

FINANCIAL MANAGEMENT ASSESSMENT

EXECUTIVE SUMMARY

1. The financial management assessment (FMA) was conducted for the proposed Greater Male Environmental Improvement and Waste Management Project (GMEIWMP) in accordance with the Guidelines for the Financial Management and Analysis of Projects (2005), Financial Due diligence a Methodology Note (2009), and Financial Management Technical Guidance Note (2015) of the Asian Development Bank (ADB).¹ The FMA considered the financial management capacity of the Ministry of Environment and Energy (MEE) under the Republic of Maldives (RoM) and its Project Management Unit (PMU) in its role acting as the implementing agency (IA). The FMA focused mainly on fund flows, organization and staffing, accounting policies and procedures, internal controls, financial reporting and monitoring, internal and external audit, and information systems.

2. The MEE has considerable experience in implementing donors assisted projects including the ongoing Preparing Outer Islands for Sustainable Energy Development Project funded by ADB.² The PMU under MEE will be headed by a dedicated project director to be assisted by a team of technical and non-technical officials to manage GMEIWMP on full time basis.³ The PMU will be responsible for the day-to-day management of GMEIWMP, including but not limited to: (i) preparing an overall project implementation plan and detail work program; (ii) providing overall monitoring and guidance on the implementation; (iii) monitoring and supervising all management activities; (iv) preparing project progress and project completion reports; (v) financial planning and budgeting including contract awards and disbursements; and (vi) ensuring full compliance with ADB's resettlement, environmental, and other safeguard policies.

3. The major risk factors identified during the assessment that need to be addressed include:

- (i) delays in setting up dedicated PMU may hamper the project's timely and effective implementation;
- (ii) insufficient training on ADB procedures to the new staff in PMU may cause delays in day-to-day financial management of the project;
- (iii) occasional delays in the release of the government's counterpart funds may cause delays in the timely and efficient implementation of the project; and
- (iv) weak internal audit system in MEE and PMU may prevent them of not being aware of key risks.⁴

4. Despite the highlighted risks, the financial management arrangements are satisfactory given that MEE has significant experience in satisfactorily implementing a number of donor-funded projects. In addition, the Project Management Consultants (PMC), proposed to be recruited under GMEIWMP, will support MEE and its PMU in enhancing the financial management

¹ (i) ADB. 2005. Financial Management and Analysis of Projects. Manila. (ii) ADB. 2009. Financial Due diligence: A Methodology Note. Manila. (iii) ADB. 2015. Financial Management Technical Guidance Note. Manila.

² (i) ADB. 2014. Proposed Grant and Administration of Grant Republic of the Maldives: Preparing Outer Islands for Sustainable Energy Development Project. Manila. (ii) World Bank funded projects include the Maldives Environmental Management Project and the Maldives Clean Environment Project.

³ The proposed staffing of PMU includes (i) Project Director (part-time, Director General of Department), (ii) Project Manager, (iii) Procurement Specialist, (iv) Finance Specialist, (v) Safeguard Specialist, (vi) Civil Engineer, (vii) Information, Education and Communication (IEC) Specialist, and (viii) administrative assistant.

⁴ There is currently no operational internal audit function in MEE.

capacity. The overall risk assessment for the project is “Moderate”. The action plan for mitigating the foreseen risks includes the following measures:

- (i) commitment of the Ministry of Finance and Treasury (MOFT) and MEE to ensure the timely setting up of PMU with qualified staff;
- (ii) extending full training and capacity building support with the help of PMCs for enhancing the financial management capacity of PMU; and
- (iii) commitment from MOFT and MEE for timely allocation and disbursement of the government’s counterpart funds.

I. INTRODUCTION

5. This financial management assessment (FMA) was conducted in accordance with ADB’s Guidelines for the Financial Management and Analysis of Projects (2005), the Financial Due diligence: A Methodology Note (2009), and the Financial Management Technical Guidance Note (2015).

6. The FMA considered the capacity of MEE and its PMU, which will be responsible for overall management, supervision, and execution of GMEIWMP as the implementing agency (IA), including funds-flow arrangement, staffing, accounting and financial reporting system, financial information system, and internal and external auditing arrangements.

