

# Financial Management Assessment Report

---

Project Number: 48289-002  
March 2017

Islamic Republic of Pakistan: Peshawar Sustainable  
Bus Rapid Transit Corridor Project

## **CURRENCY EQUIVALENTS**

(as of 10 March 2017)

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

PRe1.00 = \$ 0.0094

\$1.00 = PRs106.45

## **ABBREVIATIONS**

ADB	=	Asian Development Bank
AGP	=	Auditor General of Pakistan
APPM	=	Accounting Policies and Procedures Manual
BRT	=	Bus Rapid Transport
CFO	=	Chief Financial Officer
CGA	=	Controller General of Accounts
EA	=	Executing Agency
EPCM	=	Engineering Design, Procurement and Construction Management
FM	=	Financial Management
FMA	=	Financial Management Assessment
FMM	=	Financial Management Manual
IA	=	Implementing Agency
KP	=	Khyber Pakhtunkhwa
KPUMA	=	KP Urban Mobility Authority
OBDM	=	Operations Design and Business Model
OCR	=	Ordinary Capital Resources
PFM	=	Public Financial Management
PIU	=	Project Implementation Unit
PMCCB	=	Project Management, Coordination and Capacity Building
PMU	=	Project Management Unit
TMTD	=	Transport and Mass Transit Department

## Table of Contents

EXECUTIVE SUMMARY .....	iv
I. INTRODUCTION.....	1
II. BRIEF PROJECT DESCRIPTION.....	1
III. COUNTRY AND SECTOR FINANCIAL MANAGEMENT ISSUES .....	2
IV. PROJECT FINANCIAL MANAGEMENT SYSTEM.....	4
A. OVERVIEW .....	4
B. STRENGTHS.....	4
C. WEAKNESSES.....	4
D. PROJECT IMPLEMENTATION ARRANGEMENTS.....	5
E. PERSONNEL.....	8
F. ACCOUNTING POLICIES AND PROCEDURES .....	9
G. INTERNAL CONTROLS.....	9
H. INTERNAL AND EXTERNAL AUDIT .....	9
I. FINANCIAL REPORTING SYSTEMS, INCLUDING INFORMATION SYSTEMS .....	10
J. DISBURSEMENT ARRANGEMENTS, FUNDS FLOW MECHANISM.....	11
V. RISK DESCRIPTION AND RATING – INCLUDING THE FINANCIAL MANAGEMENT AND INTERNAL CONTROL RISK ASSESSMENT .....	11
A. INHERENT RISK.....	12
B. PROJECT RISKS.....	13
VI. PROPOSED ACTION PLAN .....	15
VII. SUGGESTED FINANCIAL MANAGEMENT COVENANTS.....	16

## EXECUTIVE SUMMARY

i. 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 for Peshawar Development Authority and TransPeshawar as implementing agencies (IAs), for Peshawar Sustainable Bus Rapid Transit Corridor Project.

ii. The Project will help develop a sustainable urban transport system in Peshawar, the provincial capital of Khyber Pakhtunkhwa in Pakistan, through the delivery of an integrated bus rapid transit (BRT) corridor. The project outcome will be improved public transport in Peshawar, directly benefiting a population of at least 0.5 million. The project will consist of two interlinked outputs: (i) full restructuring of a 25.8-kilometer BRT corridor, including BRT dedicated lanes, 31 stations, 2 depots, mixed traffic lanes, bicycle lanes, parking, sidewalks, green areas, energy-efficient streetlights and proper drainage to climate-proof the BRT infrastructure; and (ii) effective project management and sustainable BRT operations through institutional and organizational developments. The project is economically justified by major time savings for future BRT passengers, vehicle operating cost savings, and better air quality and savings in carbon emissions, which will in turn help improve the health of Peshawar's citizens and mitigate climate change. The project will also help make Peshawar safer and more livable, boost private sector investment, and foster gender equity.

iii. 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 for the Peshawar Development Authority and TransPeshawar, the two implementing agencies (IAs) for the project. The executing agency for the project is Khyber Pakhtunkhwa Urban Mobility Authority (KPUMA) which will be responsible for the overall coordination of the project. KPUMA's Board of Directors will act as the Project Steering Committee. KPUMA will not undertake procurement and financial activities, therefore an assessment of its financial management capacity is not necessary. The Transport and Mass Transit Department (TMTD) will provide administrative and secretarial support to KPUMA through the project management unit (PMU) with support from Project Management, Coordination and Capacity Building consultants who were recruited under the Project Design Advance. Currently, PMU is performing some of the activities under TransPeshawar until the company is fully staffed and operational. It is anticipated that the relevant PMU staff will be transferred as TransPeshawar staff to ensure smooth transition.

2. The financial management, internal control, and risk assessment was carried out from 20 February to 17 March 2017 by Mirza Omer Baig (Financial Management Consultant). Preparation activities included reviewing documents, interviewing counterparts, and discussing the issues with stakeholders.

