

FINANCIAL MANAGEMENT ASSESSMENT

A. Introduction

1. This Financial Management Assessment (FMA) has been prepared in accordance with Asian Development Bank (ADB) Guidelines for the Financial Management and Analysis of Projects (2005) and Financial Due Diligence, A Methodology Note (2009), and focuses on fund flows, staffing, accounting policies and procedures, internal controls, financial reporting and monitoring, and internal and external audit. The FMA considered the following:

- (i) Local Government Engineering Department (LGED), in its role as the project executing agency (EA) housing the project management office (PMO);
- (ii) Department of Public Health Engineering (DPHE) as another executing agency responsible specifically for water supply and sanitation (WSS) components; and
- (iii) Three sample Pourashavas (Lalmonirhat, Magura and Naogaon) which will be implementing agencies (IA) housing their respective project implementation units (PIUs).

2. A key aspect of the FMA is evaluating the risks associated with project financial management arrangements. 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 EA and IA financial management systems can report on the source and use of project funds. This assessment is based on the results of a FMA questionnaire, discussions with EA officials, discussions with officials of the three sample Pourashavas and information available through various reports, including LGED Annual Report (2012), DPHE Annual Report (2012) and past ADB project reports.

3. This FMA was conducted to (a) assess EA capacity to monitor, manage and support the overall program, (b) assess IA capacity to implement and manage investments and (c) propose ways and means to strengthen the capacity of EA and IAs. Specifically, the objective is to enhance competence levels to achieve the government's goals of improved access to municipal services with required climate resiliency of the towns, especially as beneficiary pourashavas will receive large amounts of investments to support these goals. Therefore, a FMA of the three sample pourashavas was also carried out with a 20 year projection of operational performance. The assessment together with the forecast outlines the financial environment of IAs and the financial risks that may affect the project impact and sustainability.

B. Country Level Issues

4. The identification of country-level issues is based on the Diagnostic Studies of Accounting and Auditing (DSAA), the World Bank Country Financial Accountability Assessments (CFAA), Reports on the Observance of Standards and Codes (ROSC) and others. The country issues that potentially impact project financial management include a weak public financial management (PFM) environment and management and skills capacity issues.

5. **Public financial management environment.** The Country Policy and Institutional Assessment (CPIA) for transparency, accountability and corruption in the public sector rating (1=low to 6=high) in Bangladesh was last reported at 2.9 in 2012 (World Bank 2012)¹. Transparency, accountability, and corruption in the public sector assess the extent to which the

¹ Available at <http://data.worldbank.org/indicator/IQ.CPA.PUBS.XQ>

executive can be held accountable for its use of funds and for the results of its actions by the electorate and by the legislature and judiciary, and the extent to which public employees within the executive are required to account for administrative decisions, use of resources, and results obtained. The three main dimensions assessed here are the accountability of the executive to oversight institutions and of public employees for their performance, access of civil society to information on public affairs and state capture by narrow vested interests.

6. **Management and skills capacity.** In common with many DMCs, Bangladesh has a shortage of skills in financial management, financial analysis and management accounting. In particular, few accounts staff has practical skills beyond basic bookkeeping. The impact of these skills shortages on government operations is amplified by high demand for financial skills from the private sector, which pays higher remuneration and, in most cases, provides better conditions.

C. Risk Analysis

7. The risk assessment is based on existing circumstances, staffing and procedures.

8. **Inherent Risk** is the susceptibility of the project financial management system to factors arising from the environment in which it operates, such as country rules and regulations and entity working environment (assuming absence of any counter checks or internal controls).

