

PHUENTSHOLING TOWNSHIP DEVELOPMENT PROJECT

FINANCIAL MANAGEMENT ASSESSMENT

OF

CONSTRUCTION DEVELOPMENT CORPORATION LIMITED

MAY 2018

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FINANCIAL MANAGEMENT ASSESSMENT of Construction Development Corporation Ltd.

I. INTRODUCTION

1. This document contains a Financial Management Assessment (FMA) of the Construction Development Corporation Limited (CDCL), which is the implementing agency of the Phuentsholing Township Development Project (PTDP), a component of the government's larger township development program called Amochhu Land Development and Township Project (ALDTP). CDCL is a wholly-owned subsidiary of Druk Holding and Investments (DHI), which in turn is wholly owned by the Government of Bhutan. The Asian Development Bank (ADB) is considering partially financing PTDP at the request of government and has undertaken this FMA of the project's implementing agency as part of its standard due diligence process. The FMA was prepared in accordance with the Bank's latest technical guidance note for financial management.¹ The assessment was based on a review and analysis of relevant documents, and interviews and discussions with staff of CDCL. The Financial Management Assessment Questionnaire is given in Annex 1.

II. PROJECT DESCRIPTION

2. **Overview.** Overall the ALDTP will develop 460 hectares (ha) of riparian land near the city of Phuentsholing that is located adjacent to the Amochhu River on Bhutan's southwestern border with India. It will provide protection from floods and erosion and construct urban infrastructure to allow phased urban expansion. A modern township will be designed on modern sustainable principles of equity, livability, and competitiveness, and it will be integrated into the fabric of the existing municipality and preserve Bhutan's unique architectural heritage. It will also protect the existing and new towns from floods and riverbank erosion which currently threatens lives and livelihoods and disrupts connectivity with nearby communities. The government plans to implement ALDTP in phases and PTDP (the "project") will develop 66 ha along the left bank of the Amochhu River while subsequent phases will develop the remaining 394 ha.

3. **Outputs.** The outputs of PTDP are the following:

- (i) **Output 1: Flood and erosion protection measures installed.** The riverbank protection works will protect Phuentsholing from flooding and erosion. Specifically, the project will (a) construct 4 kilometers of erosion-resilient river walls to protect against a 100-year probable flood; (b) raise ground levels behind the new walls to reclaim at least 66 ha of flood-protected land for urban development, and (c) establish and operationalize a flood early warning system and flood management plan in consultation with the community.
- (ii) **Output 2: Municipal infrastructure constructed.** The project will provide serviced plots of land by constructing common urban infrastructure comprising (a) about 10 kilometers of roads with footpaths, landscaping, and streetlights, which are planned in construction with women (b) modern drinking water supply and distribution systems, and wastewater collection and treatment systems that service the township and adjoining areas; and (c) a resource recovery system for managing solid waste in both the new and old townships; and (iv) power distribution and telecommunication systems throughout the new township. The

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

plots will be leased to residential and commercial investors as prescribed by the Amochhu Development Master Plan, which emphasizes principles of sustainable urban design such as maximum walkability, greenery, and open spaces.

- (iii) **Output 3: Township management systems installed.** The project will (a) establish asset management systems; (b) build the capacity of township staff to ensure sustainable and effective urban management, and (c) initiate investor promotion activities.

4. **Financial and institutional arrangements.** The project will have an implementation period of seven years. In January 2017, the project's estimated cost is \$63 million, of which at least \$26.53 million will be financed from ADB's concessional ordinary capital resources (COL), \$26.47 million from Asian Development Fund grant, and \$10 million from the government. The government's portion will be provided in the form of a counterpart fund contribution from DHI, which is the Executing Agency of the project. The implementing agency is CDCL.

III. COUNTRY FINANCIAL MANAGEMENT ISSUES

5. **Overview.** The most recent self-assessment of the public financial management (PFM) system of the government was completed in September 2016, based on the 2016 Public and Expenditure and Financial Accountability (PEFA) framework.² The assessment was undertaken by the Ministry of Finance with the support of the World Bank and International Monetary Fund. It found that the budgeting and accounting system was generally robust, especially with regards to management of assets and liabilities and external scrutiny and audit. ADB's latest Country Partnership Strategy (CPS 2014-2018) echoed this finding, and found that Bhutan's public financial management system was more robust than those of many comparable countries.³ The remainder of this section contains a summary of the 2016 PFM assessment.

6. **Fiscal discipline.** The main strengths of this area are the comprehensive coverage of the RGoB's Public Expenditure Management System, orderly execution of the budget, good control over expenditure commitments and fiscal risks, risk-based administration of revenue, timely and reliable financial reporting, and continued improvements in external audit and legislative scrutiny. At the same time, fiscal discipline is undermined by some lack of public transparency in administrative classification in the budget and accounts, which would inform and facilitate public demand for better accountability. It is also reduced by the limited economic appraisal of projects before inclusion in the budget, as the projected social and economic costs and benefits of proposed projects cannot be exposed to wider scrutiny.

7. **Strategic allocation of resources.** Bhutan's PFM is characterized by a strong planning and budgeting system that translates five-year plans into sectoral strategies, programs and annual budgets within a rolling three-year fiscal framework. Favorable factors are the amount of time allowed to agencies to prepare their budgets, and the reliability of resource flows to service delivery units in accordance with annual budgets (at least where resources are domestically funded; financial transfers of development partners are much less reliable).

8. **Efficient use of resources for service delivery.** Procurement of public and goods and services is competitive, which yields greater value for money. The recent adoption of a performance management system, based on annual performance agreements with the Prime

² Government of Bhutan and World Bank Group. 2016. *Public Financial Management Performance Report*. Washington D.C.

³ ADB. 2014. *Country Partnership Strategy Bhutan 2014-2018*. Manila.

Minister, is potentially a powerful tool for cost control and efficiency savings, but it not yet fully developed.

9. **Improvements in performance of PFM.** The previous assessment of the country's PFM, which was conducted in 2010, triggered a series of reforms. An analysis of changes in PFM performance between 2010 and 2016 indicates:

- strong aggregate expenditure and domestic revenue out-turn remain, to be strengthened further by the implementation of the web-based Multi-Year Rolling Budget and Revenue Administration Management Information System,
- adoption of Classification of Functions of Government classification of expenditure,
- introduction of a formula-based system for fiscal transfers to local governments,
- strengthened monitoring of fiscal risk over public enterprises,
- a more active Tax Appeals Board,
- a formal cash flow forecasting system,
- improved effectiveness of internal audit,
- introduction of a formal system of in-year budget execution reporting,
- constitution of a Finance Committee for legislative scrutiny of budgets, and
- a more active Public Accounts Committee for scrutiny of audit reports.

The main areas of challenge are expenditure composition out-turn, controls over payroll, expenditure arrears and public access to information, these provide opportunity to strengthen PEMS and related systems. The opportunity also exists in the areas of internal audit, legislative scrutiny of annual budget laws and quality and timeliness of annual financial statements where reforms are either underway or are to be initiated. Since CDCL is a corporation (albeit a 100% government-owned one), governed by the Companies Act and its Board of Directors, country level PFM issues impact CDCL and the proposed project to a lesser degree than government agencies.