## II. BRIEF PROJECT DESCRIPTION

3. The Project will help develop a sustainable urban transport system in Peshawar, the provincial capital of Khyber Pakhtunkhwa (KP) in Pakistan, through the delivery of an integrated bus rapid transit (BRT) corridor. The project outcome will be improved public transport in Peshawar, directly benefiting a population of half a million. The project will consist of two interlinked outputs: (i) full restructuring of a 25.8-kilometer BRT corridor, including BRT dedicated lanes, 31 stations, 2 depots, mixed traffic lanes, bicycle lanes, parking, sidewalks, green areas, energy-efficient streetlights and proper drainage to climate-proof the BRT infrastructure; and (ii) effective project management and sustainable BRT operations through institutional and organizational developments. The project is economically justified by major time savings for future BRT passengers, vehicle operating cost savings, and better air quality and savings in carbon emissions, which will help improve the health of Peshawar's citizens and mitigate climate change. In addition to providing enhanced accessibility and mobility particularly for the poor, the project will also help make Peshawar safer and more livable, boost private sector investment, and foster gender equity. The Project's outputs include:

- i. **Output 1:** Peshawar Phase 1 BRT Corridor Restructuring will deliver an integrated BRT corridor consisting of a 25.8 kilometer dedicated bus corridor, mainly at-grade with limited elevated and tunnel or trench sections at junctions. The corridor will have 31 stations, 2 depots (with park-and-ride facilities for private vehicles), one staging facility (with park-and-ride facilities and commercial areas), one parking plaza, mixed traffic lanes, bicycle lanes, roadside parking, sidewalks, green areas, energy-efficient streetlights and proper drainage to climate-proof the BRT infrastructure.
- ii. **Output 2:** Effective project management and sustainable BRT operations that will include the strengthening capacity of Khyber Pakhtunkhwa Urban Mobility Authority (KPUMA) as the regulator and TransPeshawar as the operator; structuring and delivering viable PPP arrangements; designing the BRT operational plan and business model; facilitating a bus industry transition through

negotiations and capacity building for private bus operators selected to operate the BRT; setting up a fleet scrapping program and compensation mechanism for non-participating operators; building capacity of the traffic police to enforce parking, street vendors' policy, and other traffic rules; implementing a communication and marketing plan; and implementing an urban development strategy along the BRT corridor.

4. The project is consistent with the Khyber Pakhtunkhwa Government's Vision 2030, Framework for Economic Growth (2011) and National Climate Change Policy, and supports priorities set out in KP Comprehensive Development Strategy 2010-17.

5. The project is estimated to cost \$585 million with ADB portion of \$485 million (including \$10 million from project design advance). Government of Khyber Pakhtunkhwa will provide counterpart funding for the residual amount of \$100 million, covering mainly for taxes and duties, and for land acquisition and resettlement costs. Cofinancing options from other development partners are also being explored to replace 30% of ADB financing (estimated \$150 million).

6. The project is expected to be implemented over 2017-2021. BRT operations are scheduled to commence in 2019 to meet an initial demand of approximately 480,000 passengers.

### **III. COUNTRY AND SECTOR FINANCIAL MANAGEMENT ISSUES**

7. 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. Federal as well as provincial governments over the years has made some improvements in the overall budget management. Budgeting, reporting, and introduction of medium-term planning tools and use of a risk-based audit methodology by the office of the Auditor General of Pakistan (AGP) are some of the key reforms implemented over the past few years.

8. Extensive analytical work on public financial management (PFM) systems has been conducted in the country, both at national and subnational levels. In May 2007, Public Financial Management and Accountability Assessments (PFMAA), using the PEFA PFM Performance Measurement Framework, were completed for Balochistan, Punjab, and KP and a Federal level PFMAA using the same framework was delivered in June 2009. It noted that reforms underway have contributed towards improvements in PFM systems. Most notable are the ones initiated under the World Bank-funded Project for Improvement of Financial Reporting and Auditing (PIFRA) and the implementation of a Medium Term Budgetary Framework (MTBF) which is supported by DFID. Donor-funded projects and a number of self-accounting entities currently remain outside the government FMIS. The government is yet to develop an effective internal audit function and continuing efforts are needed to improve effectiveness of tax collection and the management of cash balances impacting the predictability in availability of funds. Specific diagnostic and analytical work has not been done for FATA where Federal PFM systems are applicable.

9. The Public Financial Management and Accountability (PEFA) Assessment of 2012 provides the most recent comprehensive analysis of PFM systems in Pakistan. This was a repeat assessment with a baseline established through an earlier PEFA report in 2009. The report noted positive progress as a result of ongoing reforms for improving PFM. Budgeting,

accounting and financial reporting have been automated at the federal, provincial and district level through the nation-wide implementation of National Financial Management Information System (National FMIS) using the sophisticated SAP application with a uniform chart of accounts that is compliant with international classification standards namely UN COFOG and IMF GFSM. Connectivity is in place for all line ministries/departments to monitor budget execution in real time. Government has introduced a Medium Term Budgetary Framework (MTBF) to bring a multi-year perspective in planning and budgeting. Annual audits are completed in time using international standards and audit reports are presented to the legislature within eight months of the end of the fiscal year. Progress on transparency through public availability of financial information is also noteworthy.

10. The 2012 PEFA assessment, however, identified certain areas for improvement to achieve better PFM outcomes. On the budgeting side, the main area in need of improvement is budget credibility, which could be achieved by institutionalizing the MTBF. On the expenditure side, there is a need to strengthen expenditure controls, which could be achieved by utilizing the commitment accounting functionality available within National FMIS. The Government also needs to develop an effective internal audit function and continue efforts to improve tax collection and the management of cash balances, which are impacting the predictability of availability of funds.

