

# Financial Management Assessment

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Project Number: 51141-002  
September 2018

## Bhutan: Health Sector Development Program

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## **CURRENCY EQUIVALENTS**

(as of 10 September 2018)

Currency unit	–	Ngultrum (Nu)
Nu1.00	=	\$0.01387
\$1.00	=	Nu72.09700

## **ABBREVIATIONS**

ADB	–	Asian Development Bank
BHTF	–	Bhutan Health Trust Fund
CCA	–	Central Coordinating Agency
DMEA	–	Department of Macroeconomic Affairs
DPA	–	Department of Public Accounts
FMA	–	financial management assessment
MOF	–	Ministry of Finance
MOH	–	Ministry of Health
MYRBS	–	Multi-Year Rolling Budget System
PEMS	–	Public Expenditure Management System
PFM	–	public financial management
PMPSU	–	project management and policy support unit
RAA	–	Royal Audit Authority
RMA	–	Royal Monetary Authority
RTI	–	Right to Information
SOE	–	statement of expenditure
USD	–	United States dollar

## **NOTE**

In this report, “\$” refers to United States dollar.



## **EXECUTIVE SUMMARY**

A financial management assessment was carried out from November 2017 to April 2018 and covered both the central Ministry of Health (MOH) and district-level functions in accordance with Asian Development Bank (ADB)'s Guidelines on Financial Management and Analysis of Projects and the Financial Due Diligence: A Methodology Note. The financial management assessment considered the capacity of the MOH, including fund-flow arrangements, staffing, accounting and financial reporting systems, and internal and external audit arrangements. The overall pre-mitigation financial management risk for the MOH is considered as moderate as the ministry has well-established systems for financial management and has computerized its budgeting and expenditure management systems. The Accounts Department is fully functional with accountants responsible for different functions.

The major risks identified are: (i) the MOH does not have recent experience implementing ADB project and (ii) internal audit has limited resource and scope. However, in the discussions held between the Ministry of Finance and MOH, it was agreed that action plans will be taken to strengthen financial management capacity including: (i) the MOH will assign a dedicated accountant in the project management unit who will be trained on ADB procedures and (iii) the Ministry of Finance will increase the scope of the internal audit within the MOH. With the proposed risk mitigating measures, it is expected that the financial management capacity of the MOH for the project will be satisfactory. For the project, a project management and policy support unit will be established by the MOH to be assisted by a full-time accountant and financial management consultant.



## I. INTRODUCTION

1. A financial management assessment (FMA) was carried out from November 2017 to April 2018 in accordance with Asian Development Bank (ADB)'s Financial Management Assessment Technical Guidance Note<sup>1</sup> and ADB's Financial Due Diligence: A Methodology Note.<sup>2</sup> The FMA was conducted for the Ministry of Health (MOH) and at two sample districts to determine the institutional arrangements and control measures required to implement the project, and to ensure that funds are used for their intended purposes. A procurement assessment has been carried out separately.<sup>3</sup>

2. The FMA focuses on fund flows, budgeting, staffing, accounting policies and procedures, internal controls, financial reporting and monitoring, and internal and external audit. The assessment considers the responses by the MOH as well as recent ADB/World Bank country and sector-level experience.<sup>4</sup> The FMA questionnaire is available upon request.

## II. PROJECT DESCRIPTION

3. The proposed assistance will be delivered through a sector development program and will contribute to achieving the MOH's 12th 5-year plan (2018–2023). The project has three outputs: (i) output 1 will support outbreak surveillance health information systems, (ii) output 2 will support health financing, and (iii) output 3 will strengthen health services in peripheral areas. The government will commit an additional \$21.2 million to supplement ADB's contribution to the project.

4. The MOH will serve as the executing agency. The MOH Policy and Planning Division, supported by a project management and policy support unit (PMPSU), will be responsible for management of overall program activities. The MOH High-Level Committee will serve as the project's steering committee and is chaired by the secretary of health. Procurement of civil works and goods, and recruitment of individual consultants and recruitment firm will be in accordance with ADB's Procurement Guidelines (2015, as amended from time to time) and ADB's Guidelines on the Use of Consultants (2013, as amended from time to time).

## III. COUNTRY AND SECTOR FINANCIAL MANAGEMENT ISSUES

5. Using existing reviews and diagnostics, this section provides an overview of the country-level financial management system. The Public Financial Management (PFM) Performance Report (2016) provides scores across seven PFM dimensions (Figure 1) and indicates that the Government of Bhutan has particularly strong management of assets and liabilities and external scrutiny and audit (footnote 4). Whereas lower scores are seen in transparency of governance and accounting and reporting. A low score in budget reliability is largely attributable to the unpredictability of donor grants.

