

Supplementary Document 14:

Financial Management Assessment

CURRENCY EQUIVALENTS

(as of 15 October 2017)

Currency unit– Pakistan rupee/s (PRe/PRs)

PRe1.00 = \$ 0.0095

\$1.00 = PRs105.3050

ABBREVIATIONS

ADB	–	Asian Development Bank
AGP	–	Auditor General of Pakistan
APPM	–	Accounting Policies and Procedures Manual
EA	–	executing agency
FM	–	financial management
FMA	–	financial management assessment
FMM	–	Financial Management Manual
GFR	–	General Financial Rules
GFMIS	–	Government Financial Management Information System
IA	–	implementing agency
IPSAS	–	International Public Sector Accounting Standard
JIP	–	Jalalpur Irrigation Project
MAP	–	Manual of Accounting Principles
PAD	–	Punjab Agriculture Department
PID	–	Punjab Irrigation Department
PFM	–	Public Financial Management
PFMAA	–	Public Financial Management and Accountability Assessments
PMO	–	project management office

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EXECUTIVE SUMMARY

1. This Financial Management Assessment (FMA) is conducted in accordance with Asian Development Bank (ADB)'s Guidelines for the Financial Management Technical Guidance Note for Financial Management Assessment. The FMA is carried out in Punjab Irrigation Department (PID) as the executing agency (EA), and Punjab Agriculture Department (PAD) as implementing agency (IA), for Jalalpur Irrigation Project (JIP).

2. The proposed project aims to increase agriculture production by bringing a total of 68,263 ha of presently low-productive, predominantly rain-fed agricultural land under new coverage of surface irrigation by providing as much as 284 million m³ of fresh and quality water annually from the Jhelum River during high flow season between April and October. The proposed project is located in two districts of Jhelum and Kushab in Punjab province. The project impact will be enhancing growth in agriculture productivity, by increasing the area under cultivation, improving land resources and environment, and by better water management. The project outcome will be the increased agricultural production. The project outputs will be (i) quality available water in the project area increased; (ii) water-use skill improved in the project area; and (iii) farm management capacity improved in project areas.

3. The FMA was carried out by ADB Consultant. Preparation activities include reviewing documents, interviewing counterparts, and discussing the issues with stakeholders. A financial management, internal control and risk management assessment was conducted. While considering the present internal control environment, present staffing, technical and financial procedures; it is concluded that the overall project financial management pre-mitigation risk is 'Substantial' based on the assessed internal control environment, experience of implementing development projects, supervisory procedures, and technical and financial capability.

I. INTRODUCTION

1. This Financial Management Assessment (FMA) is conducted in accordance with ADB's Guidelines for the Financial Management Technical Guidance Note for Financial Management Assessment. The FMA is carried out in Punjab province for Irrigation Department (PID) as the executing agency (EA), and Agriculture Department (PAD) as implementing agency (IA), for Jalalpur Irrigation Project (JIP).

2. The financial management, internal control, and risk assessment was carried out from 15 June 2017 to 27 July 2017 by Usman Riaz (Financial Management Consultant). Preparation activities included reviewing documents, interviewing counterparts, and discussing the issues with stakeholders.

II. BRIEF PROJECT DESCRIPTION

3. The proposed project aims to increase agriculture production by bringing a total of 68,263 ha of presently low-productive, predominantly rain-fed, agricultural land under new coverage of surface irrigation by providing as much as 284 million m³ of fresh and quality water annually from the Jhelum River during high flow season between April and October. The proposed project is located in two districts of Jhelum and Kushab in Punjab province. The project impact will be enhancing growth in agriculture productivity, by increasing the area under cultivation, improving land resources and environment, and by better water management. The project outcome will be increased agricultural production. The project outputs will be (i) increased quality available water in the project area; (ii) improved water-use skill the project area; and (iii) improved farm management capacity in the project areas.

4. The proposed project is consistent with ADB's country partnership strategy (CPS) for Pakistan, 2015–2019, which prioritizes the promotion of better water resource management and irrigation to improve agricultural productivity, increase farm incomes, and ensure food security.¹ The proposed project is included in ADB's country operations business plan for Pakistan, 2017–2019.² The need of the expansion of cultivated area and irrigated agriculture in riverine areas is highlighted in the Punjab Government's strategy and the proposed project is included in the list of upcoming irrigation sector investments.

5. The proposed project is estimated to cost \$368.9 million with ADB portion of \$279.85 million. Government of Punjab (GoP) will provide counterpart funding for the residual amount of 82.60 million and the beneficiary farmers will provide an estimated amount of \$6.45 million as in-kind contribution. The financing ratio comes at 76:24 for ADB and GoP including farmer's contribution, respectively.