7. A key aspect of FMA is evaluating the risks associated with financial arrangements of GMEIWMP. ADB’s principal concern is to ensure that project funds are used economically and efficiently for the purpose intended. In support of this, it seeks assurance that the financial management system of MEE and its PMU can report on the source and use of the project funds. The assessment was based on the results of the FMA questionnaire, discussions with MEE and MoFT officials, and information available through various reports and desk research.

II. BRIEF PROJECT DESCRIPTION

8. The Project will establish a sustainable regional solid waste management (SWM) system in the Greater Malé capital region and its inhabited outer islands by (i) improving collection, transfer, disposal, treatment (using advanced WTE technology), recycling, and rehabilitating the existing dumpsite; (ii) strengthening institutional capacities for solid waste services delivery and environmental monitoring; and (iii) improving public awareness and behaviors in reduce-reuse-recycle (3R). The Project will be designed to reduce disaster risk and improve climate change resilience while creating a cleaner environment and reducing greenhouse gas emissions.

9. The impact of Phase 1 of the project will be a healthy living environment in the Greater Malé capital region and its outer islands by 2024. The outcome will be disaster and climate resilient SWM services delivered in the project area, benefiting the poor and women. Phase 1 of the Project will have three outputs: (i) Waste collection, transfer, and disposal systems improved and made climate and disaster resilient; (ii) Community-based outer island waste management systems targeting poor and women enhanced; and (iii) Institutional capacity and public awareness in sustainable waste management strengthened.

III. COUNTRY AND SECTOR FINANCIAL MANAGEMENT ISSUES

10. The Country Policy and Institutional Assessment rating for public sector management and institutions cluster average for Maldives was 3.1 (1=low to 6=high) in 2016.⁵ It was ranked 41 among 87 countries for which public sector management and institutions cluster average rating was provided for. This rating has progressively declined from 3.6 in 2005 to 3.1 in 2016.⁶

11. According to the Interim Country Partnership Strategy for 2014-15, Maldives PFM system has shown signs of improvement but remain weak in some areas, including fiscal risk in state-owned enterprises and local councils and capacity constraints across the PFM system. The report points out the following risks in the country:

- (i) **Governance Risks:** The report mentions that assessments carried out by ADB and others such as International Monetary Fund have identified a number of governance risks that could damage public sector effectiveness. There are a few technical governance risks in the areas of public financial management (PFM), public procurement, and efforts to combat corruption that merit some attention. However, in general, the report is of the view that there are no serious governance risks that could fundamentally jeopardize ADB operations in the country.
- (ii) **Public financial management, public procurement, and anticorruption:** The report says that PFM system has shown signs of improvement but remains weak in some areas, including fiscal risk in state-owned enterprises and local councils, and capacity constraints across the PFM system. Vulnerabilities in public procurement involve risks of collusive practices and lack of effective internal controls in public agencies. The other risks are capacity constraints in the procurement system and weak legislative scrutiny of public audits.

Risk mitigation measures include, in the main, those related to capacity enhancement in agencies associated with ADB's prioritized sectors of operations; and to working with government and development partners to address systemic vulnerabilities jointly.

12. **Performance of GOM's PFM System:** In November 2009 the government of the Maldives, the IMF and the World Bank prepared a performance report on public financial management (PFM) of the Maldives. This is the latest available published report. The assessment indicated significant weakness in public financial management and pointed out the low credibility of the budget and weakness in budget execution, control, procurement, accounting and reporting. The main findings of the report were:

- (i) **Weak budget credibility:** There are significant variations in the allocation of expenditures and actual revenue fell below estimates in each year except 2006.
- (ii) **Comprehensive budget coverage and quite high transparency:** The budget classification can provide data that are consistent with Government Finance Statistics Manual (GFSM) 2001, but there is no sub function and program classification, and the

⁵ Available at <http://data.worldbank.org/indicator/IQ.CPA.PUBS.XQ>.

⁶ The public-sector management and institutions cluster comprises 5 criteria each with ratings: (i) property rights and rule based governance, (ii) quality of budgetary and financial management, (iii) efficiency of revenue mobilisation, (iv) quality of public administration and (v) transparency, accountability, and corruption in the public sector. The reason for the decline is that the ratings for criteria (i), (ii) and (iv) have declined. The ratings for criteria (iii) and (v) have not changed.