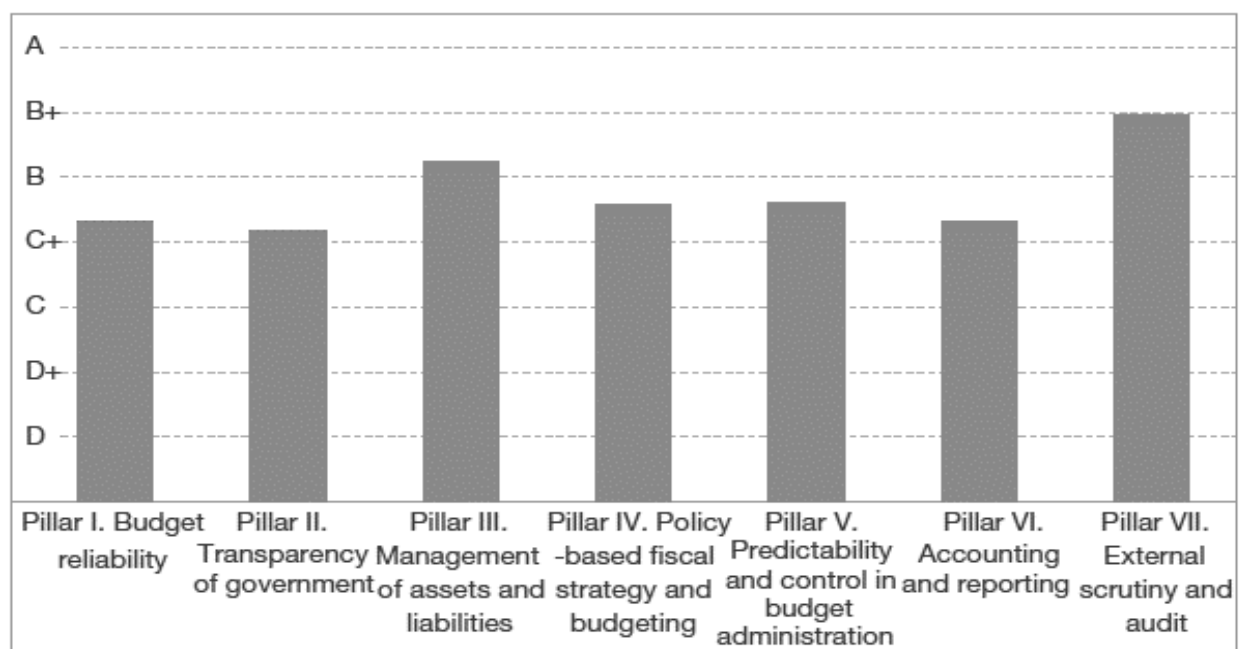
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<sup>1</sup> ADB. 2005. *Financial Management and Analysis of Projects*. Manila.

<sup>2</sup> ADB. 2009. *Financial Due Diligence: A Methodology Note*. Manila.

<sup>3</sup> Procurement Capacity Assessment (accessible from the list of linked documents in Appendix B).

<sup>4</sup> World Bank. 2016. *PFM Performance Report*. Washington, DC.

**Figure 1: Government of Bhutan – Public Financial Management Performance Report**

Source: Asian Development Bank.

6. Since the previous assessment in 2010, the government has started a comprehensive PFM reform program, with a wide array of reforms in planning and budgeting, revenue administration, asset and liability management, procurement, internal control, internal audit, reporting, and external audit and oversight. The progress in this reform program is reflected in the 2016 scores. However, challenges remain and are in the areas of expenditure composition out-turn, controls over payroll, expenditure arrears, public access to information, 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.

#### **IV. PROJECT FINANCIAL MANAGEMENT SYSTEM**

##### **A. Overview of the Executing Agency and Implementing Agencies, Financial Management System, and Institutional Context**

###### **1. Ministry of Health**

7. The MOH will be the executing agency for the project. It is responsible for policy formulation, health planning, policy implementation, monitoring, and supervision of services related to preventive, promotive, curative, and rehabilitative services both in traditional and modern medicines. It also provides technical guidance to the district health management and ensures continued availability of medical and non-medical supplies and human resources. There are five departments under the MOH: (i) Department of Public Health, (ii) Department of Medical Services, (iii) Department of Medical Supplies and Health Infrastructure, (iv) Department of Traditional Medicine Services, and (v) Directorate of Services.

## 2. District Administration

8. In line with the decentralization policy of the government, health administration and management has been devolved to districts over the past few decades. Consequently, district-level health service planning and management are decentralized to district health management teams that function within the framework of the local government. Financial resources have incrementally increased to local government units, from a centralized allocation during the early 1960s to a ratio of 70:30 for the central and local governments in the Eleventh Five-Year Plan. The government has indicated that the 12th 5-year plan will have a spending ratio of 50:50 although there are concerns whether local governments have the adequate absorptive capacity.<sup>5</sup> An analysis of two sample districts (Paro and Thimphu) shows that the districts have been spending (2015–2016) as follows: Thimphu – Nu19.85 million (\$0.31 million) and Paro – Nu66.84 million (\$1.03 million).