III. COUNTRY AND SECTOR FINANCIAL MANAGEMENT ISSUES

6. The overall fiduciary risk at provincial level is assessed to be Moderate to High with some positive progress observed within individual Public Expenditure and Financial Accountability Assessment (PEFA) dimensions and Punjab province level, the Public Financial Management and Accountability Assessments (PFMAA) dimensions. Federal, as well as provincial governments over the years have made some improvements in the overall budget management. Budgeting, reporting, and introduction of medium-term planning tools and use of a risk-based

¹ ADB. 2015. *Country Partnership Strategy: Pakistan, 2015–2019*. Manila.

² ADB. 2016. *Country Operations Business Plan: Pakistan, 2017–2019*. Manila.

audit methodology by the office of the Auditor General of Pakistan (AGP), are some of the key reforms implemented over the past few years.

7. The Public Financial Management (PFM) has been making positive progress as a result of a series of reforms. The Government Financial Management Information System (GFMS) automated budgeting, accounting, and financial reporting; and is operated at the federal, provincial, and district levels. GFMS produces budget and expenditure comparison reports on real-time basis, which enable the government to monitor budget execution of all ministries/departments. The Medium Term Budgetary Framework was introduced by all ministries to prepare a multi-year planning and budgeting. The Auditor General of Pakistan (AGP), as the supreme audit institution, performs audit under Articles 169 and 170 of the Constitution of the Islamic Republic of Pakistan 1973, read with section 7 of the Auditor General's (Functions, Powers, Terms and Conditions of Service) Ordinance, 2001. The audit report prepared, in principal, in accordance with the International Standards of Supreme Audit Institutions are laid before the National, Provincial, and District Assemblies and are considered in the Public Accounts Committee of the respective Assemblies.

8. The latest PEFA for Pakistan was undertaken in June 2012, as a follow up to the 2009 PEFA. The latest assessment reported positive progress as a result of reforms for improving PFM. The assessment in 2012 noted that 5 out of 26 (19%) available indicators are rated as high, 9 out of 26 (35%) as substantial, 8 out of 26 (30%) as moderate, and 4 out of 26 (15%) as low as shown in Table 1. The stronger performance was found in budget credibility, comprehensiveness and transparency, and Policy-Based Budgeting, whereas weaker performance was recognized in the rest of the dimensions.

9. In addition, at the Punjab province level, the PFMAA, extensive analysis PFM systems were conducted in 2007 and 2012. The latest assessment in 2012 indicated that 8 out of 28 (29%) available indicators are rated as high, 8 out of 28 (29%) as substantial, 6 out of 28 (21%) as moderate, and 6 out of 28 (21%) as low as shown in Table 1. The stronger performance were comprehensiveness and transparency, policy-based budgeting, and budget execution and cash/debt management, whereas other performance were weaker. The detailed review of both PEFA and PFMAA concluded that the weak PFM areas, which are regarded as inherent risks, are the absence of internal audit function and deviation of actual expenditure from budget estimates.

Table 1 Summary of Performance Indicator Ratings in PEFA Assessments

No.	Performance Indicators	Country			Punjab		
		2009	2012	Risk Rating for PEFA Score 2012	2007	2012	Risk Rating for PEFA Score 2012
BUDGET CREDIBILITY							
1	Aggregate expenditure out-turn compared to original approved budget	D	B	Moderate	B	B	Moderate
2	Composition of expenditure out-turn compared to original approved budget	NA	C+	Substantial	NA	D	High
3	Aggregate revenue out-turn compared to original approved budget	NA	B	Moderate	NA	A	Low
4	Stock and monitoring of expenditure payment arrears	NA	NA	NA	D	NA	NA
KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency							
5	Classification of the budget	A	A	Low	A	A	Low
6	Comprehensiveness of information included in budget documentation	B	A	Low	A	A	Low
7	Extent of unreported government operations	D+	C+	Substantial	D+	C+	Substantial
8	Transparency of intergovernmental fiscal relations	A	A	Low	A	B+	Moderate
9	Oversight of aggregate fiscal risk from other public sector entities.	C+	C+	Substantial	C	C+	Substantial
10	Public access to key fiscal information	C	B	Moderate	B	B	Substantial
Policy-Based Budgeting							
11	Orderliness and participation in the annual budget process	B+	A	Low	A	A	Low
12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	C+	B+	Moderate	B	B+	Moderate
Revenue Administration							
13	Transparency of taxpayer obligations and liabilities	B	B	Moderate	C+	C+	Substantial
14	Effectiveness of measures for taxpayer registration and tax assessment	B	C+	Substantial	C+	D+	High

