

CYCLONE PAM ROAD RECONSTRUCTION PROJECT

PROJECT FINANCIAL MANAGEMENT ASSESSMENT

Revision: 3.0 Revision
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I. INTRODUCTION

1. This Financial Management Assessment (FMA) has been prepared in accordance with ADB's Guidelines for the *Financial Management and Analysis of Projects*¹, the publication *Financial Due Diligence: A Methodology Note*² and *Financial Management Technical Guidance Note*³. The FMA considers the Ministry of Finance and Economic Management (MFEM) and Ministry of Infrastructure and Public Utilities (MIPU) as the Executing Agency (EA) and Implementing Agency (IA) respectively, for the Cyclone Pam Road Reconstruction Project. The FMA includes review of the planning and budgeting, accounting and reporting system, internal and external auditing, fund disbursement, and information system. The instrument used for the assessment was Asian Development Bank's (ADB) financial management assessment questionnaire (FMAQ). This FMA incorporates the Financial Management Internal Control and Risk Management Assessment required by the Guidelines. The completed FMAQ is in **Appendix 1**.

2. This assessment was prepared during the feasibility (design) stage of the Project, in July 2016, and may need to be amended to reflect subsequent developments and agreements. Preparation activities included reviewing documents, interviewing counterparts and consultants, and discussing issues with stakeholders. Mitigating actions were identified together with counterparts. In 2011, ADB prepared FMAs for the Port Vila Urban Development Project⁴ and Vanuatu Inter-island Shipping Support Project⁵. Those FMAs have been reviewed and relied on, in part, for the completion of this FMA.

II. PROJECT DESCRIPTION

3. The Project is expected to accelerate economic and social recovery in Vanuatu's Tropical Cyclone Pam (TCP) affected provinces. The tentative list of civil works include (i) 10 km of road rehabilitated; (ii) 8 major stream crossings and their approach roads rehabilitated and protected; (iii) minor damage to 9 bridges or box culverts and causeways repaired, and debris cleared; (iv) 200 meters (m) of river channel realigned (upstream and downstream), and river training structures constructed; (v) 1,000 m of sealed pavement protected against erosion from storm surge; (vi) 8 km of roadside and cross-road drainage improved; (vii) 6 culvert headwalls reconstructed; (viii) 250 m of guard rail reconstructed; (ix) 180 m of riverbanks protected; (x) a 100 m by 50 m landslide at Klem's hill restored and the road pavement protected; and (xi) a 600 m-long concrete longitudinal roadside drain at Klem's hill improved. All works will be designed and implemented using the "build back better" (BBB) concept, and will strengthen the climate and disaster resilience of roads and bridges. All works

¹ ADB. 2005. *Financial Management and Analysis of Projects*. Refer page 14 of Knowledge Management Addendum for more information on the Financial Management Assessment.

² ADB. 2009. *Financial Due Diligence: A Methodology Note*. Refer page 3 for more information on the Financial Management Assessment.

³ ADB. May 2015. *Financial Management Technical Guidance Note*.

⁴ ADB. 2011. *Report and Recommendations to the President for the Port Vila Urban Development Project*. Linked Document No. 15 Financial Management Assessment.

⁵ ADB. November 2011. *Report and Recommendations to the President for the Interisland Shipping Support Project*. Supplementary Documents No. 21 Financial Management Assessment.

will incorporate gender conscious designs, including construction of walkways and provision of laundry facilities in streams alongside the road. The scope of the Project will be finalised after the required due diligence has been carried out by the DSC team. The list of individual subprojects will be updated during the mid term review.

4. The project is estimated to cost USD 18.50 million⁶. The Project is funded by ADB through the Asian Development Fund (ADF) Special Fund resources grant and loan facilities in an amount equivalent to USD 7.0 million and SDR 0.71 million, respectively. ADB's Disaster Relief Facility (DRF) also provides loan and grant funds equivalent to USD 2.80 million and SDR 1.99 million, respectively. The Global Environment Facility (GEF) provides a co-financing grant of USD 2.68 million. The Government of Vanuatu (GoV) provides counterpart fund in the amount of USD 1.91 in taxes and duties and USD 0.300 in-kind for staff salaries and office accommodation. Audit fees will be met by Government.

5. The Ministry of Finance and Economic Management (MFEM) is the executing agency while the Ministry of Infrastructure and Public Utilities (MIPU) is the implementing agency for the project. As implementing agency, MIPU will oversee the implementation of the Project. MIPU has contracted design and construction supervision consultants (DSC, Cardno Emerging Markets), established the project management unit (PMU) which will be responsible for the day to day implementation of the project, including (i) preparation of an overall implementation plan and annual budget; (ii) overall interagency coordination; (iii) detailed assessment and feasibility studies; (iv) detailed engineering designs and cost estimates; (v) tendering and contract management; (vi) project supervision; (vii) project financial management; (viii) project safeguards document preparation and safeguards plans implementation; (ix) consolidation, review and submission of regular progress and financial reports to ADB, MFEM, and other development partners; and (x) monitoring and evaluation of project outputs and results.

6. The Program Recovery Committee (PRC)⁷ provides overall coordination and administrative oversight of the Strengthening Ni-Vanuatu Resilience for the National Recovery and Economic Strengthening Program. An Infrastructure Working Group (IWG) will be established to provide oversight for project implementation. The IWG will comprise of the Director General of MIPU, Public Works Department Director, operations manager, provincial engineers and project engineers.

7. The Project will be implemented over two years. The dates of physical completion of works and loans/grants closing are 31 December 2017 and 30 June 2018, respectively. If there will be an extension in the physical completion and closing dates, it will be reviewed and mutually agreed between MIPU and ADB during the mid-term review.

III. COUNTRY AND SECTOR FINANCIAL MANAGEMENT ISSUES

A. Public Financial Management

8. The current legal framework for public financial management (PFM) in Vanuatu is the Constitution and Public Finance and Economic Management (PFEM) Act of 1999 (amended in 2000, 2009, 2011 and 2012). The 1980 Constitution amended in 1988 provides the basis for sound PFM in Vanuatu. Section 25 of the Constitution sets out the provisions in relation to public finance including the appointment and functions of the Auditor General.

⁶ Total project cost reduced to USD 18.35 million (updated 13 December 2016) from USD 18.50 million at project approval. As of 13 December 2016 total loss of USD 0.149 million was recorded due to foreign exchange fluctuations.

⁷ Members of the program recovery committee include director general of the ministry of finance and economic development, foreign affairs and trade, and infrastructure and public utilities.

9. The PFEM Act is designed to: (i) ensure effective economic, fiscal, and financial management and responsibility of Government; (ii) provide accountability arrangements; (iii) requires Government to produce a variety of financial and economic statements including a Budget Policy Statement, a Fiscal Strategy Report, Economic and Fiscal Statement and 6 months Economic and Fiscal Updates. Since 2009 there have been amendments to the Public Financial and Economic Management Act. The main changes in 2010 and 2011 include: (i) improved controls over deeds of release and (ii) improvement to the approval process of guaranteeing loans including an amendment to the PFEM Act in 2012 requiring the Minister to report to Parliament on loans.

10. The Expenditure Review and Audit (ERA) Act of 1998 required the establishment of a Committee to review public expenditure and it sets out the objectives, functions and powers of the Office of the Auditor General and the role of the Public Accounts Committee (PAC) in scrutinising public finances. An amendment in 2008 changed the Auditor General's terms of employment from a permanent position to a 5-year contract. Revisions to the Expenditure Review and Audit Act are being proposed to improve the independence of the Auditor General through Parliament to directly approve the budget.

11. The Government Contracts and Tenders (GCT) Act (amended 2001) and its associated regulations, sets out the process of procurement. All contracts in excess of VT5 million must be considered by the Tender Board and be tendered by open and competitive bidding, unless the Board approves another process of procurement. The Tender Board reports to and is responsible to the Council of Ministers, who can accept or reject a tender board approval. The Chairman of the Board is appointed from the private sector. A new procurement legislation is being developed.

12. Country PFM arrangements were assessed in 2012 using the Public Expenditure Financial Accountability (PEFA) Public Financial Management (PFM) Performance Measurement Framework⁸. The assessment identified overall PFM improvements between 2012 and 2009.⁹ Vanuatu's fiscal aggregates have improved significantly since 2009 on the back of better performance, improve fiscal management, and strengthened PFM arrangements. Despite these improvements, longer term structural weaknesses remain, including the the limitations of the budget as a planning tool over the medium term, poor policy and machinery of Government processes, weak links between policies and plans, lack of internal audit across Government, weak compliance in procurement systems in the line ministries and difficulties to track and control expenditure at a disaggregated level. Since the last assessment, the Government of Vanuatu (GoV) has faced a number of economic and political challenges. Increased payroll costs and unbudgeted expenditure have raised expenditure levels. In 2009 and 2010, actual revenues were also significantly less than anticipated due to a combination of ambitious forecasts, changes in trade agreements and weak enforcement. Subsequent years are now on track. As in previous years, in terms of the three budgetary outcomes, aggregate fiscal discipline remains relatively good, although it has worsened in terms of GoV's own high standards of fiscal responsibility and the pursuit of a balanced budget. However, weaknesses and/or non-compliance with systems lead to less than optimal strategic resource allocations and inefficient service delivery.

