

FINANCIAL MANAGEMENT ASSESSMENT

EXECUTIVE SUMMARY

1. A Financial Management Assessment (FMA) has been prepared in accordance with Asian Development Bank's (ADB's) Guidelines for *the Financial Management Technical Guidance Note* (2015) for the purpose of the proposed Disaster Resilience of Schools Project (DRSP).
2. The FMA considered the capacity of Implementing Agency (IA), i.e. the Central Level Project Implementation Unit (CLPIU) – Education focusing on fund flows, staffing, accounting policies and procedures, internal controls, financial reporting and monitoring and internal and external audits.
3. The CLPIU – Education based in CLPIU Kathmandu, will be responsible for all day-to-day management of the proposed DRSP, which include: (i) overall strategic planning and guidance; (ii) project management and administration; (iii) procurement of goods, service and works; (iv) supervision and monitoring of construction and consulting works; (v) managing disbursements; (vi) accounting and reporting to NRA; (vii) retention of supporting documents; (viii) completing all reporting requirements including the annual audit report and financial statements (ix) signatory to all key documents including withdrawal applications and audit reports; (x) ensuring compliance with ADB's guidelines, procedures, and policies as well as loan covenants; (xi) reporting the project's progress to National Reconstruction Authority (NRA), Ministry of Education, Science and Technology (MOEST) and the ADB; (xii) submitting project accounts to NRA and ADB; and (xiii) facilitating interagency coordination and cooperation;
4. During the FMA process major weaknesses and risks factors identified during the assessment are: (i) Project executing and implementing entities are time bound entity created for post earthquake reconstruction and recovery. Tenure of both entities is being completed in 2020 but the government can extend the tenure for one year more. But the project is planned be completed in September, 2022. Continuation of project activates after the completion of tenure of the EA and IA is major risk factor of the project; (ii) The IA does not have adequate accounting staff to perform additional financial management responsibility due to the project; (iii) Newly deputed accounting staff may not be trained in ADB disbursement procedures, reporting and SOE process.
5. Despite the highlighted risks, the financial management arrangements are satisfactory, taking the ongoing actions IA into consideration. The overall risk assessment for the proposed DRSP is “**Substantial**”. The action plan to reduce the above risks includes; (i) Agree on reviewing implementation arrangements at middle of the project period; (ii) Ensure adequate qualified and trained accounting staff at the PIU by loan effectiveness; (iii) Organize trainings on AD disbursement process, financial reporting requirement. After taking into consideration of these action plans, the FM capacity of the entity is considered satisfactory.

I. INTRODUCTION

6. A Financial Management Assessment (FMA) was prepared in accordance with Asian Development Bank's (ADB) Guidelines for *the Financial Management Technical Guidance Note*¹ focusing on executing and implementing agency, fund flows, staffing, accounting policies and procedures, internal controls, financial reporting and monitoring and internal and external audits. The Financial Management, Internal Control and Risk Assessment (FMICRA) was under taken from October 2017 to March 2018.

7. A key aspect of FMA is evaluating the financial management, internal control and risks associated with financial arrangements of DRSP. The assessment was based on the documents reviewed, results of the FMA questionnaire and discussions with officials of Central Level Project Implementation Unit (CLPIU) – Education. The assessment included a review of the government's Public Financial Management (PFM) system and capacity in management of public funds within the Ministry of Finance (and the Financial Comptroller General's Office (FCGO) with its subsidiary payment and internal control entities. Information were collected through various government documents, audit reports of previous ADB projects implemented through the CLPIU and CLPIU's recording system, financial reports, progress reports and budgets.

8. The main documents reviewed as input for this FMICRA was the ADB's Country Partnership Strategy (2009)², The World Bank's Nepal Public Sector Accounting and Auditing A Comparison to International Standards(2007)³ and Financial Accountability in Nepal, A country Assessment (2003)⁴, Nepal's Public Financial Management Reform Strategy/Program (PFMRP) Phase II (2016/2017–2025/2026)⁵, Government of Nepal Accounting Guidelines (2016)⁶, Internal Audit Guidelines (2016)⁷, Budget formulation Manual (2017)⁸, GON Chart of Accounts (2017)⁹. Various reports from the Nepal Public Expenditure and Financial Accountability (PEFA) secretariat provided information on progress in implementation of reforms to strengthen PFM in Nepal.

9. Annual audit report of CLPIU-Education and Earthquake Emergency Assistance Project (EEAP) of FY 2015/16 and 2016/17 was reviewed in the FMA process. The auditor issues unqualified opinion and no major issue related to financial management.

II. BRIEF PROJECT DESCRIPTION

10. The proposed project is conceptualized to develop safe school infrastructure and communities. It builds on and expands ADB's on-going emergency reconstruction support.¹⁰ It will also contribute to achieving results-based lending (RBL) program's school reconstruction

¹ ADB. 2015. *Financial Management Technical Guidance Note*. Manila

² ADB. 2013. *Country Partnership Strategy: Nepal, 2013–2017*. Manila

³ The World Bank, South Asia Region Financial Management Unit. 2007. *Nepal Public Sector Accounting and Auditing A Comparison to International Standards*.