15	Effectiveness in collection of tax payments	D+	D+	High	B	D+	High
Budget Execution & Cash/Debt Management							
16	Predictability in the availability of funds for commitment of expenditures	D+	C+	Substantial	A	B+	Moderate
17	Recording and management of cash balances, debt and guarantees	B+	B+	Moderate	A	B+	Moderate
Internal Controls							
18	Effectiveness of payroll controls	C+	B+	Moderate	C+	C+	Substantial
19	Transparency, competition and complaints mechanisms in procurement	NA	D+	High	NA	D	High
20	Effectiveness of internal controls for non-salary expenditure	C	C+	Substantial	C+	C+	Substantial
21	Effectiveness of internal audit	D	D	High	D	D	High
Accounting, Recording and Reporting							
22	Timeliness and regularity of accounts reconciliation	C+	D+	High	B	B	Moderate
23	Availability of information on resources received by service delivery units	D	NA	NA	B	A	Low
24	Quality and timeliness of in-year budget reports	C+	C+	Substantial	C+	C+	Substantial
25	Quality and timeliness of annual financial statements	B+	C+	Substantial	B	C+	Substantial
External Scrutiny and Audit							
26	Scope, nature and follow-up of external audit	C+	B	Moderate	D+	B	Moderate
27	Legislative scrutiny of the annual budget law	D+	C+	Substantial	D+	D+	High
28	Legislative scrutiny of external audit reports	D+	D+	High	D+	D+	High
Donor Practices							
29	Predictability of Direct Budget Support	A	A	Low	A	D	High
30	Financial information provided by donors for budgeting and reporting on project and program aid	C+	C	Substantial	B+	D+	High

31	Proportion of aid that is managed by use of national procedures	C	D	High	A	A	Low
Central and Local Government							
32	Predictability of Transfers from Higher Level of Government	-	-	-	NA	D+	High

NA = not applicable, PEFA = public expenditure and financial accountability assessment.

Source: Public Expenditure and Financial Accountability Assessment, 2012 and Public Financial Management and Accountability Assessments, 2012.

10. ADB's CPS, 2015–2019, aims to support the government objective of improving PFM. In Pakistan, PFM has achieved some key milestones in the last years. Most significant among them is the development of a centralized and advanced financial reporting system with the support of the World Bank. The thrust of ADB's CPS, 2015–2019 is to improve connectivity, productivity, and access to markets and public services. ADB's strategy will focus on (i) infrastructure development to improve connectivity, boost productivity, help attract private investment, create jobs, and provide access to markets and basic public services; and (ii) institutional reforms (including policy, regulatory, and administrative systems as well as financial management) to help mobilize resources, facilitate effective private sector participation, and improve public service delivery.

IV. PROJECT FINANCIAL MANAGEMENT SYSTEM

A. OVERVIEW

11. Pakistan has a three-tier governance infrastructure for PFM that comprises the federal, provincial, and district governments. The Finance Ministry/Department and Line Ministries/Departments at the federal and provincial levels have well-defined roles and responsibilities for budget formulation and execution. The Controller General of Accounts, a representative of the Federal Government, through its associated offices across the country, pre-audit the transactions, make payments, and thereafter prepares financial statements. The Auditor General of Pakistan (AGP) being the Supreme Audit Institution of the country, is mandated by the Constitution to conduct audit of federal, provincial, and district government entities.

B. STRENGTHS

12. **Punjab Irrigation Department:** The proposed project will benefit from PID's experience of implementing ADB funded project (i.e., Punjab Irrigated Agriculture Investment Program). Moreover, PID is also implementing several development projects solely financed by the Government of Pakistan. The following institutional strengths of PID has been taken into account while designing the financial management system for the proposed project:

- (i) **Policies and Procedures:** PID's policies and procedures are well-established and disseminated across all the departments. Accounting policies and procedures appropriately stipulate segregation of duties among staff who execute transaction, recording of the transaction, custody of assets, ordering, receiving, accounting, paying for goods and services, and bank reconciliations.
- (ii) **Internal Control:** The accounting functions of PID are being performed in accordance with the guidelines provided in the Manual of Accounting Principles (MAP), Accounting

Policies and Procedures Manual (APPM) of the Government of Pakistan followed by the International Public Sector Accounting Standard (IPSAS). It should also be noted that pre-audit of contractor's bills is conducted by the accounting officer.

- (iii) **Prior Experience of ADB Funded Projects:** PID has been implementing the Punjab Irrigated Agriculture Investment Program, which is to be closed in September 2017. It should be stressed that all the audited project financial statement of the last Tranche of the said project are unqualified opinions.

13. **Punjab Agriculture Department:** The proposed project will benefit from PAD's experience of implementing development projects financed by the World Bank and the Government. The following institutional strengths of PAD has been taken into account while designing the financial management system for the project.