11. ADB's country partnership strategy (CPS), 2015–2019<sup>1</sup> aims to support the governmental objectives, improving public financial management (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 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.

12. Provincial Government of KP has limited capacity to implement such unique projects. Peshawar Development Authority have limited capacity to implement a project of this nature, therefore fiduciary risk is assessed as High.<sup>2</sup> There is likelihood that such fiduciary risk may hinder the project's implementation progress.

---

<sup>1</sup> ADB. 2015. *Country Partnership Strategy: Pakistan, 2015–2019*. Manila.

<sup>2</sup> The rating was based on the fact that BRT is a flagship activity in the province, although Peshawar Development Authority as noted in this report has implemented major urban projects in the past both funded by the Government and the Donors. Upgrading/developing urban road infrastructure, footpaths, parking, building overhead etc. is part of their mandate as a special purpose vehicle entity that is designed for this purpose.

## IV. PROJECT FINANCIAL MANAGEMENT SYSTEM

### A. OVERVIEW

13. Pakistan has a three-tier governance infrastructure for PFM that comprises the federal, provincial and district government(s). 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 (CGA), a representative of 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

14. **Peshawar Development Authority:** The project will benefit from Peshawar Development Authority's (the Authority) experience of implementing externally-financed projects. The Authority has implemented an ADB financed project from 1990-97; and a USAID funded project from 2010-2014. Following institutional strengths of the Authority has been taken in to account while designing the financial management system for the project:

- i. **Policies and Procedures.** The Authority's policies and procedures are well-established and disseminated within the organization, including appropriate sanctions and penalties for non-compliance. Policies and Procedures ensure adequate segregation of duties in the Finance function of the Authority.
- ii. **Internal Control:** In order to keep preventive control, the Authority follows and complies with laws, regulations and procedure manuals. Having segregation of duties, transactions are vetted by the Technical function and the Finance function of the Authority prior to processing for payment. It should be noted that PDA has well established pre-audit system.
- iii. **Staffing:** The key personnel in the Finance function are adequately qualified and experienced. There is low staff turnover in Finance function. Director Finance heads the Finance function, who has the experience of about 30 years, and possess Masters level degree in Finance.

15. **TransPeshawar:** TransPeshawar has been recently established as a commercial business entity and do not have a financial management system in place yet. Therefore, no such strengths exist as yet.

### C. WEAKNESSES

16. **Peshawar Development Authority:** Following weaknesses may hinder the swift implementation of project's designed financial management arrangements:

- i. **Staffing:** The existing Finance staff of the Authority may not be able to bear the workload of the project, while also discharging Authority's day to day operations simultaneously.
- ii. **Manual accounting system:** The Authority is still relying on manual accounting system to record and account for large volume of transactions. This will affect the ability of Authority to generate project and entity financial statements on a timely basis. Manual accounting system also increase the likelihood of occurrence of errors, omissions, and inappropriate adjustments.



- iii. **Outdated Accounting Manual:** The accounting manual in use by the Authority was latest revised in 1995. Since then the Authority is using from the old and outdated manual. There is risk that manual does not cover all aspects of accounting Authority's activities which the Authority underwent since its evolution.
- iv. **No Chart of Accounts:** The Authority has no Chart of Accounts to classify its expenditure against various Heads of Accounts. There is a risk that expenditure will not be recorded accurately. This will also lead to delays in generating various financial reports in a timely fashion.

17. **TransPeshawar:** Since the entity is relatively new, financial management systems are not in place yet.

#### **D. PROJECT IMPLEMENTATION ARRANGEMENTS**

18. The project will be implemented from September 2017 to December 2021. The Executing Agency (EA) for the project is KPUMA which is responsible for the overall coordination, supervision and execution of the project. Peshawar Development Authority and TransPeshawar will be the IAs. Peshawar Development Authority, through Project Implementation Unit (PIU) as the local municipal agency, will be responsible for the civil works contracts and their implementation. TransPeshawar as IA will be responsible for project's operations, procurement of rolling stock and equipment for the project, managing services related to bus operations and overall project management. Trans-Peshawar will operate as a commercial business entity regulated by KPUMA policies