⁸ Under the PEFA framework, performance is assessed in relation to seven dimensions of public financial management: credibility of the budget; comprehensiveness and transparency; degree to which the budget is prepared with due regard to government policy; predictability and control in budget execution; accounting, recording and reporting; external scrutiny and audit operations; appropriateness of development partner practices in country; and intergovernmental fiscal relationships.

⁹ Carole Pretorius and Ashley Schofield. Vanuatu Public Financial Management Performance Measurement Final Report. August 2013.

13. There is also an improvement in the timeliness of the financial statements of several government business enterprises (GBEs) but this has not led to an improvement in public financial management (PFM) scores. Without enabling legislation, the Ministry of Finance and Economic Management's (MFEM) ability to monitor fiscal risk and its potential exposure remains limited. Although financially less significant, the government's ability to monitor the fiscal risk of sub-national entities is also weak, and would need strengthening if service delivery responsibilities were to be decentralised in accordance with the Decentralisation Act.

14. The MFEM has identified a number of additional reforms that are required and which will be stated in their Corporate Plan, still under design. The impact of the reform agenda and leadership shown by Vanuatu's Government is reflected in an acceptable fiscal and stable macro-economic position with the maintenance of low debt levels. In Vanuatu, PFM reforms have started in the MFEM and are now radiating out to line ministries, departments and to outlying islands. As the reforms progress, there will clearly be additional demands on the MFEM. The process of expanding the reforms across government is recognised to be complex and the co-ordination mechanisms necessary are being developed as part of the MFEM's new business plan.

15. With external support from Australia's Department of Foreign Affairs and Trade (DFAT), improvements in revenue administration are beginning to show positive results and a number of additional legislative and operational reforms are planned, which would further enhance tax revenue collection. The recruitment of a new Auditor General since the previous PEFA and the provision of technical support to his office have also improved the level of oversight, including the number and quality of audits now being undertaken by the office, although its potential impact is limited by manpower constraints, independence issues and negligible parliamentary scrutiny by the Public Account Committee (PAC).

16. Providing political stability and continuity is hampered by political instability. Policies address political stability through constitutional changes, political parties, legislation and other changes to support stability were provided in the Priorities and Action Agenda (PAA). Policies to ensure that political leaders and bureaucrats are held accountable for their decisions through strengthening of the Auditor-General and Ombudsman's offices, and the Public Accounts Committee (PAC) have made some progress. Activities are on-going to strengthen the key institutions of the Office of the Ombudsman and the Office of the Auditor General (OAG). The draft amendments for the Ombudsman Act are currently going through the consultative process. There is a need to push ahead with the amendments, which were first suggested in a review of the act in 2001. The establishment of the Leadership Tribunal will be a key milestone. The government recognizes that the Office of the Auditor General (OAG) needs further strengthening. The OAG faces challenges with staffing capacity and capability as well as the efficacy of their audit methodologies and systems. These issues mean public accounts are often not audited to high standards in a timely manner.

17. Since 2009, there have been a few key amendments to the Public Finance and Economic Management Act. The main changes in 2011 and 2012 include:¹⁰

- (i) Improved controls over deeds of release; and
- (ii) Improvements to the approval process for guaranteeing loans including an amendment to the PFEM Act in 2012 requiring the Minister to report to Parliament on loans (section 54- 3A).

Other changes to legislation or proposed changes include:

¹⁰ Carole Pretorius and Ashley Schofield. Vanuatu Public Financial Management Performance Measurement Final Report. August 2013.

- (i) Amendments made to the Import Duties Act (schedule III) with the introduction of an Exemptions Committee to oversee the granting of exemptions, thus reducing earlier concerns of significant discretionary powers.
- (ii) A revised Customs Bill has been drafted together with the draft regulations. Amongst a number of improvements, if passed the Bill and regulations would introduce more concrete timelines in the penalty process.
- (iii) New procurement legislation is also being developed and revisions to the Expenditure Review and Audit Act are being proposed to improve the independence of the Auditor General through Parliament to directly approve the budget.
- (iv) A Bill prepared some years ago with respect to Public Enterprises was never passed and it is now proposed that new legislation is drafted to cover the need for regular reporting alongside other proposals for more effective corporate governance.
- (v) The amendments of the Decentralization Act and Municipalities Act in 2011 brought key senior positions in local government under the Public Services Commission (PSC) regulations. The PSC has appointed the Secretary Generals in the Provinces and Town Clerks and Accountants in Port Vila and Luganville. Other posts are waiting for funding.

18. In terms of overall performance the picture is mixed. In comparison with the previous assessment some performance indicator scores show slight improvement e.g. non-reported operations. Orderliness in budget process remains good and accounting and reporting systems are comprehensive and have the potential to support sound decision-making, if actively used by key stakeholders. As in previous years, although many systems are in place, compliance is still a problem in several ministries and agreed sanctions are not being consistently applied. Since the last assessment, there also appears to have been instances where controls have just been bypassed, for example, in the recruitment of personnel without the required financial visa by health and education and the issuing and honoring of unofficial purchase orders. This non-adherence to controls by some ministries seriously undermines the Government's ability to deliver its mandated services and to achieve its stated goal of reaching the Millennium and Sustainable Development Goal targets.

19. Although there are on-going reforms including the systematic development of government policies and the establishment of an improved monitoring and evaluation function, the ability of most ministries to link their policies, plans and budgets remains weak. There are plans to introduce a more medium-term perspective in the near future including the development of sector medium-term expenditure frameworks (MTEF). However, these are unlikely to be successful unless they are supported by training in basic budgeting principles for non-financial personnel, and clearly set within a medium-term fiscal framework. As the Government recognises, policy stability is also dependent on political stability.

20. Table 1 summarizes the overall results of the PFM assessment for 2012 and comparison with the 2009 PFM assessment. The indicators of the PFM Performance Measurement framework are scored A to D, with A indicating better performance.

Table 1: Summary of 2012 PFM Performance Measurement Framework

PFM Performance Indicator	2009 Rating	2012 Rating
A. Credibility of the Budget		
Aggregate expenditure out-turn compared with original approved budget	B	A
Composition of expenditure out-turn compared with original approved budget	A	A
Aggregate revenue out-turn compared with original approved budget	A	C
Stock and monitoring of expenditure payment arrears	A	A
B. Comprehensiveness and Transparency		

PFM Performance Indicator	2009 Rating	2012 Rating
Classification of the budget	B	B
Comprehensiveness of information included in budget documentation	B	B
Extent of unreported government operations	C+	B+
Transparency of intergovernmental fiscal relations	B	B
Oversight of aggregate fiscal risk from other public sector entities	D	D
Public access to key fiscal information	C	C
C. Policy-based Budgeting		
Orderliness and participation in the annual budget process	B	A
Multiyear perspective in fiscal planning, expenditure policy, and budgeting	C+	C+
D. Predictability and Control in Budget Execution		
Transparency of taxpayers obligations and liabilities	B	B
Effectiveness of measures for taxpayer registration and tax assessment	B	B
Effectiveness in collection of tax payments	D	D+
Predictability on the availability of funds for commitment of expenditures	A	B+
Recording and management of cash balances debt and guarantees	C+	C+
Effectiveness of payroll controls	C+	C+
Transparency, competition, and complaints mechanisms in procurement	D+	D
Effectiveness of internal control for non-salary expenditure	C+	C
Effectiveness of internal audit	C	D+
E. Accounting, Recording and Reporting		
Timeliness and regularity of accounts reconciliation	B	B
Availability of information on resources received by service delivery units	C	D
Quality and timeliness of in-year budget reports	B+	B+
Quality and timeliness of annual financial statements	A	B+
F. External Scrutiny and Audit		
Scope, nature and follow-up of external audit	D	D
Legislative scrutiny of the annual budget law	C+	C+
Legislative scrutiny of the annual audit reports	D+	D+

21. **Credibility of the budget**¹¹. As noted above, at the aggregate level, actual primary expenditure has not deviated significantly from the original budget levels, although in the period under review, adherence to GoV's fiscal responsibility framework has deteriorated and certain ministries e.g. health and prime minister's office have exceeded their authorised spending limits. At a ministerial level, calculation of expenditure composition variances has shown limited deviation reflecting GoV's stance of not permitting reallocation between ministries. Notwithstanding this finding some ministries and constitutional bodies have required significant supplementary appropriations, e.g. health and education, while other ministries have under-spent their allocations. At the last assessment, GoV had recognised that reallocations within ministries were taking funds away from service delivery efforts and had modified its legislation to restrict these changes. Unfortunately, at the time of this assessment, several studies (both internal and external) have found that some ministries are still not focussing their expenditure on the achievement of their agreed plans. GoV's centralised payments system, funds control system and requirement for ministries to provide details of outstanding bills annually are all designed to minimise the occurrence of arrears. Since the last assessment however, MFEM's ability to contain arrears is being stretched as ministries including health and lands do not pay their regular bills e.g. utility and rents, the result of poor budgeting and unbudgeted expenditure.

22. Unlike the previous two assessments, actual revenue fell short of budgeted revenue in two of the three years. This has been due to a number of factors including changes in revenue forecasting techniques and the impact of delayed donor projects on the predicted levels of

¹¹ Carole Pretorius and Ashley Schofield. Vanuatu Public Financial Management Performance Measurement Final Report. August 2013.

economic activity¹², trade agreements changes and poor tax enforcements measures. Since 2011, however, there has been a reversal in this trend and figures for 2012 are also showing positive gains.