## 3. Bhutan Health Trust Fund

9. In 1998, the government set-up the Bhutan Health Trust Fund (BHTF) as a self-sustaining financing facility with a target corpus of \$24 million. The objective of the BHTF is to help sustain primary health care through providing finance for the uninterrupted supply of essential drugs and vaccines, needles, syringes, cold chain equipment, and other related drugs/equipment.<sup>6</sup> As per the BHTF website; “The Fund envisages an investment to generate sufficient returns to meet all annual expenditure on essential drugs and vaccines and help eliminate financing uncertainties for purchase of these crucial components and other related drugs/equipment. Capitalization of the Fund is done through contributions from donor countries, organizations of private and public status, financial institutions and individuals. It is based on the principle of one-to-one partnership.” The balance of the BHTF as of 30 June 2017 was Nu1,724 million (\$26.57 million) compared to 30 June 2016, which was Nu1,496 million (\$23.05 million).<sup>7</sup> 97% of the BHTF’s investments are in local currency (investment decisions are taken by the board of the BHTF, headed by the minister of the MOH, in bank and insurance funds in Bhutan) and 97% of the BHTF’s expenditure is on procurement of essential drugs (in 2017) (the BHTF undertakes procurement for essential drugs and other items through the Department of Medical Supplies and Health Infrastructure and the National Hospital at Thimphu).

10. The BHTF prepares and maintains its accounts on an accrual basis, except government and donor contributions which are accounted for on a cash basis. Accounting is undertaken on the Tally Accounting System and the government’s Public Expenditure Management System (PEMS).<sup>8</sup> Financial statements are prepared on an annual basis (1 July to 30 June of the succeeding year). The audit is conducted by the Royal Audit Authority (RAA) which has been providing an unqualified audit report.<sup>9</sup> Audit is conducted as required under the Audit Act of Bhutan (2006) and in accordance with International Standards of Supreme Audit Institutions.

<sup>5</sup> The foreword in the Gross National Happiness Commission’s 12th 5-year plan guidance documents has noted “The Twelfth Five-Year Plan guideline takes decentralization further to the grassroots through almost doubling the share of resources to the local government from the plan allocation. From the current plan share of 30% of capital allocation, the Twelfth Five-Year Plan provides for increasing the capital share to 50%. Additionally, the revised Division of Responsibilities framework also provides for greater decentralization of roles, functions, and authority to the local government. While this will pose considerable challenges and risk, it is expected to take us closer to His Majesty’s vision of a democratic and responsible society.”

<sup>6</sup> <http://www.bhtf.bt/bhtf/about-bhutan-health-trust-fund.html>.

<sup>7</sup> BHTF, Statement of Affairs (Balance Sheet) as of 30 June 2017.

<sup>8</sup> Tally is an off-the shelf accounting system.

<sup>9</sup> Annual financial statements for FY2014–2015, FY2015–2016, and FY2016–2017.

#### 4. Others

11. The Department of Revenue and Customs is responsible for collecting revenue and taxes which is deposited into one central account from which the allocations are made for expenditures. It has an electronic Revenue Accounting and Management Information System. The government has financial rules, which outlines the system of financial management in the country, budget formulation and implementation, principles of government accounts, works, procurement of goods and services, inventory management, contract management, grants-in-aid, and government guarantees and establishment, among other things.

12. The budgets are prepared and approved by the Parliament by the end of June for the next fiscal year. There is a unified budgeting system (for government and projects externally financed by development partners). The Department of National Budget has introduced the Multi-Year Rolling Budget System (MYRBS) and the Department of Public Accounts (DPA) has introduced the PEMS. These are real-time, web-based systems, and currently, quarterly budget reports are prepared using these systems.

#### B. Strengths

13. The following strengths have been identified based on the FMA:

- (i) **Computerization.** The government has computerized its annual budgeting and expenditure reporting processes through the MYRBS and PEMS processes. This is a substantial move forward in ensuring that budgets are done in a timely manner.
- (ii) **Low corruption perception.** Bhutan is ranked 26 out of 180 countries as per the latest report of Transparency International (Corruption Perception Index 2017).<sup>10</sup> Bhutan ranks 1st in the South Asia region and 6th in the Asia Pacific Region only after New Zealand, Singapore, Australia, Hong Kong, and Japan (20). Bhutan has a particularly strong Anticorruption Commission.<sup>11</sup>
- (iii) **Prior experience in donor-funded projects.** The MOH has the experience of implementing donor-funded projects from United Nations agencies and the Global Fund.
- (iv) **Budget out-turn.** The budget out-turn (difference between actual expenditure and the originally budgeted expenditure) of the MOH was 98.3% for FY2014–2015.<sup>12</sup> Expenditure includes debt interest and expenditure for donor-funded projects (whether from loans and grants) but not lending by the government or government's repayments of loans. Expenditure includes both current and capital expenditure. The budget out-turn is also good at a district level. In FY2015–2016, the budget out-turn at Thimphu district was 94%, Paro at 99%, and Chukha at 98%.