- (i) **Policies and Procedures.** PAD's policies and procedures are well-established and disseminated across all the departments. The duties of all staff in respect of authorization to execute a transaction, recording of the transaction, custody of assets, functions of ordering, receiving, accounting, paying for goods and services, and bank reconciliations, have properly been segregated in accordance with APPM.
- (ii) **Internal Control:** The accounting functions of PAD are being performed in accordance with the guidelines provided in the MAP, APPM of the Government of Pakistan followed by the IPSAS. Deputy Director (Audit & Account) under the financial management team in the Project Implementation Office (PIO) is responsible for the internal audit function. It should also be noted that pre-audit of contractor's bills is conducted by the accounting officer.
- (iii) **Prior Experience of the World Bank Funded Project:** PAD has project implementation experience of the Punjab Irrigated-Agriculture Productivity Improvement Project (PIPIP) funded by the World Bank. Not only the financial management arrangement but also other organizational arrangement such as procurement arrangement established through the PIPIP will be utilized in the JIP with incremental adjustments.

C. WEAKNESSES

14. **Punjab Irrigation Department:** The following weaknesses may hinder the swift implementation of the project's designed financial management arrangements:

- (i) **Staffing:** The project management unit (PMU)-PID has staff experienced in managing ADB projects. To deal with the day to day financial matters/affairs of the proposed project, the existing PMU-PID will establish additional two positions, an accountant and an assistant accountant.
- (ii) **Manual accounting system:** PID is still relying on manual accounting system to record and account for large volume of transactions. This will affect the ability of PID to generate project financial statements on a timely basis. Manual accounting system also increase the likelihood of occurrence of errors, omissions, and inappropriate adjustments.

- (iii) **Non-existent Internal Audit function:** Internal audit function is non-existent in PID, which renders to a weak internal control environment.

15. **Punjab Agriculture Department:** The following weaknesses may hinder the swift implementation of the project's designed financial management arrangements:

- (i) **Staffing:** The PIO-PAD has staff experienced in managing the World Bank projects. To deal with the day to day financial matters/affairs of the proposed project, the PIO-PAD will establish an additional accountant position.
- (ii) **Manual accounting system:** PAD will rely on manual accounting system to record and account for large volume of transactions for the proposed project. This will affect the ability of PAD to generate project financial statements on a timely basis. Manual accounting system also increase the likelihood of occurrence of errors, omissions, and inappropriate adjustments.

D. PROJECT IMPLEMENTATION ARRANGEMENTS

16. PID will be the EA, responsible to oversee the entire project. PID will cause the project management unit (PMU) in the existing project management office for canals (PMO-canals), i.e. the project management office that implemented ADB Loans 2299/2300-PAK for the Lower Bari Doab Canal Improvement Project under the Punjab Irrigated Agriculture Investment Program, to be responsible for the execution of Output 1. PAD will be the IA, and a PIO to be established in PAD will implement Outputs 2 and 3, under overall coordination and oversight by PID.

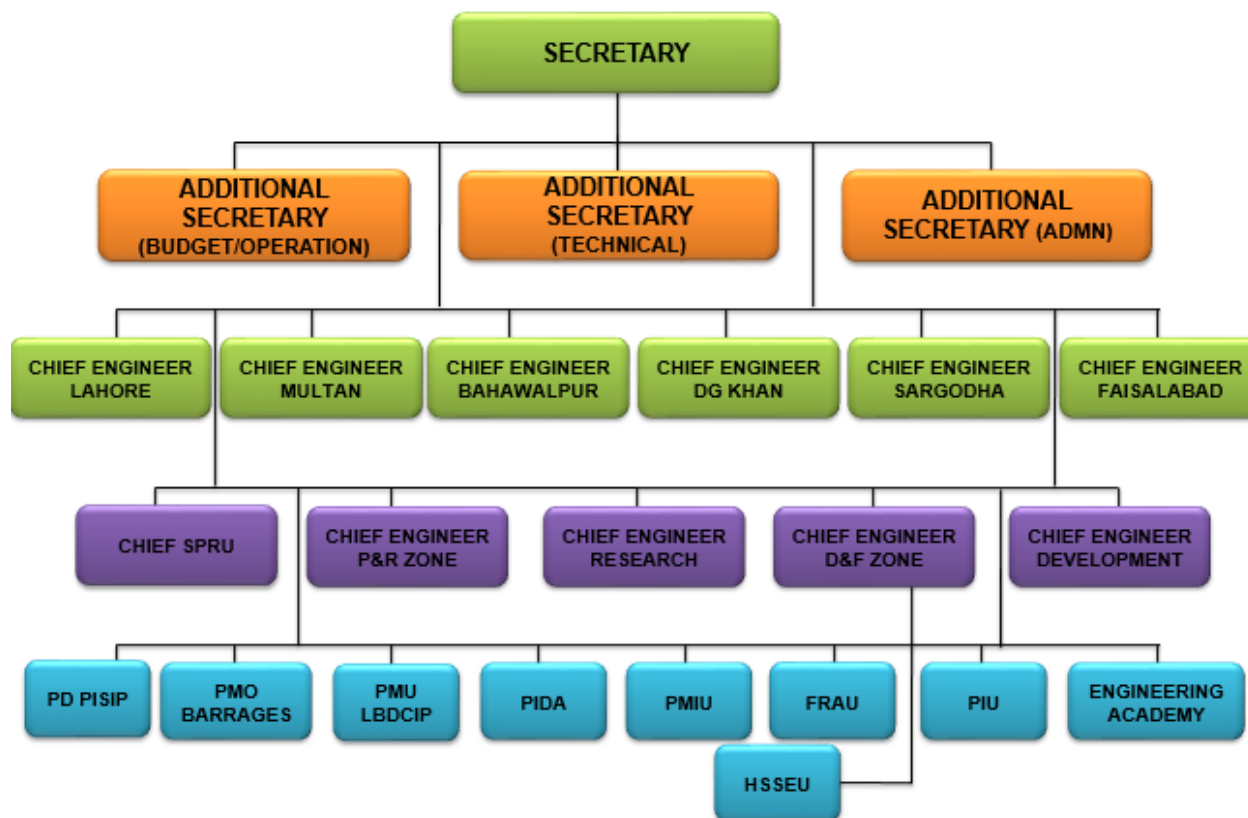
a. Punjab Irrigation Department (PID)