23. **Comprehensiveness and transparency**¹³. As in earlier assessments, in terms of comprehensiveness and transparency, its ability to oversee fiscal risk remains a significant concern to the GoV, as it is unable to have a complete and up-to-date picture of its exposure to contingent liabilities. Since the last assessment, GoV has not reduced its holding of government business enterprises (GBE) any further, although some work is currently on-going with respect to the liquidation of three companies. However, timeliness of the financial statements of several other GBEs has improved significantly. According to the Auditor General, basic bookkeeping and accounting skills are insufficient in some of the other entities. Legislation to force GBEs to provide MFEM with relevant data is still outstanding, but support from the ADB is available to address the whole issue of non-productive and non-viable entities, provided widespread political support can be obtained. The government's ability to monitor the fiscal risk of sub-national entities is also weak, if service delivery responsibilities were to be decentralised as envisaged under the Decentralisation Act, there would be a greater potential fiscal risk. In the period under review, availability of information to the public remained poor, despite the launching of MFEM's new website many key documents are not available. Audit reports and audited financial statements need to be tabled with Parliament before access is available and despite the efforts of the Auditor General, timeliness of his reporting to Parliament is still an issue.

24. **Policy-based budgeting**¹⁴. As in the two previous assessments the GoV has a clear budget calendar and set of guidelines, which include the approved ministerial ceilings. These set out clearly what needs to be done by whom and when. Some delays are experienced in its implementation but in general the timetable is broadly followed. The Executive, through the Ministerial Budget Committee and the Council of Ministers are actively involved in the process and in the period under review the legislature has approved the budget prior to the start of the new fiscal year, providing predictability from the outset.

25. Since 2009, the Prime Minister's Office (PMO) and MFEM discuss policy priorities towards the beginning of the year and advise ministries if any changes are required to their budget narratives to meet policy direction changes. A medium-term fiscal framework is prepared and is updated annually however changes from previous forecasts are not explained in great detail. Discussions are on-going to develop medium-term expenditure frameworks at the sector level, but these may prove ineffectual even at the technical level, if not accompanied by greater consistency in medium-term fiscal frameworks and general improvements in basic budgeting skills by line ministries. Work is in progress to improve the links between national (e.g. trade) and sector policies (e.g. education), long and medium-term plans (such as the Priority Actions Agenda (PAA) and the Planning Long, Acting Short (PLAS), ministerial corporate and business plans, budget narratives and actual budget submissions. GoV is also developing its monitoring and evaluation function in both the National Statistics Office and the M&E Unit within the Prime Minister's Office.

26. Sector strategies are in place for education, health and water, but these are not fully costed with programmes and activities prioritised. Although technically the recurrent cost implications of capital expenditure should be assessed as part of the development of new policy proposals (NPP), in practice this is reported to be of variable quality. The lack of a

¹² Vanuatu PFM Performance Report April 2013

¹³ Carole Pretorius and Ashley Schofield. Vanuatu Public Financial Management Performance Measurement Final Report. August 2013.

¹⁴ *ibid*

medium-term perspective also limits¹⁵ the extent to which the estimated recurrent cost implications can be systematically included in future budget submissions.

27. **Predictability and control in budget execution**¹⁶. Tax revenues account for more than 90% of GoV's overall domestic revenues. In order to improve taxpayers' access to information on their liabilities, the Customs and Inland Revenue Department (CIRD) has developed a comprehensive website and opened offices in all the main islands. Since 2009, GoV has also reviewed its exemption policies for import duties, and put in place an exemptions committee to review all requests in a more transparent way. Improvements in internal business processes for both customs and VAT are also proving to be beneficial with increased compliance and more consistent enforcement campaigns. Although not yet impacting on the indicator scores, work is also on-going to improve overall tax administration processes and to improve and update legal frameworks. There are also plans to take a more holistic review of current tax practices. Non-tax revenues represent approximately 10% of domestic revenue. As noted in the previous two assessments, outstanding accounts receivable remain a major problem, particularly for wharfage charges and land rents.

28. The GoV is determined to follow a prudent approach to financial management and consequently the MFEM operates a monthly or bi-monthly warrant system, based on the cash flow forecasts prepared by the ministries. This facilitates both cash management and expenditure checks. Frequent requests for advances are a symptom of poor cash planning and no procurement planning by ministries, but no ministry has been denied additional release for proper expenditure, which is within the total budget appropriated. Currently debt administration in Vanuatu is fairly straightforward with relatively few external loans and domestic debts, although both are now increasing, and GoV recognise that they need to improve their debt management capability, especially if this trend continues.

29. As in 2009, once data reaches the human resource management information system, the payroll accounting procedures and controls are reasonable, although non-approval by management of pay run listings is a concern. Some action has been taken, but delays are still reported at the Service Commissions (e.g. Public Service, Police and Teachers) in the processing of recruitments and particularly terminations. Since 2009, a worrying trend in Education and Health has emerged whereby controls over budgeted establishment figures are being ignored and significant overspends on payroll budgets are taking place.

30. **Accounting, recording and reporting**¹⁷. The GoV operates a centralised payments and payroll and personnel system using SmartStream financial software. Comprehensive and detailed in year budget execution reports can be extracted as required by all users, although a key weakness is that although access is available for finance staff in ministries, many line managers and senior management do not have direct access to, are unaware of or do not understand the information available to them. Bank account reconciliations have been automated/semi-automated for the key treasury managed bank accounts. School bank accounts are captured through an agreement with the National Bank of Vanuatu. Financial statements are produced on an accrual basis and have been produced for FYs 2009 -2011, within ten months of year-end. GoV adopted International Public Sector Accounting Standards voluntarily for some time, but this is now required by law. As the five year 'grace' period for full compliance is now over, difficulties experienced in other countries in full compliance apply in Vanuatu particularly with respect to asset valuation and depreciation. This has consequently led to a slight decline in the score, but this is quite understandable given the demands that IPSAS place on the most sophisticated reporting systems. A breakdown of parliamentary

¹⁵ Vanuatu Draft PFM Performance Report April 2013

¹⁶ Carole Pretorius and Ashley Schofield. Vanuatu Public Financial Management Performance Measurement Final Report. August 2013.

¹⁷ *ibid*

appropriations (on a modified cash basis) to programme level is included in the financial statements to Parliament.

31. **External security and audit**¹⁸. As noted in the previous assessment, the formal committee structure for the review of estimates has not been operational, but general procedures for the timely if not detailed review of the budget by Parliament have been followed. The basic legal framework for external scrutiny and audit is in place, although there are real concerns over the true independence of the external audit function. Since 2009, there has been a marked improvement in the external audit function, with the appointment of a new Auditor General and provision of technical assistance. A number of audits have been carried out, opinions issued and reports prepared. Despite the outsourcing of some audits, capacity constraints (both in terms of staffing and expertise) are currently limiting the scope and nature of the work. Impact is undermined by the fact that the PAC has not met on a regular basis.

B. Procurement

32. In relation to Procurement, the 2013 public expenditure and financial accountability assessment reviewed procurement policies and processes, and assigned procurement arrangements an overall D rating (comprising three D ratings).¹⁹ Since the last assessment, there is an improvement in the availability of information on procurement activities, and an increase in the contracts being monitored by the Central Tender Board (CTB). Despite these improvements, there remain many challenges in ensuring that the whole procurement process is conducted in an equitable, transparent and effective manner. Australia's DFAT have supported the Central Tender Board with the funds for advisory support to assist MFEM and CTB in their reform process. The indicator assessed and corresponding rating is in Table 2.

Table 2: Transparency, Competition and Complaints Mechanisms in Procurement

Performance Indicator	2013 Assessment	Rating
Use of competitive procurement methods	Based on interview less than 50% of procurement went through CTB for 2009 to 2011. CTB granted exemptions to the value of 17% of government expenditures through the CTB in 2012. Overall there is limited evidence to reasonably assess this indicator.	D
Public access to complete, reliable and timely procurement information	Information on bidding opportunities are advertised in paper and occasionally radio. No notice board in operation. The procurement process meets only one element (bidding opportunities).	D
Existence of an independent administrative complaints system	There is no independent complaints system in operation except through the judicial system.	D

Source: Carole Pretorius and Ashley Schofield. Vanuatu Public Financial Management Performance Measurement Final Report. August 2013.

C. Governance

33. Table 3 presents the summary of 2014 governance indicators for Vanuatu²⁰. The indicators are measured in the range of -2.5 to +2.5, with higher score indicating better

¹⁸ Carole Pretorius and Ashley Schofield. Vanuatu Public Financial Management Performance Measurement Final Report. August 2013.

¹⁹ *ibid*

²⁰ The Worldwide Governance Indicators (WGI) area research dataset summarizing the views on the quality of governance provided by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries. These data are gathered from a number of survey institutes, think-tanks, non-government organizations, international organizations and private sector firms.

governance. Positive trends are discernible particularly for voice and accountability, political stability and absence of violence, and rule of law.