Table 1: Inherent Risk Summary

Risk	Risk Assessment	Risk Mitigation Measures
1. Country-Specific	Substantial	Increasing political instability, hampering economic development and possible investments in municipal infrastructure projects. ADB will monitor closely the political situation of the country.
2. Entity-Specific	Substantial	IA: Revenue generating operations (e.g. water supply) at the <i>pourashava</i> level are not currently ring-fenced from general <i>pourashava</i> budget in some <i>pourashavas</i> . The project requires ring fencing of water supply accounts and the introduction of volumetric tariff as key entry criteria; and tariff revisions at regular intervals over a period of 20 years.
3. Project-Specific	Substantial	Financial absorption capacity model of <i>pourashavas</i> requires them to increase property tax collection (rates and collection efficiency which average around 60%) and increase tariffs of revenue generating services (e.g. water supply, market, terminals). If revenues are not increased significantly and sustained then it will be difficult for <i>pourashavas</i> to properly operate and maintain new investments. The competencies and experience of EA and IA financial staff in automatic accounting and reporting systems are limited. Intensified continuation of ongoing FM training program is clearly required. Same applies for related MIS & Control systems. The project will invest in capacity support to enhance municipal financial systems through a performance based approach in the form of Urban Governance Improvement Action Program (UGIAP) to incentivize governance improvements.

Risk	Risk Assessment	Risk Mitigation Measures
Overall Inherent Risk	Substantial	Political unrest and violence may destabilize IA willingness to increase taxes and tariffs in the coming years, and possibly affect their development and financial situation. ADB will closely monitor and address specific capacity gaps with technical support and incentives for governance improvements through a performance based approach to fund allocation.

9. **Control Risk** is the risk that the project's accounting and internal control framework are inadequate to ensure project funds are used economically and efficiently and for the purpose intended, and that the use of funds is properly reported.

Table 2: Control Risk Summary – LGED and DPHE

Risk Type	Risk Description	Risk Assessment	Proposed Mitigation Measures
1. Executing Entity	LGED's and DPHE's Finance Sections will be responsible for project FM, accounting and reporting. LGED and DPHE will continue to follow project FM and accounting systems. LGED and DPHE staff has donor project management experience – including ADB, JICA and World Bank. Recent reports ² highlight problems with internal controls and transparency.	Substantial	ADB Review missions Regular FAPAD audits Use of e-procurement Anti-corruption training Business fair for contractors Grievance redresses system to be established for procurement issues.
2. Funds Flow	LGED will manage overall project funds. Project imprest account will be used to cover other payments. LGED will have its own project account ³ ; and DPHE will have a separate subaccount for training and office expenses only.	Substantial	ADB Review missions Direct payments may be used by ADB for major contracts Capacity building for project financial management Dedicated project financial management staff in PMO supported by GICD, MDS & Individual consultants of the project.
3. Staffing	LGED and DPHE Finance Sections are adequately staffed with competent and experienced personnel. The Sections provide professional quality service.	Moderate	Project will ensure that all FM positions are filled and staff is trained on ADB FM procedures
4. Accounting Policies and Procedures	Policies and procedures are well documented. LGED and DPHE use GOB accounting	Moderate	GICD, MDS & Individual consultants will provide oversight and support

² Transparency International Bangladesh. 2012. Local Government Engineering Department: Problems of Good Governance and Way Forward.

³ LGED will have imprest accounts for ADB-ADF & OFID funds.

Risk Type	Risk Description	Risk Assessment	Proposed Mitigation Measures
	standards.		
5. Internal Audit	LGED has an internal audit cell. Most staff are qualified and experienced in the field of auditing and they also receive regular training. DPHE does not have an internal audit cell but will submit financial reports to PMO.	Substantial	Internal audits are complemented by external audits (FAPAD)
6. External Audit	At the project level, Foreign Aided Project Audit Directorate (FAPAD) of C&AG has the constitutional mandate to conduct external audits of donor funded projects. Annual audit reports are typically produced within 6 months of the end of the financial year. At the entity level, audited financial statements are generally delayed by the CAG	Moderate	Statement of Audit Needs provided for audit of the PFS
7. Reporting and Monitoring	Comprehensive monthly and quarterly FM reporting systems are in place. Routine reports are produced from the Accounting System – others are prepared on spreadsheets with figures extracted from the accounting system.	Substantial	GICD, MDS & Individual consultants will build capacity of PMO staff to produce automated reports using existing accounting software
8. Information Systems	LGED's accounts are computerized under the Unified Financial Management Software (UFMS) system.	Negligible	Not applicable
Overall Control Risk	LGED's financial management practices and procedures are considered to be adequate for management and control of project finances – and project funds will be managed and audited separately from LGED funds. DPHE's financial management practices and procedures are considered to be adequate for managing a subaccount.	Substantial	See measures listed above to provide additional checks and build capacity