#### C. Weaknesses

14. The following weaknesses related to the proposed program were identified as:

<sup>10</sup> [https://www.transparency.org/news/feature/corruption\\_perceptions\\_index\\_2017](https://www.transparency.org/news/feature/corruption_perceptions_index_2017).

<sup>11</sup> Asia Pacific countries sit in the bottom half of the Corruption Perceptions Index attributed to unaccountable governments, lack of oversight, insecurity, and shrinking space for civil society pushing anticorruption action to the margins in those countries. ([https://www.transparency.org/news/feature/corruption\\_perceptions\\_index\\_2017](https://www.transparency.org/news/feature/corruption_perceptions_index_2017)).

<sup>12</sup> World Bank. 2016. *PFM Performance Report*. Washington, DC.

- (i) **Lack of experience in ADB projects.** The MOH has not implemented an ADB project for a long time and is not familiar with ADB policies and procedures.
- (ii) **Internal audit.** The MOH's internal audit function is relatively weak and needs to be strengthened in terms of staffing, coverage, and introducing performance and risk-based audit.
- (iii) **Budget for procurement.** The World Bank identified that across the government, procurement processes are manual and do not link with the computerized budgeting and accounting systems. There is no requirement to prepare procurement plans and there are no commitment controls for checking budget availability before solicitation of tenders. These weaknesses are addressed in the Procurement Capacity Assessment Report.

## **D. Personnel, Accounting Policies and Procedures, Internal and External Audit**

### **1. Personnel**

15. In Bhutan, each ministry has a finance section which is staffed with accountants. Qualifications of accountants are determined by the Ministry of Finance (MOF) as those having at least 4 years of experience and with training in financial and accounting. They mainly reconcile budgets and expenditures based on the financial records created by each department or project office.

### **2. Accounting Policies and Procedures**

16. The Government of Bhutan follows a cash-based accounting system. The fiscal year starts on 1 July and ends on 30 June every year. Financial management is guided by the Financial Rules and Regulations (2016) of the government. It defines the role and responsibility of each government agency, external auditor, and other related agents and covers all key aspects of financial management, i.e., physical asset management, cash flow management, procurement, debt management, budget, accounting system, internal control, record keeping and reporting, following the international practices and standards. All government-budgeted agencies, including the MOH, are required to follow online budgeting accounting system software called the MYRBS and PEMS for cash-based, double-entry accounting system developed by the DPA and Department of National Budget of the MOF. All government letter of credit accounts, limited liability companies, and project letter of credit accounts and operating agencies have to follow the online system. The MOF can view all financial reports of all government-budgeted agencies and, therefore, submission of such financial reports is not required.

### **3. Internal Audit**

17. The MOF's Central Coordinating Agency (CCA) is responsible for administering internal audit service to all public-sector agencies under the government. Internal audit was first introduced in 2000 and since then, its importance as a governance mechanism to control risk has increasingly been recognized. The CCA issues internal audit guidelines and evaluates internal audit activities in agencies. The CCA has issued a Charter, Internal Audit Manual, Code of Conduct, and internal control framework. It has also provided standard operating procedures for auditing the procurement system in the country.

18. In the MOH, the internal auditor reports directly to the secretary of the ministry. There are separate internal auditors at the district level. The internal audit unit has limited staff and as a consequence has limited coverage. The department needs to build its capacity in terms of staff,

coverage of audit, and quality of reports. The need for a robust internal audit system for the proposed project was discussed with the MOH. The appointment of independent chartered accountant firms to undertake internal audit in the MOH was discussed with the internal audit team but was not considered feasible as there is no precedence of external firms undertaking internal audit of government departments.

#### **4. External Audit**

19. The RAA is the supreme audit institution of Bhutan and executes the audit of all government ministries and autonomous agencies on a yearly basis. It has a well-established reputation for independence and effectiveness. The budget reports are distributed at least 5 days before the budget deliberation to allow members of Parliament to scrutinize the budgets. Parliamentarians scrutinize and actively debate appropriations in the Parliament. Audit reports are regularly uploaded by the RAA on its website. The latest audit report is available for 2015–2016. It generally takes a year after the end of the financial year for the audit report to be completed and approved by the Parliament. The audit report for FY2016–2017 is under preparation.