- reporting of foreign-funded projects is based on ad hoc procedures. The budget documents provide basic information about the government's fiscal policies. The public has access to important fiscal information.
- (iii) **No clear linkage between budget figures and underlying policies:** There was no explicit multi-year perspective in fiscal planning and no comprehensive explanations of the fiscal implications of specific policies.
 - (iv) **Significant shortfalls in the management of cash, debt and guarantees:** There are critical weaknesses in the management of government cash, debt and guarantees. Public reporting of these areas is limited and without systematic disclosure of sizeable risks involved. Internal control procedures are not fully defined, and there is no systematic internal audit function.
 - (v) **Implementation of Public Accounting System (PAS):** The report anticipated that the Public Accounting System (PAS), that was under implementation at the time of report, will enable preparation of full-fledged financial statements in line with acceptable international standards.
 - (vi) **Establishment of independent Auditor General Office (AGO):** The establishment of an independent AGO in early 2008 led to significant improvement in external audit. However, the absence of a comprehensive government accounting system inhibited the AGO's ability to do financial audits.
 - (vii) **Excessive reliance on uncommitted, external project financing:** The reliance on uncommitted, external project financing for a large share of budgeted expenditure creates greater uncertainty and undermines the credibility of the budget as a planning and decision-making tool.

13. **Accounting, recording and reporting:** Quality of public sector accounting and auditing should be good to ensure implementation of an effective PFM system. In 2007 assessment of public sector accounting auditing standards was done by World Bank. The report raised the following major public sector accounting issues in the Maldives:

- (i) Public Sector Accounting Law had not adopted International Public-Sector Accounting Standards (IPSAS).
- (ii) Education and training of accountants did not accord with International Education Standards for Professional Accountants (IES).
- (iii) A code of ethics equivalent to International Organization of Supreme Audit Institutions (INTOSAI) had not been adopted.
- (iv) The accountability process in the Supreme Audit Institution (SAI) was not in accordance with INTOSAI Accounting Standards.
- (v) The education and training of auditors was not in accordance with INTOSAI and IES Standards.

IV. PROJECT FINANCIAL MANAGEMENT SYSTEM

14. **Overview.** The MEE is responsible for the Government's environmental, energy, and climate policy. The MEE works on issues concerning the climate, energy, biological diversity, marine and water environments, and international environmental cooperation. The MEE and its agencies support the government to formulate an integrated policy for sustainable energy, solid waste management, and environmental affairs. One of the key areas of responsibility of MEE is to draft laws and regulations to ensure appropriate solid waste management mechanisms,

establish comprehensive facilities to dispose solid waste throughout the Maldives, and provide assistance to the local councils in establishing a viable solid waste management system at island level.

15. The MEE is directly responsible for setting up and overseeing the operation of the PMU that will be formed shortly. Currently, the PMU staff have not been recruited due to pending approval from MOFT. Project assets, once constructed, will be handed over to the Waste Management Corporation Ltd. (WAMCO), a wholly owned government company, to operate the assets established under GMEIWMP.

16. **Experience of managing externally financed projects.** The MEE is experienced in implementing donor funded projects including the World Bank (WB) funded Maldives Environmental Management Project and the EU/WB funded Wetland Management and Waste Management Project that were successfully completed in 2016 and 2015, respectively. The Project's Implementation Completion and Results Report concluded that "the procurement and financial management processes were sound and in compliance with World Bank procedures". The MEE is currently implementing the ADB and European Investment Bank (EIU) co-funded Preparing Outer Islands for Sustainable Energy Development Project. Other donor funded projects currently being implemented by MEE include the Maldives Clean Environment Project and the Small-scale Waste to Energy Project.

17. **Funds Flow Arrangements.** The GoM's share of the project funds will be made available to PMU through budget allocation. ADB funds will be disbursed through the direct payment procedures with ADB directly making the payment to the contractors. MOFT will approve withdrawal applications from the PMU and submit them to ADB for direct payment for goods, works and consultancy services of the project. MEE will be accountable and responsible for proper use of advances to the advance account, if utilized, which will be maintained with the Central Bank under Maldives Monetary Authority. MEE receives counterpart funds from GoM (MOFT) through budget allocation and disburses to PMU for implementation.