IV. PROJECT FINANCIAL MANAGEMENT SYSTEM

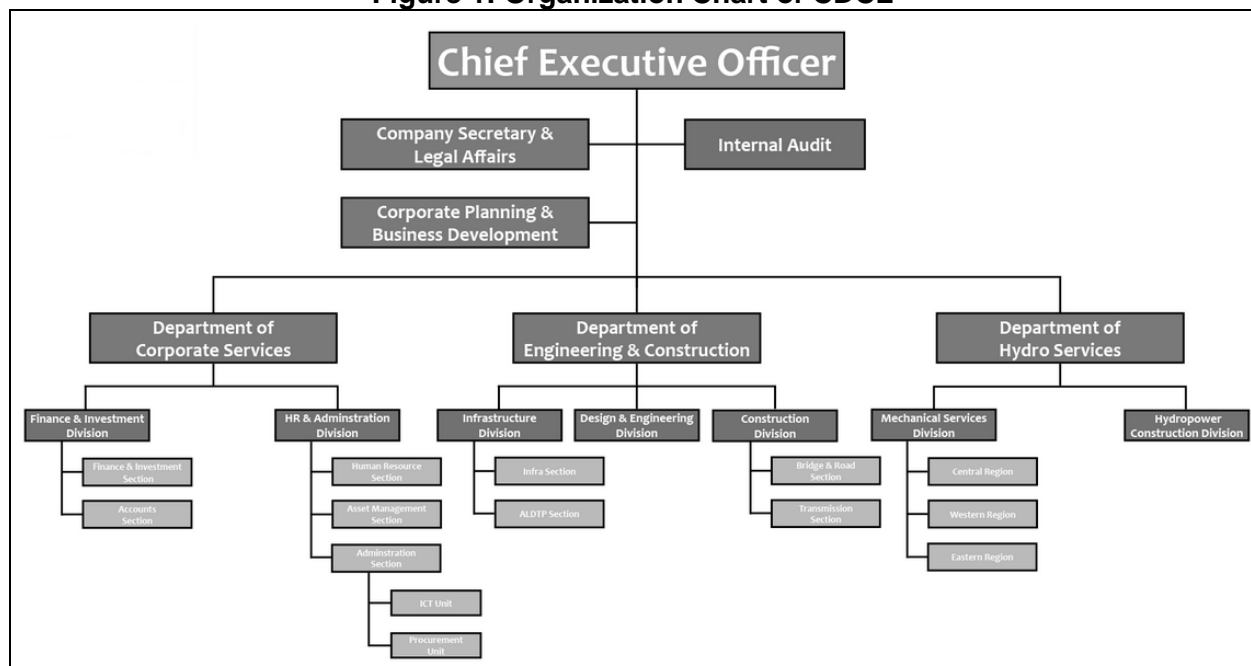
A. Overview

10. **Organization and staff capacity.** CDCL was legally established by incorporation under the Companies Act of the Kingdom of Bhutan in 2009. In 2015, the company had a turnover of about Nu475 million (approximately \$7 million) and employed about 400 persons (of which about 200 were permanent employees). The company is specialized in the construction of roads, bridges, hydropower dams and other civil engineering works. It has implemented an ADB-financed project (the Samdrupcholing-Samrang Road and Bridge Project) and constructed many roads and bridges financed by the Government of India. CDCL has an Internal Audit Section, which is a staff unit under the Chief Executive Officer (CEO) and a Finance and Investment Section and Accounts Section that form part of the company's Corporate Services Department. Refer to Figure 1 for an organization chart.

11. CDCL is a wholly-owned subsidiary of DHI, which is the commercial arm of the Government of Bhutan. DHI was established by Royal Charter in 2007 with the objective "to hold and manage the existing and future investments of the Royal Government for the long-term benefit of the people of Bhutan". At present, DHI is the largest company in Bhutan, and has shareholdings in 21 companies operating in the manufacturing, energy, natural resources, financial, communication, aviation, trading and real estate sectors. All shares of DHI are owned by the government; there are no other shareholders. In the second quarter of 2016, DHI

announced that it will merge CDCL with DHI Infra, another wholly-owned subsidiary. The merger would be completed in the first half of 2017.

Figure 1: Organization Chart of CDCL



Source: CDCL.

12. CDCL is managed by highly qualified individuals with many years of relevant work experience. The company has set up a project team for the development of PTDP, also with highly relevant academic background and work experience (see Table 1; refer to paras 20-21 for details about accounting staff). CDCL will establish a dedicated Project Management Unit (PMU). To the extent possible, the company will assign existing staff to the PMU (including a full-time accountant), but will recruit additional personnel if required.

Table 1: Key Personnel of CDCL and the PTDP Team

CDCL Management	Project Team for PTDP
CEO: Mr. Phuntsho Gyeltshen Qualification: MSc in Civil Engineering Years of relevant work experience: 27	Project Manager: Mr. Tshering Dupchu Qualification: MSc in Project Management Years of relevant work experience: 18
Director of Engineering and Construction Department: Mr. Reezang Wangdi Qualification: MSc in Structural Engineering Years of relevant work experience: 27	Chief Architect: Mrs. Kamala Thapa Qualification: MSc in Urban Management and Development Years of relevant work experience: 15
Director of Hydro Services Department: Mr. Karma Gayley Qualification: MSc in Hydropower Development Years of relevant work experience: 15	Project Engineer: Mr. Kamal Dhakal Qualification: MSc in Water Management Years of relevant work experience: 13
Director of Financial Services Department: Mrs. Dechen Wangmo Qualification: BSc in Applied Accounting Years of relevant work experience: 11	

Source: CDCL.

13. **Information management.** CDCL has an accounting system in place 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. The company is currently using Tally ERP 9, an off-the-shelf stand-alone software package, to manage its accounts and intends to use the same software for the management of PTDP accounts. Tally ERP 9 can automatically produce project financial reports, but requires manual adjustments to generate periodic financial statements or produce the information that DHI needs to consolidate CDCL's statements. This is in line with general industry practice. Additionally, CDCL's staff is adequately trained in the use of the system, and the data generated by Tally ERP 9 meets the company's standards with regards to confidentiality, integrity and availability of accounting data.

14. **Budgeting and funds flow arrangements.** The Head of the Finance and Investment Section is responsible for preparation of budgets, including budgets for individual projects. The Head will first compile a budget in September and present the budget to the management for endorsement in October. After endorsement, it will be presented to the Board of CDCL for approval before the start of the financial year in January. Budgets include physical and financial targets in sufficient detail to allow meaningful monitoring of subsequent performance. Approval for variations from the budget are required in advance; without prior approval, expenditures must not exceed the budget.

15. In recent years, there were no major revisions to budgeted expenses, and actual expenses were lower than the budget in the past three years (Table 2). In 2015, the variance was higher than in preceding years because of unexpected delays in obtaining environmental clearances for major construction projects. However, budgets are regularly revised mid-year at the request of the government to undertake public projects. In 2015, these included the development of commercial space at Thimphu Techpark, the construction of a bus shelter, and the refurbishment of the national referral hospital. There is therefore a risk that unexpected requests of funds for other government projects may cause delays in the provision of counterpart funds reserved for PTDP.

Table 2: Budgeted vs. Actual Expenses of CDCL, 2013-2015
(Nu million)

	2013	2014	2015
Budgeted Expense	557.5	506.3	534.4
Actual Expense	523.4	476.9	435.1
Variance (Budgeted – Actual Expense)	34.1	29.4	99.3
Variance as % of Budgeted Expense	6.1	5.8	18.6

Source: CDCL financial reports (2014-2016).

16. **Accountability measures.** CDCL is subject to considerable legislative oversight. The company's reporting requirements can be summarized as follows:

- semi-annual and annual filing of accounts to the Department of Revenue and Customs,
- annual statutory audit in accordance with International Accounting Standards (see para 32 for details),
- periodic compliance audit by the Royal Audit Authority (see also para 32 for details),
- semi-annual and annual accounts submission of financial accounts to DHI (for consolidation), and

- annual reporting to the Registrar of Companies.

17. In addition, CDCL needs to comply with the provisions in the trade license, which is issued by Department of Trade under Ministry of Economic Affairs, and with the Companies Act. CDCL is also licensed by the Construction Development Board (CDB), which acts as a bridge between the private and public sector. CDB supports the development of the construction industry and ensures that qualified contractors have fair and equal access to contracts and are treated fairly during contract implementation.

18. In addition to the externally imposed accountability measures, CDCL also has developed a code of ethics, which is incorporated in the company's Service Rules and Regulations of 2016. To date, there has been no major breach of the code, except for one corruption case against a former CEO in 2009. The matter was forwarded to the anti-corruption commission, which, in turn, forwarded the case of the Office of the Attorney General for prosecution. At the time of writing, the case is in court and a verdict is yet to be issued. A separate Integrity Due Diligence has also been conducted, the results of which were satisfactory.

B. Strengths

19. The company employs qualified and experienced accountants and financial managers, has a well-developed internal control system (with an internal audit section established directly under the CEO), and its accounts are audited annually by an external auditor in accordance with International Accounting Standards. Audited financial statements are available on a timely basis (within six months from the end of the financial year), and are published on the CDCL's website. During the past three years, the external auditor accorded an unqualified opinion to CDCL's accounts, except in 2015 (because of incomplete recording of land transactions and physical inventories, deficiencies which have both been resolved since).

C. Weaknesses

20. The financial management system of CDCL has no obvious weaknesses. However, the Internal Audit Section, which was established in 2015, is presently understaffed (CDCL intends to expand the section from one to three persons during 2017). In addition, CDCL staff is not familiar with ADB procedures, which may adversely affect the financial management of PTDP. To address this deficiency, it is proposed that ADB will provide training in the application of its procedures to selected staff in the second half of 2017 (see Table 4).

D. Personnel, Accounting Policies and Procedures, Internal Control, Internal and External Audit

21. **Personnel.** The finances of CDCL are managed by the Finance and Investment Section and Accounts Section in the company's Finance and Investment Division (Figure 1). The Head of this division is a highly-experienced accountant, who is also a member of the Association of Chartered Certified Accountants of the United Kingdom. The project accounts manager and the project accountant have qualifications as Bachelor of Commerce and Financial Accounting, respectively, and many years of relevant work experience. CDCL has written position descriptions in place that clearly define duties, responsibilities, lines of supervision, and limits of authority for all the officers, managers, and staff, including staff involved in financial management. Turnover of finance and accounting personnel is relatively low, and was estimated at 10% in 2015. At present, all key positions in project finance and accounting are filled and no new staff are expected to be recruited soon (except for a full-time accountant for the PMU that

would be established for PTDP).

22. All project finance and accounting staff are adequately qualified and experienced for CDCL's ongoing activities, but do not have experience with the financial management of ADB-financed projects. For this reason, there appears to be a need for training in the use of ADB procedures, including disbursement guidelines.

23. **Accounting policies and procedures.** CDCL uses accrual accounting, and follows Bhutan Accounting Standards (BAS), which are equivalent to International Financial Reporting Standards. If the company wishes to adopt new accounting policies, these must be approved by the Board of Directors. CDCL plans to adopt project implementation procedures for PTDP based on an existing implementation manual for projects currently undertaken by the company. The Internal Audit Section and various external auditors verify compliance with prevailing accounting policies and procedures (see paras 27-34 for details).