#### **5. Grievance Redressal**

20. Bhutan has an online grievance redressal system where a citizen can log into the web portal “eKaaSel” and register a complaint about any government service. The web portal is under the Public Services and Grievances Redressal Division under the cabinet secretariat. The portal also provides service registration, acknowledgement and payment receipts, service status tracking, and service output generations.

#### **6. Right to Information**

21. Bhutan does not have a Right to Information (RTI) Act for its citizens. The RTI was an electoral promise of the current government and the National Assembly had passed the bill on 5 February 2014, but the national council refused to deliberate the bill, citing limited time given to the council members.<sup>12</sup> There are no laws that guarantee citizens' RTI. Censorship in Bhutan is still common with restrictions on the ownership of media outlets, licensing of journalists, and the blocking of websites.

### **E. Financial Reporting Systems Including Use of Information Technology**

22. Both the MOH and districts use the PEMS where all reports are generated. However, for specific report for donor-funded projects, Microsoft Excel is used.

### **F. Disbursement Arrangements and Funds Flow Mechanism**

#### **1. Flow of Funds**

#### **23. Output 1 – Project investment support to Ministry of Health:**

Step 1: Separate advance account is established and maintained by the MOF-Department of Macroeconomic Affairs (DMEA) at the Royal Monetary

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<sup>12</sup> No hope for RTI Act, Business Bhutan, 22 Apr 2017, Alka Katwal, <https://www.pressreader.com/bhutan/business-bhutan>.

- Authority (RMA) in Bhutan in United States dollars (USD). The MOF-DMEA is accountable and responsible for proper use of advance to the advance account (including advances to sub-accounts).
- Step 2: The MOH-PMPSU submits request for initial and additional advances to the advance account through the DPA and DMEA. Request of advance is based on the estimated expenditures to be financed through the account for the forthcoming 6 months.
- Step 3: ADB disburses advance fund in USD to the advance account of DMEA maintained by the RMA in Bhutan.
- Step 4: Based on the request of the MOH to the DMEA, the DMEA releases funds to the DPA in local currency at the DPA's bank account (pass-through account) maintained in the Bank of Bhutan.
- Step 5: The DPA issues a project letter of credit towards proposed project activities in favor of the MOH-PMPSU and disburses funds in local currency to the MOH's bank account maintained in the Bank of Bhutan. This will be designated as the sub-advance account and used exclusively for ADB's share of eligible expenditure.
- Step 6: Based on the invoices submitted by suppliers, contractors, or consultants, the MOH-PMPSU releases funds to the respective vendor, following the ministry's payment procedures. The MOH-PMPSU maintains all supporting documents for audit purposes.

24. Statement of expenditure (SOE) may be used to support request for reimbursement and liquidation of advances to the advance account. The ceiling of the SOE procedure is the equivalent of \$100,000 per individual payment. Supporting documents and records for the expenditures claimed under the SOE should be maintained by the MOH-PMPSU and made readily available for review by ADB and for independent audit.

**25. Output 2 – Budgetary support to Bhutan Health Trust Fund:**

- Step 1: The MOH-PMPSU to send withdrawal application to ADB through the DPA and DMEA, with a request to disburse funds directly to the RMA's bank account maintained in USD in the United States.
- Step 2: ADB disburses funds in USD directly to the RMA's bank account maintained in the United States.
- Step 3: The RMA releases funds to the BHTF in the most economical and efficient manner for its purpose in accordance with the country's policy and regulation on foreign exchange transactions, in consultation with the RMA/MOF (e.g., transfer fund to the BHTF's account maintained in USD in the United States).

