



Technical Assistance Report

Project Number: 46539
Regional—Capacity Development Technical Assistance (R-CDTA)
August 2014

Improving the Financial Management Capacity of Executing Agencies in Afghanistan and Pakistan

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Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
CWRD	–	Central and West Asia Department
IPSAS	–	International Public Sector Accounting Standards
TA	–	technical assistance

NOTE

In this report, "\$" refers to US dollars.

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CAPACITY DEVELOPMENT TECHNICAL ASSISTANCE AT A GLANCE

1. Basic Data		Project Number: 46539-001	
Project Name	Improving the Financial Management Capacity of Executing Agencies in Afghanistan and Pakistan	Department /Division	CWRD/CWOD-PSS
Country Borrower	REG n/a	Executing Agency	Asian Development Bank
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Public sector management	Public expenditure and fiscal management		0.50
		Total	0.50
3. Strategic Agenda	Subcomponents	Climate Change Information	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low
4. Drivers of Change	Components	Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Institutional development Organizational development	No gender elements (NGE)	✓
5. Poverty Targeting		Location Impact	
Project directly targets poverty	No	Regional	High
6. TA Category:	A		
7. Safeguard Categorization	Not Applicable		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		0.50	
Sovereign Capacity development technical assistance: Technical Assistance Special Fund		0.50	
Cofinancing		0.00	
None		0.00	
Counterpart		0.00	
None		0.00	
Total		0.50	
9. Effective Development Cooperation			
Use of country procurement systems		No	
Use of country public financial management systems		No	

I. INTRODUCTION

1. All investment projects financed by the Asian Development Bank (ADB) require executing agencies to take necessary measures to ensure that the proceeds of loans and grants are used only for the purposes for which the loan or grant were approved and due attention is given to economy and efficiency. Executing agencies are required to submit annual audited project financial statements and, where applicable, an independent entity's audited financial statements.¹ In addition, executing agencies must ensure that their financial management and reporting systems are adequate to generate reliable financial data relevant to each ADB-financed project, including the review and audit thereof. However, the audited project financial statements submitted by executing agencies are often late and often do not meet ADB's requirements.

2. ADB's Central and West Asia Department (CWRD) conducted consultations in the second half of 2013 on financial management matters of ADB-financed projects in CWRD's developing member countries. As a result of those consultations, the technical assistance (TA) focuses on two countries in immediate needs —Afghanistan and Pakistan.² The fact-finding in these two countries took place in February–May 2014.³ The oversight and executing agencies in Afghanistan and Pakistan requested ADB to provide capacity building to enable them to effectively monitor financial transactions and prepare financial reports in accordance with international principles and practices.

3. This regional capacity development TA⁴ will strengthen financial management in Afghanistan and Pakistan. The design and monitoring framework is in Appendix 1.

II. ISSUES

4. **Afghanistan.** ADB receives annually an average of 40 audited project financial statements and audited financial statements from executing agencies implementing ADB-financed projects in Afghanistan. The quality and timeliness of audited project financial statements is a major concern. The project financial statement is often presented in a nonstandard form and is inconsistent among executing agencies. The project financial statements for ADB-financed projects are generally prepared in accordance with cash basis International Public Sector Accounting Standards (IPSAS).

¹ ADB. 2012. Project Financial Reporting and Auditing. *Operations Manual*. OM J7. Manila. Independent entity refers to executing agencies or implementing agencies that are separate legal entities required by national law or regulation to prepare audited financial statements, including income financial position, and cash flow (OM, Section J7).

² The current combined program portfolio for Afghanistan and Pakistan is \$6 billion, accounting for 41% of CWRD portfolio. As per the loan covenants of these projects, the executing agencies collectively are required to submit an average of 120 audited project financial statements and audited financial statements annually to ADB. Providing targeted attention to strengthening financial management skills in executing agencies implementing ADB-financed projects in Afghanistan and Pakistan will provide the largest value for money across all developing member countries in CWRD's portfolio.

³ During fact-finding in February and April 2014, the Economic Affairs Division of the Ministry of Finance in Pakistan supported capacity development to executing agencies if ADB could provide this. The Department of the Auditor General of Pakistan fully supported the capacity development to the government auditors. Aide-mémoire were provided to the government. Because of security considerations in Afghanistan (April and May 2014 election), a video conference with representatives from government and executing agencies and the Afghanistan Resident Mission was arranged in lieu of mission to Afghanistan. Government of Afghanistan concurrence will be obtained after TA approval.

⁴ The TA first appeared in the business opportunities section of ADB's website on 6 June 2013.