17. The PID is a statutory body functioning under the Government of Punjab through the Ministry of Irrigation. It is responsible for planning, administration, operation and maintenance, and distribution of water of the irrigation system of the province which includes rivers, barrages, canals, drainage, ground water resources, storages, and reservoirs in accordance with the prescribed rules and regulations.

18. The main functions of PID are:

- (i) Monitoring, collection, and compilation of water quality and hydro meteorological data;
- (ii) Design and construction of flood irrigation, and drainage and flood protection schemes to protect irrigated land, population, and other infrastructure facilities;
- (iii) Rehabilitation of damaged irrigation and/or drainage facilities;
- (iv) Environmental and social impact mitigation measures; and
- (v) Coordination for Public Sector Development Programs.

Figure 1: Organogram – Punjab Irrigation Department



D&F Zone = Drainage and Flood Zone, FRAU = Flood Risk Assessment Unit, HSSEU = Hydraulic Structures Safety Evaluation Unit, PIDA = Punjab Irrigation and Drainage Authority, PISIP = Punjab Irrigation System Improvement Project, PIU = Project Implementation Unit, PMIU = Programme Monitoring and Implementation Unit, PMO Barrages = Project Management Office for Barrages, PMU LBDCIP = Project Management Unit for Lower Bari Doab Canal Improvement Project, P&R Zone = Planning and Review Zone, SPRU = Strategic Planning and Reform Unit.

Source: Punjab Irrigation Department.