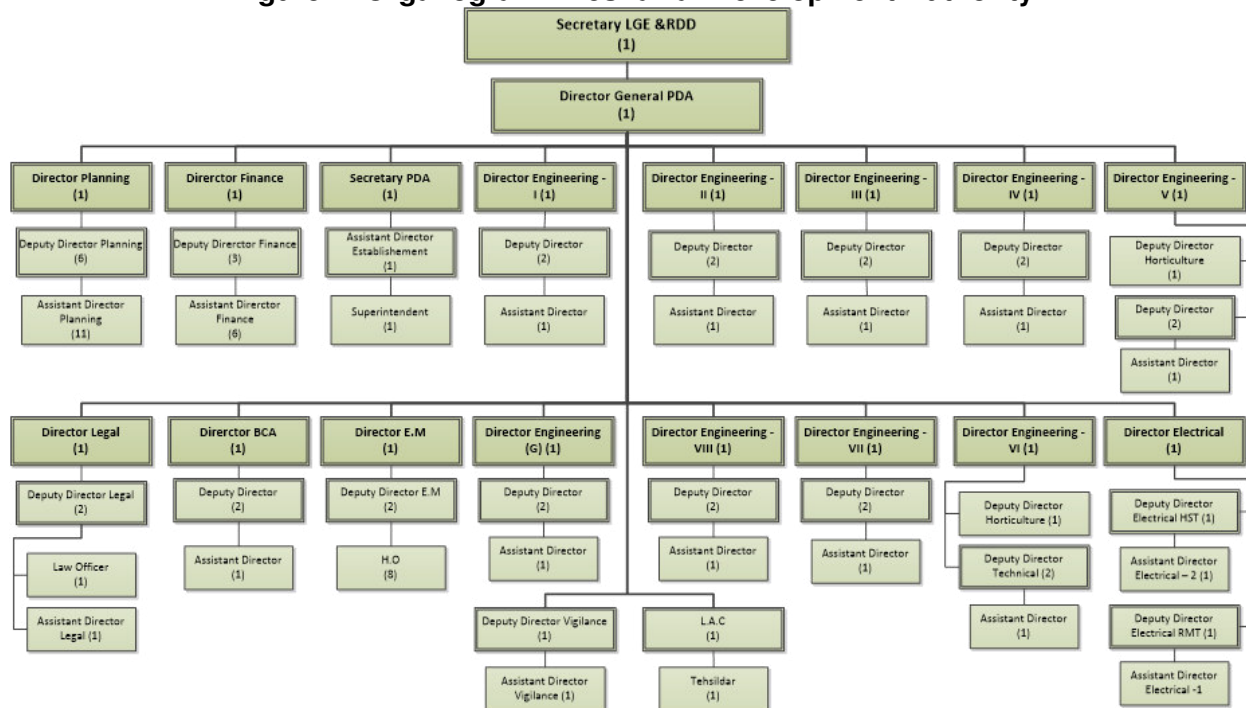
#### **Peshawar Development Authority**

19. Peshawar Development Authority (PDA) was established in 1980 under The North-west Frontier Province Urban Planning Ordinance, 1978. PDA is administratively aligned to Local Government & Rural Development Department Government of Khyber Pakhtunkhwa. It is responsible for the planning, designing and implementation of various urban development projects. PDA prepares and sanctions the town planning schemes, development plans, deals with urban transport, water supply, sanitation, development of new towns, roads, Infrastructure, parks and horticulture through execution of annual development projects. Peshawar Development Authority comprises upon following Functional Groups:

- (i) Urban Development and Municipality Wing
- (ii) Water and Sanitation Wing
- (iii) Traffic Engineering Wing
- (iv) Parks and Horticulture Wing

20. The functional groups are not transformed into the organizational structure. There are 8 Director Engineering in PDA and any one can be tasked for the construction of roads, flyovers underpasses in Peshawar city including Jamrud Road-Khyber-GT Road. It does not have any dedicated / specialized traffic engineering wing like the Traffic Engineering and Transport Planning Agency (TEPA) Lahore to perform all the roles concerning traffic management and transport planning within the metropolitan area of Peshawar.

**Figure 1: Organogram - Peshawar Development Authority**



Source: Asian Development Bank.