18. The budgeting system appears to be robust with periodic reporting and review of actual expenditures against the budget with due explanations for significant variations and approvals for budget variations being obtained in advance. However, there is sometimes delay in receiving counterpart funding for budgeted expenditures.⁷

19. **Organization and Staffing.** MEE's Finance Section comprises of two sub-sections including Accounts and Financial Control. The Finance Section is headed by a Director who is well qualified with almost 20 years of experience and holds a post-graduate degree in finance. The Director is supported by an Assistant Director and 6 other professional staff most of whom are qualified accountants or undergoing training in accounting. There are however 3 vacant positions in the organization chart that have not been filled for some time as MOFT has withheld approval from these positions being filled. As a result, the Finance Section is under staffed and could result in delays in processing payments of counterpart funds for the PMU. The capacity to supervise and advise PMU accounts staff will also be limited.

20. The PMU's initial staff comprising 3 officers, including a Finance Executive who will be the project accountant, has not been recruited as MOFT has withheld the recruitment approval due to budget constraints. Currently there is no PMU staff and any related work is being carried out

⁷ The delay in receipt of counterpart funds is mainly due to the several layers of administration and approvals through PMU, MEE and MOFT or occasional delays in transmission of funds from MOFT.

by MEE staff. It is anticipated that the accounting team in the PMU will comprise two contractors – a finance executive/project accountant and an accounts assistant. The accountant will be required to have experience with donor funded projects but may require refresher training on ADB procedures.

21. **Accounting Policy and Procedures.** MEE follows GoM's accounting policy and procedures and PMU will do likewise. The accounting system allows for proper recording of financial transactions. The accounting is done in line with the MEE's chart of accounts which is adequate. MEE's records retention is for a minimum period of 5 years, consistent with GoM guidelines. MEE needs to ensure that project documents retention is also within the 2-year period from the completion of the project, as required by ADB guidelines.

22. **Segregation of Duties.** The organizational structure of MEE and PMU ensures adequate segregation of duties with different persons doing the transactions authorization, recording, custody of assets in the transaction and reconciliation of bank accounts and subsidiary ledgers. MEE's Finance Section with a staff of eleven at full strength and the anticipated PMU organization with a staff strength of thirteen will have enough officers to enable complete segregation of duties.

23. **Budgeting System.** Budget inputs are provided by the various functional units including the PMU for review and consolidation. MEE Permanent Secretary has the final responsibility for the budget preparation. The budget is submitted to the MOFT for review and final approval is given by Parliament following which it forms part of the National Budget from which allocations are available to MEE and PMU.

24. **Payments.** Proper invoice processing procedures are in place within MEE and the existing PMUs. Payments are made against invoices and other supporting documents that have been verified and submitted for payments. Sufficient safeguards exist for approval of expenditure against the allocated budget with procedures in place for approvals for variation from allocated budget and quarterly reporting and explanations for variance of actuals versus budget.

25. **Safeguard of Assets.** The accounting system followed by MEE provides for adequate safeguards of assets from fraud, waste and abuse with appropriate record and labelling of fixed assets, inventory and stocks. There are periodic audits by the Auditor General's office and with internal checks at different levels within the organization to ensure verification and protection of assets. The PMU will follow the same procedures and will also be subject to audit. Assets such as vessels and vehicles are covered by insurance policies.

26. **Contract management and accounting.** MEE maintains all contract-wise records that indicate gross and net values with adjustments for payments and contract variations in order to monitor contracts. The records are periodically reconciled with the physical outputs and deliverables, and these are regularly verified with the contractor. The PMU will follow similar contract management and accounting procedures.

27. **Internal Audit.** While the MEE organization chart has provision for 4 staff in the internal audit section, the section has not been functioning since 2013 when the Ministry of Environment was split away from the then Ministry of Housing and Environment to form MEE. In June 2017, a finance officer was transferred from MOFT to MEE to head the internal audit function. However, without any supporting staff, the officer is currently not performing any internal audit roles and is doing other unrelated work. While MEE is in communication with MOFT for approval to recruit the 3 remaining positions, there is no immediate plan to recruit these officers and it is unlikely that the internal audit function will be operational any time soon.