Table 3: Control Risk Summary – Sample Pourashavas

Risk Type	Risk Description	Risk Assessment	Proposed Mitigation Measures
1. Implementing Entity	<i>Pourashavas</i> will be the IAs for their respective towns. A dedicated PIU will be established to cover technical, procurement and payment approval processes. The PIU Finance Section is responsible for project financial management, accounting and	Substantial	LGED and DPHE to provide training and capacity building with consultant support (Municipal taxation and financial specialist) recruited under the project.

Risk Type	Risk Description	Risk Assessment	Proposed Mitigation Measures
	reporting. PIU will adopt project FM and accounting systems and will be assisted by LGED in this regard. Staff in PIU have project management experience but no previous experience with ADB procedures except Lalmonirhat.		
2. Funds Flow	PIU will receive project funds from LGED. Direct payments by ADB may be used for all major contracts.	Substantial	ADB reserves the right to randomly audit all project subaccounts GICD, MDS & Individual consultants will provide another layer of support for proper fund flow management
3. Staffing	Accounts Officer position is vacant in all sample Pourashavas. Accountant in Naogaon is working on deputation. The Accountant and other staff of accounts section are competent, appropriately qualified and experienced. The Section can provide professional quality service to PIU.	Moderate	Training will be provided on ADB project procedures for all FM staff LGED to ensure placement of Accounts Officer All <i>pourashava</i> accounts staff requires further training in UFMS. Training to be provided by GICD, MDS & Individual consultants.
4. Accounting Policies and Procedures	Policies and procedures are well documented. PIUs have adopted GoB accounting standards	Substantial	Capacity building consultant will strengthen accounting function
5. Internal Audit and controls	Pourashavas have no internal audit section. In addition to annual audit, Audit & Accounts Standing Committee may carry such audit; will require capacity support from project to operationalize the committee and review internal controls.	Substantial	Capacity building consultant under the project will provide support and build capacity of committee
6. External Audit	PIUs will be audited by C&AG's office. Annual audit reports are typically produced within 6 months of the 30 th June Year End. Audit is currently delayed in the case of Magura – last report was for FY	Substantial	FAPAD to audit all project <i>pourashavas</i> subaccounts annually and PMO to submit consolidated auditing report to ADB.

Risk Type	Risk Description	Risk Assessment	Proposed Mitigation Measures
	2009-2010. Lalmonirhat and Naogaon – last report was for FY 2011-2012.		ADB to liaise with C&AG and request that Magura is audited prior to project commencement
7. Reporting and Monitoring	Routine reports are manually produced from the Accounting System – others are prepared with spreadsheets using figures extracted from manual records. An electronic, project specific reporting system will be established as per ADB's requirements.	Moderate	LGED to provide relevant assistance and training with support from consultant (Municipal taxation & financial specialist) recruited under the project.
8. Information Systems	PIUs' accounts are already computerized under LGED UFMS.	Negligible	LGED to provide assistance for MIS.
Overall Control Risk	With the support of a dedicated consultant in financial management in the PMO,⁴ an accounts officer in the PMO and a dedicated accountant in each PIU there will be adequate financial management capabilities and support for implementing the project.	Substantial	See measures listed above to provide additional checks and build capacity.