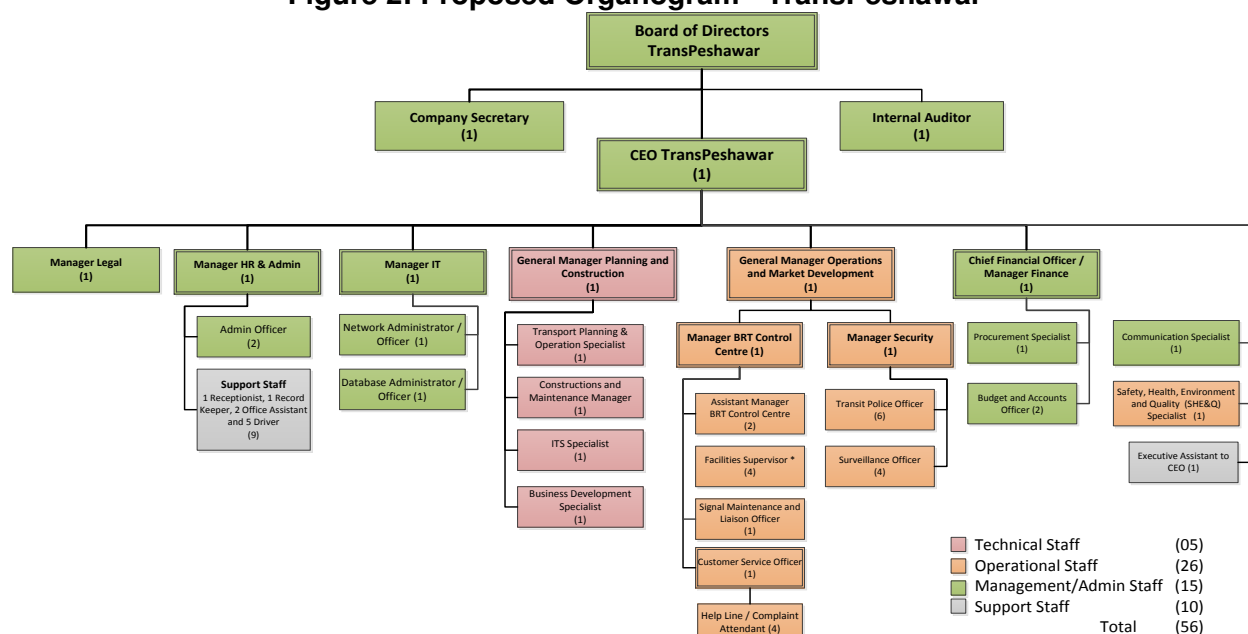
## TransPeshawar

21. TransPeshawar has been established as a non-profit organization set up under Section 42 of Companies Ordinance 1984. It is responsible for project implementation, management and maintenance of urban rapid transit projects in Peshawar as assigned by KP Urban Mobility Authority (KPUMA) for the benefits of public at large.

22. The main functions of TransPeshawar are:

- (i) Plan and design operations, build operate and maintain infrastructure including the mass transit system and prepare specific business plans/models
- (ii) Implement BRT under supervision and oversight of KPUMA
- (iii) Procure the services attached to the project assigned by KPUMA
- (iv) Assist KPUMA for consolidation of existing bus industry to operate buses on the mass transit area
- (v) Collect and use fees, fines and all other revenues generated from any urban rapid transport project assigned by KPUMA.
- (vi) To undertake management and maintenance of urban rapid transit activities as assigned to it by KPUMA.

**Figure 2: Proposed Organogram - TransPeshawar**



Source: Asian Development Bank.

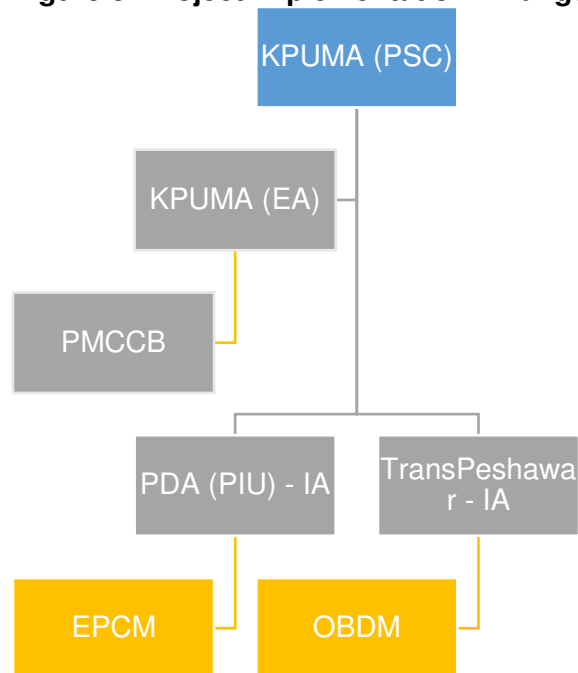
### Project Management Implementation Structure

23. A project management unit (PMU) headed by Project Director has been set up for project execution. The Project Steering Committee (PSC) will provide overall guidance, while overseeing the implementation progress. PSC will be housed in Khyber Pakhtunkhwa Urban Mobility Authority (KPUMA). KPUMA has been established under the Khyber Pakhtunkhwa Mass Transit Act and is the Regulator for the urban mobility and mass transit activities. PMU's technical team will consist of a Project Director, Senior Traffic Engineer, Public Transport Operations Expert, Social and Resettlement Specialist, Chief Financial Officer/PPP Specialist, Procurement and Contract Manager, and 2 Research Assistants. In Administration Team, PMU consists of Accounts Officer, Assistant Accounts Officer, and 2 Program Assistants.

24. TransPeshawar will have overall responsibility for BRT project management and implementation. TransPeshawar was formed as public company limited by guarantee and not having a share capital. Being headed by Board of Directors (BOD), the company affairs are taken care by a Secretary and Chief Executive Officer (CEO) who reports to BOD. In addition, Internal Auditor also reports directly to BOD as additional layer of oversight on company's operations. Currently, Secretary and CEO positions have been deputed by TMTD to TransPeshawar as an interim arrangement until all positions are filled and selected on competitive basis.

25. A project implementation unit (PIU) headed by a Chief Engineer will be housed in Peshawar Development Authority. PIU will be overall responsible for managing project's civil works contracts and their implementation. PIU team will consist of 2 Director Engineering and a Finance Director. All Directors are supported by Deputy Directors (2 each for a Director) as key staff.

**Figure 3: Project Implementation Arrangements**



KPUMA = Khyber Pakhtunkhwa Urban Mobility Authority, EA = executing agency, EPCM = Engineering Design, Procurement and Construction Management, IA = implementing agency, ODBM = Operations Design and Business Model, PDA = Peshawar Development Authority, PIU = project implementation unit, PMCCB = Project Management Coordination and Capacity Building

Source: Asian Development Bank.