Table 3: Governance Indicators, 2015

Governance Indicator	Score
Voice and accountability	0.72
Political stability and absence of violence/terrorism	0.57
Government effectiveness	-0.79
Regulatory quality	-0.37
Rule of law	0.03
Control of corruption	-0.18

Source: www.govindicators.org, accessed 22 May 2017. Based on research by Kaufmann, D., Kraay, A., Mastruzzi, M., 2010, "The Worldwide Governance Indicators : A Summary of Methodology, Data and Analytical Issues". World Bank Policy Research Working Paper No. 5430.

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1682130

IV. PROJECT FINANCIAL MANAGEMENT SYSTEM

34. Assessment of the project financial management system comprise: (i) financial management systems and capacity of the implementing agencies or executing agency including potential strengths and weaknesses of project-specific financial management arrangements; (ii) risk assessment and preparation of a risk management plan; (iii) funds flow; and (iv) accounting and auditing arrangements.

A. Overview of the Executing and Implementing Agencies Financial Management System and Institutional Context

35. MFEM is responsible for the formulation of sound and effective national economic policies and managing and coordinating the distribution of the Government financial resources. MFEM key responsibilities include (i) budget planning; (ii) preparation and execution; (iii) financial management; (iv) monitoring of the performance of government business enterprises; and (v) delivery of important services such as payroll, payments and the provision of the government's financial management information system.

36. The financial management information system (FMIS) provided by MFEM uses the package software SmartStream. It includes modules for general ledger, accounts payable, accounts receivable, funds control, purchasing, payroll/human resources, and asset register. Since 2008, a Vanuatu Budget Management System (VBMS) is being used for inputting of budget data by line ministries. The VBMS is directly linked to the SmartStream system. Access to the system(s) by line ministries is provided by a wide area network (wan) that covers all ministry headquarters in Port Vila and a number of provincial offices located in Luganville on the Island of Santo. Increase in access is planned in both Port Vila and other islands. Financial reporting is done by MFEM using Vision and OLEF²¹. Bank reconciliation is automated/semi-automated through the SmartStream system. There are a significant number of reports available from, or which can be generated from GoV's accounting and budget systems, however, not all managers in the ministries have the training and/ or the inclination to access these reports.

37. The financial year for central and provincial government in Vanuatu is from January to December. The municipal councils in Luganville and Port Vila have a July to June financial year. Processing and recording of transactions is done centrally. Accounting and reporting is done on an accrual basis and consolidated financial statements are produced by MFEM. Budget preparation is centrally driven with MFEM providing ministries with baseline estimates, ministries are then required to request additional support. For ministries the budget process is

²¹ Off-the-shelf ledger reporting tools.

as follows: appropriation (by Parliament), authorisation (by the Minister through the signing of a general warrant), commitment (by relevant accounting officer through the raising of a local purchase order) and payment (on receipt and validation of invoice by Treasury).

B. Strengths and Weaknesses

38. Strengths and weaknesses in the financial management system will have a direct impact on the delivery of services. As noted by the assessment conducted by PEFA which includes lack of timely response to internal audit report recommendations and non-observance of competitive tendering practices can limit the efficiency of service delivery by increasing costs or lowering the quality of goods and services provided. Increased activity of the external audit function is a positive sign in terms of service delivery effectiveness. Improved access to the financial information available, particularly at the community level can assist in improved financial management and efficient service delivery, particularly in more remote areas, where centralised controls are inappropriate and counter-productive.

39. MIPU has been involved with a number of donor-funded projects²² but, until this Project, has never undertaken the financial management responsibility for any of these projects. Financial management, monitoring and control, reporting and external audit has always been done with the support of consultants as the agreed implementation arrangements with the donors. Hence, there is no transfer of technology or skills from these projects to the finance staff in MIPU particularly in financial management.

C. Personnel

40. The current accounting organisation in MIPU is headed by a Senior Finance Officer assisted by one Finance Officer and one Project Finance Officer. The accounting staff have formal accounting qualifications, however they have no experience in ADB disbursement guidelines and procedures. The current MIPU accounting staff capabilities and responsibilities will not match the needs and requirements of the Project hence staff will be trained on ADB disbursement procedures.

D. Accounting Policies and Procedures

41. The GoV operates a centralized payment and payroll system using SmartStream financial software. The MFEM also established a Financial Management Information System (FMIS) that is generic to all government line ministries and some provincial offices in Santo, Espiritu Island. They have direct access to the system through a wide area network. Comprehensive and detailed in-year budget execution reports can be extracted as required by all users and financial accounts are being prepared on an accrual basis and in accordance with most International Public Sector Accounting Standards (IPSAS).

42. Subsidiary ledgers are adequate for the reconciliation of accounts with the general ledger. All reports and supporting documents on all transactions are stored and retained by the finance officer, and are available. MIPU has implemented a clear segregation of the accounts management duties. As required by ADB's Guidelines for the *Financial Management and Analysis of Projects*, appropriate International Financial Reporting Standards will be applied for project reporting by MIPU with the assistance of the Design and Supervision Consultants (DSC).

43. MFEM and MIPU, through the DSC, shall maintain separate accounts for the project for each loan and grant including the government contribution and have such accounts and

²² Refer 1.2 of Financial Management Assessment Questionnaire (FMAQ).

related financial statements audited annually, in accordance with appropriate auditing standards.

E. Internal Audit

44. There is no internal audit function in MIPU. MFEM has an internal audit department, although its effectiveness has been limited by lack of staff. The internal audit department also does not have full independence from management. It is proposed that MIPU be included within the normal program of activities of MFEM internal audit department. Creation of an internal audit office in MIPU is also an area that has been identified in the long term.

F. External Audit

45. MIPU accounts are audited annually by the Office of the Auditor General (OAG). Audit is carried out in accordance with the auditing standards and requirements of the Government. For the project, OAG will engage an independent external auditor acceptable to ADB and Government of Vanuatu to audit the project accounts annually. MIPU through MFEM will furnish certified copies of audited accounts and financial statements (including the auditor's report and auditor's opinion on the use of the loan and grant proceeds and compliance with the financial covenants of the loan and grant agreements) to ADB within 6 months after the end of each fiscal year. The issues raised by the auditor should be addressed through the management letters and submitted along with the audit report to ADB.

46. In the case of other projects in Vanuatu, the audit process has been lengthy, leading to the grant/loan covenant not being met on the timely provision to ADB of audited project accounts. There are several reasons for this, the main reason being poor preparation of annual project accounts, and the poor state of record-keeping and reconciliations. This means that the audit process is more laborious and time-consuming and involves a higher level of audit queries requiring resolutions. The time taken to resolve these queries pushes the audit finalisation beyond the covenanted period.

G. Financial Reporting Systems

47. MFEM established an integrated financial management information system (FMIS) using SmartStream financial software that is generic to all government ministries and offices. The integrated FMIS contains most sub-ledgers. The project financial reports will be prepared using the same system and will be submitted on a monthly, quarterly and annual basis. The reports will highlight the physical and financial progress of projects being undertaken. MIPU monitoring system is capable of generating project reports for both external and internal use. In addition, staff are trained and are very familiar with the system. Regular backups of all accounting systems and appropriate security measures over backed-up data are in place.

48. MIPU, with the assistance of the DSC team, will provide ADB with quarterly progress reports (QPR) in a format consistent with ADB's project performance reporting system which will include: (i) a narrative description of progress made during the reporting period; (ii) changes in the implementation schedule; (iii) problems or difficulties encountered; (iv) updated procurement plan and (v) activities to be undertaken in the next reporting period. The QPR will be submitted to ADB no later than the fourth week after the end of quarter. MIPU will submit a draft project completion report (PCR) within 3 months of physical completion of the project.

H. Disbursement Arrangements

49. MIPU is responsible for implementing the project according to the loan and grant agreements. On its part, ADB will monitor the project and review its progress to ensure that

the loan and grant proceeds are spent as agreed. When a loan/grant becomes effective, a loan/grant account will be opened in ADB's books in the name of the borrower and the loan/grant amount is credited to that account. All disbursements under the loan will be carried out in accordance with ADB's *Loan Disbursement Handbook* (2015, as amended from time to time).

50. Loan and grant proceeds will be disbursed in accordance with ADB procedures. Direct payment procedures (where ADB, at the borrower's request, pays a designated beneficiary directly will generally be used for civil works and consulting service contracts). Imprest accounts will not be used. MIPU, through DSC, is responsible for (i) preparing disbursement projections; (ii) requesting budgetary allocations for counterpart funds; (iii) checking invoice of consultants and contractors against project progress; (iv) collecting supporting documents; and (v) preparing and sending withdrawal applications through MFEM (for approval) to ADB.

I. Funds Flow Mechanism

51. The funds flow mechanism of the project is presented in section D of the Project Administration Manual (PAM). It shows how the funds will flow from ADB to the Government of Vanuatu to implement project activities.

V. RISK DESCRIPTION AND RATING

52. A Financial Management Internal Control and Risk Management Assessment was conducted.²³ The risk-assessment approach is based largely on International Standard on Auditing 400: *Risk Assessment and Internal Control*. The following risk assessments are based on existing circumstances, staffing and procedures, and include recommendations for risk mitigation measures. The risk mitigation measures considered the factors which will significantly reduce or eliminate the risks identified.

53. The following risks are assessed: (i) 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 the entity working environment (assuming absence of any counter checks or internal controls), and (ii) control risk is the risk that the project's accounting and internal control framework are inadequate to ensure project funds are used economically and efficiently and for the purpose intended, and that the use of funds is properly reported.