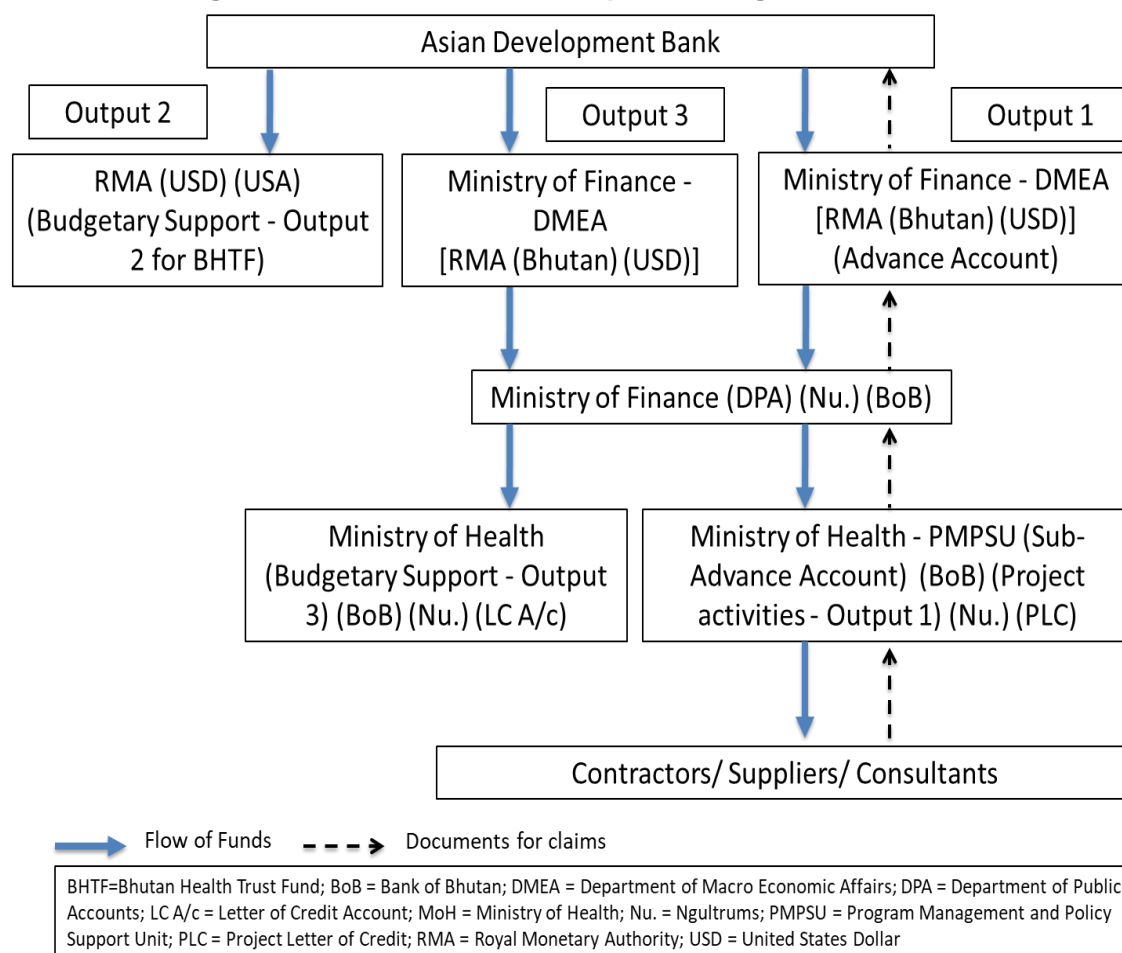
**26. Output 3 – Budgetary support to Ministry of Health:**

- Step 1: The MOH-PMPSU to send withdrawal application to ADB through the DPA and DMEA.
- Step 2: ADB disburses funds in USD to the DMEA's account maintained by the RMA in Bhutan. The RMA will open a new account for output 1 funds, which will be separate from the advance account for output 3.
- Step 3: Based on the request of the MOH to DMEA, the DMEA releases funds to the DPA in local currency in the DPA's bank account (pass-through account) maintained in the Bank of Bhutan.

Step 4: The DPA issues a letter of credit towards budgetary support in favor of the MOH and disburses funds in local currency in the MOH's bank account maintained in the Bank of Bhutan.

27. The following diagram shows the above-mentioned steps:

**Figure 2: Health Sector Development Program Fund Flow**



Source: Asian Development Bank.

28. The grant proceeds will be disbursed in accordance with ADB's Loan Disbursement Handbook (2017, as amended from time to time), and detailed arrangements agreed upon between the government and ADB. This will be used where ADB pays from the grant account to the country's account for eligible expenditures that have been incurred and paid for by the project out of its budget allocation or its own resources. Other disbursement methods as outlined in ADB's Loan Disbursement Handbook (2017, as amended from time to time) can also be adopted, as suitable for the project. Detailed fund flow procedures are also given in the project administration manual.

## 2. Availability of Funds

29. It has been assured that there is no problem with respect to availability of budgetary funds in the MOH. Funds will be released to the MOH by the DPA and from the MOH to respective districts, as and when they are required.