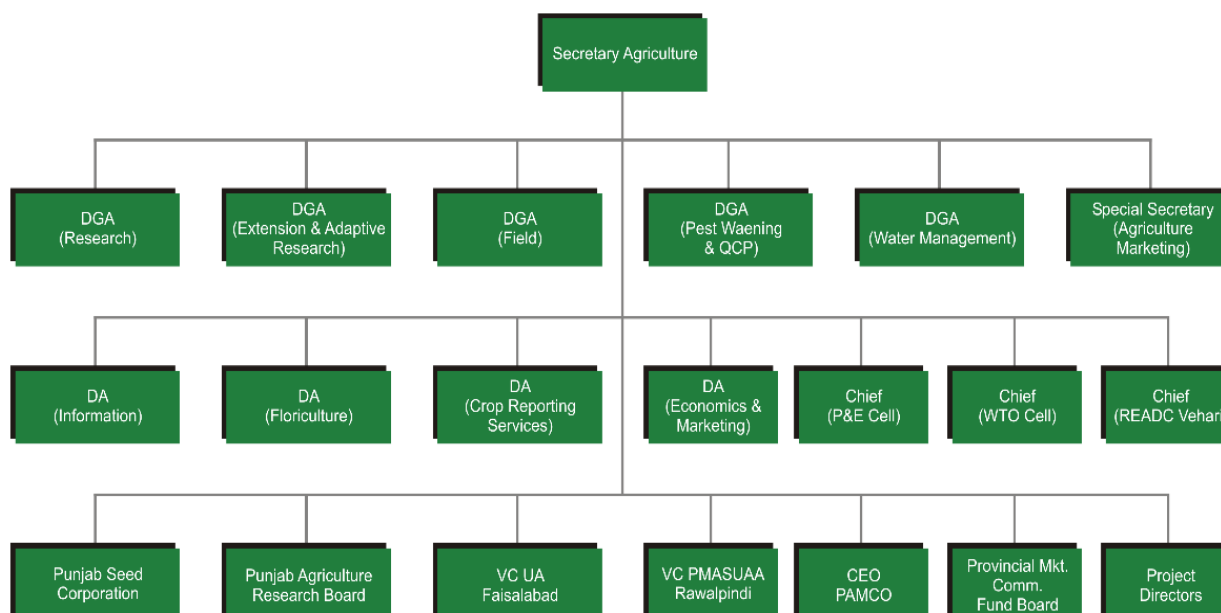
b. Punjab Agriculture Department

19. The On-Farm Water Management (OFWM) is part of the PAD which is an attached department functioning for the Government of Punjab under the Ministry of Agriculture. The OFWM is headed by the Director General who is assisted by Directors and Deputy Directors as well as support staff. The OFWM program has been recognized as one of the major driving forces for transforming Punjab's agriculture into a science based, vibrant, and internationally linked sector. The OFWM's objective is to maximize crop and water productivity by ensuring efficient conveyance, application, and use of irrigation water vis-a-vis promoting improved water management interventions through user participation. The OFWM performs its functions as per prescribed rules and regulations. The departmental functions include:

- (i) Organization and registration of water users' associations (WUAs);
- (ii) Renovation, rehabilitation, and improvement of watercourses;
- (iii) Strengthening of precision land levelling services in the private sector;
- (iv) Promotion of high efficiency pressurized (drip and sprinkler) irrigation systems;
- (v) Development of small scale irrigation schemes in non-canal commanded areas;
- (vi) Construction of water storage ponds and/or tanks;
- (vii) Provision of solar system with high efficiency irrigation systems;

- (viii) Provision of subsidy on installation of tunnels with high efficiency irrigation systems;
- (ix) Provision of on-farm surface drainage facilities;
- (x) Identification, acquisition, pilot testing and evaluation, indigenization, and promotion and/or up-scaling of the latest irrigation water management interventions and technologies through adaptive research;
- (xi) Capacity building of stakeholders (technical staff, trainers and extension workers, and farmers) in improved water management interventions; and
- (xii) Coordination with international, regional, national, and provincial organizations as well as research, extension and field wings of PAD for irrigation water management technology transfer.

Figure 2: Organogram – Punjab Agriculture Department



CEO PAMCO = Chief Operating Officer, Punjab Agriculture and Meat Company; DA = Director, Agriculture; DGA = Director General, Agriculture; P & E = planning and evaluation; QCP = quality control of pesticides; READC = regional economic agriculture development center; VC PMASUAA = Vice Chancellor, Pir Mehr Ali Shah Arid Agriculture University; VC UA = Vice Chancellor, University of Agriculture; WTO = World Trade Organization.

Source: Punjab Agriculture Department.

c. Project Management Implementation Structure

20. A PMU to be headed by the Project Director will be housed in PID for project execution. PAD will be the IA for the on-farm component, in coordination with the PMU.

E. PERSONNEL

21. In general, AGP is entrusted the responsibility to transfer, allocate, and appoint accounting and finance staff to all the provincial government departments. However, the PID and PAD have introduced and adopted the policy of hiring and/or recruiting the staff of different specialties including finance staff from market on contract basis to deal with the donor funded development projects. The employment contracts of the staff to be hired shall be initially one year period which can be extended year by year as per necessity until the completion of the proposed project.

22. Any newly appointed staff shall need training on ADB project management procedures and disbursements as well as in departmental procedures to go through the financial policies for proper implementation of the proposed project. To address the said weaknesses, PID and PAD need to be strengthened by appointing two additional positions, an account and an assistant accountant for PID, and an accountant position for PAD by loan effectiveness under the terms of reference acceptable to ADB.

F. ACCOUNTING POLICIES AND PROCEDURES

23. In PMU-PID and PIO-PAD, separate books of accounts will be maintained for project and loan activities. PMU-PID and PIO-PAD will follow cash basis of accounting to record transactions in appropriate books of accounts. ADB has recently developed a Financial Management Manual (FMM) for projects financed by ADB. FMM contains detailed procedures on budgeting & planning, funds withdrawal and management, bank account management, expenditure management, accounting and book keeping (chart of accounts), financial reporting, and fixed asset management. In the chapter of accounting and bookkeeping, the FMM steers the reader to the procedures on recording of transactions in appropriate books of accounts. This FMM will be extended to PID and PAD for adoption.

G. INTERNAL CONTROLS

24. For PMU-PID and PAD, detailed internal controls for the proposed project as a whole is defined in the FMM. A separate chapter on 'Expenditure Management and Controls' sets out the processes on incurrence of eligible expenditures and processing of payments. The processes entail steps to steer the incurrence of expenditure in accordance with the applicable legal framework and internal controls; and swift processing of payments by Finance Section. FMM provides a comprehensive set of preventive, detective, and corrective controls for different processes and transactions. In addition, other relevant internal controls are enshrined in the General Financial Rules and the APPM of the Government. All these sums up to a robust internal control framework for PMU-PID and PIO-PAD for implementing the proposed project.