Table 4: Financial Management, Internal Control and Risk Assessment

Risk Description	Impact	Likelihood	Risk Assessment ²⁴	Mitigation Measures
Inherent Risk				
1. Country Specific				
Audit reports of the Office of the Auditor General are submitted with delay. The last audit report is submitted to Parliament in 2011. Public Accounts Committee (PAC) has not met on a regular basis. (From PEFA Assessment Report of August 2013)	High	Likely	High	There are ongoing reforms being undertaken by the Government of Vanuatu designed to address identified weaknesses such as new legislations to improve the independence of the OAG being paid directly by Parliament; recruit more staff and improve the salaries to attract and retain staff.

²³ Refer page 24 of *Financial Management and Analysis of Projects*. ADB. 2005.

²⁴ Risk assessment rating: H = High, S = Substantial, M = Moderate, N = Negligible or Low

Risk Description	Impact	Likelihood	Risk Assessment ²⁴	Mitigation Measures
2. Entity Specific ADB and other development partners past projects were mainly supported by construction supervision consultants. MIPU has not been involved in the financial management of projects, accounting, financial reporting and audit. These factors may result in undue delays in implementing key activities	Low	Likely	Low	MIPU will be supported by Design and Supervision Consultants to manage the project. MIPU will provide counterpart staff and technology transfer will be ensured.
Overall Inherent Risk	Moderate			
Control Risk				
1. Implementing Entity The organizational structure of MIPU/PWD is appropriate for implementing the operational needs of the project	Low	Likely	Low	MIPU had previously implemented several foreign funded projects. A Project Management Unit comprising the DSC has been established in the MIPU for project design and implementation.
2. Funds Flow The funds flow mechanism of the project is presented in section D of the Project Administration Manual (PAM). It shows how the funds will flow from ADB to the Government of Vanuatu to implement project activities.	Low	Likely	Low	The ADB funds will be disbursed under the direct payment procedures. ADB will finance 100% of total eligible expenditures for each loans and grants MFEM will be provided access to the ADB's database on the loans and grants to monitor the foreign exchange fluctuations. MIPU through the DSC will work closely with MFEM to monitor the foreign exchange fluctuations and record regularly in project reports.
3. Staffing The current staffing of the Accounts section in MIPU is not adequate to serve the needs of the Project. Staff is not trained in ADB disbursement procedures.	Moderate	Likely	M	MIPU through the DSC team will coordinate with ADB for the appropriate training of MIPU accounts staff in ADB disbursement procedures.
4, Accounting Policies and Procedures An automated system to generate financial reports is in place. Financial reports are generated from SmartStream financial software established by MFEM and used by all Ministries of the Government. Staffs are trained in the use of the system. Comprehensive and detailed in year budget execution reports can be extracted as required by all users and financial accounts are being prepared on an accrual basis and in accordance with most IPSAS.	Low	Likely	Low	In 2002 MFEM established an integrated financial management information system that is generic to all government ministries and offices. MFEM will set up the project accounts using SmartStream financial software. MFEM and MIPU shall maintain separate accounts for the project for each loans and grants and government counterpart contribution.

Risk Description	Impact	Likelihood	Risk Assessment ²⁴	Mitigation Measures
5. Internal Audit There is no internal audit function in MIPU	High	Likely	High	To mitigate any risks arising from the absence of an internal audit function within MIPU, MFEM will regularly conduct internal audit of the project activities.
6. External Audit External Audit not completed within 6 months from end of fiscal year as required by grant/loan covenants	Substantial	Likely	Substantial	An external auditor will be hired by OAG to audit the project accounts. Audit fees will be funded by the Government of Vanuatu, and audit report will be submitted to ADB within six months after the end of each financial year during implementation.
7. Reporting and Monitoring Financial reports provided on a timely manner to enable regular management analysis and corrective actions to be undertaken to address any delays and/or deficiencies occurring during project implementation	Low	Likely	Low	MIPU with assistance from the DSC team will provide ADB quarterly progress reports (QPR) in a format consistent with ADB's project performance reporting system including progress achieved by outputs as measured through the DMF indicator's targets and key implementation issues and solutions. The QPR should be submitted to ADB no later than fourth week after the end of quarter.
8. Information Systems The MFEM established a FMIS that is generic to all government line ministries and some provincial offices in Santo, Espiritu Island. They have direct access to the system through a wide area network. Comprehensive and detailed in year budget execution reports can be extracted as required by all users.	Low	Likely	Low	A separate asset register will be maintained for the project by MIPU through the DSC and will be updated from time to time.
Overall Control Risk	Moderate			
Overall Combined Risk	Moderate			

VI. FINANCIAL MANAGEMENT ACTION PLAN

The following are the proposed actions to be undertaken during the implementation of the Project by MIPU through PMU and other stakeholders of the Project.

Table 5: Financial Management Action Plan

Weakness	Risk	Action Items	Period	Responsibility	Status 23/05/2016
No Internal Audit in MIPU	H	Conduct regular internal audit	Continuous (2016 to 2018)	MFEM	Letter to Office of the Auditor General 12/12/16 resulted in agreement that OAG would either undertake future audits themselves or undertake procurement of external services for the audit. To be paid for under that government's in-kind contribution of this item, up to USD 300,000
Audit not Completed within 6 months from end of fiscal year as required by grant/loan covenants	H	Establish an Internal Audit Unit in MIPU	By 2018	MFEM	Not started. Will be assisted by the R4D project if necessary
		Regular external audit of annual project financial statements (APFS)	Continuous (2016-2018)	MFEM and MIPU/PMU	2016 accounts currently being audited by OAG. OAG plan to consider internally or externally sourcing 2017-2018 audit services in late 2016.
		OAG may outsource the audit requirements of the project to an external auditor acceptable to GoV and ADB	Q4 2016	OAG	OAG noted that they will confirm whether internal or external audit services will be used in 2017-2018. If external, procurement to be undertaken by OAG and paid for by government
		Annual project accounts and underlying working papers prepared on a timely basis in time for the annual financial audit	By 30 April 2017 and every 30 April thereafter during project implementation	MIPU/PMU	Annual project accounts for 2016 provided to OAG in April 2017

Weakness	Risk	Action Items	Period	Responsibility	Status 23/05/2016
The staffing structure of the Accounts is not adequate to serve the needs of the Project due to lack of staff. Further staff are not currently trained on ADB disbursement procedures	S	Monitor compliance with loan covenants including submission of audited project financial statements not more than 6 months after the close of the financial year to ADB for their review and necessary action	Continuous (2016-2018)	MIPU/PMU	Audit of 2017 accounts by OAG underway. Expected to be completed in May 2017
		Staff assigned (should have sufficient overlap with consultants ensuring proper training and handover)	Q4 2016	MIPU	Adequate staff provided by the project. PWD staff being trained in processing of WAs, review of ADB guidelines and use of Project reports for internal reporting
		Training on financial management and accounting procedures	Q4 2016	MIPU/PMU	Training provided on an ongoing basis by R4D project. ADB's Client Portal Disbursement training planned for mid-June 2017
		Provide regular training on ADB's disbursement processes	Q4 2016	ADB and MIPU/PMU	Training provided on an ongoing basis by R4D project. ADB's Client Portal Disbursement training planned for mid-June 2017

ADB = Asian Development Bank; APFS = annual project financial statement; FMS= financial management system; GoV = Government of Vanuatu; MFEM = Ministry of Finance and Economic Management; MIPU = Ministry of Infrastructure and Public Utilities; OAG = Office of the Auditor General; PMU = Project Management Unit

APPENDIX 1
COMPLETED FINANCIAL MANAGEMENT QUESTIONNAIRES²⁵

Topic	Response	Potential Risk Event
1. Executing / Implementing Agency	Ministry of Finance and Economic Management is the Executing Agency (EA) and Ministry of Infrastructure and Public Utilities (MIPU) through Public Works Department (PWD) is the Implementing Agency (IA) for the Project.	
1.1 What is the entity's legal status / registration	Public Works Department is a government department under the Ministry of Public Utilities. Public Works Department is responsible for the rehabilitation, maintenance and further development of national roads and other government owned infrastructure in order to facilitate economic growth and service delivery.	
1.2 How much equity (shareholding) is owned by the Government?	Not applicable	
1.3 Obtain the list of beneficial owners of major blocks of shares (non-government portion), if any ²⁶	Not applicable	

²⁵ This questionnaire is administered by the ADB Consultant, and utilized only to obtain information, and to identify and describe potential risk events. Rating of risks should be carried out separately by assessing their likelihood and impact.

²⁶ In such cases, consult OAI on the need for integrity due diligence on non-governmental beneficial owners.