D. Project Financial Management System: Strengths and Weaknesses

1. Executing Agencies

10. **Strengths.** The main strength of the existing project FM is that both EAs (LGED and DPHE) have had significant experience over the last decade in financial management of international financial institution (IFI) funded projects. However, this experience has not always translated into effective financial management. The main weaknesses are discussed below.

11. **Weaknesses.** Some of the major weaknesses listed below apply to EAs and *pourashavas* – but not necessarily to the project *pourashavas*. These are issues that are pervasive throughout central and local government.

- (i) **Capacity:** *Pourashava* staff are trained and applying the basic functions of the Uniform Financial Management System (UFMS) software. However, they do not have the required skills to use current accounting software to generate automated reports. There is also need to build PMO and PIU capacity for monitoring and evaluation.
- (ii) **Accountability.** LGED does not undertake an internal audit of *pourashavas* at present. IAs are supposed to have an audit & accounts committee (in addition to annual audit of *pourashava* accounts) that meets on a needs basis and reports to the mayor; but this committee is not functioning like an internal audit section. The project will support the operationalization and build capacity of the audit & accounts committee to perform internal audit of each project of *pourashava* and FAPAD will conduct the external audit of all project accounts, including at PIU level. One sample *pourashava* (Magura) has not had audited reports since

⁴ Municipal taxation & financial specialist will provide capacity support to both PMO and all PIUs.

FY2009/2010. A 2009 World Bank study⁵ found that LGED internal controls do not always ensure properly recorded transactions, or properly accounted for and controlled assets, or a focus on the highest priority projects. The same report found that accounting staff in LGED lack sufficient qualifications to properly manage internal controls. To mitigate these risks, the project will have its own, dedicated financial management staff and will be audited by FAPAD on an annual basis. ADB reserves the right to audit the project and project entities or contractors at anytime during project implementation. ADBs procurement guidelines will be implemented and ADB will carry out periodic review missions.

- (iii) **Transparency in the tender process.** A recent Transparency International report (2012)⁶ suggests that there is not always transparency in tender process and highlights common practices like influencing the tender evaluation committee and nepotism, among others. ADB reserves the right to carry out periodic review missions on the tender process. E-procurement will be used to the extent possible.
- (iv) **Irregularities in contract management.** The recent Transparency International report highlighted recurring issues such as illegal withdrawal of contractor security money, contract variations (with additional amounts split between contractors and office staff) and bribes paid by contractors for release of payment. These issues will be monitored closely by ADB and by FAPAD.

12. Bangladesh has implemented key governance and anti-corruption reforms in the recent years. These include constitution of an independent Anti Corruption Commission (ACC) in 2004, enactment of a law on right to information (RTI) and establishment of the Information Commission in 2009, enactment of a law on whistle blower protection in 2011, and anti money laundering act in 2012. It has also implemented extensive PFM and procurement reforms including introduction of medium term budgetary framework (MTBF) for budget formulation, uniform procurement laws for all public sector agencies and e-procurement for selected agencies, including the EA of the project, LGED. It has approved recently a comprehensive National Integrity Strategy (NIS) to address corruption holistically and strengthen country's watchdog institutions by formulating phased actions for each of them. Under this, all line ministries have established an Ethics Committee and a focal point to undertake preventive measures to control corruption. At the national level, a National Integrity Advisory Committee has been formed with the Prime Minister as the chair to steer anti-corruption drive in the country.

2. Implementing Entity

13. The structures envisaged to manage and oversee Project implementation have been designed to encourage accountability and minimize corruption risks. An inter-ministerial project steering committee at national level, chaired by the Secretary LGD, will provide overall policy guidance and oversight to the project. The committee will include key government stakeholders. LGED and DPHE are the executing agencies, with LGED taking the lead. Overall coordination of the project will be provided by a Project Director from LGED who heads the PMO. The participating pourashavas are the implementing agencies and they will each establish a project implementation unit (PIU) within the pourashava structure.

⁵ World Bank. 2009. Operational Risk Assessment (ORA) for Local Government Engineering Department (LGED) Bangladesh. Final Implementation Plan.