## V. RISK DESCRIPTION AND RATING

30. Table 1 outlines the risks to financial management and the proposed mitigation measures.

**Table 1: Financial Management and Internal Control Risk Assessment**

Risk	Pre-Mitigation Risk Rating	Mitigation Measures
<b>Inherent risks</b>		
The 2016 PEFA assessment indicates that the country has made good progress in PFM since the previous assessment in 2010. The PFM reforms are however, still incomplete. If progress in national PFM reforms stall, line ministries will also be affected, and the PFM performance in the project may be lower than expected.	Moderate	The Government of Bhutan, with World Bank support, is expected to establish a multi-donor trust fund to support a new government PFM reform program, which implementation progress will be monitored closely.
<b>Executing and/or implementing agencies.</b> The MOH follows government Financial Rules and Regulations but do not have adequate exposure to ADB procedures, which may result in implementation delays.	Moderate	A project management unit will be established, including a full-time accountant and financial management consultant to assist capacity building of the MOH. ADB will also facilitate attendance of the MOH staff in its financial management and disbursement workshops.
<b>Overall Inherent Risk Rating</b>	Moderate	
<b>Control risks</b>		
<b>Funds flow.</b> The government has issues with the timely release of counterpart funds in other ADB projects in Bhutan and this experience may be repeated with this project with a risk of delays in the release of funds.	Low	Government's contribution to the investment component of this project will be in the form of tax and duties and recurrent costs in order to avoid any potential delays in counterpart financing of civil works. All project payments will be done by the MOH-PMPSU so that there is adequate control over expenditure and there is no delay in payments due to the transfer of funds.
<b>Staffing.</b> The MOH will depute a full-time accounts officer to the PMPSU, but all government accounting staff are centrally recruited and frequently rotated across ministries. Continuity in project management support may be disrupted if movements of account staff assigned to the PMPSU are frequent and therefore delay project implementation.	Moderate	The MOH will ensure that the accountant designated for the PMPSU should continue for the full term of the project. A financial management consultant will be recruited to assist in building the capacity of the accountant.
<b>Accounting policies and procedures.</b> The MOH prepares its accounts based on 2016 Financial Rules and Regulations. These rules incorporate the latest trends in finance and accounting and are in line with the	Low	The MOH will maintain project-related records in the MYRBS and PEMS software.

<b>Risk</b>	<b>Pre-Mitigation Risk Rating</b>	<b>Mitigation Measures</b>
computerized MYRBS and PEMS software.		
<b>Internal audit.</b> There is insufficient staff in the MOH internal audit to cover all the MOH programs, and quality of internal audit is neither based on performance nor risk.	Substantial	A financial management consultant will be engaged to support the MOH capacity, and performance- and risk-based audit will be used to improve quality of internal audit. The MOF has agreed that the ADB project will be included in the annual cycle of internal audit.
<b>External audit.</b> Timely submission of audited project financial statements to ADB may be delayed beyond the required 6 months. The government's usual cycle for reporting and disclosure is within 12 months of FY's end, which includes presentation to the Parliament and disclosure on the MOF website.	Moderate	The RAA will provide the APFS within 6 months of FY's end subject to the MOH preparing their accounts and presenting it to the RAA for audit within 3 months of FY's end. The PMPSU will ensure timely meeting of deadlines by the MOH for audit preparation.
<b>Reporting and monitoring/information systems.</b> In line with the financial rules and regulations, the MOH uses the PEMS, a cash-based double-entry accounting system for the preparation of financial statements. The PEMS is a web-based government-wide system for financial reporting and monitoring, but PEMS cannot produce customized financial reports for ADB's financial reporting.	Moderate	The PEMS will be used for accounting purposes for the project, but financial data will be transferred to a Microsoft Excel sheet to generate financial reports. The financial management consultant will assist in developing the financial reporting system (including review/reconciliation process) and formats.
<b>Overall Control Risk Rating</b>	<b>Moderate</b>	

ADB = Asian Development Bank, APFS = audited project financial statement, FY = fiscal year, MOF = Ministry of Finance, MOH = Ministry of Health, MYRBS = Multi-Year Rolling Budget System, PEFA = Public Expenditure and Financial Accountability, PEMS = Public Expenditure Management System, PFM = public financial management, PMPSU = project management and policy support unit, RAA = Royal Audit Authority.

<sup>a</sup> Government of Bhutan, Ministry of Finance. 2016. *Finance and Accounting Manual*. Thimpu.

Source: Asian Development Bank.

## VI. PROPOSED ACTION PLAN

31. The proposed action plan for financial management-related activities is presented in Table 2 below.

**Table 2: Financial Management Action Plan**

<b>Key Risk</b>	<b>Description</b>	<b>Timeline</b>	<b>Responsibility</b>
Delay in the release of funds	The DPA, MOF to release the PLC for project activities immediately upon receiving the request from the MOH-PMPSU.	Upon receipt of Advance Fund	DPA, MOF
Delay in the release of funds	The MOH to ensure adequate project budget allocation.	Before grant effectiveness and annually	MOF (DNB) and MOH
Lack of dedicated FM staff may result in delays	Appoint accountant in the PMPSU at MOH.	Before grant negotiation	MOH