Topic	Response	Potential Risk Event
<p>1.4 Has the entity implemented an externally-financed project in the past? If yes, please provide details.</p>	<p>Yes, the externally funded projects implemented through PMUs with financial management provided by contracted consultants are shown below.</p> <p>Asian Development Bank (ADB):</p> <ul style="list-style-type: none"> • Port Vila Urban Development Project • Interisland Shipping Support Project • Outer Islands Infrastructure Development <p>Agence de France:</p> <ul style="list-style-type: none"> • Outer Island Airports Upgrade (Agence de France) • Civil Works at Pekoa Airport-Luganville • Civil Works at Bauerfield Airport-Port Vila • Bauerfield and Pekoa Airport Terminal Upgrading • Cyclone Dani Rehabilitation Project <p>Australia Department of Foreign Affairs and Trade (DFAT)</p> <ul style="list-style-type: none"> • Vanuatu Transport Sector Support Project <p>European Commission (EU)</p> <ul style="list-style-type: none"> • PWD Maintenance Training Program • Rural Access Road Project • Technical Support to PWD <p>Government of Japan</p> <ul style="list-style-type: none"> • Maintenance of Lenakel Wharf-Tanna Island • Improvement of Efate Ring Road-Phase 1 • Improvement of Efate Ring Road-Phase 2 • Rehabilitation of Teouma and Rentabao Bridges • Improvement of Port Vila Main Wharf <p>Millennium Challenge (USA):</p> <ul style="list-style-type: none"> • Millennium Challenge Account Project 	

Topic	Response	Potential Risk Event
1.5 Briefly describe the statutory reporting requirements for the entity.	<p>The reporting requirements of MIPU including other line ministries are provided for in section 6 of the Public Finance and Economic Management (PFEM) Act of 1998 (as amended).</p> <p>MIPU is also required to comply with the requirements of the Government Contracts and Tenders Act of 1998 and subsequent revisions, Tender Regulations of 1999, Expenditure Review and Audit (ERA) Act of 1998 and subsequent revisions, Finance Regulations issued in 2000 and its subsequent revisions which contain the economic, fiscal and financial management regulations.</p>	
1.6 Describe the regulatory or supervisory agency of the entity.	<p>The Implementing Agency is not a separate and independent entity but rather a line ministry of the government. The Director General (DG) of MIPU is appointed as the administrative head under the Public Service Act (1998). His responsibilities include compliance with the PFEM Act as well as sound economic and expenditure management of the Ministry's affairs. The 2009 revision of the PFEM Act also assign responsibility to the head of an agency²⁷ for the effective, efficient, and ethical use of the agencies public resources and public funds. MIPU has a corporate services unit responsible for human resources, financial, administrative and support services.</p> <p>Public Works Department through MIPU will implement the Project. The IA will establish a Project Management Unit (PMU) to handle the day-to-day project operations. The PMU will be assisted by Design and Supervision Consultants (DSC).</p>	
1.7 What is the governing body for the project? Is the governing body for the project independent?	<p>PWD is not a separate or independent entity but rather a department under the Ministry of Public Utilities and Infrastructure.</p>	

²⁷ An Agency is defined as a i) a Ministry or ii) a Ministerial office or (iii) an office established by or under the Constitution or iv) an office or body established by or under an act of Parliament, or (v) a prescribed agency.

Topic	Response	Potential Risk Event
1.8 Obtain current organizational structure and describe key management personnel. Is the organizational structure and governance appropriate for the needs of the project?	<p>The current organizational structure of MIPU is appropriate to meet the operational, technical and financial management needs of the Ministry.</p> <p>The finance and accounts staffing structure is adequate for the needs of the Project. It is suggested that a dedicated staff be assigned to the Project to receive on-the-job training and mentoring.</p>	Lack of staff to be assigned to the Project may delay the timely release of funds.
1.9 Does the entity has a Code of Ethics in place?	Yes	
1.10 Describe (if any) any historical issues reports of ethics violation involving the entity and management. How were they addressed?		
2. Funds Flow Arrangements		
2.1 Describe (proposed) project funds flow arrangements in detail, including a funds flow diagram from ADB, Government and other financiers, to the government, EA, IA, suppliers, contractors, ultimate beneficiaries, etc. as applicable.	<p>ADB will finance the Project through an ADF and DRF loans and grants and GEF grants in the amount equivalent to US\$18.50²⁸ million over a 2-year implementation period. Government will finance taxes and duties and will provide in kind contribution for salaries of counterpart staff, office accommodation, and audit fees.</p> <p>The grant and loan proceeds will be disbursed using ADB's the direct payment procedures.</p>	
2.2 Are the (proposed) arrangements to transfer the proceeds of the loan (from the government / Finance Ministry) to the entity and to the end-recipients satisfactory?	The arrangements to transfer the proceeds of the grant and the loan from ADB to the consultants, contractors and suppliers are satisfactory.	
2.3 Are the disbursement methods appropriate?	Yes, the disbursement methods are appropriate	

²⁸ Total project cost was updated during Inception Review Mission held 29 July 2016 to 3 August 2016. Total project cost estimated reduced to USD17.40 from USD18.50 at approval due to foreign exchange fluctuations.

Topic	Response	Potential Risk Event
2.4 What have been the major problems in the past involving the receipt, accounting and/or administration of funds by the entity?	There have been no major problems in the past in receipt of funds by MIPU/PWD for externally-funded projects.	
2.5 In which bank will the Imprest Account (if applicable) be established?	Not applicable, the IA will not open and maintain an imprest account for the Project.	
2.6 Is the bank in which the imprest account is established capable of: <ul style="list-style-type: none"> • Executing foreign and local currency transactions? • Issuing and administering letters of credit (LC)? • Handling a large volume of transaction? • Issuing detailed monthly bank statements promptly? 	Not applicable	
2.7 Is the ceiling for disbursement from the imprest account and SOE appropriate/required?	Not applicable	
2.8 Does the (proposed) project implementing unit (PMU) have experience in the management of disbursements from ADB?	A PMU supported by Design and Construction Consultants (DSC) will be responsible for implementation of the project. MIPU will be responsible for engaging consulting services and civil works contractors. At the time of completing the FMAQ the PMU has been established at MIPU.	
2.9 Does the PMU have adequate administrative and accounting capacity to manage the imprest fund and statement of expenditures (SOE) procedures in accordance with ADB's Loan Disbursement Handbook (LDH)? Identify any concern or uncertainty about the PMU's administrative and accounting capability which would support the establishment of a ceiling on the use of the SOE procedure.	Not applicable	

Topic	Response	Potential Risk Event
2.10 Is the entity exposed to foreign exchange risk? If yes, describe the entity's policy and arrangements for managing foreign exchange risk.	The Department of Finance and Treasury of the Ministry of Finance and Economic Management manages foreign exchange risks.	
2.11 How are the counterpart funds accessed?	Counterpart funds will be appropriated annually in the MIPU budget.	
2.12 How are payments made from the counterpart funds?	It will be disbursed by MIPU in accordance with the GoV disbursement procedures.	
2.13 If the project will flow to communities or NGOs, does the PMU have the necessary reporting and monitoring features built into its systems to track the use of project proceeds by such entities?	Communities and NGOs are not expected to be significantly involved in the project. Where communities will be involved in the project, reporting and monitoring procedures will be developed.	
2.14 Are the beneficiaries required to contribute to project costs? If beneficiaries have option to contribute in kind (in the form of labor), are proper guidelines formulated to record and value the labor or material contributions at appraisal and during project implementation?	Where communities will be involved in the maintenance of the completed project assets, reporting and monitoring procedures will be developed.	
3. Staffing		
3.1 What is the current and/or proposed organizational structure of the accounting department? Attach an organization chart.	Currently there are three staff under the Procurement and Administration Unit handling financial management for MIPU. Each department has its own finance staff. There is one Finance Officer in charge of financial management of foreign funded projects that are implemented by MIPU.	
3.2 Will existing staff be assigned to the project, or will new staff be recruited?	The Finance Officer from Projects Division is proposed to be assigned to the project.	
3.3 Describe the existing or proposed project accounting staff, including job title, responsibilities, educational background and professional experience. Attach job descriptions and CVs of key accounting staff.	Finance Officer (Projects) PMU Accountant- Certificate in Management Practices	

Topic	Response	Potential Risk Event
3.4 Is the project finance and accounting function staffed adequately?	The current staffing structure of the Finance Section is adequate for MIPU's current functions and responsibilities. The project finance and accounting staff is adequate. A finance staff from MFEM will be seconded to assist the MIPU in financial management.	
3.5 Are project finance and accounting staff adequately qualified and experienced?	Yes	
3.6 Is the project finance and accounts staff trained in ADB procedures, including the disbursement guidelines (i.e., LDH)?	No	Delay in processing and payments of consultant and contractor/supplier invoices
3.7 What is the duration of the contract with the project finance and accounting staff?	Finance staff are permanent public servants posted to the Ministry as public service staff.	
3.8 Identify any key positions of project finance and accounting staff not contracted or filled yet, and the estimated date of appointment.	At the time of assessment all positions are filled up.	
3.9 For the new staff, describe the proposed project finance and accounting staff, including job title, responsibilities, educational background and professional experience. Attach job descriptions.	MIPU has written positions descriptions which are updated from time to time to reflect the current staff establishment for the ministry as set out in the recurrent budget document.	
3.10 Does the project have written position descriptions that clearly define duties, responsibilities, lines of supervision, limits of authority for all of the officers, managers and staff?	Yes	
3.11 What is the turn-over rate for finance and accounting personnel (including terminations, resignations, transfers, etc.)?	There are no training policies in place for accounts staff, however, staff training requirements are considered based on training needs analysis conducted from time to time by the Human Resource Division.	
3.12 What is the training policy for the finance and accounting staff?		