H. INTERNAL AND EXTERNAL AUDIT

25. While the internal audit at PID is non-existent, PAD's Deputy Director (Audit & Account) under the financial management team is responsible for the internal audit function which prepares its own monthly reports and conducts quarterly, semi-annual, and annual audits in compliance with established rules and practices. This internal audit team ensures internal controls, compliance, and recoveries before the external audit.

26. The AGP of Pakistan will conduct annual audit of the proposed project, which is acceptable to ADB. The AGP is the supreme audit institution of the country bestowed with powers given by the Constitution of Pakistan to conduct audit of government. The AGP will provide annual audit reports and the management letters highlighting any weaknesses in the financial reporting system and the overall systems of internal control in respect of project at PMU-PID and PAD. The audit for the account for the proposed project will be carried out accordingly.

27. The Director General (Works) of Civil Audit, Punjab conducts the audit of the project with a view to expressing opinion on Financial Statements and reporting significant findings to the management. Audit examines the economy, efficiency, and effectiveness aspects of the proposed

project. Further, the audit assesses whether the management comply with applicable laws, rules, and regulations in managing the proposed project on a risk-based audit methodology.

28. PID and PAD will timely submit annual financial statements of the proposed project to AGP for audit. The AGP will initiate field work and will submit audited financial statements of the proposed project to ADB through the Punjab government within six months of the close of each financial year (i.e. before Dec 31 each year). As of now, there are no overdue audit reports for PID.

Table 2: Required Audit Reports for Project

Audit report type	Due date for submission to ADB
Audited Project Financial Statements (APFS) for Financial Year ended June 30 each year – PID	December 31 of each year
Audited Project Financial Statements (APFS) for Financial Year ended June 30 each year – PAD	December 31 of each year

Source: Asian Development Bank.

I. FINANCIAL REPORTING SYSTEMS INCLUDING INFORMATION SYSTEMS

29. The information system for the proposed project in PID and PAD is non-existent. The financial reports are prepared manually on spreadsheets. However, for project accounting and financial reporting needs, FMM includes guidance on deployment of a suitable software. PAD has a plan to roll out the additional software for project financial reporting.

J. DISBURSEMENT ARRANGEMENTS FUNDS FLOW MECHANISM

30. PID and PAD will be responsible for implementing of the proposed project according to the legal agreements and other implementation arrangements described in the Project Administration Manual. ADB will monitor the proposed project and review its progress to ensure that the loan proceeds are spent as agreed upon. All disbursements will be carried out in accordance with ADB's *Loan Disbursement Handbook* (2017, as amended from time to time).

31. PID and PAD will use direct payment, advance account loan disbursement, and statement of expenditures (SOE) procedures. Retroactive financing will be applied to PID's disbursement. A brief of each procedure of loan disbursement method is as follows. Detailed procedures are outlined in ADB's *Loan Disbursement Handbook* and ADB's *Project Financial Management Manual*.

32. **Direct Payment:** Under the direct payment procedure, ADB loan proceeds will be directly credited to a nominated bank account of a supplier, contractor, or consultant at the request of PID (as the case may be).

33. **Advance Fund:**³ Two segregated advance accounts (at PID and PAD) in US Dollars will be established at the National Bank of Pakistan for receipt of funds from ADB. Under this procedure, advance equivalent to six months forecast or 10% of the loan amount will be credited to the advance accounts, and subsequently replenished. The advance accounts will be operated in accordance with the provisions of "Revised Accounting Procedure for Revolving Fund Account (Foreign Aid Assignment Account)" dated 2 August 2013 issued by the Finance Division, Government of Pakistan.

³ Formally called imprest fund procedure.

34. **Statement of Expenditures:** The SOE procedure is a simplified procedure requiring no submission of supporting documentation of expenditures to reimburse eligible expenditure or to liquidate and replenish the advance account for any individual payments of USD100,000 and below. The SOE sheet replaces the usual supporting documents of expenditures, which should be retained by the borrower and made available for examination by auditors and by ADB representatives upon request.

35. **Retroactive Financing:** Retroactive financing is the financing of project expenditures incurred by the borrower prior to the effective date of the related loan agreement. Retroactive financing is specifically agreed by ADB and the borrower in the loan agreement, pursuant to the terms of the relevant agreement.

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

36. A financial management internal control and risk management assessment was conducted, while considering the adequate implementation capacity of PID and PAD. Factors of staffing, country systems, and implementation readiness were also considered. Based on the assessment, it is concluded that the overall project financial management pre-mitigation risk is ‘Substantial’, considering both EA/IA management styles, experiences, supervisory, technical and financial capabilities.