⁶ Transparency International Bangladesh. 2012. Local Government Engineering Department: Problems of Good Governance and Way Forward.

14. The PMO will tender and manage all international competitive bidding (ICB) contracts; and PIU will tender and manage all national competitive bidding contracts. The PMO will also engage all technical assistance (TA) consultants under the project: (i) Governance Improvement & Capacity Development (GICD) Consultants, (ii) Management Design and Supervision (MDS) Consultants, and (iii) Individual Consultants.

15. LGED will have a project account. DPHE will have its own subaccount for office expenses.

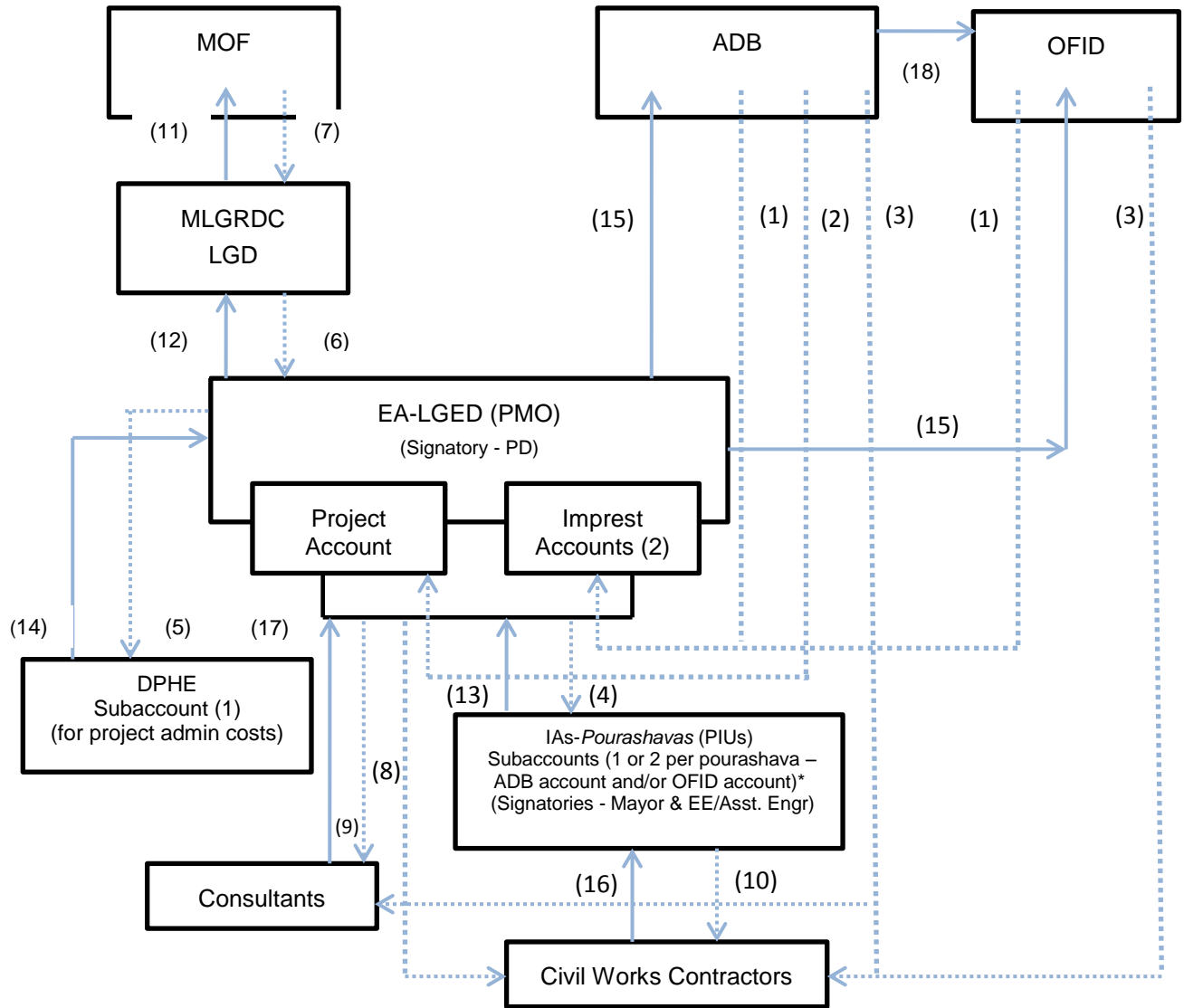
16. To foster sustainability, and in keeping with Paris and Kavieng Declaration commitments, Government procedures and documentation will be used in all implementation stages. In addition to direct implementation roles, consultants will build capacity in key technical and management functions by training PMO and PIU staff.