5. There are few qualified chartered accountants or certified public accountants in Afghanistan and it is often difficult for project management units to recruit qualified accountants.⁵ Frequent turnover in personnel undermines institutional capacity development, and gaps in knowledge are a major challenge in project implementation. Because of the lack of qualified project accountants, the financial management capacity of executing agencies is weak. Therefore, ADB's financial reporting and auditing requirements are often misunderstood and subject to varied interpretation, resulting in nonstandard and inconsistent reports being prepared by the executing agencies.⁶ In addition, no single document fully incorporates all financial management requirements of ADB and the Government of Afghanistan, which leads to duplication of efforts in recording financial transactions and preparing financial reports, and lack of clarity on (i) eligible expenditures to be charged to the project, (ii) treatment of in-kind contributions, and (iii) treatment of loan capitalization. As a result, inconsistent information is presented in financial reports among executing agencies.

6. The audit reports often do not provide the required opinion so as to be acceptable to ADB.⁷ This limits the value of financial information in monitoring project performance and the assurance on financial management of ADB-financed projects. One of the identified challenges in preparing audit reports of a suitable quality is the lack of standard terms of reference for auditors engaged to audit the projects. Audit terms of reference often include scope and requirements of nonfinancial audit such as compliance with ADB's procurement guidelines or compliance with all loan covenants (not limited to financial covenants). The process of recruiting external auditors may be delayed by unclear expectations, resulting in further delays of the audits which, once conducted, vary in quality and degree of completion.⁸ Clarifying ADB's expectations and requirements related to audits will help expedite audits and will raise the quality of reports received.

7. **Pakistan.** An average of 80 audited project financial statements and audited financial statements are submitted annually to ADB by executing agencies. However, audited project financial statements are often nonstandard in presentation, contain varying degrees of information, vary in accuracy, and may have misleading conclusions. Executing agencies often undermine the audit process. Therefore, the audit process provides limited assurance on the financial management of a project.⁹

8. In Pakistan, executing agencies of most ADB-financed projects have project accountants who have reasonable accounting knowledge to record financial transactions and to prepare financial reports, although few hold the qualifications of chartered accountant or certified public accountant, or membership of the Association of Chartered Certified Accountants. Because of the lack of qualified project accountants and an absence of clear guidance about what should be presented in the project, financial statements have been nonstandard and financial reports among executing agencies inconsistent. Project financial statements of ADB-financed projects

⁵ World Bank. 2009. *Afghanistan Report on Observance of Standards and Codes Accounting and Auditing*. 16 February. http://www.worldbank.org/ifa/rosc_aa.html. There is a shortage of qualified accountants in Afghanistan. There are only 20 qualified accountants in the country and few universities offer accounting and finance courses.

⁶ ADB requires that the audited project financial statements are prepared in accordance with the International Financial Reporting Standards, IPSAS, or national equivalents. The audit of the project should be conducted in accordance with International Standards on Audit, International Standards of Supreme Audit Institutions, or equivalent national auditing standards.

⁷ The audit report of the Office of the Auditor General in August 2010 reported the same concerns on the audited project financial statements for ADB-financed projects in Afghanistan.

⁸ In Afghanistan, project financial statements of ADB-financed projects are audited by private audit firms.

⁹ The audit report of ADB's Office of the Auditor General in February 2014 reported the same concerns on the audited project financial statements for ADB-financed projects in Pakistan.

in Pakistan are generally prepared in accordance with cash basis IPSAS. Project accountants may not always understand the requirements of financial statements prepared under cash basis IPSAS. Helping project accountants become familiar with cash basis IPSAS and learn how to prepare a project financial statement in accordance with cash basis IPSAS will raise the quality of project financial statements. In addition, frequent turnover in personnel is an issue. Therefore, gaps in knowledge become a challenge during project implementation.

9. In Pakistan, ADB-financed projects are generally audited by the Department of the Auditor General of Pakistan. The Office of the Auditor General of Pakistan and its provincial audit offices are not consistently familiar with ADB's audit requirements, including what expenditures are eligible under ADB-financed projects. Executing agencies often fail to respond promptly or are reluctant to respond to audit observations raised by the auditors because of disagreement with the auditors on ineligible or irregular expenditures. In some cases, the auditor reported ineligible expenditures, which were considered eligible under ADB-financed projects. These delayed finalization of the audit reports or the audited project financial statements are then submitted to ADB without executing agencies' management response. Therefore, clarifying ADB's audit requirements and giving clear guidance on eligible expenditures of ADB-financed projects will help the audit process and improve the quality of the audit report.