## E. PERSONNEL

26. The Finance function of TransPeshawar will be headed by CFO, who will be supported by two Budget and Accounts Officers. PMCCB consultants under the Project design Advance is in the process of devising respective job descriptions and hiring through advanced recruitment methods. The job description of Finance function should be clear and detailed, also considering adequate segregation of duties among the Finance team. ***Finance team of TransPeshawar will be solely responsible for BRT project's FM arrangements.***

27. At Peshawar Development Authority, a qualified and experienced Director Finance heads the Finance function. Director Finance is supported by Deputy Directors Finance and Audit. All Deputy Directors are equipped with adequate human resources of Assistant Directors and supporting staff. Deputy Director Audit is responsible for pre-audit of payments, followed by Deputy Director Finance who is responsible for processing the payments. Director Finance will be overall responsible for project related FM arrangements which include timely disbursements, expenditure management, accurate accounting and timely financial reporting, and facilitating auditors in project/loan external audit. **Finance function of Peshawar Development Authority has sufficient qualified personnel to perform project/loan financial management functions.**

## F. ACCOUNTING POLICIES AND PROCEDURES

28. 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 Book Keeping, the FMM steers the reader to the procedures on recording of transactions in appropriate books of accounts. **This FMM will be adopted for use of the PIUs at TransPeshawar and Peshawar Development Authority, which will be customized according to the requirements of the project.**

29. Upon operation of TransPeshawar and hiring of Finance positions, an imprest account will be opened by TransPeshawar for receipt of funds by ADB. These funds will be used by TransPeshawar for meeting the administrative expenses of the company. For accounting of these funds, separate books of accounts will be maintained for project/loan activities.

30. Peshawar Development Authority is following cash basis of accounting. Peshawar Development Authority follows an Accounting Manual devised under Provincial Urban Development Board Rules 1993 and revised in 1995. However, since then, no revisions are made in this manual. For project/loan accounting at Peshawar Development Authority, cash basis of accounting will be followed. PIU-Peshawar Development Authority will maintain separate books of accounts to record transactions of the project.

## G. INTERNAL CONTROLS

31. For TransPeshawar, detailed internal controls for BRT project as a whole are 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 to, other relevant internal controls are enshrined in GFRs and the Accounting Policies and Procedures Manual (APPM) of the Government. All these sums up to a robust internal control framework for and TransPeshawar for implementing the BRT project.

32. For PIU-Peshawar Development Authority, FMM will be tailored to fit in the Authority's payment processes. The Peshawar Development Authority derives its power to incur expenditure from 'Delegation of Financial Powers of the Provincial Government'. The transactions/invoice/bills are first vetted by the Deputy Director Engineering/Technical, followed by a pre-audit by Deputy Director Audit. Deputy Director Audit forwards the transactions to Deputy Director Finance for payments processing. In case, Deputy Director Audit, finds any missing/incomplete documentary evidence supporting the transaction, the case is reverted to Deputy Director Engineering/Technical for compliance and resubmission.

## H. INTERNAL AND EXTERNAL AUDIT

33. Internal Audit at Peshawar Development Authority is non-existent. Being a government department, Peshawar Development Authority external audit is also conducted by AGP. Moreover, Peshawar Development Authority is also audited by a firm of chartered accountants. The audit report by a firm of chartered accountants is submitted to the relevant stakeholders

charged with governance. In TransPeshawar, an Internal Auditor who reports to BOD for all internal audit matters, is in place.

34. TransPeshawar will be required to appoint external auditors, a firm of chartered accountants, Companies Ordinance 1984. The auditors of a company shall be appointed by the Board of Directors.

35. Whereas, in Peshawar Development Authority, its management is responsible for the preparation of financial statements in accordance with Public Sector Accounting Standards as applicable in Pakistan and Khyber Pakhtunkhwa, Urban Planning Ordinance 1978. The firm of Chartered Accountants conducts annual audit of Peshawar Development Authority in accordance with International Standards on Auditing as applicable in Pakistan.

36. The Office of the Auditor General of Pakistan (AGP) will conduct annual audit of the project (PIU-Peshawar Development Authority and TransPeshawar), which is acceptable to the ADB. AGP is the supreme audit institution of the country bestowed with powers given by Constitution of Pakistan to conduct audit of government. AGP will carry out the audit of the project in accordance with International Standards of Supreme Audit Institution (ISSAI). 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 PIU-Peshawar Development Authority and TransPeshawar.

37. PIU-Peshawar Development Authority and TransPeshawar will timely submit annual financial statements of the project to AGP for audit. AGP will initiate field work and will submit audited financial statements of the project to ADB 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 Peshawar Development Authority.

**Table 1: Required Audit Reports for Project**

<b><i>Audit report type</i></b>	<b><i>Due date for Submission to ADB</i></b>
Audited Project Financial Statements (APFS) for Financial Year ended June 30 each year – Project Implementation Unit-Peshawar Development Authority	December 31 each year
Audited Project Financial Statements (APFS) for Financial Year ended June 30 each year – TransPeshawar	December 31 each year
Entity Audited Financial Statements (AFS) for Financial Year ended June 30 each year – TransPeshawar audited by external audit firm	Starting financial year ended 30 June 2019, submit AFS within 1 month after TransPeshawar’s Board of Director approval

Source: Asian Development Bank.

