both local and international). Firms can bring capacity and credibility when the independence of government agencies is questionable. In Uganda's Reproductive Health Voucher program, weak professional councils and other regulatory bodies justified the use of a firm as an interim measure to conduct output verification. In the long run, strengthening country systems to do so will become critical.

When government agencies perform verification functions, ideally, an independent and capable regulatory or audit agency should be designated. Finding such an entity may be challenging. Internalizing the verification function is the typical approach in the telecom sector, where the telecom sector regulatory authority itself conducts verification. While in some cases, the regulator hires individual consultants to assist, the regulator bears the full responsibility for verification of outputs. For example, for the universal access project funded by the World Bank that replicated the Mongolia GPOBA-funded telecom pilot, the country's Communications Regulatory Commission hired a local firm with an engineering background to conduct the independent verification. The use of state auditors is proposed in PforR operations such as Vietnam's results-based Rural Water Supply and Sanitation and Indonesia's Strengthening DAK Transfers to Local Governments Program.

The qualifications of any verification agent's team are critical. Although the practice of output verification is relatively new, finding qualified teams has not been a major challenge for GPOBA. In only two GPOBA-funded projects (in Indonesia and in Cameroon) has the lack of qualified agents led to delays in implementation. Teams most often possess technical sector expertise such as engineering, combined with financial audit expertise. The selection criteria have also included experience working in poor communities, and, especially for rural projects, an understanding of the local culture and language. For example, the international firm recruited as IVA for the health project in Yemen hired a local medical doctor to help with the verification process. Finally, statistical knowledge is useful to conduct customer satisfaction surveys.

Recruitment process and payment

In principle, to expedite disbursement, it is preferable for the verification mechanisms to be ready as early as possible.

However, if an external party is to be recruited, the hiring process must be considered. Competitive selection takes time. For example, in the GPOBA-funded water project in Cameroon, the first bidding was unsuccessful, as all proposals exceeded the available budget, requiring rebidding.

The decision of who hires the verification agent is also critical: the hiring agency should not have vested financial interest in the performance. When it is not practical for the implementing agency to hire the verification agent, the service provider itself may do so. If the same service provider is the direct funds recipient, there exists scope for conflict of interest such as collusion or lax application of verification protocols, as the verification agent has to provide independent assessment of output delivery while maintaining a business relationship with the service provider. Risks can be mitigated by hiring either a reputable auditing firm with technical capabilities in the sector, or the service provider's existing external auditors. The belief is that auditors are subject to established professional standards, and will not risk their reputation, credibility and license. Noteworthy, in projects where the World Bank funds the verification agent's contract, conflict of interest are mitigated by requiring the hiring entity to follow World Bank selection of consultant guidelines, which include World Bank prior-review of the process and no-objection to the contract award.

Considering sustainability and ensuring sufficient resources for verification activities are important issues. Project implementers need to budget adequate funding, as the verification of results can be costly (and it is not always clear who pays for it, as governments are not used to this type of function). In GPOBA projects, the average contract value of IVA averages 2 to 5 percent of the total GPOBA project funding. For some of the projects, the budget allotted for output verification turned out to be quite low. Rural projects tend to be more expensive to verify because the outputs tend to be more dispersed. Recognizing this, in Brazil's REAGUA, the state authorities allocated 7 percent of the program amount (US$10 million) to the IVA contract.

Internal controls and capacity

Verification is also directly impacted by the reporting capacity and internal control systems of service providers and/or implementing agencies. In the GPOBA-funded project in Cameroon for example, initial weak reporting capacity of both the service provider and the implementing agency resulted in delays in delivering the output verification reports, which in turn delayed disbursement to the water operator. It may be necessary to strengthen the accountability and transparency of billing systems, financial accounting, and data collection systems in service providers and/or implementing agencies (such as local governments), to demonstrate that services have actually been delivered.

Generally, RBF tends to increase the accuracy of reporting of results, and in particular the completeness of reporting. In the water supply and sanitation GPOBA-funded project in Morocco, the quarterly inspections by the independent

consultant helped to improve the operators' progress reporting requirements and implementation methods. A robust verification and counter-verification system remains crucial to minimize the risk of inaccurate reporting of levels of service provision and of quality measurement.

Collaboration among stakeholders

Due to the pressure to get paid, service providers expect verification to be carried out as soon as they have delivered the service. Collaboration of all parties (funders, implementing agency, service providers, communities, and verification agent) is critical in ensuring timely disbursement. At the beginning of the project, the verification agent should agree on the verification protocol (including the format for the verification reports and sampling methodology), and make sure that it is acceptable to all parties. Debriefing on preliminary findings at the end of each verification exercise then gives the service provider and the implementing agency an opportunity to respond and take corrective measures while the verification agent prepares its report.

Similarly during implementation, it is in the interest of service providers and implementing agencies to facilitate verification. For example, in two GPOBA-funded water projects in Uganda and Mozambique, the service providers did not provide appropriate staff or logistical support, leading to delays in the verification efforts and subsequent disbursements. Conversely, if the pace of output delivery is slower than expected, flexibility in verification may be required. In several GPOBA-funded projects, IVAs performed *ad hoc* verifications, as they were not able to predict when service providers would deliver the outputs.

Last, making verification findings available to the public provides necessary checks and balances, reinforcing demand-side governance and accountability to the end users.

Conclusion

Independent verification is not yet an established practice in development projects. The challenge is to put in place effective mechanisms to promptly trigger payments for results. With the mainstreaming of RBF approaches, internal monitoring and controls, as well as verification procedures in implementing partners, may need strengthening for the incentive framework, and the verification that goes with it, to function well. The design of a verification system involves practical choices, depending on parameters such as the size of the program, resources and capacity available, and the broader operating environment. Ultimately, all parties should work together to structure verification systems that link financing and results.

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