28. **External Audit.** The Auditor General of Maldives, who is appointed by Parliament, is the independent external auditor of MEE and the PMU. Audits of the entity and PMUs are carried out annually. There have been no significant delays in the external audit for completed and ongoing donor funded projects and the audit reports are generally issued within six months from the end of financial year.⁸ External audit is conducted in accordance with the International Standards on Auditing (ISA).

29. **Reporting systems.** Financial Statements are prepared for both the IA and PMUs annually and financial reporting done quarterly. Financial reports are generated by the accounting systems and they show comparisons of actual expenditures against budgeted expenditures. The entity has experience in implementing projects funded by other donors and ADB.⁹

30. **Information System.** The accounting division of MEE uses computerized accounting systems developed for the Government Accounting System. For preparing separate financial statements for the project, the PMU will install an appropriate stand-alone accounting system for cash-based double entry system of accounting for the project's receipts and payments.

V. RISK ASSESSMENTS

31. The FMA has considered two types of risks, (i) inherent risks, i.e. risks outside the direct control of the entity financial management, and (ii) control risks, i.e. risks concerning the internal functioning and control of the entity's accounts division. The following key risks have been identified.

Table 1: Financial Management Inherent and Control Risk Assessment

Risk	Risk Assessment	Risk Mitigation Measures
A. Inherent Risk		
1. Country-Specific (Maldives)	MODERATE <ul style="list-style-type: none"> Increasing political instability may hamper economic development and possible investments in infrastructure projects. 	<ul style="list-style-type: none"> ADB will monitor closely the political situation of the country.
2. Entity-Specific (MEE)	SUBSTANTIAL <ul style="list-style-type: none"> There is deficiency in the public financial management with low credibility of the budget and weakness in procurement, control, accounting and reporting. 	<ul style="list-style-type: none"> GMEIWMP will provide support to enhance the public financial management of RoM.
3. Project-Specific Risks	SUBSTANTIAL <ul style="list-style-type: none"> Inadequate tariff revisions for solid waste treatment may hamper the sustainability of newly developed assets under GMEIWMP. 	<ul style="list-style-type: none"> The commitment of RoM to provide sufficient financial support to WAMCO for covering O&M costs is required. MEE and WAMCO need to prepare and implement the systematic plans to enhance revenues and reduce costs.
Overall Inherent Risks	SUBSTANTIAL	

⁸ The Financial Year end in Maldives is 31st December.

⁹ AB funded project includes Preparing Outer Islands for Sustainable Energy Development (POISED) Project.

Risk	Risk Assessment	Risk Mitigation Measures
	Entity-specific risks may be mitigated by provision of capacity development support from ADB. In case of project-specific risks, RoM needs to provide its support to WAMCO in ensuring the project sustainability.	
B. Control Risk (MEE/PMU)		
1. Executing Entity	<p style="text-align: center;">SUBSTANTIAL</p> <ul style="list-style-type: none"> • MEE has considerable experience in implementing external donors assisted projects including the ongoing Preparing Outer Islands for Sustainable Energy Development Project funded by ADB. • However, PMU has not been formed yet and the experience and skills of PMU staff needs to be assured. 	<ul style="list-style-type: none"> • MoFT and MEE need to timely set up PMU with qualified staff.
2. Funds Flow	<p style="text-align: center;">SUBSTANTIAL</p> <ul style="list-style-type: none"> • Funds flow for GMEIWMP will be similar with other ongoing projects. There have been no major problems identified. • There have been occasional delays in allocation or processing of counterpart funds for other projects, resulting in late payment to contractors. 	<ul style="list-style-type: none"> • RoM needs to provide assurance that funds will be released in a timely fashion.
3. Staffing	<p style="text-align: center;">MODERATE</p> <ul style="list-style-type: none"> • Inadequate staff capacity in the accounts section of PMU and lack of training to new accounting staff may cause delays in day-to-day financial management and submission of periodical financial reports. 	<ul style="list-style-type: none"> • Extending full training and capacity building support for enhancing the financial management capacity of MEE and PMU is required.
4. Accounting Policies and Procedures	<p style="text-align: center;">LOW</p> <ul style="list-style-type: none"> • Policies and procedures are well documented. PMU will use the accounting standards of RoM. 	<ul style="list-style-type: none"> • Not applicable
5. Internal Audit	<p style="text-align: center;">SUBSTANTIAL</p> <ul style="list-style-type: none"> • MEE's internal audit function has not been operational since 2013, as positions in the Internal Audit function have not been filled. 	<ul style="list-style-type: none"> • MEE needs to appoint qualified staff to carry out internal audit of both MEE and the project.
6. External Audit (entity level)	<p style="text-align: center;">LOW</p> <ul style="list-style-type: none"> • MEE is audited annually. There have been no significant delays in the entity audit and submission of audited financial statements. 	<ul style="list-style-type: none"> • Not applicable
7. External Audit (Project level)	<p style="text-align: center;">LOW</p> <ul style="list-style-type: none"> • Project financial statements are regularly audited by the Auditor General's office including performance of surprise checks on cash and stock. • There have been no delays in the project audit and submission of audited project financial statements for previous projects. 	<ul style="list-style-type: none"> • Not applicable
7. Reporting and Monitoring	<p style="text-align: center;">LOW</p> <ul style="list-style-type: none"> • Regular reports are generated from the accounting system and regular monitoring is carried out by management. 	<ul style="list-style-type: none"> • Not applicable
8. Information Systems	<p style="text-align: center;">LOW (MEE)</p>	<ul style="list-style-type: none"> • Not applicable