10. There is an urgent need to help executing agencies develop their capacity through trainings or workshops so as to overcome financial management knowledge gaps, strengthen executing agencies' capacity on financial management during project implementation, improve the quality of project financial statements prepared by executing agencies, and provide clear guidance in both Afghanistan and Pakistan. To ensure that capacity development is sustained, the TA will develop financial management manuals for each country so as to provide clear guidance on ADB's financial management requirements, and the manuals will be incorporated in project administration manuals or facility administration manuals.

III. THE CAPACITY DEVELOPMENT TECHNICAL ASSISTANCE

A. Impact and Outcome

11. The impact will be improved financial management compliance across all ADB-financed projects in Afghanistan and Pakistan. The outcome will be improved financial management of ADB-financed projects during project processing and implementation in Afghanistan and Pakistan.

B. Methodology and Key Activities

12. **Output 1: Improved quality of project financial statements.** ADB staff acting as resource persons in the workshops and consultants will provide support to executing agencies in both Afghanistan and Pakistan. The workshops will help project accountants become familiar with cash basis IPSAS and will demonstrate how to prepare a project financial statement in accordance with cash basis IPSAS by using country-specific project financial statements. The workshops will also help executing agencies understand the importance of independent audit as well as timely response to audit findings raised by the auditors. After the workshops, executing agencies will be able to prepare project financial statements acceptable by ADB. An unaudited project financial statement will be provided to ADB within 3 months after the workshops. Consultants will be available to monitor the progress and support weak executing agencies.

13. **Output 2: Improved quality of audit reports.** This output is only applied to ADB-financed projects in Pakistan. ADB will provide workshops to government auditors on ADB's auditing requirements, relevant auditing standards under International Standards of Supreme Audit Institutions, as well as eligible expenditure under ADB-financed projects. ADB staff will be key resource persons in the workshop. The workshops will include practical audit report samples and guidelines on eligible expenditures under ADB-financed projects.

14. **Output 3: Country project financial management manuals.** To ensure the manual is owned and used by executing agencies, consultants will conduct workshops to gather the requirements from executing agencies. By working with executing agencies, and with ADB guidance, consultants will develop country project financial management manuals for Afghanistan and Pakistan to identify specific requirements and clarify which actions need to be undertaken when, how, and by whom. The manual should be discussed with executing agencies and consensus on it obtained. Consultants will advise and support executing agencies during the implementation of the manual. The manual will help executing agency staff who are implementing the projects to record financial transactions, strengthen internal control, prepare financial reports, and administer ADB-financed projects. The manual will help executing agencies improve their capacity in financial management. It will also include samples of project financial statements for that country and, for Afghanistan, terms of reference for external auditors. The manual can be inserted into project administration manuals or facility administration manuals for ongoing and future projects.

15. Change in executing agencies' management and security considerations in Afghanistan during TA implementation are considered risks because they may delay the decision on acceptance of the manual and also delay TA implementation. It is assumed that trained executing agency staff will be retained during the TA implementation period.

C. Cost and Financing

16. The TA is estimated to cost \$500,000, which will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF-Others). The cost estimates and financing plan are in Appendix 2.

D. Implementation Arrangements

17. ADB will be the executing agency for the TA. CWRD's Portfolio, Results, Safeguards and Social Sector Unit will be the focal point within ADB, working closely with CWRD's sector divisions and ADB resident missions in Afghanistan and Pakistan. The TA will be implemented over 32 months from October 2014 to June 2017. The Portfolio, Results, Safeguards and Social Sector Unit's financial management specialist (TA team leader) will lead the overall TA implementation, coordinate activities and outputs with collaborating partners and other stakeholders, ensure relevance of the TA, and guide and finalize publication of relevant knowledge products.

18. The TA will require one international consulting firm. Appendix 3 presents the outline terms of reference for consultants. The firm will be engaged through quality- and cost-based selection by ADB in accordance with its Guidelines on the Use of Consultants (2013, as amended from time to time). The selection method and weighting for quality- and cost-based selection is 90% quality and 10% cost, and will be done on a biodata technical proposal basis. Disbursement will be in accordance with ADB's *Technical Assistance Disbursement Handbook* (2010, as amended from time to time).

19. ADB staff will be involved in the workshops as resource persons, and the consulting firm will advise and support executing agencies in preparing project financial statements for outputs 1 and 2. For output 3, the international consulting firm will develop project financial management manuals for Afghanistan and Pakistan through a series of workshops and discussions to be held with executing and government agencies. The firm will provide overall support to coordination consistency between the manual under development and local practices and requirements. The firm will also assist in planning workshops, conducting workshops, and providing support to executing agencies in implementing the manual. Resource speakers will be invited to add knowledge value to the trainings and workshops.