⁴ The World Bank. 2013. *Financial Accountability in Nepal, A country Assessment*.

⁵ Government of Nepal, Ministry of Finance. *Nepal's Public Financial Management Reform Strategy/Program (PFMRP) Phase II (2016/2017–2025/2026)*; Public Expenditure and Financial Accountability (PEFA) Secretariat.

⁶ Nepal Governments Accounting Guidelines, Financial Comptroller General Office, Ministry of Finance, Government of Nepal, 2016

⁷ Government of Nepal, Ministry of Finance, Financial Comptroller General Office. 2016. *Internal Audit Guidelines*. Kathmandu

⁸ Government of Nepal, Ministry of Finance. 2017. *Budget Formulation Manual (7th Edition)*. 2017

⁹ Government of Nepal, Ministry of Finance, Financial Comptroller General Office. 2016. *Chart of Accounts for Financial Transaction of Government of Nepal based on Federal Structure*. Kathmandu

¹⁰ ADB. 2015. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Technical Assistance Grant to Nepal for the Emergency Earthquake Assistance Project*. Manila

targets and complement efforts to improve quality of school education, access to education and school management.¹¹

III. COUNTRY AND SECTOR FINANCIAL MANAGEMENT ISSUES

11. ADB's Nepal Country Partnership Strategy (CPS) for the period 2013-2017 identified risks relating to country governance. It cited Public Financial Management (PFM), public procurement, and corruption and prepared a risk management plan by following the Second Governance and Anticorruption Plan framework and guidelines. Major risks and risk management plan prepared in the Country Partnership Strategy are indicated in **Table 1**.

Table 1: Governance Strategy – ADB County Partnership Strategy (Key Risks and Risks Management Plan Related to Public Financial Management and Corruption)

Major Risks	ADB Actions
A. Public Financial Management	
Budget execution follows elaborate and complex processes, leading to an uneven pace of expenditure	(i) Engage with the government to make budget execution smooth by simplifying procedural matters in PFM, such as authorization, procurement plan, annual program approval, contract timing and timely reportage; and(ii) Put in place a Medium-Term Budget Framework for MOFALD.
Accounting system not able to provide a fair, accurate and timely picture of public finances	(i) Engage with the government and other DPs on speedy implementation of NPSAS and fully operationalization of within FCGO; and (ii)Provide support to FCGO.
Lack of capacity of relevant central and local level bodies in all aspects of PFM	(i) Provide targeted technical assistance support to relevant bodies; (ii) Help finalize the PFM protocols and assist agencies to finalize relevant capacity building plans; and (iii)Assist in following through on capacity building plans.
Ineffective internal controls, audit, monitoring and evaluation systems	(i) Provide support to strengthen capacity of internal auditing system; and (ii)Build capacity of OAG and Public Accounts Committee to follow up irregularities.
Final auditing system not able to function effectively due to time and quality issues.	(i) Explore the possibility of concurrence audit with the government and DPs; (ii) Working with other DPs, provide necessary support to OAG for conducting final audits on time; and (iii) Encourage OAG to roll out risk based auditing more widely.
Fiscal transparency low at all levels	(i) Ensure timely and regular public access to budget documents. Build demand for seeking fiscal information; and (ii) Provide TA support for enhancing fiscal transparency on a sustainable basis.
B. Combating Corruption	
Low capacity of central agencies and LGs to investigate corruption cases and to implement the rules and regulations in place	(i) Engage with the government to maintain political support for the anticorruption agenda; (ii) Ensure some levels of support to LGs to review good governance practices in ADB projects and programs; and (iii) Coordinate with development partners on provision of needed technical assistance so as to maximize impact.
Weaknesses in audit provisions and follow-up at all levels of administration	(i) Provide needed technical assistance on audit provisions to relevant agencies (OAG, Public Accounts Committee, LGs, etc.); and (ii) Engage with government to continue to emphasize follow up on audits.

¹¹ ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Results-Based Loan and Technical Assistance Grant to Nepal for Supporting School Sector Development Plan*. Manila

Major Risks	ADB Actions
No institutional presence of anticorruption agencies at the local level	(i) Help assess the extent of need of institutional presence of relevant anticorruption agencies, particularly CIAA, at the local level; (ii) Assess existing provisions on District Administration Office work on anticorruption, and provide technical assistance as needed; and (iii) Strengthen existing auditing and other control provisions at local level.
Weak whistle-blowing provisions	(i) Review existing provisions and ascertain gaps; (ii) Assess whether similar provisions can be built into other existing laws; (iii) Strengthen grievance handling mechanisms in government institutions and in service delivery agencies; and (iv) Organize seminars and workshops on ethical values and provide technical assistance to establish public complaint systems.

CIAA = Commission for Investigation of Abuse of Authority; DP = Development Partner; FCGO = Financial Comptroller General's Office; LG = Local Government; MOFALD = Ministry of Federal Affairs and Local Development; NPSAS = Nepal Public Sector Accounting Standards; OAG = Office of the Auditor General; PAC = Public Accounts Committee; PFM = Public Financial Management.