Risk	Risk Assessment	Risk Mitigation Measures
	<ul style="list-style-type: none"> • The system in operation suits MEE's requirements. A backup procedure is also in place. <p style="text-align: center;">MODERATE (PMU)</p> <ul style="list-style-type: none"> • PMU will install the necessary systems for recording and reporting of project activities. • The financial reporting system will have links with the financial information systems of individual projects. 	<ul style="list-style-type: none"> • Not applicable
Overall Inherent Risks	<p style="text-align: center;">MODERATE</p> <p>Several financial management risks have been identified but none are high. However, delays in providing the government's counterpart funds, inadequate PMU accounts staff not yet recruited, and no internal audit division of MEE may hamper the effective implementation of GMEIWMP. The initial support and capacity development for MEE and PMU on ADB procedures will be implemented with the support of qualified and experienced PMC.</p>	

VI. STRENGTHS AND WEAKNESSES

32. **Strengths.** A significant strength of the financial management systems of MEE is that it has sufficient experience in handling large-scale projects with substantial values.

33. **Weaknesses.** The following weaknesses in financial management system have been identified and need to be addressed:

- (i) delays in setting up dedicated PMU may hamper the timely and effective implementation of GMEIWMP;
- (ii) insufficient training on ADB procedures to the new staff in PMU may cause delays in day-to-day financial management of GMEIWMP; and
- (iii) occasional delays in the release of the government's counterpart funds may cause delays in the timely and efficient implementation of GMEIWMP.

VII. PROPOSED ACTION PLAN

34. The following actions agreed are noted as an action plan to address issues that the financial management assessment identified in MEE and PMU.

Table 2: Risk Assessment and Mitigation Plan

Area	Current scenario	Risk	Mitigation measure suggested	Target date
Setting up dedicated PMU	No PMU established.	This may hamper the timely and effective implementation of the project.	Commitment of MOFT and MEE to ensure the timely setting up of PMU with qualified staff.	before loan signing
Training	Insufficient training on ADB procedures to the new staff in PMU.	This may cause delays in day-to-day financial management of the project.	Extending full training (including available ADB online trainings) and capacity building support with the help of PMCs for enhancing the financial management capacity of PMU.	before loan effectiveness
Counterpart funds	Occasional delays in the release of the government's counterpart funds.	This may cause delays in the timely and efficient implementation of the project.	Commitment from MOFT and MEE for timely allocation and disbursement of the government's counterpart funds.	before and during implementation
Internal audit	Weak internal audit system in MEE and PMU.	This may prevent them of not being aware of key risks.	Strengthening the internal audit process of MEE and PMU by appointing qualified staff.	before loan effectiveness