Topic	Response	Potential Risk Event
3.13 Describe the list of training programs attended by finance and accounting staff in the last 3 years.		
4. Accounting Policies and Procedures		
4.1 Does the entity have an accounting system that allows for the proper recording of project financial transactions, including the allocation of expenditures in accordance with the respective components, disbursement categories, and sources of funds (in particular, the legal agreements with ADB)? Will the project use the entity accounting system? If not, what accounting system will be used for the project?	MFEM uses the SmartStream financial software and will also be used by the project.	
4.2 Are controls in place concerning the preparation and approval of transactions, ensuring that all transactions are correctly made and adequately explained?	Yes, controls are in place for all financial transactions which ensures that preparation and approval of transactions is segregated and in compliance with the PFEM Act.	
4.3 Is the chart of accounts adequate to properly account for and report on project activities and disbursement categories? Obtain copy of the chart of accounts.	Yes	
4.4 Are cost allocations to the various funding sources made accurately and in accordance with established agreements?	Yes	
4.5 Are the General Ledger and subsidiary ledgers reconciled monthly? Are actions taken to resolve reconciliation differences?	A commitment ledger is set up for normal transactions and is reconciled against the balances from the MFEM financial report balances before preparation of the Ministry's internal management report that inform divisional directors of their available budget balances.	

Topic	Response	Potential Risk Event
4.6 Describe the EA's policy for retention of accounting records including supporting documents (e.g., ADB policy requires that all documents should be retained for at least 1 year after ADB receives the audited project financial statements for the final accounting period of implementation, or 2 years after the loan closing date, whichever is later). Are all accounting and supporting documents retained in a defined system that allows authorized users easy access.	Yes, only photocopies are retained as all original documents are forwarded to MFEM for payment.	
4.7 Describe any previous audit findings that have not been addressed.	Not applicable	
Segregation of Duties		
4.8 Are the following functional responsibilities performed by different units or persons: (i) authorization to execute a transaction; (ii) recording of the transaction; and (iii) custody of assets involved in the transaction; (iv) reconciliation of bank accounts and subsidiary ledgers?	Yes. The Director General will authorize to execute a transaction; the Senior Finance Officer commits and records the transaction; and the requisitioning division will have the custody of the assets involved in the transaction.	
4.9 Are the functions of ordering, receiving, accounting for, and paying for goods and services appropriately segregated?	Yes, requisitions are made by Managers of Division; Accounting staff will commit and record and approve by Manager of Finance and payments by MFEM.	
Budgeting System		
4.10 Do budgets include physical and financial targets?	Official budget has only financial targets while physical targets are set in the Department's work program managed and maintained by the divisional heads.	
4.11 Are budgets prepared for all significant activities in sufficient detail to provide a meaningful tool with which to monitor subsequent performance?	Detailed activities are described and itemized in the work plan of each individual divisions and measurement of accomplishment is measured on the remaining balance in the budget through the accounts section budget variance report.	

Topic	Response	Potential Risk Event
4.12 Are actual expenditures compared to the budget with reasonable frequency? Are expenditures required for significant variations against the budget?	Managers of division use the reports to measure the performance of their division and identify the causes of the variances. This guides them in planning their future activities.	
4.13 Are approvals for variations from the budget required (i) in advance or (ii) after the fact?	Variations are requested and must be approved in advance. Variations are approved by MFEM and supplementary budget are put through in the Parliament before the implementation of activities.	
4.14 Is there a ceiling, up to which variations from the budget may be incurred without obtaining prior approval?		
4.15 Who is responsible for preparation, approval and oversight/monitoring of budgets?	Budgets are prepared by the Department's heads of division before being sent to MFEM for finalization and submission to Parliament for approval.	
4.16 Describe the budget process. Are the procedures in place to plan project activities, collect information from the units in charge of the different components, and prepare the budgets?		

Topic	Response	Potential Risk Event
<p>4.17 Are the project plans and budget of project activities realistic, based on valid assumptions, and developed by knowledgeable individuals?</p> <p>Is there evidence of significant mid-year revisions, inadequate fund releases against allocations, or inability of the EA to absorb/spend released funds?</p> <p>Is there evidence that government counterpart funding is not made available adequately or on a timely basis in prior projects?</p> <p>What is the extent of over-or-under-budgeting of major heads over the last 3 years? Is there a consistent trend either way?</p>	<p>Yes</p> <p>No</p> <p>No</p>	
Payments		
<p>4.18 Do invoice-processing procedures provide for: (i) Copies of purchase orders and receiving reports to be obtained directly from issuing departments? (ii) Comparison of invoice quantities, prices and terms, with those indicated on the purchase order and with records of goods actually received? (iii) Comparison of invoice quantities with those indicated on the receiving reports? (iv) Checking the accuracy of calculations? (v) Checking authenticity of invoices and supporting documents?</p>	<p>The checking and preparation of payment certificate is the responsibility of heads of department. Payment vouchers are passed for payment after the requirements of (i) to (iv) have been complied.</p> <p>All payments that are certified and approved by MIPU are sent to MFEM for payment.</p>	
<p>4.19 Are all invoices stamped PAID, dated, reviewed and approved, and clearly marked for account code assignment?</p>	<p>Invoices are paid by MFEM. The heads of department checks the FMIS for differences or if payments are rejected, the matter is corrected by the party in error.</p>	

Topic	Response	Potential Risk Event
4.20 Do controls exist for the preparation of the payroll and are changes (additions/deductions/modifications) to the payroll properly authorized?	Payroll is prepared using the payroll module by MFEM using base data supplied by head of Department's Human Resources	
<i>Policies and Procedures</i>		
4.21 What is the basis of accounting (e.g., cash, accrual) followed (i) by the entity? (ii) by the Project?	MIPU uses the accrual system and the Project will use the same as basis of accounting.	
4.22 What accounting standards are followed (International Financial Reporting Standards, International Public Sector Accounting Standards-cash or accrual, or National Accounting Standards (specify) or other?	The International Public Sector Accounting Standards (IPSAS) – accrual system are followed.	
4.23 Does the project have an adequate policies and procedures manual(s) to guide activities and ensure staff accountability?	An update of the Financial and Administration Procedures Manual will be undertaken.	
4.24 Is the accounting policy and procedure manual updated regularly and for the project activities?	The manual will be updated by the Project Accountant of the DSC team	
4.25 Do procedures exist to ensure that only authorized persons can alter or establish a new accounting principle, policy or procedure to be used by the entity?	Yes	
4.26 Are there written policies and procedures covering all routine financial management and related administrative activities?	Yes	
4.27 Do policies and procedures clearly define conflict of interest and related party transactions (real and apparent) and provide safeguards to protect the organization from them?	Yes	

Topic	Response	Potential Risk Event
4.28 Are manuals distributed to appropriate personnel?	Yes	
4.29 Describe how compliance with policies and procedures are verified and monitored.	Yes	
<i>Cash and Bank</i>		
4.30 Indicate names and positions of authorized signatories for bank accounts. Include those persons who have custody over bank passwords, USB keys, or equivalent for online transactions.	Not applicable for the Project	
4.31 Does the organization maintain an adequate, up-to-date cashbook, recording receipts and payments?	Yes	
4.32 Describe the collection process and cash handling procedures. Do controls exist for the collection, timely deposit and recording of receipts at each collection location?	Yes, cash collected and schedule of receipts is lodged with the MFEM cashier on a daily basis	
4.33 Are bank accounts reconciled on a monthly basis? Or more often? Is the cash on hand physically verified, and reconciled with the cash books? With what frequency is this done?	Bank accounts are reconciled on a monthly basis. Cash-on-hand is physically verified and reconciled with the cash books on a daily basis.	
4.34 Are all reconciling items approved and recorded?	Yes	
4.35 Are all unusual items on the bank reconciliation reviewed and approved by a responsible official?	Yes	
4.36 Are there any persistent/non- moving reconciling items?	No	

Topic	Response	Potential Risk Event
4.37 Are there appropriate controls in safekeeping of unused cheques, USB keys and passwords, official receipts and invoices?	Yes	
4.38 Are any large cash balances maintained at the head office or field offices? If so, for what purpose?	No	
4.39 For online transactions, how many persons possess USB keys (or equivalent), and passwords? Describe the security rules on password and access controls.		
Safeguard over Assets		
4.40 What policies and procedures are in place to adequately safeguard and protect assets from fraud, waste and abuse?		
4.41 Does the entity maintain a Fixed Asset Register? Is the register updated monthly? Does the register record ownership of assets, any assets under lien or encumbered, or have been pledged?	Yes. The asset register is being updated from time to time.	
4.42 Are subsidiary records of fixed assets, inventories and stocks kept up to date and reconciled with control accounts?	Yes	
4.43 Are there periodic physical inventories of fixed assets, inventories and stocks? Are fixed assets, inventories and stocks appropriately labelled?	Yes	
4.44 Are physical inventory of fixed assets and stocks reconciled with the respective fixed assets and stock registers, and discrepancies analysed and resolved?	Yes	