Source: Country Partnership Strategy Nepal, 2013 – 2017, ADB 2013

IV. PROJECT FINANCIAL MANAGEMENT SYSTEM

A. Overview

12. Nepal's legal and regulatory framework for ensuring public sector financial accountability is specified in constitutional provisions of the Office of the Auditor General (OAG), the Commission for Investigation of Abuse of Authority (CIAA), and the Public Accounts Committee. The Financial Procedures Act and Financial Procedures Rules specifies comprehensive provisions for budget preparation and approval, accounting and reporting, and internal control mechanisms. However, in its country assessment report, the World Bank ranked Nepal as a "High" fiduciary risk country due to the failure to comply with the legal and regulatory framework (footnote 3).

13. Constitution of Nepal, promulgated in 2015, and the federal governance system is envisioned in place of current unitary governance system. Based on the provisions of federal constitution, the government is in process of state reconstitution after completion of all three level elections in December 2017. The state reconstruction process may cause significant changes in existing service delivery instructional mechanism and financial management system of the country. Existing roles and responsibility of Ministry of Education on financial management may be divided into federal, provincial and local governments. Local governments may responsible for school level education.

14. In 2008, the PEFA Secretariat under the Ministry of Finance prepared a Public Financial Management Strategy for 2010 – 2012 for Nepal's Public Financial Management Reform Program Phase 1, which defined a number of reforms to be carried out over the period. The government is addressing these weaknesses through the introduction of a Treasury Single Account System, preparation of Nepal Public Sector Accounting Standards (NPSAS), development of a computerized government accounting system, and capacity development through training, workshops and studies.

15. The second PEFA Assessment was conducted in 2014 based on the data from FY 2011/12 to FY 2013/14. This assessment highlights progress achieved in the areas of financial management information systems, treasury systems including the Treasury Single Account System (TSA), Nepal Public Sector Accounting Standards (NPSAS), planning and budgeting, accounting and reporting, adoption of Government Finance Statistics standards, taxation, audit, procurement, external oversight, accountability and foreign aid management, **Table 2** provides a summary.

16. Out of 31 major PFM indicators, there were upgrades in 19 indicators (61%), downgrades in 2 indicators (7%) while 10 (32%) indicators remained constant. There was only one indicator with "A" grade in the first assessment improved to nine indicators grading "A" in second assessment. It is clear that many of the improved scores can be attributed to various government initiatives. However, the assessment has pointed out some discrepancies in budget formulation and execution, internal control, internal audit and oversight, accounting, recording and reporting, procurement, debt, revenue and investment management, access to information, human resource management and capacity development, payroll control and pension management, usage of financial management information systems, foreign aid management, and monitoring and evaluation.

Table 2: Summary of Public Expenditure and Financial Accountability Rating

FM Performance Indicators	2008	2014	Comparable Scores	Change since 2008
I. Credibility of the Budget				
PI-1: Aggregate expenditure out-turns compared to original approved budget	B	A	Yes	Variances reduced
PI-2 Composition of expenditure out-turns compared to original approved budget	C	C+	Changed methodology	No direct comparability
PFM Performance Indicators				
2008 2014 Comparable Scores Change since 2008				
PI-3 Aggregate revenue out-turns compared to original approved budget	A	A	Changed methodology	Performance unchanged
PI-4: Stock and monitoring of expenditure payment arrears	D+	B+	Yes	Stock of arrears below 2% and system in place
II. Comprehensiveness and Transparency				
PI-5 Classification of the budget	C	A	Yes	Expanded budget classifications
PI-6 Comprehensiveness of information included in the budget documentation	B	A	Yes	Performance improvement
PI-7 Extent of unreported government operations	C	D+	Yes	Higher proportion of extra budgetary operations than before
PI-8 Transparency of Inter-Governmental Fiscal Relations	C	C+	Yes	Sub national government's fiscal data reporting strengthened
PI-9 Oversight of aggregate fiscal risk from other public sector entities	D+	C	Yes	Performance improves
PI-10 Public access to key fiscal information	B	A	Yes	Performance improved
III. Policy-Based Budgeting				
PI- 11 Orderliness and participation in the annual budget process	C+	B	Yes	Issuance and adherence of budget discussion as per budget calendar
PI- 12 Multi-year perspective in fiscal planning, expenditure policy and budgeting	C+	B	Yes	Debt Sustainability Analysis conducted annually
IV. Predictability and Control in Budget Execution				
PI- 13 Transparency of tax payer obligations and liabilities	C+	A	Yes	Performance improved