24. The company's chart of accounts adequate to properly account for and report on project activities and disbursement categories. At present, it is being updated to incorporate projects and activities of DHI-Infra, the company with which it will be merged (see para 11). The general ledger, as well as any subsidiary ledgers, is reconciled monthly and any differences are resolved immediately.

25. The retention of accounting records by DHI and CDCL is governed by the Financial and Accounting Manual of the Royal Government of Bhutan. Per the manual, the minimum period for preservation of accounting records is 24 months for records of release of funds, 12 months after liquidation of the borrowings for loan agreements, 12 months after the completion of the project for grant agreements, and 36 months for other books of accounts. The minimum period is reckoned from the date of completion of audit by the RAA and settlement of audit observations pertaining to the contents of the records.

26. The company's existing company's Service Rules and Regulations, as well as DHI's corporate governance code and procurement manual have proven effective in protecting CDCL from conflict of interest and related party transactions.

27. **Internal controls.** CDCL has established large number of internal controls. Apart from the Internal Audit Section (see para 28), the most important of these can be summarized as follows:

- (i) **Segregation of duties.** Different persons perform the functions of ordering, receiving, accounting for, and paying for goods and services. Similarly, different persons authorize or execute a transaction, record the transaction, and reconcile financial records related to the transaction.
- (ii) **Checking of invoices.** All invoices are cross-checked for arithmetical errors.
- (iii) **Review of unusual items on bank reconciliation.** Yes, these are reviewed by the Finance Manager and require approval by the Head of the Finance and Investment Section.
- (iv) **Safekeeping of cheques and passwords.**
- (v) **Minimize cash balances.** No large cash balances are maintained either at headquarters or field offices.
- (vi) **Regular inventory of physical assets.** The internal auditor is required to conduct a physical audit of assets quarterly. Also, subsidiary records of fixed

assets, inventories and stocks are up to date and all fixed assets are appropriately labelled and reconciled with control accounts.

- (vii) **Regular reconciliation between head office and branch accounts.** Reconciliations between CDCL's head office and its site or branch offices are carried out by the Accounts Section monthly.

28. **Internal audit.** CDCL established an Internal Audit Section in 2015. At present, the section consists of one employee only: this person is a Bachelor of Commerce and has six years of practical work experience in the internal audit field, mostly with projects financed by the Government of India, but not with ADB-financed projects. CDCL intends to recruit two additional internal auditors soon.

29. The Internal Auditor reports administratively to the CEO and functionally to the Audit Committee of the Board of Directors. (A charter for the Board Audit Committee has been drafted and is expected to be approved by the Board in Q4 of 2016.) All internal audit activities are free of influence from any element in the organization, including matters of audit selection, scope, procedures, frequency, timing, or report content to permit maintenance of an independent and objective mental attitude necessary to produce unbiased reports.

30. The scope of work the Internal Audit Section is governed by the Internal Audit Terms of Reference, which was prepared in 2016. In principle, all activities of CDCL fall within the remit of the internal audit, including but not limited to all operational and management controls and is not restricted to the audit of systems and controls necessary to form an opinion on the financial statements. Since its inception, however, the section has only covered transactions post-audit (i.e. after these have been conducted), and has not been involved in operational activities. The Head of the Internal Audit Section will periodically assess whether the purpose, authority, and responsibility, as defined in the Terms of Reference, continue to be adequate to enable the internal audit function to accomplish its objectives. The result of this periodic assessment should be communicated to senior management and the Board of Directors through the Audit Committee.

31. The Internal Audit Section develops and undertakes an annual work program based on its Terms of Reference. The Audit committee reviews the progress of the annual work program of the section semi-annually. As required by the Corporate Governance Code of DHI, there should not be fewer than four Board Audit Committee meetings in any one year, and the Internal Audit Section files a quarterly progress report which is discussed during these meetings. In 2016, three Board Audit Committee meetings were conducted and one more is scheduled for Q4 of 2016.

32. Internal audit findings are discussed starting from the concerned individual, division, department, the company's management and finally in the Board's Audit Committee. To date, the Internal Auditor has not found major issues about availability and completeness of records. He has, however, identified minor deficiencies, which were mostly concerned incorrect bookings and missing documents. These were reported and resolved.

33. **External audit.** The financial statements of CDCL are audited annually by statutory auditors as approved by the Royal Audit Authority (RAA). At present, the company's statutory auditor is M/s T.K Ghose & Company, and the external audit is prepared in accordance with International Accounting Standards (IAS). The RAA also conducts an audit of CDCL once every one to four years (depending on the availability of resources) to assess its compliance with the RGoB's rules and regulations about payment and procurement. In addition, the Department of

Revenue conducts a tax audit once every two years to assess compliance with the Income Tax Law of Bhutan (2000).

34. To date, CDCL has not experienced delays with external audits. During the past three years, the external auditor has not noted any major accountability issues, or issues concerning the availability of financial records or supporting documents, and all its recommendations have been implemented promptly by CDCL. In 2015, the external auditor recommended asset revaluation and physical verification of inventories, which were both promptly undertaken by the company. There are no indications of other material issues that were not covered in CDCL's audited financial statements of the past three years.

35. Because the proposed ADB-financed loan for PTDP will be co-financed by the government through an equity investment by DHI, the RAA will be responsible for auditing the project's financial accounts in addition to the external audit that will be conducted by CDCL's statutory auditor. The RAA has audited government agencies and companies involved in the management of ADB-funded projects for a considerable time so it has sufficient knowledge of ADB's guidelines and procedures. To ensure that RAA that has sufficient recourses at its disposal to conduct the audit, CDCL (through DHI) will request the Authority to include the audits of PTDP in its work plan.

E. Financial Reporting Systems

36. CDCL prepares financial statements twice a year (at the end of the second quarter and at year end), following reporting requirements established by DHI and the company's external auditors. The company uses its accounting software Tally ERP 9 to prepare draft statements, which are then manually adjusted to ensure compliance with International Financial Reporting Standards and government tax regulations. Financial statements are actively used by management and contain comparisons of actual and budgeted income and expenses. They do not, however, permit the linking of financial with physical data.

F. Disbursement Arrangements

37. **Channeling of loan and grant proceeds.** The proposed ADB loan and grant would be channeled to the government in US Dollar, and the government will on-lend the loan and passed on the grant to DHI. The subsidiary loan will have a 32-year term, including an 8-year grace period. The subsidiary loan will have an annual interest rate at 1% during the grace period and 2.55% thereafter. The subsidiary loan will be provided in Ngultrum and the government will bear the exchange rate risk. DHI would provide funds from the ADB loan and grant, and from DHI equity, to CDCL for the project.

38. **Imprest fund procedure.** Two separate imprest accounts will be opened for expenses under the ADB loan and grant. These will be established at the Royal Monetary Authority (RMA). ADB funds will be disbursed to imprest accounts at RMA in US Dollar (loan) and US Dollar (grant) in favor of DHI (see Flow Fund Diagram in Chapter IV). The fund will be then transferred to a three projects account maintained by CDCL at the Bank of Bhutan, the country's most reputable commercial bank (one account for loan proceeds, one for grant proceeds, and one for counterpart fund contributions). The project accounts will be for the exclusive use of the project, and receive and pool funds from ADB and RGOB through DPA, following Bhutan's country system, which is well-established and robust.

39. Project Director and Project Manager of PMU and PIU, both under CDCL will be responsible for (i) preparing disbursement projections; (ii) requesting budgetary allocations for counterpart funds; (iii) collecting supporting documents; and (iv) preparing withdrawal applications. CDCL and DHI are responsible for reviewing the prepared withdrawal applications, obtaining project account statements, and submitting them to Department of Public Accounts (DPA). DPA will be responsible for obtaining account statements of imprest account and submitting withdrawal applications to ADB.

40. The total outstanding advance to the imprest account should not exceed the estimate of ADB's share of expenditures to be paid through the imprest account for the forthcoming 6 months, or 10% of the loan or grant amount, whichever is less. CDCL may request initial and additional advances to the imprest account based on an estimate of expenditure sheet setting out the estimated expenditures to be financed through the account for the forthcoming 6 months.⁴ Supporting documents should be submitted to ADB or retained by the borrower in accordance with ADB's Loan Disbursement Handbook (2015, as amended from time to time) when liquidating or replenishing the imprest account.

41. **Project account.** CDCL will open a project account at the Bank of Bhutan. The Bank of Bhutan is the country's oldest and largest bank, and has substantial experience with executing foreign and local currency transactions, issuing and administering letters of credit (L/C), handling a large volume of transaction, issuing detailed monthly bank statements promptly and providing other relevant banking services. Payments to contractors, suppliers and service providers will be made from the project account at the request of the PMU. DHI will also transfer its counterpart fund contributions to this account.

42. **Reconciliation of imprest and project accounts.** The PMU will be responsible for monthly reconciliation of the project accounts and provision of supporting documents for withdrawal applications to ADB for liquidation or replenishment of each project account. DPA is responsible for the reconciliation of the imprest accounts with project accounts before submitting withdrawal applications to ADB.