E. Fund Flow Mechanisms

17. The project specific fund flow mechanism is illustrated in Figure 1. The government will be responsible for implementing the project according to the loan agreement and other agreements. ADB will monitor the project and review its progress to ensure that loan proceeds are spent as previously agreed. When a loan becomes effective, a loan account will be opened in ADB's books in the name of the borrower and the loan amount is credited to that account. All disbursements under the loan will be carried out in accordance with ADB's Loan Disbursement Handbook 2007, as amended from time to time. The last disbursement under the project is expected to be made by 30 June 2020.

18. ADB disburses loan proceeds to the GOB account in the Bangladesh Bank. GOB will make funds available to LGED on a quarterly basis through the Treasury. LGED, as head of the PMO, will manage loan proceeds through direct payment procedures for major contracts – i.e. international competitive bidding (ICB) contracts. Other payments will be covered through statement of expenditure procedures and reimbursement procedures from project imprest accounts. PIUs will have subaccounts for day-to-day project administration costs and payments to contractors engaged through NCB. Expenditures are consolidated and reviewed on a monthly basis by the PMO from LGED, DPHE and PIUs and reimbursement claims are submitted to ADB for review and approval.

Figure 1: Fund Flow Mechanism



ADB = Asian Development Bank, DPHE = Department of Public Health and Engineering Department, IA= Implementing Agency, LGD = Local Government Division, LGED = Local Government Engineering Department, MLGRDC = Ministry of Local Government, Rural Development and Cooperatives, MOF = Ministry of Finance, PMO = project management office, PIU= project implementation unit.

Fund Flow →

- (1) Disbursement Procedure: Advance/Replenishment of Imprest Account
- (2) Disbursement Procedure: Reimbursement
- (3) Disbursement Procedure: Direct Payment/Commitment
- (4) Advances
- (5) Advances
- (6) Budget Allocation
- (7) Budget Allocation
- (8) Payment to Contractors
- (9) Payment to Consultants
- (10) Payment to Contractors

Document Flow →

- (11) Budget request
- (12) Budget request
- (13) Liquidation
- (14) Liquidation
- (15) Withdrawal Applications
- (16) Invoice of Contractors
- (17) Invoice of Consultants
- (18) Payment advice

*out of 30 project towns, civil work packages for 5 to 7 towns will be financed by OFID fund. They will have two accounts. Others, solely financed by ADB, will have only one account.

F. Personnel

19. The PMO will have a dedicated accountant and two accounts officers and each PIU will have a dedicated accounts officer. PMO FM staff will be drawn from LGED finance department, line agencies and contract employees as required.

20. Pourashava staff will need to be trained on ADB disbursement procedures, along with improving their budgeting, expenditure and financial reporting activities. ADB will provide training to the pourashavas as will the Government through the National Institute of Local Government (NILG). Project consultants will also build financial and accounting capacity at pourashava level.

G. Accounting Policies and Financial Reporting

21. Project financial statements shall be prepared to achieve maximum alignment with Cash-Basis International Public Sector Accounting Standards (IPSAS). The cash basis of accounting will be adopted, with additional disclosures.