37. Inherent risk is the susceptibility of the project financial management system to factors arising from the environment in which it operates, such as country rules and regulations and entity working environment (assuming absence of any counter checks or internal controls).

38. Control risk is the risk that the project’s accounting and internal control framework be inadequate to ensure project funds are used economically and efficiently and for the purpose intended, and that the use of funds is properly reported.

Risk Type	Risk Assessment	Risk Description	Proposed Mitigating Measures
Inherent Risk			
Country – Specific	S	Internal audit has not yet been established at the provincial government level.	PID will follow FMM, which includes procedures that gives assurance on intended utilization of loan proceeds. Deputy Director (Audit & Account) in the financial management team of PIO-PAD is responsible for internal audit function.
Country – Specific	M	Budget Execution Risk – Actual Expenditure deviates from budget estimates.	Both EA and IA will be required to prepare budget monitoring reports, which will timely highlight any significant deviations for management attention. FMM includes guidance on preparation of budget monitoring reports.
Overall Assessment of Inherent Risk	S		

Risk Type	Risk Assessment	Risk Description	Proposed Mitigating Measures
Control Risks			
Funds Flow	L	There is some risk that adequate counterpart funds will not be provided on timely basis.	Adequate budget will be allocated to ensure timely availability of counterpart funds.
Staffing	S	Execution Risk –PMU-PID and PIO-PAD may be lack of staff to deal with financial matters/affairs of the project. PIO-PAD may not have a sufficient understanding of ADB's financial management requirements and procedures which contributes to project delay and non-compliance of requirements.	Establish an accountant position and assistant accountant position for PMU-PID and an accountant position for PIO-PAD. Trainings and technical hand holding will be provided to staff.
Internal Audit	S	Absence of internal audit at provincial departments may affect the effectiveness of risk management, control, and governance processes.	PID and PAD will follow FMM, which includes procedures that gives assurance on intended utilization of loan proceeds. Deputy Director (Audit & Account) in the financial management team of PIO-PAD is responsible for internal audit function.
External Audit	L	A high-quality external audit is an essential requirement for creating transparency in the use of public funds.	The ADB-funded program will be audited annually in accordance with international standards by the AGP. The audit reports will be submitted to ADB by due dates.
Reporting, Monitoring and Information Systems	S	In the absence of information systems, there is risk of delayed interim financial reporting. Poor project monitoring and accountability will impact on project progress.	PMU-PID and PIO-PAD will adopt ADB's FMM in preparing financial reports. PIO-PAD ensures that a new financial software will be rolled out for the project financial reporting.
Internal Controls	S	There is some risk that expenditure incurred will not be in accordance with applicable legal framework.	A comprehensive section is included in FMM which describes step-wise guidance on expenditure management defining the service standards and pre-requisite supporting documentation for payment processing. FMM will be adopted by PMU-PID and PIO-PAD.
Overall Assessment of Control Risk	S		
Overall Control Risk	S		

H=High (likely to occur, will have high impact if occurs), S=Substantial (unlikely to occur, will have high impact if occurs), M=Moderate (likely to occur, will have low impact if occurs), L=Low (not likely to occur, will have low impact)

if occurs), ADB = Asian Development Bank, AGP = Auditor General of Pakistan, EA = Executing Agency, FMM = financial management manual, IA = implementing agency, PAD=Punjab Agriculture Department, PID=Punjab Irrigation Department, PIO = project implementation office, PMU=project management unit.
Source: Asian Development Bank.

VI. PROPOSED ACTION PLAN

Action	Risk Assessment	Responsibility	Resources	Timeline
1. Adopt Financial Management Manual and tailor it accordingly to the need of the project	Substantial	PMU-PID and PIO-PAD	Project Director (PMU-PID) and Director General Agriculture (PIO-PAD)	Within 3 months after effectiveness
2. Establish an accountant position and assistant accountant position for PMU-PID and an accountant position for PIO-PAD.	Substantial	PMU-PID and PIO-PAD	Project Director (PMU-PID) and Director General Agriculture (PIO-PAD)	By loan effectiveness
3. Timely opening of Advance Accounts	Low	PMU-PID and PIO-PAD	Project Director (PMU-PID) and Director General Agriculture (PIO-PAD)	Start opening procedure upon effectiveness
4. Prepare for retroactive financing arrangement based on the Loan Disbursement Handbook and the Financial Management Manual	Low	PMU-PID and PIO-PAD	Project Director (PMU-PID)	Ongoing

Source: Asian Development Bank.

VII. SUGGESTED FINANCIAL MANAGEMENT COVENANTS

39. The loan agreement shall require a covenant on the retroactive financing arrangement under the schedule, Allocation and Withdrawal of Loan Proceeds.