43. **Applicable disbursement procedures.** The use of imprest account procedures have been adopted for previous ADB-funded projects in the country, following the established government budget and fund management system, with which the Executing Agency is familiar.

44. **Statement of expenditure procedure.**⁵ The SOE procedure may be used for reimbursement of eligible expenditures or liquidation of advances to the imprest account(s). Supporting documents and records for the expenditures claimed under the SOE should be maintained and made readily available for review by ADB's disbursement and review missions, upon ADB's request for submission of supporting documents on a sampling basis, and for independent audit.

45. Before the submission of the first withdrawal application, the borrower should submit to ADB sufficient evidence of the authority of the person(s) who will sign the withdrawal applications on behalf of the government, together with the authenticated specimen signatures of each authorized person. The ceiling of the SOE procedure is the equivalent of \$100,000 per

⁴ ADB. 2015. Loan Disbursement Handbook. Appendix 10B.

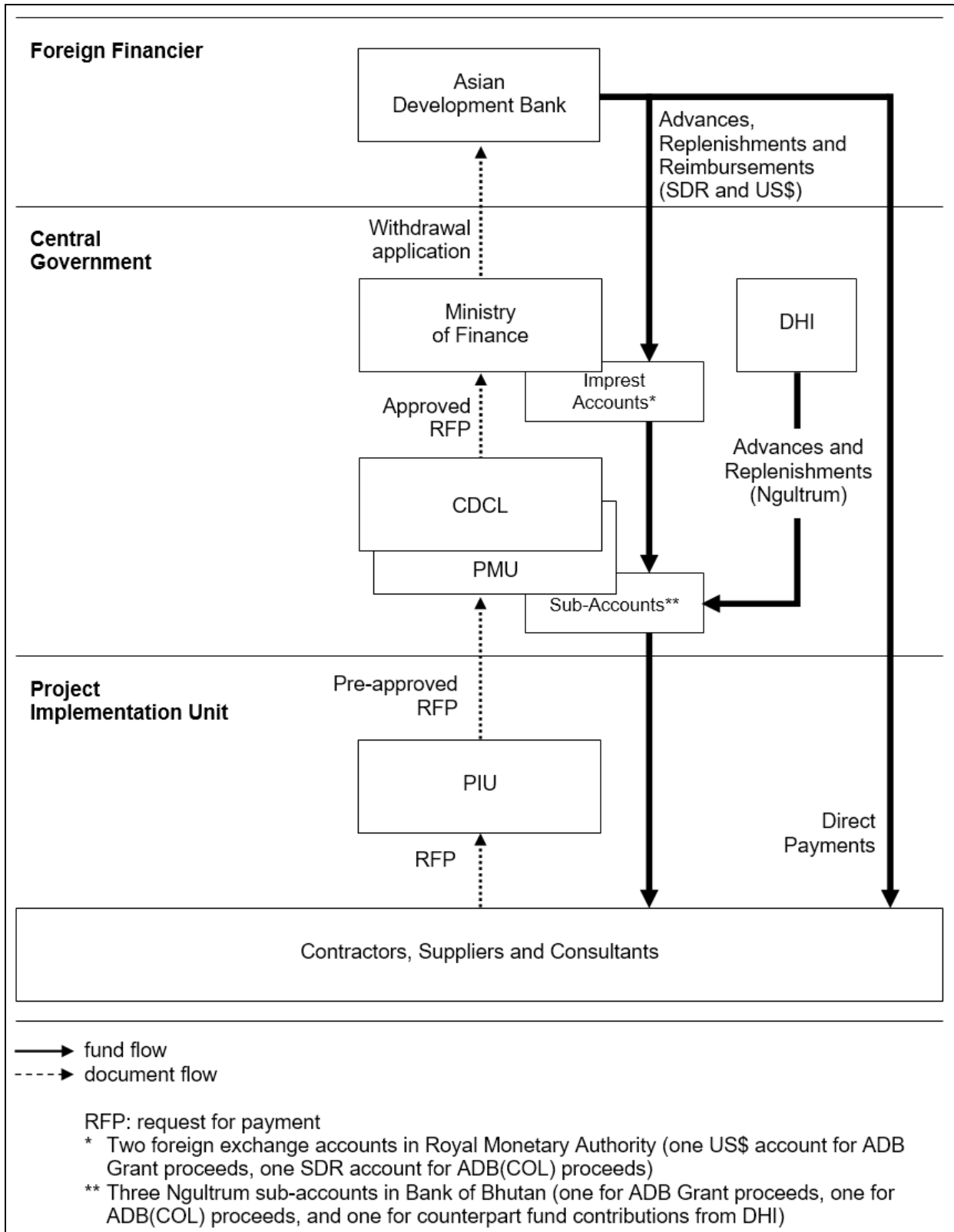
⁵ SOE forms are available in Appendix 9B and 9C of ADB's *Loan Disbursement Handbook* (2015, as amended from time to time).

individual payment.⁶ Individual payments below this amount should be paid through the imprest fund procedure, unless otherwise accepted by ADB.

46. Withdrawal applications and supporting documents will demonstrate, among other things that the goods, and/or services were produced in or from ADB members, and are eligible for ADB financing.

⁶ For project loans, normally the ceiling is not exceeding \$100,000 per individual payment (section 9.18 of the *Loan Disbursement Handbook*).

Figure 2: Fund Flow Diagram



Source: Asian Development Bank.

V. RISK DESCRIPTION AND RATING

47. The inherent financial management risk of the project is rated “medium”, mainly because of lack of experience of CDCL with the financial management of ADB-financed projects (Table 3). Overall control risk was rated “low” because of CDCL’s generally good financial systems and the presence of adequate internal and external controls. The overall financial management risk of the project, after risk mitigation measures, was also rated “low”.

Table 3: Financial Management and Internal Control Risks Assessment (FMICRA)

Risk Description	Risk Assessment*	Risk Mitigation Measures
INHERENT RISK		
1. Country-Specific Risks: (i) lack of skills in PFM in general, (ii) limited internal control and internal audit capability at all levels, and (iii) inadequate funding of O&M	M	ADB to (i) work with other development partners to strengthen controls, (ii) build up the capacity of RAA further, and (iii) build the capacity of organizations that consistently feature as the worst offenders in the audit reports.
2. Entity-Specific Risks: CDCL has no direct expertise in implementing ADB projects.	M	ADB to provide training to CDCL internal auditor, financial managers, accountants and PMU staff involved in financial management.
Overall Inherent Risk	M	
CONTROL RISK		
1. Funds Flow Risk: potential delays in reconciliation of project account with imprest accounts, resulting in delayed preparation of withdrawal applications.	M	RGoB to request DPA to reconcile project sub-accounts with imprest accounts at RMA.
2. Internal Control Risk: no specific risk identified (CDCL has a well-established system of internal controls that appear to function adequately)	L	(none)
3. Internal Audit Risk: Internal Audit Section in CDCL is relatively new (set up in 2015) and small (one full-time employee)	M	(i) CDCL to recruit two additional full-time employees for the Internal Audit Section, one of whom to have an internal audit certification by the Institute of Internal Auditors (IIA) or equivalent, and (ii) include PTDP in the internal audit work plan at least once during project implementation
4. External Audit Risk: Delay in the submission of the audited project financial statements	L	RGoB to request RAA that external audit of PTDP to be included in its annual work plan.
5. Reporting and Monitoring Control Risk: no specific risk identified (CDCL uses an accrual-based based double entry system in line with Financial Rules and Regulations, with annual financial statements prepared and regular progress reporting).	L	(none)
6. Information Systems Risk: no specific risk identified (CDCL uses a computerized accounting information system, the output of which is adjusted manually for producing tax reports and inputs for consolidated financial statements at holding level).	L	(none)
Overall Control Risk	L	
OVERALL RISK	L	

Source: ADB (2016).

H = High; S = Substantial; M = moderate; L = low

VI. PROPOSED TIME-BOUND ACTION PLAN

48. The FMICRA identified a series of potential risk events. These risks events, and the suggested actions to mitigate their impacts, are listed in the proposed time-bound action plan below (Table 4). ADB discussed the proposed plan with DHI on 19 January 2017, and the Executing Agency in principle agreed to its implementation.