IV. THE PRESIDENT'S DECISION

20. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$500,000 on a grant basis for Improving the Financial Management Capacity of Executing Agencies in Afghanistan and Pakistan, and hereby reports this action to the Board.

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
<p>Impact Improved financial management compliance across all ADB-financed projects in Afghanistan and Pakistan</p>	<p>By 2020, compliance with ADB's policy on financial management increased from 35% in 2012 to 95% for projects in Afghanistan and Pakistan</p>	<p>ADB's financial management specialist assessment on the financial covenant compliance for projects in Afghanistan and Pakistan</p>	<p>Assumption Governments' continued commitment to good corporate and financial governance</p>
<p>Outcome Improved financial management of ADB-financed projects during project processing and implementation in Afghanistan and Pakistan</p>	<p>By 2018, audited project financial statement acceptable to ADB increased from 35% in 2012 to more than 95% in Afghanistan and Pakistan</p>	<p>ADB's financial management specialist assessment and conclusion on audited project financial statement submission</p>	<p>Assumption Governments' continued commitment and enforcement to apply IPSAS, IFRS, ISA, and ISSAI by accountants, auditors, and regulators</p>
<p>Outputs</p> <p>1. Improved quality of project financial statements</p> <p>2. Improved quality of audit reports</p> <p>3. Country project financial management manuals</p>	<p>By 2015, at least 70 project accountants from executing agencies completed the workshops and improved project financial statement preparation</p> <p>Interim audited project financial statement submitted to ADB with acceptable quality by executing agencies within 3 months after the workshop</p> <p>By 2015, at least 20 government auditors completed the workshop and improved the audit report</p> <p>AGP submitted to ADB audited project financial statement of acceptable quality by December 2015</p> <p>By 2016, manuals accepted and implemented by executing agencies</p>	<p>Consultants' interim and progress reports</p> <p>ADB's financial management specialist assessment and conclusion on audited project financial statement submission report</p> <p>Accepted financial management manual</p>	<p>Assumptions Availability of consultant to support project accountants in applying cash basis IPSAS</p> <p>Trained staff will be retained</p> <p>Risks Change in executing agencies' management may delay decision on acceptance of manual and study</p> <p>Security considerations in Afghanistan may delay technical assistance implementation</p>

Activities with Milestones	Inputs
<p>1. Improved quality of project financial statements</p> <p>1.1 Prepare workshop materials and conduct workshops for project accountants of executing agencies (November 2014–October 2015)</p> <p>1.2 Support executing agencies in preparing project financial statements and monitor executing agencies' application of skills acquired from workshops (February 2015–December 2015)</p> <p>2. Improved quality of audit reports</p> <p>2.1 Prepare workshop materials and coordinate with government auditors (February 2015–April 2015)</p> <p>2.2 Conduct workshops for government auditors (April 2015–July 2015)</p> <p>2.3 Convene follow-on sessions after workshop with local audit offices (July 2015–December 2015)</p> <p>3. Country project financial management manuals</p> <p>3.1 Recruit consultants (September 2014–January 2015)</p> <p>3.2 Conduct interviews or workshops with executing agencies and government agencies concerned, if required for information gathering (February 2015–May 2015)</p> <p>3.3 Prepare draft manuals (March 2015–July 2015)</p> <p>3.4 Conduct workshop to discuss the draft manuals and get consensus from executing agencies (May 2015–September 2015)</p> <p>3.5 Finalize the manuals (July 2015–November 2015)</p> <p>3.6 Conduct workshops of the manuals and provide support to executing agencies (September 2015–August 2016)</p>	<p>ADB: Technical Assistance Special Fund (TASF-Others)</p> <p>\$500,000</p>

ADB = Asian Development Bank, AGP = auditor general of Pakistan, IFRS = International Financial Reporting Standards, IPSAS = International Public Sector Accounting Standards, ISA = International Standards on Auditing, ISSAI = International Standards of Supreme Audit Institutions, TASF = Technical Assistance Special Fund.
Source: Asian Development Bank.

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Amount
Asian Development Bank^a	
1. Consultants	
a. Remuneration and per diem	
i. International consultants	100.0
ii. National consultants	132.0
b. International and local travel	46.0
c. Reports and communications	5.0
2. Training, seminars, and workshops ^b	196.0
3. Miscellaneous administration and support costs	3.0
4. Contingencies	18.0
Total	500.0

^a Financed by the Asian Development Bank's Technical Assistance Special Fund (TASF-Others).

^b Includes the Asian Development Bank's staff travel as resource person including travel for administrative services.

Source: Asian Development Bank estimates.