FM Performance Indicators	2008	2014	Comparable Scores	Change since 2008
PI- 14 Effectiveness of measures for taxpayer registration and tax assessment	C	A	Yes	Overall improvement in taxpayer registration and tax assessment
PI- 15 Effectiveness in collection of tax payments	D+	D+	Yes	Performance unchanged
PI- 16 Predictability in the availability of funds for commitment of expenditures.	C+	C+	Yes	Performance unchanged
PI- 17 Recoding and management of cash balances, debt and guarantees	C+	C+	Yes	Performance unchanged
PI- 18 Effectiveness of payroll controls	C+	C+	Yes	Performance unchanged.
PI- 19 Competition, value for money and controls in procurement	C	B	Yes	Use of open competition
PI- 20 Effectiveness of internal controls for non-salary expenditures.	C	C	Yes.	Performance unchanged
PI- 21 Effectiveness of internal audit	D+	D+	Yes	Performance unchanged
PFM Performance Indicators	2008	2014	Comparable Scores	Change since 2008
V. Accounting Recording and Reporting				
PI- 22 Timeliness and regularity of accounts reconciliation	C+	C+	Yes	Performance unchanged
PI- 23 Availability of information on resources received by service delivery units	C	A	Yes	Improvement on resources made available to service delivery units
PI- 24 Quality and timeliness of in year budget reports	C+	C+	Yes	Performance unchanged
PI- 25 Quality and timeliness if annual financial statements	C+	C+	Yes	Performance unchanged
VI. External Scrutiny and Audit				
PI- 26 Scope, nature and follow-up of external audit	D+	C+	Yes	Audit coverage expanded and timely submission of audit reports
PI- 27 Legislative scrutiny of annual budget law	D+	D	Yes	No parliament
PI- 28 Legislative scrutiny of external audit reports	D	D	Yes	No parliament
D. Donor Practices				
D-1 Predictability of Direct Budget Support	D	D+	Yes	Improvement in timeliness
D-2 Financial information provided by donors for budgeting and reporting on project and program aid	D	C+	Yes	Improvement in donor information
D-3 Proportion of aid that is managed by use of national procedures.	D	C	Yes	Greater use of national procedures

Source: Nepal PFM Performance Assessment – II as of FY2013/14. Government of Nepal. Ministry of Finance.

17. **Reform Strategy:** The government has formulated Nepal's Public Financial Management Reform Strategy - phase II for the period 2016/17 to 2025/26 based on the

strengths and weakness identified in the second PEFA assessment. The strategy is prepared taking account of on-going reform program of the government in areas such as further enhancement of the treasury single account system, strengthening accounting and reporting practices - NPSAS and strengthening PEFA Secretariat. There are all together 119 reform action plans identified and developed on the basis of the recognized PFM performance gaps observed from the second PEFA assessment covering all outcome areas. Some of the activities which will also contribute to strengthening project financial management system and reduce the risks under the DRSP are given in **Table 3** below.

Table 3: Related Government of Nepal's PFM Reform Strategy Actions FY2017–2025

SN	Government of Nepal PFM Reform Strategy Actions	Responsible
1	Prepare and introduce Budget Management and Financial Responsibility Law.	MOF
2	Review current PFM systems and procedures (budgeting processes of expenditures and revenues, allocation of resources, transfer of budget, etc.) and prepare roadmap in line with the federal structure as provisioned in the Constitution, defining roles and responsibilities of key stakeholders including civil society.	MOF
3	Redesign the BMIS to record information on quarterly estimates of both the government and donor fund	MOF
4	Redesign the FMIS to record the information on annual disbursement.	MOF
5	Systems (BMIS, LMBIS, FMIS, RMIS and TSA) harmonized & interconnected by building interfaces.	MOF
6	Prepare and submit project account on time to ensure timely audit and submission of audit report to the donors.	MOF
7	Allocate a separate budget code to identify the budgetary support flow donor-wise.	MOF
8	Prepare and implement an action plan for enhancing the final audit addressing to improve various subjects.	OAG
9	Established the direct linkage and ownership between NPC, MOF and sectoral ministries in the use of LMBIS / MTEF.	NPC
10	Review of Charts of accounts (Revenue and expenditure) and make it applicable in federal system.	FCGO
11	Enhance the reconciliation system of bank accounts and other government transactions (of spending units).	FCGO
12	Make necessary arrangements for submission of consolidated financial statement within the first trimester.	FCGO
13	Improve the SOE (monthly) by adding expenditure of direct payment.	FCGO
14	Strengthen Public Assets Inventory System (PAIS) of FCGO to make updated central record of public properties.	FCGO
15	Review current PFM systems and procedures (treasury, budget expenditure control, accounting and reporting, internal auditing systems) and prepare roadmap for supporting evolving federal structures as mandated by the Constitution of Nepal, 2015.	FCGO
16	Conduct feasibility study on e-Payment System through TSA system and initiate e-Payment system on pilot base with intact monitoring.	FCGO
17	Introduce modified cash basis accounting system to record the outstanding expenditures incurred.	FCGO
18	Prepare & implement a comprehensive plan of action for Internal Auditing System reform.	FCGO

BMIS = Budget Management Information System; FCGO = Financial Comptroller General's Office; FMIS = Financial Management Information System; LMBIS = Line Ministry Budget Information System; MTEF = Mid Term Expenditure Framework; MOF = Ministry of Finance; NPC = National Planning Commission; OAG = Office of the Auditor General; PFM = Public Financial Management, SOE – Statement of Expenditure, TSA = Treasury Single Account.