Table 4: Proposed Action Plan to Address Financial Management Issues

Potential Risk Event	Suggested Action	Target Date for Implementation	Responsibility
Funds Flow Arrangements			
If GOB would re-lend the ADB loan to DHI in US Dollar instead of Ngultrum, this would reduce the project's limited financial viability.	GOB to confirm that it will take on foreign exchange rate risks by re-lending ADB loan to DHI in Ngultrum instead of US Dollar.	None (MOF has confirmed that it will on-lend the ADB loan to DHI in Ngultrum).	MOF
Delays in reconciliation of project account with imprest accounts, resulting in delayed withdrawal applications	GOB to confirm that DPA will oversee reconciling project account with imprest accounts at RMA.	None (MOF has confirmed that DPA will be responsible for reconciling project accounts).	MOF
Staffing			
Proposed PMU is not familiar with ADB procedures	Provide training to PMU and CDCL staff in ADB procedures	December 31, 2017	ADB, CDCL
Financial management staff of CDCL is not familiar with ADB disbursement procedures	Recruit an accountant for the PMU or assign a dedicated accountant from CDCL staff	December 31, 2017	ADB, CDCL
Budgeting			
Potential delays in the provision of counterpart funds reserved for the project if GOB unexpected requests these funds for other government projects.	GOB to confirm that DHI counterpart fund contributions to PTDP may not be diverted to other purposes after having been approved.	December 31 of every year	GOB
Auditing			
Internal Audit Section is relatively new	(i) Recruit an additional internal auditor, and (ii) include PTDP at least once during project implementation in the work plan of the Internal Audit Section	(i) December 31, 2017, and (ii) December 31 of the year in which PTDP is included in the workplan	CDCL
Delay in the submission of audited project financial statements	GOB to request RAA that external audit of PTDP to be included in its annual work plan at least once during implementation of PTDP.	December 31 of the year in which PTDP is included in the work plan	GOB

Source: ADB, based on discussions with CDCL (2016).

VII. SUGGESTED FINANCIAL MANAGEMENT COVENANTS

49. With respect to the financial management of PTDP, it is suggested that CDCL will ensure that the following conditions are met:
- (i) Prepare and submit audited project financial statements to ADB within 6 months of the end of the financial year. These shall be prepared in accordance with International Accounting Standards and the government's prevailing regulations, and be disclosed in ADB's website conform the Bank's *Public Communications Policy* (2011). ADB reserves the right to commission an independent audit if the project audit is substantially delayed or to confirm that the share of ADB's financing is used in accordance with ADB's policies and procedures.
 - (ii) Prepare and submit to ADB, annual contract awards and disbursement projections at least one month before the start of each financial year.
 - (iii) Ensure that adequate counterpart fund contributions are allocated to the project in a timely manner.
 - (iv) Prepare an annual budget for PTDP for submission to DHI based on the project implementation plan for the next year, as well as a rolling three-year budget.

All documents to be submitted to ADB shall be prepared in English.

50. To monitor compliance with loan covenants, ADB and the government will jointly undertake reviews of the project at least twice a year. These reviews will include a review of financial management and procurement arrangements. The reviews are to assess progress in each component, identify issues and constraints, and determine necessary remedial actions. A mid-term review will be conducted during the third year of implementation. The mid-term review will (i) review the scope, design and implementation arrangements and identify adjustments required, (ii) assess progress of the project implementation against performance indicators, and (iii) recommend changes in the design or implementation arrangements, if necessary.

VIII. CONCLUSIONS

51. **Suitability of CDCL for financial management of ALTPD.** The government has appointed the Construction Development Corporation Ltd. as the implementing agency of the proposed project. CDCL is a wholly-owned subsidiary of Druk Holding and Investments, which in turn is wholly owned by the government. CDCL intends to establish a dedicated Project Management Unit that would be responsible for the management (including financial management) of the implementation of PTDP. Although CDCL has no prior experience with implementing an ADB-financed project, it is nonetheless considered a suitable candidate from a financial management perspective. The project's overall financial management risk was rated "low", mainly because of moderate country-specific risks and entity-specific risks, and low overall control risks.

52. **Risk mitigation measures.** To further reduce financial management risks, a series of follow-up actions have been suggested. These are: (i) provision of training to selected CDCL and PMU staff in ADB financial management procedures, (ii) allocation of foreign exchange rate risk to the government, (iii) securing of resources for compliance audits by RAA, (iv) high-level guarantees for timely availability of sufficient counterpart fund contributions, and (v) strengthening of the Internal Audit Section.

ANNEX 1: Financial Management Assessment Questionnaire

TOPIC	RESPONSE	POTENTIAL RISK EVENT
1. Executing / Implementing Agency		
1.1 What is the entity's legal status / registration?	Incorporated under the Companies Act of the Kingdom of Bhutan, 2000 on December 7, 2009.	
1.2 How much equity (shareholding) is owned by the Government?	Construction Development Corporation Limited (CDCL) is wholly owned by Druk Holding and Investments (DHI) Limited, which is in turn fully owned by the Government.	
1.3 Obtain the list of beneficial owners of major blocks of shares (non-governmental portion), if any.	Not applicable (see 1.2).	
1.4 Has the entity implemented an externally-financed project in the past? If yes, please provide details.	<p>CDCL has implemented various externally funded projects. Some of these projects are:</p> <p>1. ADB-funded project:</p> <p>RNP-II project through Department of Road- Nu. 333.7 million Samdrupcholing-Samrang Road (24.15km) and Bridge Project implemented over 41 months (2012-2014).</p> <p>2. Projects funded by the Government of India:</p> <p>2.1 Designed and built 128 meter Pantang Bridge (in Zhemgang) at the cost of Nu. 271.4 million over 25 months</p> <p>2.2 Designed and built Hejo bridge (steel plate grider) at Nu.49.2m over 12 months</p> <p>2.3 Designed and constructed 30m span prestreed concrete I-gridder Dechencholing bridge-at the cost of Nu 45.6m over 14 months</p> <p>2.4 Designed and Constructed 18km Digala (Zhemgang) at the cost of Nu.185.2m over 24 months</p> <p>2.5 Designed and constructed Bongdingma road (800 m) and bridges (39m RCC) at the cost of Nu. 70.8m over 14 months</p> <p>2.6 Construction of 50m arch bridge in Samdrupjongkhar at the cost of Nu. 64.4 million (ongoing).</p>	
1.5 Briefly describe the statutory reporting requirements for the entity.	<ul style="list-style-type: none"> ▪ Half-yearly and annual filing of accounts to Department of Revenue and Custom ▪ Annual statutory audit ▪ Half yearly and annual accounts submission to DHI for the consolidation. ▪ Trade license is issued by Department of Trade under Ministry of Economic Affairs 	

TOPIC	RESPONSE	POTENTIAL RISK EVENT
	<ul style="list-style-type: none"> ▪ Comply with Companies Act and annual reporting to Registrar of the Companies. 	
1.6 Describe the regulatory or supervisory agency of the entity.	<p>Holding company. Druk Holding and Investments (DHI), the commercial arm of the Royal Government of Bhutan, was established in 2007 upon issuance of Royal Charter in 2007 "to hold and manage the existing and future investments of the Royal Government for the long-term benefit of the people of Bhutan". DHI, the largest and only government-owned holding company in Bhutan, has shares in 21 different companies operating in the manufacturing, energy, natural resources, financial, communication, aviation, trading and real estate sectors.</p> <p>Construction Development Board (CDB). CDCL is licensed by the CDB, which acts as a bridge between the private and public sectors; assists contractors in undertaking a more expansive part in the industry and ensure genuine contractors fair and equal access to the award of contracts as well as fair treatment in the execution of contracts.</p> <p>Royal Audit Authority (RAA). The statutory auditor of the company is approved by RAA, and the RAA also conducts compliance audit periodically.</p>	
1.7 What is the governing body for the project? Is the governing body for the project independent?	The Board and Management of CDCL is a governing body for the project.	
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>CEO: Mr. Phuntsho Gyeltshen Qualification: Master in Civil Engineering Experience: 27 years of job experience in the relevant fields</p> <p>Director of Engineering and Construction Department: Mr. Reezang Wangdi Qualification: Master in Structural Engineering Experience: 27 years of job experience</p> <p>Director of Hydropower Services Department: Mr. Karma Gayley Qualification: Master in Hydropower Development Experience: 15 years</p> <p>Project Manager for PTDP: Mr. Tshering Dupchu Qualification: Master in Project Management Experience: 18 years</p>	

TOPIC	RESPONSE	POTENTIAL RISK EVENT
	<p>Chief Architect: Mrs Kamala Thapa Qualification: Masters in Urban Management and Development Experience: 15 years</p> <p>Project Engineer: Mr. Kamal Dhakal Qualification: MSc. in Water Management Experience: 13 years</p>	
1.9 Does the entity have a Code of Ethics in place?	Yes. The code is incorporated in CDCL's Service Rules and Regulations of 2016.	
1.10 Describe (if any) any historical issues reports of ethics violations involving the entity and management. How were they addressed?	There is no major breach of code of ethics involving the entity and management except one corruption case against former CEO in 2009. The matter was forwarded to the anti-corruption commission, which, in turn, forwarded the case of the Office of the Attorney General for prosecution. At the time of writing, the case is in court and a verdict is yet to be issued.	
2. Funds Flow Arrangements		
2.1 Describe the (proposed) project funds flow arrangements in detail, including a funds flow diagram and explanation of the flow of funds from ADB, government and other financiers, to the government, EA, IA, suppliers, contractors, ultimate beneficiaries, etc. as applicable.	The proposed ADB loan and grant would be channeled to the Royal Government of Bhutan (RGoB) in US\$, and passed on in Ngultrum to DHI at the same conditions. DHI would provide funds from ADB loan and DHI equity to CDCL for the deposit work undertaken. DHI would repay the ADB loan through RGoB at the same conditions as the underlying ADB loan except for the currency (Ngultrum instead of US\$).	If RGoB would pass on FOREX risks to CDCL, this would further reduce the project's already limited financial viability
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 Government is expected to on-lend ADB Loan to DHI at same terms and conditions. Subsequently, DHI will disburse the loan to CDCL in the form of a deposit for works, not as a capital injection. If the proposed arrangement is approved, CDCL would consider this satisfactory.	If RGoB would apply a surcharge to the interest rate, this would further reduce the project's already limited financial viability
2.3 Are the disbursement methods appropriate?	Yes.	
2.4 What have been the major problems in the past involving the receipt, accounting and/or administration of funds by the entity?	There were no major problems in the past involving the receipt, accounting and/or administration of funds by the entity.	