Key Risk	Description	Timeline	Responsibility
in execution of project's FM-related activities			
The MOH is not very familiar with ADB procedures	Develop capacity in ADB's FM procedures including attending training in ADB's procurement, FM, and disbursement procedures.	Ongoing	MOH-PMPSU
The MOH is not very familiar with ADB procedures	Recruitment of FM consultant to build FM capacity of the PMPSU.	By grant effectiveness	MOH
Timely monitoring of project and addressing issue	The MOH will develop quarterly physical and financial targets for the project with respect to activities to be undertaken and budget required.  Submit regular project progress reports to ADB including on financial progress.	Quarterly	MOH (PMPSU)
Sufficient internal audit may not be conducted	The MOH to strengthen their internal audit function in terms of comprehensiveness and to be undertaken on a risk-based assessment.	Within 1 year of grant effectiveness	MOH in consultation with CCA (MOF).
Sufficient internal audit may not be conducted	Internal audit of ADB project to be conducted every year.	Annual basis	MOH in consultation with CCA (MOF).  MOH to write a letter to CCA requesting them to audit the project on an annual basis.  PMPSU need to train CCA on ADB procedures.
Delay in submission of the APFS to ADB	The MOH to complete project annual accounts within 3 months of the end of FY and present to the RAA for audit.	Within 3 months of end of FY	MOH (PMPSU)
Delay in submission of the APFS to ADB	Submission of annual APFS	6 months from end of financial year and on an annual basis (APFS)	MOH (PMPSU) in consultation with RAA.  MOH (PMPSU) to write a letter to RAA requesting them to audit the APFS before start of project.
Audit issues may not be properly addressed timely	Finance and Audit Committee at the MOH to be set-up (as per section 178 of the Public Finance Act of Bhutan, 2007) and made functional which takes up, but not limited to, audit issues regularly and prepares an Action Taken Report. It will ensure audit issues are addressed timely.	Before grant effectiveness	MOH
Timely monitoring of project and addressing issue	The MOH will develop quarterly physical and financial targets for the project with respect to activities to be undertaken and budget required.	Quarterly	MOH (PMPSU)

Key Risk	Description	Timeline	Responsibility
	<p>Submit regular project progress reports to ADB including on financial progress.</p> <p>The FM consultant will assist in developing the financial reporting system (including review/reconciliation process) and formats.</p>		

ADB = Asian Development Bank, APFS = audited project financial statement, CCA = Central Coordinating Agency, DNB = Department of National Budget, DPA = Department of Public Accounts, FM = financial management, FY = fiscal year, MOF = Ministry of Finance, MOH = Ministry of Health, PLC = project letter of credit, RAA = Royal Audit Authority, PMPSU = project management and policy support unit.

Source: Asian Development Bank.

## VII. SUGGESTED COVENANTS

32. Schedule 5 of the legal agreement shall require the implementation of the financial management action plan as stipulated in the project administration manual.

**APPENDIX 1**  
**BROAD TERMS OF REFERENCE OF FINANCE AND AUDIT COMMITTEE**

Below is the terms of reference of the finance and audit committee:

- (i) review and monitor the auditor's (statutory and internal) independence and performance, and effectiveness of audit process;
- (ii) examine the financial statement and the auditors' report (statutory and internal) thereon;
- (iii) approve or subsequently modify transactions of the company with related parties;
- (iv) evaluate internal financial controls and risk management systems;
- (v) monitor the end use of funds raised through grants and loans, especially donor-funded projects;
- (vi) call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the board and discuss any related issues with the internal and statutory auditors and the secretary/minister;
- (vii) ensure addressing audit issues or audit observations in a timely manner and preparation of the Action Taken Report;
- (viii) investigate into any matter in relation to the items specified above; and
- (ix) any other tasks as may be required.

## **APPENDIX 2**

### **SCOPE OF WORK OF INTERNAL AUDIT**

The scope of internal auditing encompasses, but is not limited to, the examination and evaluation of the adequacy and effectiveness of the organizations' governance, risk management, and internal controls; as well as the quality of performance in carrying out assigned responsibilities to achieve the organizations' stated goals and objectives. This includes:

- (i) evaluating risk exposure relating to achievement of the organization's strategic objectives;
- (ii) evaluating the reliability and integrity of information and the means used to identify, measure, classify, and report such information;
- (iii) evaluating the systems established to ensure compliance with those policies, plans, procedures, laws, and regulations which could have a significant impact on the organization;
- (iv) evaluating the means of safeguarding assets and, as appropriate, verifying the existence of such assets;
- (v) evaluating the effectiveness and efficiency with which resources are employed;
- (vi) evaluating operations or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned;
- (vii) monitoring and evaluating governance processes;
- (viii) monitoring and evaluating the effectiveness of the organization's risk management processes;
- (ix) evaluating the quality of performance of external auditors and the degree of coordination with internal audit;
- (x) reporting periodically on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan;
- (xi) reporting significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by the management; and
- (xii) evaluating specific operations at the request of the management, as appropriate.