Source: Nepal's Public Financial Management Reform Strategy/Program (PFMRP) Phase II (2016/17-2025/26) Public Expenditure and Financial Accountability (PEFA) Secretariat, Ministry of Finance, Government of Nepal

B. Strengths

18. A strength of the financial management system of CLPIU is that they are experienced in handling externally financed funded projects, including Emergency Earthquake Assistance Project (EEAP) of the ADB and other donors (e.g., JICA, USAID). In addition, key strengths on overall PFM system of the country and proposed project implementing entity are (i) Government of Nepal initiated a number of PFM reform activities and that will help in project financial management activities in future; (ii) CLPIU– Education was established in 2016 to work exclusively on post earthquake reconstruction and recovery in education sector¹²; (iii) Financial Administration Section is established under the CLPIU and staff are deputed from the Financial Comptroller General Office (FCGO), who are permanent government staff and experienced in public financial management; (iv) CLPIU follows government accounting policy, procedures and standards in financial transactions, accounting and reporting; (v) Internal and external audit are in place, external audit is carried out by OAG; (vi) Most of accounting transactions are done using accounting software.

C. Weaknesses

19. Key weaknesses assessed for financial management are: (i) Project executing and implementing entities are time bound entity created for post earthquake reconstruction and recovery. Tenure of both entities is being completed in 2020 but the government can extend the tenure for one year more. But the project is planned be completed in September, 2022. Continuation of project activates after the completion of tenure of the EA and IA is major risk factor of the project; (ii) The IA does not have adequate accounting staff to perform additional financial management responsibility due to the project; (iii) Newly deputed accounting staff may not be trained in ADB disbursement procedures, reporting and SOE process. Summary of risk assessment is provided in Table 4.

D. Personnel, accounting policies and procedures, internal control and external audit

20. **Personnel.** The Financial Administration Section of CLPIU will oversee the major financial management functions of the project. Under the financial Management Section, a separate unit will be established to carry out regular financial administrative functions of the project. Existing accounting staff working in the Financial Administration Section of the CLPIU are fully engaged to cover existing workload, therefore, for additional project accounting functions due to the project, the CLPIU needs more accounting staff. The CLPIU has to request additional accounting staff (one account officer and one accountant) to the Financial Controller General's Office (FCGO). In addition to the regular accounting staff from the FCGO, the project requires a financial management expert to provide technical support to the project accounts by Q3 2018. The financial management expert need to be hired by the project as a consultant in individual basis. The accounts staff working at the CLPIU are trained in ADB procedures but the new staff may not be trained in ADB procedures. Therefore, the project needs to prepare a plan to provide training to the accounts staff on ADB procedures on Statement of Expenditure (SOE), disbursement, reporting etc. Job descriptions of all accounting staff including financial management expert needs to be prepared and included in Project Administration Manual (PAM).

21. **Accounting policy and procedures.** Project accounting will follow the government procedures as directed by the FCGO and OAG, which are based on international standards. The accounting system of the CLPIU is cash based. The Financial Procedures Act and Rules, and the Procurement Act and Rules cover key routine financial management and related

¹² Currently 42 staff are working under the CLPIU.

administrative matters. Existing accounting policy and procedures are fully followed by the CLPIU and controls are in place following approval of transaction, internal audit and external audit. The CLPIU will prepare two type of reports – one for government agencies and another for ADB. Trainings to the accounting staff is required to prepare financial reports satisfactory to the ADB.

22. **Segregation of duties.** The existing practice of the CLPIU adequate segregation of duties in financial operation. While the store unit is responsible for ordering, receiving custody of the assets and goods, accounts section is responsible for accounting and reporting. The Project Director is responsible for authorization of payments and oversee store management.

23. **Budgeting system.** Program officer of the CLPIU is responsible for formulating budget in coordination with accounts and procurement unit and the project director. Line Ministry Budget Information System (LMBIS) is being used by the government to formulate and approve government budget. Project budget will be reviewed and finalized by the National Reconstruction Authority (NRA), National Planning Commission (NPC) and Ministry of Finance (MOF). Budgets are prepared in details for all significant activities and provide benchmarks for budget variance analysis. Actual expenditures are compared with the budget before each transaction. Variation approvals are required in advance if required. The CLPIU is not being able to absorb allocated budget in past two years because of delay in construction work than expected. There is no process of mid-year revision of budget.

24. **Payments.** Payments are made against the invoices submitted for the payment and the verification system is established.

25. **Cash and bank.** The project director and financial administration section chief will be responsible for payments. The accounts section ensures reconciliation of all accounting records. Due to adaptation of single treasury system, concerned District Treasury Controller Office (DTCO) is responsible for bank reconciliation.

26. **Safeguard over assets.** Store units in the CLPIU will be responsible in keeping records of fixed assets and stocks. Annual assets valuation system is not in practice due to adaptation of cash based accounting system. Assets are recorded in fixed asset register with purchase price (no depreciation calculation system exists). Office chief carries out periodic physical verification of fixed assets and stocks. Only vehicles and heavy machineries are covered by insurance policies.