Topic	Response	Potential Risk Event
4.45 Describe the policies and procedures in disposal of assets. Is the disposal of each asset appropriately approved and recorded? Are steps immediately taken to locate lost, or repair broken assets?		
4.46 Are assets sufficiently covered by insurance policies?	Yes	
4.47 Describe the policies and procedures in identifying and maintaining fully depreciated assets from active assets.		
<i>Other Offices and Implementing Entities</i>		
4.48 Describe any other regional offices or executing entities participating in implementation?	Provincial staff of PWD will be involved in the Project during construction and after project commissioning.	
4.49 Describe the staff, their roles and responsibilities in performing accounting and financial management functions of such offices as they relate to the project.		
4.50 Has the project established segregation of duties, controls and procedures for flow of funds, financial information, accountability, and audits in relation to the other offices or entities?	Yes	
4.51 Does information among the different offices/implementing agencies flow in an accurate and timely fashion? In particular, do the offices other than the head office use the same accounting and reporting system?	Financial transactions are recorded in the integrated FMIS and can be viewed and accessed by finance staff involved in the Project	
4.52 Are periodic reconciliations performed among the different offices/implementing agencies? Describe the project reporting and auditing arrangements between these offices and the main executing/implementing agencies.	Reconciliations are done on a regular basis	

Topic	Response	Potential Risk Event
4.53 If any sub-accounts (under the Imprest Account) will be maintained, describe the results of the assessment of the financial management capacity of the administrator of such sub-accounts.	Not applicable, imprest account procedure will not be used in the Project	
Contract Management and Accounting		
4.54 Does the agency maintain contract-wise accounting records to indicate gross value of contract, and any amendments, variations and escalations, payments made, undisbursed balances? Are records consistent with physical output/deliverables of the contract?	Yes, records are consistent with physical output indicated in the contract.	
4.55 If contract records are maintained, does the agency reconcile them regularly with the contractor?	Yes	
<i>Other</i>		
4.56 Describe the project arrangements for reporting fraud, corruption, waste and misuse of project resources. Has the project advised employees, beneficiaries and other recipients to whom to report if they suspect fraud, waste or misuse of project resources or property?	Yes, the Project has advised staff of the anti-corruption policies of ADB. If fraud, waste of resources and misuse of funds are suspected it will be reported to the Project Director.	
5. Internal Audit		
5.1 Is there an internal audit (IA) department in the entity?	There is no internal audit function at MIPU.	
5.2 What are the qualifications and experience of the IA staff?	Not applicable	
5.3 To whom does the head of the internal auditor report?	Not applicable	

Topic	Response	Potential Risk Event
5.4 Will the internal audit department include the project in its annual work program?	Not applicable	
5.5 Are actions taken on the internal audit findings?	Not applicable	
5.6 What is the scope of the internal audit program? How it was developed?	Not applicable	
5.7 Is the IA department independent?	No, the IA is a department of the Ministry of Public Utilities and Infrastructure	
5.8 Do they perform pre-audit of transactions?	No	
5.9 Who approves the internal audit program?	Not applicable	
5,10 What standards guide the internal audit program?	Not applicable	
5.11 How are audit deficiencies tracked?	Not applicable	
5.12 How long have the internal audit staff members been with the organization?	Not applicable	
5.13 How long have the internal audit staff have IT background?	Not applicable	
5.14 How frequently does the internal auditor meet with the audit committee without the presence of management?	No applicable	
5.15 Has the internal auditor identified/reported any issue with reference to availability and completeness of records?	Not applicable	
5.16 Does the internal auditor have sufficient knowledge and understanding of ADB Guidelines and Procedures, including the disbursement guidelines and procedures (i.e., LDH)?	Not applicable	

Topic	Response	Potential Risk Event
6. External Audit		
6.1 Is the entity financial statement audited regularly by an independent auditor? Who is the auditor?	<p>Financial statements of MIPU are subject to audit by the Office of the Auditor General (OAG). The audit scope of OAG is for all agencies which are substantially owned and controlled by Government. This includes central government ministries such as MIPU.</p> <p>A consolidated government statement is prepared annually and includes full information on revenue, expenditure and financial assets/liabilities.</p>	
6.2 Are there any delays in audit of the entity? When are the audit reports issued?	<p>The consolidated government statements have been lodged with the Auditor General within 10 months of the end of the financial year.</p> <p>MFEM has not provided the financial statements to the Auditor General within 3 months at year end as the legal requirement in submitting the accounts.</p> <p>In the last 3 years at least the first draft of the financial statements are submitted within six to ten months of year-end.</p>	
6.3 Is the audit of the entity conducted in accordance with International Standards on Auditing or the Internal Standards for Supreme Audit Institutions, or national auditing standards?	<p>The audit is undertaken by the Auditor General and is conducted according to International Standards on Auditing and standards set by the International Organization of Supreme Audit Institutions (INTOSAI) of which the Auditor General is a member.</p>	
6.4 Were there any major accountability issues brought out in the audit report of the past three years?	None	
6.5 Does the external auditor meet with audit committee without the presence of management?	The Auditor General always meet the audit committee with the presence of management.	

Topic	Response	Potential Risk Event
6.6 Has the entity engaged the external audit firm for any non-audit engagements (e.g., consulting)? If yes, what is the total value on non-audit engagements, relative to the value of the audit services?	No	
6.7 Has the external auditor expressed any issues on the availability of complete accounting records and supporting documents?	The Auditor General in previous audits has not expressed any issues on the availability of complete records and supporting documents.	
6.8 Does the external auditor have sufficient knowledge and understanding of ADB's guidelines and procedures, including the disbursement guidelines and procedures (i.e., LDH)?	The Auditor General has sufficient knowledge of ADB's auditing and disbursement guidelines and procedures.	
6.9 Are there any material issues noted during review of the audited entity financial statements that were not reported in the external audit report?	None	
External Audit- Project Level		
6.10 Will the entity auditor audit the project accounts or will another auditor be appointed to audit the project financial statements?	OAG will engage a national firm to audit the project accounts.	There is a risk that the audited financial statements are submitted late and hence non-compliance with the covenants of the loan and grant agreements which may result to suspension of project implementation and disbursements.
6.11 Are there any recommendations made by the auditors in prior project audit reports or management letters that have not been implemented?	None	
6.12 Is the project subject to any kind of audit from an independent government entity (e.g., the supreme audit institution) in addition to the external audit?	Yes	

Topic	Response	Potential Risk Event
6.13 Has the project prepared acceptable terms of reference for an annual project audit? Have these been agreed and discussed with the EA and the auditor?	The terms of reference (TOR) of the audit are with the OAG.	
6.14 Has the project auditor identified any issues with the availability and completeness of records and supporting documents?	Not applicable	
6.15 Does the external auditor have sufficient knowledge and understanding of ADB's guidelines and procedures, including the disbursement guidelines and procedures (i.e., LDH)?	Knowledge and experience with ADB's guidelines and procedures will be included as part of the criteria in the selection of the external auditor.	
6.16 Are there any recommendations made by the auditor that have remained unaddressed in prior audit reports or management letters that have not been implemented?	Not applicable	
(For second or subsequent projects) 6.17 Were past audit reports complete, and did they fully address the obligations under the loan agreements? Were there any material issues noted during the review of the audited project financial statements and related audit report that have remained unaddressed?	Not applicable	
7. Reporting and Monitoring		
7.1 Are financial statements and reports prepared for the entity?	Yes	
7.2 Are financial statements and reports prepared for the implementing unit(s)?	Yes	

Topic	Response	Potential Risk Event
7.3 What is the frequency of preparation of financial statements and reports? Are the reports prepared in a timely fashion so as to be useful to management for decision making?	One month after the end of each financial year.	
7.4 Does the entity reporting system need to be adapted for project reporting?	Yes	
7.5 Has the project established financial management reporting responsibilities that specify the types of reports to be prepared, the report content, and purpose of the reports?	Yes	
7.6 Are financial management reports used by management?	Yes	
7.7 Do the financial reports compare actual expenditures with budgeted and programmed allocations?	Yes	
7.8 How are financial reports prepared? Are financial reports prepared directly by the automated accounting system or are they prepared by spreadsheets or some other means?	Financial reports are generated through the integrated FMIS.	
7.9 Does the financial system have the capacity to link the financial information with the project's physical progress? If separate systems are used to gather and compile physical data, what controls are in place to reduce the risk that the physical data may not synchronize with the financial data?	Yes, the FMIS has project module.	
7.10 Does the entity have experience in implementing projects of any other donors, co-financiers or development partners?	Yes	
8. Information Systems		

Topic	Response	Potential Risk Event
8.1 Is the financial accounting reporting system computerized?	Yes	
8.2 If computerized, is the software off-the-shelf or customized?	Customized	
8.3 Is the computerized system standalone, or integrated and used by all departments in the headquarters and field units using modules?	It's integrated and used by all ministries and departments.	
8.4 How are the project financial data integrated with the entity financial data? Is it done through a module in the enterprise financial system with automatic data transfer, or does it entail manual entry?	Separate accounts will be opened and maintained for each loan and grant proceeds and government counterpart contributions for the Project in the integrated system.	
8.5 Is the computerized software used for directly generating periodic financial statements, or does it require manual intervention and use of Excel or similar spreadsheet software?	The integrated system could generate periodic financial statements.	
8.6 Can the system automatically produce the necessary project financial reports?	Yes, the system can produce financial reports required by the Project.	
8.7 Is the staff adequately trained to maintain the computerized system?	Yes, the accounting system was established in 2002. Staff are well trained in the use of the system.	
8.8 Do the management, organization and processes and systems safeguard the confidentiality, integrity and availability of the data?	Yes	
8.9 Are there back-up procedures in place?	Yes	
8.10 Describe the backup procedures-online storage, offsite storage, offshore storage, fire, earthquake and calamity protection and backups.	Yes	