TOPIC	RESPONSE	POTENTIAL RISK EVENT
2.5 In which bank will the Imprest Account (if applicable) be established?	Bank of Bhutan.	
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 (L/C)? ▪ Handling a large volume of transaction? ▪ Issuing detailed monthly bank statements promptly? 	The Bank of Bhutan was established in May 1968, and is the country's oldest and largest bank. Bank of Bhutan operates as an authorized dealer of foreign exchange in Bhutan and has been handling all the services as mentioned. Website link: http://www.bob.bt/	
2.7 Is the ceiling for disbursements from the imprest account and SOE appropriate/required?	For the imprest account, maximum advance shall be computed based on the requirements for the next 6 months. For SOE, while CDCL has [low/moderate] financial management risk, since they do not have experience in ADB disbursement procedures, a ceiling of \$ 100,000 is proposed for use of SOE procedures. This may be removed after the first year, based on APFS submitted and history if withdrawal applications.	
2.8 Does the (proposed) project implementing unit (PMU) have experience in the management of disbursements from ADB?	No. PMU does not have any experience in the management of disbursements from ADB.	Proposed PMU is not familiar with ADB procedures
2.9 Does the PMU have adequate administrative and accounting capacity to manage the imprest fund and statement of expenditure (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.	CDCL has adequate accounting and finance personnel to handle the project accounting headed by the Finance and Accounts General Manager. The Finance GM is a member of the Association with Chartered Certified Accountant (ACCA), UK. However, she and her staff do not have experience with ADB fund disbursement. The same accounts team will be responsible for fund management. Given their wide experience in managing funds for projects, the team members are expected to be able to cope up with new procedures	Financial management staff of CDCL is not familiar with ADB disbursement procedures
2.10 Is the entity exposed to foreign exchange risk? If yes, describe the entity's policy and arrangements for managing foreign exchange risk.	No, the foreign exchange risk is expected to be absorbed by Royal Government of Bhutan.	To be confirmed (see 2.1)
2.11 How are the counterpart funds accessed?	DHI will source its fund from its reserves. DHI's contribution of \$10 m was 2.6% of DHI's consolidated reserves in 2015.	
2.12 How are payments made from the counterpart funds?	DHI will provide the funds to CDCL who in turn will make the payment to the project.	

TOPIC	RESPONSE	POTENTIAL RISK EVENT
2.13 If project funds will flow to communities or NGOs, does the PMU have the necessary reporting and monitoring arrangements and features built into its systems to track the use of project proceeds by such entities?	Not applicable; funds will not flow to the NGOs or communities	-
2.14 Are the beneficiaries required to contribute to project costs? If beneficiaries have an option to contribute in kind (in the form of labor or material), are proper guidelines and arrangements formulated to record and value the labor or material contributions at appraisal and during implementation?	No.	-
3. Staffing		
3.1 What is the current and/or proposed organizational structure of the accounting department? Attach an organization chart.	See 1.8 above.	
3.2 Will existing staff be assigned to the project, or will new staff be recruited?	Where possible, existing staff will be assigned to the project. Where additional expertise is required recruitment will be made (a River training expert, geologist and chief engineer were envisaged at the time of writing).	
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 existing accounting staff.	GM Finance: Member of the Association of Chartered Certified Accountants, UK Project Accounts Manager: Bachelor in Commerce Project Accountant: Diploma in Financial Accounting (CVs have been made available to ADB)	
3.4 Is the project finance and accounting function staffed adequately?	Yes. CDCL is ready to assign more Accounts Officers for this project if need be. CDCL is planning to set up PMU.	
3.5 Are the project finance and accounting staff adequately qualified and experienced?	Yes.	
3.6 Are the project finance and accounting staff trained in ADB procedures, including the disbursement guidelines (i.e., LDH)?	No.	No experience with ADB procedures
3.7 What is the duration of the contract with the project finance and accounting staff?	GM Finance: contract of 4 years. Project Accounts Manager: regular staff. Project Accountant: regular staff.	
3.8 Identify any key positions of project finance and accounting staff not	All key positions of project finance and accounting staffs are filled.	

TOPIC	RESPONSE	POTENTIAL RISK EVENT
contracted or filled yet, and the estimated date of appointment.		
3.9 For new staff, describe the proposed project finance and accounting staff, including job title, responsibilities, educational background and professional experience. Attach job descriptions.	No new staff are expected to be recruited soon.	
3.10 Does the project have written position descriptions that clearly define duties, responsibilities, lines of supervision, and limits of authority for all the officers, managers, and staff?	Yes, a project implementation manual and procedures are in place.	
3.11 What is the turnover rate for finance and accounting personnel (including terminations, resignations, transfers, etc.)?	About 10% (2015).	
3.12 What is training policy for the finance and accounting staff?	It is governed by the internal service rules and regulations (2016).	
3.13 Describe the list of training programs attended by finance and accounting staff in the last 3 years.	<ul style="list-style-type: none"> ▪ IFRS training in Sri Lanka (10 days) ▪ Royal Audit Authority (RAA) system familiarization in Thimphu (2 days). ▪ Training on effective financial decision making in Nepal. 	
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?	Yes. Currently, CDCL is using Tally ERP 9 software, and is expected to use the same software for the project.	
4.3 Is the chart of accounts adequate to properly account for and report on project activities and disbursement categories? Obtain a copy of the chart of accounts.	The existing chart of accounts is adequate. However, it is in the process of being updated to incorporate the projects and activities of DHI-INFRA.	
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	Yes, they reconciled monthly and any differences are resolved immediately.	

TOPIC	RESPONSE	POTENTIAL RISK EVENT
actions taken to resolve reconciliation differences?		
4.6 Describe the EA's policy for retention of accounting records including supporting documents (e.g., ADB's 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?	<p>The retention of accounting records of Executing Agency is governed by the Section 10.1 Preservation of Financial Records of Financial and Accounting Manual of Royal Government of Bhutan, Ministry of Finance. Per the Manual, the minimum period for preservation of accounting records is 24 months for records of release of funds and BRS, 12 months after liquidation of the borrowings for loan agreements, 12 months after the completion of the project for grant agreements, and 36 months for other books of accounts. The minimum period is reckoned from the date of completion of audit by the RAA and settlement of audit observations pertaining to the contents of the records.</p> <p>Website link: http://www.mof.gov.bt/publications/manuals/</p>	
4.7 Describe any previous audit findings that have not been addressed.	The external auditor recommended CDCL to undertake re-valuation of assets and physical verification of inventories. CDCL has since implemented these recommendations.	
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; (iii) custody of assets involved in the transaction; (iv) reconciliation of bank accounts and subsidiary ledgers?	Yes.	
4.9 Are the functions of ordering, receiving, accounting for, and paying for goods and services appropriately segregated?	Yes	
Budgeting System		
4.10 Do budgets include physical and financial targets?	Yes.	
4.11 Are budgets prepared for all significant activities in sufficient detail to allow meaningful monitoring of subsequent performance?	Yes.	

TOPIC	RESPONSE	POTENTIAL RISK EVENT																
4.12 Are actual expenditures compared to the budget with reasonable frequency? Are explanations required for significant variations against the budget?	Yes.																	
4.13 Are approvals for variations from the budget required (i) in advance, or (ii) after the fact?	Approvals for variations from budget are required in advance.																	
4.14 Is there a ceiling, up to which variations from the budget may be incurred without obtaining prior approval?	Without prior approval, no expenditures can exceed the budget.																	
4.15 Who is responsible for preparation, approval and oversight/monitoring of budgets?	The Head of Finance and Accounts is responsible for preparation of budgets. The Head will first compile and present the budget to the management for endorsement. After endorsement, it will be presented to the CDCL Board for approval.																	
4.16 Describe the budget process. Are procedures in place to plan project activities, collect information from the units in charge of the different components, and prepare the budgets?	By the end of September, GM Finance will send a notice for budget preparation; by the end of October, GM Finance will prepare the budget and submit to the management for endorsement. After that, it will be presented to the CDCL Board for approval.																	
<p>4.17 Are the project plans and budgets 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 style="text-align: right;">Figures in Million Ngul</p> <table border="1" data-bbox="696 1171 1289 1360"> <thead> <tr> <th>Year</th> <th>Budgeted</th> <th>Actual</th> <th>Variance</th> </tr> </thead> <tbody> <tr> <td>2013</td> <td>557.54</td> <td>523.40</td> <td>34.14</td> </tr> <tr> <td>2014</td> <td>506.27</td> <td>476.86</td> <td>29.42</td> </tr> <tr> <td>2015</td> <td>534.43</td> <td>435.05</td> <td>99.38</td> </tr> </tbody> </table> <p>Note: Actual is actual expenses as per P&L audited Account</p> <p>There is no major mid-year revision for planned activities. However, some ad hoc government projects are accommodated in between. In 2015, these included the development of commercial space at Thimphu Techpark, the construction of a <i>changjiji</i> bus shelter, and the refurbishment of Jigme Dorji Wangchuk national referral hospital.</p> <p>No</p> <p>No</p>	Year	Budgeted	Actual	Variance	2013	557.54	523.40	34.14	2014	506.27	476.86	29.42	2015	534.43	435.05	99.38	<p>Potential delays in the provision of counterpart funds reserved for the project if RGoB unexpected requests these funds for other government projects.</p>
Year	Budgeted	Actual	Variance															
2013	557.54	523.40	34.14															
2014	506.27	476.86	29.42															
2015	534.43	435.05	99.38															