27. **Other offices and implementing entities.** The project will be implemented by the CLPIU established in Kathmandu. The CLPIU will receive necessary engineering support from the District Level Project Implementation Units (DLPIU) in planning, budgeting, supervision and monitoring. The DLPIUs will not involve in financial transactions of the project activities.

28. **Contract management.** The CLPIU will be mainly responsible for procurement of consultants, works and goods to implement project activities. CLPIU has established systems for contract management.

29. **Internal audit.** Internal audits of the CLPIU will be performed every month by the staff assigned by the relevant District Treasury Controller Office (DTCO), who submits audit report on a quarterly basis to the project director and finance chief. The government has prepared an internal audit guidelines to carry out internal audit of the government accounts. However, internal audit staff are accounting staff, not professionally qualified for auditing. The internal audit system is based on compliance audit (not risk-based) and most of them and experienced in ADB's disbursement procedures. Per the review of internal audit reports, no major issues are noted.

30. **External audit.** The OAG of Nepal is a constitutional independent body responsible to carry out statutory audit of the government transactions. The statutory audit of CLPIU are conducted after the end of each fiscal year by the staff appointed by the OAG. Audit is conducted according to Nepalese Auditing Standards which is in accordance to the International Organization for Supreme Audit Institutions (INTOSAI) and Fundamental Accounting Principles. The same external auditor will carry out external audit of the entity and the project. There is no significant audit issues raised in external CLPIU and management letter for ADB funded EEAP project in FY 2015/16 and 2016/17. The CLPIU is committed to submit external audit report within 6 months after completion of fiscal year from 2016/17 and onwards.

E. Financial reporting systems including use of information technology

31. **Reporting and monitoring.** The CLPIU prepares financial reports together with supporting schedules based on the government's accounting standards. It includes monthly, trimester and annual financial reports while physical progress reports prepared separately in trimester basis. Since the financial reporting system compares budget with actual expenditure, it provides information for management decision-making. The CLPIU is using locally developed accounting software program for accounting, however, spread sheets are also being used to generate additional financial reports. The NRA is developing a common accounting software program with the support of USAID expected to be in operation from FY 2018/19. A physical progress report shows physical progress against the target and links financial information with physical progress.

32. **Information systems.** The CLPIU is using locally developed accounting software program for accounting. It is standalone and customized software as per entity's accounting needs. The system is not integrated with the central system; therefore, manual entry is required to integrate data with the central system. The software generates reports for the government purpose only. Additional calculation in spreadsheet is required to prepare financial reports as per the requirement of donors and NRA. The NRA is developing a standard software program to meet financial reporting requirement of Government, NRA and donors, expected to be implemented by FY 2018/19.

F. Disbursement arrangements, funds flow mechanism

33. **Funds flow arrangements.** The project financing will consist of OCR loan, ADF grant, CEPFP grant and the Government's counterpart funds. The MOF will provide counterpart funds to the project and pre finance ADB share of funds. The GON pre financed ADB share funds will be reimbursed to the GON accounts by the ADB based on the expenditure statements submitted by the CLPIU. In case of large payments and/or payment in USD, the government will make provisions for such budgets in direct payment budget headings. The CLPIU will also establish a US dollar imprest account at the Central Bank (Nepal Rastra Bank). The CLPIU will withdraw money from this account periodically to reimburse funds pre financed by the government for the project and also for the foreign currency payment. The CLPIU will submit statement of expenditure and other supporting documents to the ADB for reimbursement and liquidation. In case larger amounts need to be payable to the vendors, the CLPIU will submit withdrawal applications to ADB for direct payment. The CLPIU has experience with the operation of an imprest account and statement of expenditure (SOE) procedures in the EEAP project, and no issues encountered at the CLPIU so far.

V. RISK DESCRIPTION AND RATING – INCLUDING THE FINANCIAL MANAGEMENT AND INTERNAL CONTROL RISK ASSESSMENT

34. The FMA reviewed two types of risks: (i) inherent risks; i.e. risks outside the direct control of the executing/implementing agency's financial management, and (ii) control risks; i.e. risks concerning the internal functioning and control of the executing/implementing agency's finance and accounting section. The FMA identified the following key risks:

Table 4: Financial Management, Internal Control and Risk Assessment

SN	Risk Description	Impact	Likelihood	Risk Assessment	Mitigation Measures
1	Inherent Risks				
1.1	Country Specific –Based on the PEFA assessment 2014, Government of Nepal prepared PFM reform strategy actions from FY 2017-2015 based on weaknesses assessed during the process. The plan specifies improve PFM system as per the federal structure as well. Weakness in implementation of the PFM reform strategy may effect in PFM system of the country.	High	Unlikely	Substantial	World bank, USAID, DFID and other development partner are providing support in this sector reform. The development partners should engage to provide support to the government to implement the reform action plan. The ADB also providing support to the government to improve public financial management system as per the country partnership strategy. The ADB support in this sector in next country partnership strategy will help to mitigate risks.
1.2	Entity Specific - Nepal is in process of state restructuring and implementation of federal government system. Constitution of existing Ministry of Education and their roles may change after fully implementation of federal governance system. There is high chance of shifting existing role of MOEST on school level education to the provincial government and local governments. However, this will not affect FM related project activities as fund flow will continue to be centralized. In addition, based on the legal mandate the NRA may	High	Unlikely	Substantial	GON and ADB should continue the policy dialogues through various occasions including the country partnership strategy and the country operations business plan to restructure project implementation plan as per the changed situation.