H. Internal Audit

22. LGED's Internal Audit Cell reports to the head of agency, the Chief Engineer. Internal audit tests whether:

- (i) transactions are executed in accordance with management's authorization,
- (ii) transactions and other events are promptly recorded in the correct amount, in the appropriate accounts, and in the proper accounting period,
- (iii) access to assets is permitted only in accordance with management's authorization, and
- (iv) recorded assets are compared with the existing assets at reasonable intervals and appropriate action is taken regarding any differences

23. LGED 2011-2012 Annual Report mentions that there were 147 new, unresolved cases of audit objections on foreign funded projects for FY11-12. In total, there are 432 unresolved cases for foreign funded projects and 145 unresolved cases for GOB funded projects. ADB will work closely with PMO to quickly address any issues highlighted in FAPAD reports and not leave any unresolved issues related to the project.

24. DPHE does not have an internal audit department. However, one accountant from C&AG's office is posted in DPHE on a part-time basis. The accountant reviews all transactions. This system is adequate to manage a subaccount account. DPHE will be subject to the project procedures for financial management, including regular submission of financial reports to PMO.

25. Pourashavas do not have any internal audit department; and LGED does not undertake an internal audit of pourashavas. Each pourashava is however supposed to have an audit and accounts standing committee that may work on a needs basis in addition to the annual audit of accounts of pourashava as required by Local Government (Pourashava) Act, 2009. These committees are supposed to report to their respective Mayors. The project will support pourashavas to operationalize these committees to perform internal audit. The PMO will request this committee to undertake internal audit of the PIU's activities and transactions to complement the external audit.

I. External Audit

26. All state entities (including LGED, DPHE and Pourashavas) are subject to external audit of the Office of the Comptroller and Auditor General (C&AG) of Bangladesh. C&AG reviews and comments on state entities' financial reporting and records on an annual basis and following GOB accounting rules. The external statutory Audit Report is required be submitted within six months from the end of each financial year although it is often delayed.

27. The scope of the external audit includes:
- (i) adequacy of the accounting and internal control systems,
 - (ii) ability to maintain adequate documentation for transactions,
 - (iii) eligibility of incurred expenditures,
 - (iv) basis of estimates, and
 - (v) an opinion concerning the fairness of the accounts

28. For development projects, a project audit is performed by the FAPAD unit of the C&AG. This unit is specifically trained on loan procedures and loan negotiation documents. This unit reviews if the project is being implemented according to the approved loan agreements and also reviews tax payments, deviations from the loan agreements, authorizations, and disbursements. FAPAD will audit PMO and PIUs separately and provide separate audit reports for each subaccount; with a management letter for each subaccount. FAPAD may also prepare a consolidated, summary report for the project highlighting main findings. FAPAD will not be required to issue a management letter for the consolidated project financial statements.

29. For the Project, one set of audited project financial statements shall be submitted by the PMO to ADB annually within six months of the financial year end.

J. Procurement

30. LGED, DPHE and project pourashavas need to comply with both government and ADB procurement rules and guidelines applicable for all procurements of goods, works, and services. The PMO and PIU will receive relevant training on ADB requirements.

31. Procurement of goods and services under government financing is conducted under the Public Procurement Act 2006 and the guidelines of the Public Procurement Rules (PPR) 2008 following a competitive bidding process.

32. LGED is one of 4 pilot agencies engaged in the current government initiative, E-government procurement (E-GP), to transfer all government procurement processes to e-systems. This applies to the acquisition of goods, works and consultancy services. It currently applies only to NCB contracts. The project will build capacity of pourashavas to use e-procurement for works contracts funded by the project to the extent feasible; and build awareness of e-procurement system among contractors, including through business fairs organized by PMO and PIU.