TOPIC	RESPONSE	POTENTIAL RISK EVENT
Payments		
4.18 Do invoice-processing procedures require: (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 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?	(i) Yes, it requires copies of purchase orders and receiving reports from procurement or material management unit. The procurement person will check the invoice quantities and unit rates with those on the receiving reports. (ii) Yes (iii) Yes (iv) Yes (v) Yes	
4.19 Are all invoices stamped PAID, dated, reviewed and approved, recorded/entered into the system correctly, and clearly marked for account code assignment?	All invoices are properly cross-checked for arithmetical errors. After that, the system entry for the payment voucher is passed for payment. After payment, the receipt is attached.	
4.20 Do controls exist for the preparation of the payroll? Are changes (additions/deductions/modifications) to the payroll properly authorized?	The Finance and Accounts department run the payroll and makes the payment. However, any additions and deductions must be authorized by the HR Department.	
Policies and Procedures		
4.21 What is the basis of accounting (e.g., cash, accrual) followed (i) by the entity? (ii) By the project?	The basis of accounting followed by CDCL is accrual.	
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?	Bhutan Accounting Standards (BAS), which are equivalent to International Financial Reporting Standards (IFRS).	
4.23 Does the project have adequate policies and procedures manual(s) to guide activities and ensure staff accountability?	Based on an existing Project Implementation Manual (PIM), Project Implementation Procedures (PIPs) for will be developed for the project.	
4.24 Is the accounting policy and procedure manual updated regularly and for the project activities?	As per the need basis and BAS/IFRS.	
4.25 Do procedures exist to ensure that only authorized persons can alter or establish a new accounting policy or procedure to be used by the entity?	Yes. New accounting policies must be approved by the CDCL board.	
4.26 Are there written policies and procedures covering all routine financial management and related	CDCL is following BAS/IFRS and other relevant rules of the Financial and Accounting Manual of the Royal Government of Bhutan.	

TOPIC	RESPONSE	POTENTIAL RISK EVENT
administrative activities?		
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?	DHI Corporate Governance Code, Procurement Manual and Internal Service Rules clearly define the conflict of interest and related party transactions.	
4.28 Are manuals distributed to appropriate personnel?	Yes. Appropriate personnel are expected to maintain softcopies of this documents.	
4.29 Describe how compliance with policies and procedures are verified and monitored.	<p>The internal auditor conducts a system and compliance audit twice a year. A statutory auditor (Chartered Accountant) approved by the Royal Audit Authority conducts an accounting audit once a year, at the end of accounting year.</p> <p>Royal Audit Authority (RAA) conducts a compliance audit based on their schedule and availability (generally once every 1 to 4 years). The Department of Revenue and Custom conducts a tax audit, also once every two years.</p>	
Cash and Bank		
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.	<p>Authorized Bank Signatories:</p> <p>Phuntsho Gyeltshen: CEO</p> <p>Pema Wangchuk: Director, Corporate Service Department</p> <p>Dechen Wangmo: General Manager, Finance and Accounts</p> <p>Premika Kr. Tamang: Finance Manager</p> <p>Above signatories have access to company's internet banking password but are authorized for viewing purpose only, not for transactions.</p>	
4.31 Does the organization maintain an adequate and 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?	<p>Bill Collection Process: Accountant collects the payment and deposits on the day of receipt.</p> <p>Cash handling procedures: There are not any transactions that involves cash transactions except in the sale of tender documents and imprest money for the site engineers.</p> <p>The sale of tender documents will be deposited after the closure of tender sale to the bank by the accountant. Regarding the imprest money handled by the site engineers which are meant for ad hoc purchases for construction sites, Site engineers must settle imprest funds with the</p>	

TOPIC	RESPONSE	POTENTIAL RISK EVENT
	Finance and Accounts Department of the Head Office and recoup regularly depending upon the location of the project site (twice or thrice a month).	
4.33 Are bank accounts reconciled on a monthly basis? Or more often? Is cash on hand physically verified, and reconciled with the cash books? With what frequency is this done?	The bank account is reconciled monthly. Almost all transactions are done by bank transfer except in case of imprest money and sale of tender documents which are reconciled and settled immediately.	
4.34 Are all reconciling items approved and recorded?	Yes, by the GM Finance and Finance Manager	
4.35 Are all unusual items on the bank reconciliation reviewed and approved by a responsible official?	Yes, by the GM Finance and Finance Manager	
4.36 Are there any persistent/non-moving reconciling items?	No, not any as of now.	
4.37 Are there appropriate controls in safekeeping of unused cheques, USB keys and passwords, official receipts and invoices?	Yes, all the unused cheques/official receipts are kept in the safe box by the safe box custodian (Accountant). The passwords are kept by the General Manager of Finance.	
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.	CEO, Director, Corporate Service, GM Finance, GM Corporate Service and Finance Manger possess internet banking passwords. None of the above mentioned personnel has the authority for online transactions except for the viewing purpose only for the purpose of internet banking.	
Safeguard over Assets	Asset Management Head	
4.40 What policies and procedures are in place to adequately safeguard or protect assets from fraud, waste and abuse?	Currently, CDCL has a fixed assets management system (FAMS) in place to update and track the company's assets. In addition, BAS/IFRS 16 and 36 provide the standards to protect the assets from fraud, waste and abuse. The internal auditor is required to conduct a physical audit of assets quarterly. At present, physical verification of project assets has been carried out twice (at mid-term and at the end of the project).	
4.41 Does the entity maintain a Fixed Assets Register? Is the register updated monthly? Does the register record ownership of assets, any assets under lien or encumbered, or have been pledged?	Yes, through FAMS. It is updated as and when required or annually, whichever is early.	

TOPIC	RESPONSE	POTENTIAL RISK EVENT
4.42 Are subsidiary records of fixed assets, inventories and stocks kept up to date and reconciled with control accounts?	The subsidiary records of fixed assets, inventories and stocks are up to date and all the fixed assets are appropriately labelled and reconciled with control accounts.	
4.43 Are there periodic physical inventories of fixed assets, inventories and stocks? Are fixed assets, inventories and stocks appropriately labeled?	Physical inventories are carried out twice a year. Yes.	
4.44 Are the physical inventory of fixed assets and stocks reconciled with the respective fixed assets and stock registers, and discrepancies analyzed and resolved?	The Fixed Asset Management Division is currently carrying out the physical verification of assets and inventories. Additionally, the Internal Auditor also carries out physical verification of assets, especially for projects.	
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?	Disposal of assets is done through open auction after obtaining approval from the Board, based on government policies and guidelines on auctions, and the disposal of each assets is approved and recorded. Also, steps are immediately taken to locate lost, or repair broken assets.	
4.46 Are assets sufficiently covered by insurance policies?	All major fixed assets are insured except office equipment.	
4.47 Describe the policies and procedures in identifying and maintaining fully depreciated assets from active assets.	Fully depreciated assets (book value 1 assets) are identified but not maintained. However, IFRS 36 allows CDCL to revalue the assets and use these accordingly.	
<i>Other Offices and Implementing Entities</i>		
4.48 Describe any other regional offices or executing entities participating in implementation.	CDCL has a site office in Phuentsholing. If PTDP would be approved, the company plans to set up the full-fledged project office with accounting, administrative and engineering personnel.	
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.	After project, accounting staff will be sent to the Phuentsholing Office. The project accountant will look after the daily record keeping of the project transactions. The Project accountant will update and provide the monthly statement of accounts to the head office.	
4.50 Has the project established segregation of duties, controls and procedures for flow of funds and financial information, accountability, and reporting and audits in relation to the other offices or entities?	The segregation of duties, controls and procedures for flow of funds and financial information, accountability and reporting and audits are clearly laid out in the project implementation Guidelines.	
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	The information flow among different offices/implementing agencies are clearly laid down in the internal service rules and regulations and project implementation guidelines. The	

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head office use the same accounting and reporting system?	accounting system are followed in all CDCL offices.	
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.	The monthly reconciliations between head office and site/branch office are carried out by the head office finance and accounts department. Internal Audit Team carries out the auditing of the project twice a year.	
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.	For the purchase of adhoc items at the site, project engineers are entitled to maximum of Nu 40,000. The site engineer needs to settle this account with all the supporting documents and report to the head office Finance and Accounts.	
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, and undisbursed balances? Are the records consistent with physical outputs/deliverables of the contract?	Yes, CDCL maintains the contract wise accounting records to indicate the gross value of the project. Most the cases the records are consistent with the physical outputs/deliverables of the contract.	
4.55 If contract records are maintained, does the agency reconcile them regularly with the contractor?	-	
Other		
4.56 Describe 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?	The core business of CDCL is the construction of bridges, roads, tunnels and similar structures – all of which are projects of CDCL itself. Therefore, the internal auditor conducts audits of the company's projects (these are indirect system or control audits) twice a year and any discrepancies found are reported to the Board Audit Committee Meeting. The employees may choose to complaint directly to the management or board or Anti-Corruption Commission of Bhutan.	
5. Internal Audit		
5.1 Is there an internal audit (IA) department in the entity?	CDCL has established an Internal Audit Section as per the Corporate Governance Code issued by DHI.	
5.2 What are the qualifications and experience of the IA staff?	Currently, the Internal Audit Section consists of one employee only. He is a Bachelor of Commerce with six years of practical work experience in the internal audit field. He has audited many Government of India funded projects. Two additional internal auditors are expected to join soon.	