SN	Risk Description	Impact	Likelihood	Risk Assessment	Mitigation Measures
	not be continued after 2020. However, there is provision of one year extension after 2020.				
1.3	Overall Inherent Risk			Substantial	
2	Control Risks				
2.1	Implementing Entity - CLPIU (Education) is established under the NRA to work on earthquake reconstruction and recovery in Education sector. After completion of NRA mandate, the CLPIU may not be continued till the end of the project period i.e. September, 2022.	High	Likely	High	The ADB and the GON will be agree on reviewing implementation arrangements at middle of the project period for alternative arrangements to implement remaining project activities including hand over and take over modalities.
2.2	Funds Flow - The CLPIU is facing problems in fund management due to mix of several donors' funds into a single budget line and program. It has created complexity in accounting and financial reporting to the government and donors.	Low	Likely	Moderate	GON and ADB will be agree on providing separate budget line for the project considering extended duration of the project after the tenure of NRA and facilitate clear accounting and financial reporting.

SN	Risk Description	Impact	Likelihood	Risk Assessment	Mitigation Measures
2.3	<p>Staffing –</p> <p>(i) The CLPIU has only three accounting staff to perform existing financial administration activities of the entity and are overloaded. After the project, they need at least two accounting staff from the FCGO within Q3 2018 and one financial management expert in Y1 of the project. Considering the bureaucratic process, there may be delay in deputation of accounting staff from the FCGO. The newly deputed project accounting staff may not be experienced in ADB disbursement procedures, reporting and SOE process.</p> <p>(ii) In absence of procedures manuals the staff may have different understanding on roles, responsibility and accountability caused conflict in project implementation activities.</p>	High	Likely	High	<p>The CLPIU will send staffing request letter to the FCGO within Q2 2018 with necessary supporting documents and start recruitment process for the for financial management expert after loan agreement with the ADB.</p> <p>The CLPIU with the support of the ADB will organize trainings to the accounting staff of the project at least once in every two years on disbursement procedures, reporting and SOE procedures.</p> <p>(ii) Define roles, responsibilities and accountability of project staff in PAM.</p>
2.4	<p>Accounting Policy and Procedures</p> <p>(i) The government has prepared chart of accounts as per the NPSAS for government purpose and does not financial reports based on the project outputs. Therefore the project need to maintain additional project accounts separately as per the need of project reporting. In absence of clear guidance on project accounting and reporting there may be delay in disbursement and accounts settlement.</p> <p>(ii) The CLPIU has maintained contract records and communicated them at the time of payment. The formal reconciliation</p>	Low	Likely	Moderate	<p>(i) Provide guidance/training to the accounting staff for satisfactory accounting and reporting to the ADB.</p> <p>(ii) Start contract account reconciliation with the contractor after each bill payment.</p>
		High	Unlikely	Low	

SN	Risk Description	Impact	Likelihood	Risk Assessment	Mitigation Measures
	process to be done to avoid potential disputes between two parties on contract record and payment.				
2.5	Internal Audit - Internal audit of the government accounts are carried out by the DTCO staff mostly and accounting staff rather than qualified internal auditors. This may effect in quality of internal audit of the entity.	Low	Likely	Moderate	Under the PFM reform strategy, internal auditing reform is one of the area identified. The project will provide necessary support to implement internal audit reform activities.
2.6	External Audit - There may be delay in submitting audit report to the ADB within 6 months.	High	Unlikely	Substantial	The government and CLPIU will ensure the OAG will complete external audit program of CLPIU within 6 months after the completion of fiscal year.
2.7	Reporting and Monitoring –The NRA is developing integrated accounting software with the support of USAID and expected to be in operation from FY 2018/19. The integrated accounting software system may not be completed in stipulated timeframe.	Low	Unlikely	Low	While the new software is under development, manual preparation of reporting will be enhanced by developing checklist for review.
2.8	Information System –The CLPIU is using a standalone accounting software for the use of CLPIU accounting, Common accounting software may be delayed.	Low	Unlikely	Low	Continue existing locally developed accounting software with necessary modification until the common software became ready to use.
	Overall Control Risk			Moderate	
	Overall (combined) Risk			Substantial	

ADB = Asian Development Bank; CLPIU = Central Level Project Implementation Unit; DTCO = District Treasury Controller Office; FCGO = Financial Comptroller General's Office; GON = Government of Nepal; MOEST = Ministry of Education, Science and Technology; MOF = Ministry of Finance; NPSAS = Nepal Public Sector Accounting Standards; NRA = National Reconstruction Authority; PEFA = Public Expenditure and Financial Accountability; PFM = Public Financial Management, SOE – Statement of Expenditure,
Source: Asian Development Bank

35. The table above presents a summary of key risks for the proposed mitigating actions. The overall risk is considered Substantial. This is primarily due to (i) limited duration of tenure of NRA and CLPIU to implement project activities, (ii) lack of adequate accounting staff at the CLPIU to perform project financial management activities and (iii) absence of procedure manuals with clear roles, responsibility and accountability of staff.