## **I. FINANCIAL REPORTING SYSTEMS, INCLUDING INFORMATION SYSTEMS**

38. The information system Peshawar Development Authority and TransPeshawar is non-existent. The financial reports are prepared manually on spreadsheets. Upon, TransPeshawar becoming functional, its capacity will be assessed and a suitable software will be proposed for its budgeting, accounting and financial reporting appetite. With TransPeshawar entrusted with the overall project management for BRT, software will be reference point to generate financial reports as a monitoring tool to cost control and budget. TransPeshawar has hired Project

Management, Coordination and Capacity Building (PMCCB) consultants under the Project Design Advance; and one of the outputs agreed with PMCCB is deployment of Cost Control system. Once TransPeshawar becomes functional, its capacity will be built and strengthened through on-field and off-field trainings.

## **J. DISBURSEMENT ARRANGEMENTS, FUNDS FLOW MECHANISM**

39. TransPeshawar and Peshawar Development Authority will be responsible for implementing the project according to the legal agreements and other implementation arrangements described in the Project Administration Manual (PAM). ADB will monitor the project and review its progress to ensure that the loan proceeds are spent as agreed upon. Upon effectiveness, a loan account under the borrower (check with David who sign Loan agreement, project agreement) name will be opened in ADB's books where the loan proceeds will be credited for use of TransPeshawar, and Peshawar Development Authority. All disbursements will be carried out in accordance with ADB's Loan Disbursement Handbook (2015, as amended from time to time).

40. TransPeshawar will use direct payment, commitment and imprest account loan disbursement procedures. Whereas, PIU Peshawar Development Authority will use direct payment and imprest account loan disbursement procedures. 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.

41. **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 TransPeshawar or PIU Peshawar Department Authority (as the case may be).

42. **Commitment Procedure.** Under the commitment procedure, TransPeshawar will open a letter of credit in the name of the contractor and/or supplier which will be confirmed by ADB through a commitment letter. Payments under the commitment letter will be made by ADB (to the extent of ADB share) directly to the negotiating bank by withdrawal of equivalent amount from the loan proceeds.

43. **Imprest Account.** Two separate Imprest Accounts (at each implementing agency) 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 will be credited to Imprest Accounts, and subsequently replenished. The Imprest Accounts will be operated in accordance with the provisions of "Revised Accounting Procedure for Revolving Fund Account (Foreign Aid Assignment Account)" dated August 02, 2013 issued by the Finance Division, Government of Pakistan.

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

44. A financial management internal control and risk management assessment was conducted, while considering the present circumstances of being IAs new to ADB systems and requirements. Factors of staffing, country systems and autonomous nature of Peshawar Development Authority were also considered. Based on the assessment, it is concluded that the overall project financial management pre-mitigation risk is '**Substantial**', considering both IAs' management style, experience, supervisory, technical and financial capability.

## A. INHERENT RISK

45. 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).

Risk Type	Risk Assessment	Risk Description	Proposed Mitigating Measures
Country – Specific	S	Internal audit has not yet been established at the Provincial government level.	When TransPeshawar becomes functional, an Internal Audit Committee will be constituted. An Internal Auditor is included in TransPeshawar's organogram, who will report to Board of Director for all internal audit matters.
	M	Budget Execution Risk – Actual Expenditure deviates from budget estimates	Both IAs will be required to prepare monthly budget monitoring reports. TransPeshawar will be deployed with a cost control system (software) to monitor project's budget management.
	S	Delayed Legislative Scrutiny of Audit Observations (External Audit Reports). Departmental Accounts Committee (DAC) is not convened within reasonable time frame to discuss / settle audit observations.	Both IAs will follow up with Administrative Department and AGP for timely convening of DAC. ADB will follow up with both IAs on settlement of audit observations
Entity – Specific	M	<b>Implementation:</b> TransPeshawar is implementing ADB-financed project for the first time. .	Adequate staff are being hired for TransPeshawar by PMCCB. Moreover, manuals outlining procedures policies roles, responsibilities are also being devised by PMCCB for smooth functionality of TransPeshawar. Also, FMM will be adopted by IAs for guidance on BRT's FM matters. Regular trainings and hand holding will be provided by ADB in project's implementation through supervision missions and workshops
	M	<b>Staffing:</b> The existing Finance staff of Peshawar Development Authority may not be able to bear the workload, while discharging Authority's day to day operations simultaneously.	A Separate PIU is established within Peshawar Development Authority with dedicated staff to implement the component related to civil works and engineering.
	S	Outdated and Incomplete Accounting Manual in use of Peshawar Development Authority will increase likelihood of errors and omissions.	FMM developed by ADB will be adopted by both IAs. Subsequently, regular supervision missions and trainings by ADB will further enhance the capacity to build and establish an effective financial management system.



<b>Risk Type</b>	<b>Risk Assessment</b>	<b>Risk Description</b>	<b>Proposed Mitigating Measures</b>
		In the absence of financial management system, TransPeshawar will not be able to accurately record transactions	For TransPeshawar, PMCCB will deploy an accounting software which will be a stepping stone in establishment of a financial management system for the project and TransPeshawar. Moreover, PMCCB is also in the process of hiring staff for TransPeshawar; and devising manuals for its functioning.
<b>Overall Assessment of Inherent Risk</b>	<b>S</b>		

M=Moderate, S=Substantial

ADB = Asian Development Bank, AGP = Auditor General of Pakistan, BRT = bus rapid transit, FM = financial management, FMM = financial management manual, IA = implementing agency, PIU = project implementation unit, PMCCB = Project Management Coordination and Capacity Building

Source: Asian Development Bank.