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

1. A reputable consulting firm in accounting and auditing will be hired to (i) provide support to executing agencies or implementing agencies in preparing project financial statements in accordance with cash basis International Public Sector Accounting Standards (IPSAS), thereby improving project financial management efficiency; and (ii) develop the financial management manuals for Afghanistan and Pakistan. Team members assigned by the firm shall have a university degree in accounting or finance (preferably postgraduate level) and be a certified public accountant, chartered accountant, or a member of the Association of Chartered Certified Accountants.

2. **Financial management specialists.** The firm should assign a minimum of three members, as follows:

- (i) **International expert, team leader (4 person-months) with 20 years general experience and 15 years specific experience relevant to the assignment.** The team leader will be a focal person to report to the Asian Development Bank (ADB) technical assistance team leader. The expert will provide guidance to the team and ensure the quality and timely delivery of the outputs of the assignment. The expert will ensure all communications are appropriate to ADB, executing agencies and/or implementing agencies, government agencies, other financial institutions, and stakeholders. The expert should have excellent knowledge of the financial management systems of Afghanistan and Pakistan. The expert should have broad experience in internal control and financial reporting prepared in accordance with cash basis IPSAS, and be very familiar with ADB or multilateral development bank financial management requirements. The expert will, together with team members, conduct, lead the field works, and deliver the outputs.
- (ii) **National expert assigned for Pakistan, team member (7 person-months) with 12 years general experience and 10 years specific experience relevant to the assignment.** The expert should have good knowledge of the financial management system in Pakistan. The expert should have experience in internal control and financial reporting prepared in accordance with cash basis IPSAS, and be familiar with ADB or multilateral development bank financial management requirements. The team member will assist the team leader in delivering the outputs.
- (iii) **National expert assigned for Afghanistan, team member (7 person-months) with 12 years general experience and 10 years specific experience relevant to the assignment.** The expert should have good knowledge of the financial management system in Afghanistan. The expert should have experience in internal control and financial reporting prepared in accordance with cash basis IPSAS, and be familiar with ADB or multilateral development bank financial management requirements. The team member will assist the team leader in delivering the outputs.

A. Objective and Purpose of the Assignment

3. The objective is to assist executing agencies or implementing agencies of ADB-financed projects in Afghanistan and Pakistan to improve project financial management efficiency, and develop financial management manuals for the two countries. The firm, in coordination with the ADB technical assistance team leader, will liaise with executing agencies or implementing agencies, government agencies, financial institutions, nongovernment organizations, and other

stakeholders as required in obtaining necessary information during the preparation of the manual.

B. Scope of Work

4. The firm will work with low-capacity executing agencies or implementing agencies to build their capacity in financial management during the implementation of ADB-financed projects. The firm will provide training to the project accountants of individual project management units in establishing and maintaining project accounts and ensuring that the accounts are in order and that financial reports and related notes are prepared accurately and submitted on time and in accordance with cash basis IPSAS, the requirements of the project, and ADB's guidelines on financial management. The firm will also prepare financial management manuals for Afghanistan and Pakistan.

C. Detailed Tasks and Expected Outputs

5. The detailed tasks and expected outputs are as follows:

- (i) **Provide support to project management units.** Advise and support two executing agencies or implementing agencies in Afghanistan and two executing agencies or implementing agencies in Pakistan (total of four agencies) identified by ADB to strengthen the financial management capacity of these agencies. The firm will perform the following:
 - (a) Provide on-the-job training and help the project management units to strengthen internal control, establish and maintain project accounts, and ensure that the accounts are in order and that financial reports and related notes are prepared accurately and submitted on time and in accordance with cash basis IPSAS.
 - (b) Evaluate and provide one progress report and one final report for each country about financial management capacity of executing agencies or implementing agencies which receive support from the firm during the assignment.
- (ii) **Develop financial management manuals for Afghanistan and Pakistan.** Develop a financial management manual for each country which includes ADB and government requirements. This will be done through participating in workshops and interviewing executing agencies, implementing agencies, and government representatives (if any). The manual shall include the use of the Financial and Budgeting Accounting System for Pakistan, and the Afghanistan and Pakistan financial management systems through research and by interviewing ADB's financial control officer in the Afghanistan Resident Mission, Pakistan Resident Mission, and interviews with relevant government agencies. The manual will be in two languages (English and Dari) for Afghanistan. The manual should be agreed upon and accepted by the executing agencies and implementing agencies. The firm will perform the following tasks:
 - (a) Advise and support executing agencies or implementing agencies during implementation of the agreed manual by the executing agencies or implementing agencies.
 - (b) Evaluate and prepare a progress report of the implementation of the manual.