36. In response to the identified risks, risk-mitigating measures will be implemented to ensure alternative project implementation provision after completion of tenure of NRA and

CLPIU, adequate and capable accounting staff, and clarity in roles, responsibility and accountability of project staff. In addition, ADB support to implement PFM reform strategy will enhance efficiency in budgeting, accounting, disbursement, fund management, reporting, and internal audit to improve service delivery of all level of the government.

VI. PROPOSED TIME-BOUND ACTION PLAN

37. CLPIU and ADB have agreed to an action plan to address the following issues that the financial management assessment identified. The CLPIU will prepare quarterly progress report by including progress on implementation of this time bound action plans well.

Table 5: Time-bound Action Plan

No	Risks	Mitigation Actions	Responsibility	Timeframe
1	Tenure of NRA will be completed in 2020 with possible extension of 2021. Continuation of project activities might be hampered.	The ADB and the GON will review and agree on implementation arrangements at middle of the project period to ensure project implementation will not be disrupted.	NRA, MOEST and MOF	Mid-term review (2020)
2	The CLPIU does not have adequate accounting staff to perform additional financial management responsibility for the project. This may hamper timely and efficient implementation.	Three additional staff (Senior accounts officer, accounts officer and accountant from FCGO) and financial management expert (consultant) will be deployed: (i) The CLPIU will send staffing request letter to the FCGO with necessary supporting documents (ii) The CLPIU will start recruitment process for the for financial management expert.	CLPIU, MOEST, MOF and FCGO	July 2018.
3	Newly deputed accounting staff may not be trained in ADB disbursement procedures. This may hamper the timely and efficient implementation.	Organize trainings on ADB disbursement process, financial reporting requirement and SOE once in every two years	ADB and CLPIU	As soon as new staff is deployed
4	Under the on-going project (EEAP), CLPIU donors' funds are managed under a single budget line and program. It has created complexity in accounting and financial reporting to the government and donors. The same might happen if no separate budget line is provided.	GON will provide a separate budget line for the project.	CLPIU, NRA and MOF	March 2018 To be implemented by June 2018
5	The government chart of account does not provide complete financial information based on the project outputs and sub-components. This	Chart of account to be reviewed and manual to be developed. Provide trainings to the accounting staff on	CLPIU	Beginning of fiscal year 2018/2019.

No	Risks	Mitigation Actions	Responsibility	Timeframe
	might hamper proper accounting and reporting.	project accounting and reporting based on the ADB's reporting requirements.		
6	Submission of audited financial statements (APFS) might be delayed.	Government and CLPIU to ensure external audit program of OAG will be prepared to complete external audit of CLPIU within 6 months after the completion of FY.	CLPIU and MOF	Beginning of every fiscal year.
7	Existing computer software is not able to produce financial reports and not linked with the other GON systems. This might hamper proper financial reporting.	Operationalize common accounting software being developed under the NRA and FCGO for all reconstruction programs. While the new software is under development, manual preparation of reporting will be enhanced by developing checklist for review.	NRA and CLPIU	Beginning of fiscal year 2018/2019

ADB = Asian Development Bank, CLPIU = Central Level Project Implementation Unit, FCGO = Financial Comptroller General's Office, GON = Government of Nepal, MOEST = Ministry of Education, Science and Technology; MOF = Ministry of Finance, NRA = National Reconstruction Authority, SOE – Statement of Expenditure
Source: Asian Development Bank.

VII. SUGGESTED FINANCIAL MANAGEMENT COVENANTS

38. The audited project financial statements with management letter, prepared in accordance with Nepal Government Auditing Standards, will be submitted by the executing agency to ADB within six months after end of the fiscal year. A management letter shall also be provided indicating any weaknesses in the internal control system. This shall also include a status update on the follow-up on previous year's audit observations. The Government of Nepal and the executing agency have been made aware of ADB's policy on delayed submission, and the requirements for satisfactory and acceptable quality of the audited accounts. ADB reserves the right to commission an independent audit if the audit is substantially delayed or to confirm that the share of ADB's financing is used in accordance with ADB's policies and procedures. The audited program financial statements shall be disclosed to the ADB and the project website in accordance with ADB's Public Communications Policy (2011). This includes the audit opinion, the program financial statements and accompanying notes. Management letter shall not be disclosed.

39. The Government and The ADB will agree at loan appraisal for mid-term review of the project. The review process will set project implementation organization set-up considering limited tenure of NRA and CLPIU. This process will identify appropriate executing and implementing agency for implementing project activities in remaining period.

40. The government will provide additional accounting staff to the CLPIU to cover additional work load of the CLPIU before Q4 2018. For the purpose the CLPIU will start deputation of the staff for the CLPIU in advance considering time taken for deputation process. It is estimated that the existing work load of the Financial Administration Section will be almost double after the project start.