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5.3 To whom does the head of the internal audit report?	The Internal Auditor reports administratively to the Chief Executive Officer and functionally to the Audit Committee of the Board of Directors.	
5.4 Will the internal audit department include the project in its annual work program?	The Internal Audit section undertakes a programme of work, based on a strategy authorized by the company on the advice of the Audit Committee. The Internal Audit section prepares annual work plan which includes the projects which is reviewed semi-annually by the Board Audit Committee	
5.5 Are actions taken on the internal audit findings?	Internal audit findings are discussed starting from the concerned individual, divisions, departments, management and finally in the Board's Audit Committee. The accountabilities are also fixed on the concerned officials who are charged with incorrect bookings of transactions, lack of physical verification of assets and other lapses.	
5.6 What is the scope of the internal audit program? How was it developed?	The scope of the internal audit is governed by the Internal Audit Terms of Reference. All activities of CDCL fall within the remit of the internal audit. The Internal Audit section will consider the adequacy of controls necessary to secure propriety, economy, efficiency and effectiveness in all areas. The scope of Internal Audit work covers all operational and management controls and compliance and is not restricted to the audit of systems and controls necessary to form an opinion on the financial statements.	
5.7 Is the IA department independent?	All Internal Audit activities are free of influence from any element in the organization, including matters of audit selection, scope, procedures, frequency, timing, or report content to permit maintenance of an independent and objective mental attitude necessary in rendering reports.	
5.8 Do they perform pre-audit of transactions?	No. The Internal Audit only covers post-audit of transactions and is not involved in operational activities	
5.9 Who approves the internal audit program?	Annually, the Internal Audit submits to senior management and the Audit Committee a summary of the audit work schedule, staffing plan, and budget for the following financial year, for approval by the chairperson of Board Audit Committee.	
5.10 What standards guide the internal audit program?	The internal audit program is guided by the Internal Audit Terms of Reference (2016) based on the Corporate Governance Code developed by Druk Holding and Investments, of which CDCL is a wholly-owned subsidiary. The Board Audit Committee charter is also drafted and is expected to be approved by the Board in Q4 of	

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	2016.	
5.11 How are audit deficiencies tracked?	The Head of Internal Audit periodically assess whether the purpose, authority, and responsibility, as defined in the ToR, continue to be adequate to enable the internal audit function to accomplish its objectives. The result of this periodic assessment should be communicated to senior management and the Board of Directors through the Audit Committee.	
5.12 How long have the internal audit staff members been with the organization?	The Internal Audit section was introduced in 2015 and accordingly the current internal auditor has been with the company for about one year. However, he has prior professional work experience of about six years in the internal audit field.	
5.13 Does any of the internal audit staff have an IT background?	No. The current internal auditor does not have IT background but is capable of operating basic Microsoft Office functions and simple accounting software effectively.	
5.14 How frequently does the internal auditor meet with the audit committee without the presence of management?	As required by the Corporate Governance Code of DHI, there should not be fewer than four Board Audit Committee meetings in any one year. In 2016, three Board Audit Committee meetings were conducted and one more is scheduled for Q4.	
5.15 Has the internal auditor identified / reported any issue with reference to availability and completeness of records?	No major issues with regard to availability and completeness of the records have been observed. Minor deficiencies concerned incorrect bookings and missing documents; these were reported and resolved.	
5.16 Does the internal auditor have sufficient knowledge and understanding of ADB's guidelines and procedures, including the disbursement guidelines and procedures (i.e., LDH)?	The internal auditor does not have experience of working with ADB projects.	Internal auditor not familiar with ADB procedures
6. External Audit – entity level		
6.1 Is the entity financial statement audited regularly by an independent auditor? Who is the auditor?	The company's financial statements are audited annually by the statutory auditors as approved by the Royal Audit Authority. Currently, the statutory auditor of the company is M/s T.K Ghose & Company. The Royal Audit Authority (RAA) also conducts a compliance audit depending upon its schedule and availability (once every 1-4 years). The Department of Revenue conducts a tax audit once every two years.	
6.2 Are there any delays in audit of the entity? When are the audit reports issued?	To date, CDCL has not experienced delays in audit. The draft audit report is presented in the audit exit meeting and the final report is made	

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	available within 1-2 weeks.	
6.3 Is the audit of the entity conducted in accordance with the International Standards on Auditing, or the International Standards for Supreme Audit Institutions, or national auditing standards?	A Statutory Audit (Financial Accounting) is conducted as per International Auditing Standards. However, the compliance audit by the RAA is conducted to audit compliance with rules and regulations of the Company and RGoB with respect to procurement and payment. A periodic tax/revenue audit is conducted by Department of Revenue to assess compliance with the Income Tax Act of Bhutan (2000).	
6.4 Were there any major accountability issues noted in the audit report for the past three years?	No.	
6.5 Does the external auditor meet with the audit committee without the presence of management?	Yes, the external auditor meets with the Audit Committee without the presence of management.	
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 of non-audit engagements, relative to the value of audit services?	No.	
6.7 Has the external auditor expressed any issues on the availability of complete records and supporting documents?	No.	
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)?	No.	
6.9 Are there any material issues noted during the review of the audited entity financial statements that were not reported in the external audit report?	No.	
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?	Yes. The internal auditor generally audits all project accounts twice a year (such as the construction of the Dechenchoeling, Hejo, and Tang bridges). As PTDP is a public-funded project, the RAA will be responsible for preparing an external audit of the project accounts (especially compliance audit)	
6.11 Are there any recommendations made by the auditors in prior project audit reports or management letters that have not yet been implemented?	Not as of now.	

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6.12 Is the project subject to any kind of audit from an independent governmental entity (e.g. the supreme audit institution) in addition to the external audit?	Yes, RAA Audit does the project audit as explained in section 6.10	
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?	Yes, the project will be audited along with other projects by statutory auditor as approved by RAA.	
6.14 Has the project auditor identified any issues with the availability and completeness of records and supporting documents?	Yes, a qualified opinion with given on the financial report of 2015, because of incomplete recording of 1.22 acres of land and the pending completion of a physical verification of property and equipment.	
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)?	The Royal Audit Authority (RAA) has audited government agencies and companies involved in the management of ADB-funded projects for a considerable time. RAA has sufficient knowledge of guidelines and procedures specific to ADB.	RAA to be requested to include the project in its work plan.
6.16 Are there any recommendations made by the auditors in prior audit reports or management letters that have not yet been implemented?	No.	
[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?	No, to date CDCL has not availed of any long-term loan.	
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)?	No.	
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?	The financial statements are prepared twice (half-yearly and year end) to enable proper decision making.	
7.4 Does the entity reporting system need to be adapted for project reporting?	No.	
7.5 Has the project established financial management reporting responsibilities	No.	

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that specify the types of reports to be prepared, the report content, and purpose of the reports?		
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 generally prepared by automated systems. However, spreadsheets are used to make some adjustments as required by tax regulations, BAS/IFRS, etc.	
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?	No. Physical certification from the concerned site	
7.10 Does the entity have experience in implementing projects of any other donors, co-financiers, or development partners?	Yes. Refer to 1.4.	
8. Information Systems		
8.1 Is the financial accounting and reporting system computerized?	Yes. The company has implemented Tally ERP 9.	
8.2 If computerized, is the software off-the-shelf, or customized?	Off the shelf.	
8.3 Is the computerized software standalone, or integrated and used by all departments in the headquarters and field units using modules?	Standalone.	
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?	Manual entry.	
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?	Manual intervention.	
8.6 Can the system automatically produce the necessary project financial	Yes.	

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reports?		
8.7 Is the staff adequately trained to maintain the computerized system?	Yes.	
8.8 Do the management, organization and processes and systems safeguard the confidentiality, integrity and availability of the data?	Yes, as per the service manual and employee contracts.	
8.9 Are there back-up procedures in place?	The company has adequate safeguard measures of data and back-up facilities as required by the Company's Act.	
8.10 Describe the backup procedures – online storage, offsite storage, offshore storage, fire, earthquake and calamity protection for backups.	All the data and information are backed up manually. No online backup is available as of now.	