33. IA/PIU accountant will review the following financial issues related to procurement:
- (i) whether the PPR has been followed
 - (ii) suppliers' bills
 - (iii) material receiving reports (MMR) from store keeper
 - (iv) whether quality has been certified by concerned experts
 - (v) whether any earlier payments have already been made

- (vi) security deposits
- (vii) whether deductions at sources have been made (VAT-Taxes-IT)

34. GICD, MDS & Individual Consultants Engineering staff will provide support to PIU accountant for engineering related tasks (e.g. verifying quality of materials).

K. Assurance/Covenants

1. Right of Audit

35. LGED, DPHE and project pourashavas will ensure that contracts financed by ADB will include provisions specifying the right of ADB to audit and examine the records and accounts of LGED, DPHE and project pourashavas and all contractors, suppliers, consultants, and other service providers as they relate to the Project.

2. Financial Management

36. FAPAD will audit the PMO and PIUs annually with a focus on project funds. Audit reports shall be available within 6 months of the financial year end. The PMO will build PIU capacity to ensure, among other things, timely and rigorous reconciliations, orderly record keeping, and strict adherence to financial management policies and internal controls, and to ensure an orderly and timely year-end process for the preparation and audit of annual project accounts.

3. Governance and Anticorruption

37. The Government will ensure that (a) the project is carried out in compliance with all applicable GoB anticorruption regulations, and ADB's Anticorruption Policy (1998, as amended to date); (b) all PMO and PIU staff actively participate in the training in GoB's anticorruption regulations and ADB's Anticorruption Policy; and (c) a website is developed and maintained to disclose the audited annual project accounts, project progress, and procurement activities.

4. Financial sustainability

38. The Borrower shall cause each of the participating pourashavas with water and sanitation subprojects to adopt a volumetric water tariff system as part of an overall tariff enhancement plan. Performance criteria require an increase in holding tax collection efficiency and indirect taxes and fees as set out under UGIAP. Fulfilment of this requirement shall be a condition to receive funding under next phases. Pourashavas, for introduction of volumetric/metered piped water supply systems in the project towns, will carry out a public awareness campaign throughout the project on the need for metering and tariff changes.

L. Conclusions

39. FMA indicates there are significant FM risks. Consequently, the project has proposed a series of targeted mitigation measures to increase transparency, internal controls and reporting. Given the scale of the planned investments for these towns and expected increase in O&M costs for project pourashavas in the coming years, EA and IA officials should give more and serious attention to financial management risks and make available the required resources to mitigate these risks. A positive finding is that the EAs have a sound record of experience with

ADB and donor lending procedures and projects and have implemented several projects and programs. The IAs have a range of experience with donor projects (e.g. ADB, DANIDA, World Bank). The UGIAP addresses improvement of financial management in stages. This will help mitigate the risks substantially, as failure to meet the requirements of the UGIAP means that such pourashavas will not be entitled to the next phase of budget allocation for infrastructure improvement.

40. Some of the FM weaknesses to be addressed by the project are summarized below:
- (i) **Lack of ADB Experience:** The majority of the pilot pourashavas does not have experience with ADB projects and will require adequate training on ADB processes and procedures.
 - (ii) **Gaps in audit and reporting:** LGED does not undertake an internal audit of pourashavas. Pourashavas have no internal audit section. The audit & accounts standing committee may meet requirement of internal audit on a needs basis and reports to their respective Mayor. There is room for LGED to improve its oversight of pourashavas' financial management.
 - (iii) **Insufficient transparency:** A recent Transparency International (2012) study finds that there is a lack of transparency in tendering process and contract management. The project will encourage e-procurement on NCB, and business opportunity fairs will encourage wide competition; and ADB and procurement specialist in MDS consultants will monitor contract management closely.
41. The recent TI report raised issues regarding LGED financial management, for which LGED responded positively and publicly to development partners. This project will have ring fenced account, dedicated financial management and procurement staff with consultant support, and regular audits. PMO and PIU staff will receive training on ADB and GOB corruption rules as well as ADB and GOB financial management and procurement rules. The loan covenants address financial management issues and these have been discussed with the government.