## **B. PROJECT RISKS**

46. Project 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.

<b>Risk Type</b>	<b>Risk Assessment</b>	<b>Risk Description</b>	<b>Proposed Mitigating Measures</b>
1. Implementing Entity	M	Compliance Risk – Being non-conversant with ADB's FM requirements; and also limited capacity and exposure of development projects, there is a risk that financial management policies and procedures will not be complied with	FMM will be adopted by IAs for guidance on BRT's FM matters.  Regular trainings and hand holding will be provided by ADB in project's implementation through supervision missions and workshops
2. Funds Flow	M	As 15% of the project cost is financed from counterpart resources, therefore there is a risk that adequate counterpart funds will not be provided on timely basis. Moreover, as IAs are involved, there is a risk of delays in release of counterpart funds to the respective EA and IAs because of government's cumbersome funds flow procedures	in The Provincial government agreed to allocate fund timely to PIU-Peshawar Development

3. Staffing	M	Execution Risk – Staff at PIU and TransPeshawar may not have a sufficient understanding of ADB’s financial management requirements and procedures which contributes to project delay and non-compliance of requirements.	PMCCB is in the process of hiring staff for TransPeshawar with advanced recruitment methods to attract the best talent in the market. Moreover, trainings and technical hand holding will be provided to staff at PIU and TransPeshawar to adapt with ADB’s FM requirements
4. Accounting and Reporting	S	<p>Outdated and Incomplete Accounting Manual in use of Peshawar Development Authority will increase likelihood of errors and omissions.</p> <p>In the absence of financial management system, TransPeshawar later, will not be able to accurately record transactions</p>	<p>FMM developed by ADB will be adopted by both EA and IAs as technical back-stopping. Subsequently, regular supervision missions and trainings by ADB will further enhance the capacity to build and establish an effective financial management system.</p> <p>For TransPeshawar, PMCCB will deploy an accounting software for cost control which will be a stepping stone in establishment of a financial management system for the project and TransPeshawar.</p>
5. Internal Audit	S	Absence of internal audit at provincial government may affect the effectiveness of risk management, control, and governance processes	Finance section under PDA perform budget and compliance checks before any payment is processed.
6. 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, with audit reports provided to ADB.
7. Reporting and Monitoring	M	Project Execution Risk – In the absence of financial management system, there is risk of delayed interim financial reporting at PIU-PDA and TransPeshawar. Poor project monitoring and accountability will impact on project progress.	<p>For TransPeshawar, PMCCB will deploy accounting software for cost control which will be a stepping stone in establishment of a financial management system for the project and TransPeshawar. PMCCB will provide operational guidelines such as project management, budgeting and reporting. PMCCB is also in the process of hiring staff with advanced recruitment methods to attract the best talent in the market.</p> <p>PIU-PDA and TransPeshawar will adopt ADB’s FMM in preparing financial reports.</p>

8. Information Systems	M	Information systems are non-existent, which results in the risk of inaccurate and delayed reporting	For TransPeshawar, PMCCB will deploy an accounting software for cost control which will be a stepping stone in establishment of a financial management system for the project and TransPeshawar.
9. Internal Controls	M	PIU-PDA and TransPeshawar being non-conversant with ADB's Policies and Procedures; there is a 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 PIU-PDA and TransPeshawar.
<b>Overall Assessment of Control Risk</b>	<b>S</b>		
<b>Overall Project Risk</b>	<b>S</b>		

H=High, S=Substantial, M=Moderate, L=Low

ADB = Asian Development Bank, AGP = Auditor General of Pakistan BRT = bus rapid transit, EA = executing agency, FM = financial management, FMM = financial management manual, IA = implementing agency, PIU = project implementation unit, PMCCB = Project Management Coordination and Capacity Building

Source: Asian Development Bank.

## VI. PROPOSED ACTION PLAN

Action	Responsibility	Resources	Timeline
1. Adopt Financial Management Manual and tailor it accordingly to the need of the project	PIU Peshawar Development Authority	Director Finance (PIU)	Within 1 month after effectiveness
	TransPeshawar	Chief Financial Officer	Within 1 month after hiring of CFO TransPeshawar
2. Hire Accounts Officer and Assistant Accounts Officer.	TransPeshawar	Chief Financial Officer	Within 1 month after effectiveness
3. Dedicate full-time staff to PIU for executing project related activities	Peshawar Development Authority	Director General	Within 1 month after effectiveness
4. Timely opening of Imprest Accounts	TransPeshawar PIU-PDA	Director Finance(PIU) CFO, TransPeshawar	Start opening procedure upon effectiveness
5. Deployment of software to ensure cost control in project management	PMCCB	Chief Financial Officer	Within 12 months after CFO is hired

CFO = Chief Financial Officer, PIU = project implementation unit, PMCCB = Project Management, Coordination and Capacity Building.

Source: Asian Development Bank.

**VII. SUGGESTED FINANCIAL MANAGEMENT COVENANTS**

47. Disbursement condition for TransPeshawar: TransPeshawar shall appoint a Chief Financial Officer before the first disbursement is released by ADB.