

## **FINANCIAL MANAGEMENT ASSESSMENT**

### **A. Executive Summary**

1. Financial management assessment of Karnataka Neeravari Nigam Limited (KNNL) the proposed EA was carried out for the project and the Advance Center for Integrated Water Resources Management (AC-IWRM) – the implementing agency for the project. The assessment was primarily undertaken to assess the adequacy of the existing procedures relating to financial management capacity of these agencies pertaining to planning, budgeting, accounting, fund flow arrangements, accounting and financial reporting, internal controls systems, audit and asset management. The objective is to assess the overall capacity to utilize funds provided for the intended purposes, and to maintain proper documentation. Accordingly, the assessment was designed to determine whether the executing /implementing agencies' (i.e. KNNL and AC-IWRM) financial management arrangements are adequate for recording all transactions and balances supporting the preparation of regular and reliable Project Financial Statements (PFS), which could be subjected to audit to comply with the fiduciary requirements of ADB. The findings from this assessment were considered while drawing up the financial management arrangements and oversight for the project.

### **B. Methodology**

2. Documents pertaining to ADB's Financial Management and Analysis Questionnaire (FMAQ) were applied for drawing information of the financial management for each of the aforesaid agency, in addition to study of the recent annual report of KNNL which includes the audited PFS, audit report and analysis of the financial operations of KNNL and AC-IWRM. Since AC-IWRM is a nascent organization (less than an year old) no annual report was available, while the first annual audit was scheduled to take place towards end of June 2013. A indicative checklist (for internal reference in addition to FMAQ) was developed to cover assessment of areas like Governance, Financial Management, Accounting, Budgetary Control, Staffing, Internal & External Audit and Management Information System, to enable the project to draw up the institutional implementation arrangements for utilization of ADB financed Program funds.

### **C. Key Findings**

#### **1. Executing Agency and Implementing Agency**

3. Both the agencies are organisations registered under the Societies Act 1956, and are governed by the State policies and regulations laid down from time to time. While KNNL was formed and established in 1998, and have been implementing various projects in the sector financed by SGOK and or Government of India. The procurement and financial management of the organisation is well established at the headquarters and at the field level, with seamless and timely fund transfers for payment of approved expenditures for procurement of goods, services and works.

4. AC-IWRM was formed and registered in 2012. Being a nascent agency it is still in various stages of operationalization of its mandated activities and has no prior experience in implementation of externally aided projects.

#### **2. Staffing**

5. KNNL is being staffed with key experienced personal drawn from other departments including the Water Resources, and State Finance Departments with additional inputs from

contractual experts drawn from the market to service the gaps to facilitate execution of KNNL activities.

6. AC-IWRM is also being staffed with finance personnel drawn from the state accounts cadre. These personnel are well versed with the accounting and auditing procedures followed by the State and are capable of proper maintenance of records. Being a nascent organization (one year old) the agency is thinly staffed with most of the regular staff deputed on a dual charge basis.

### **3. Accounting Systems and Procedures**

7. The mainstream Government Accounting System is being followed by KNNL and AC-IWRM in maintenance of books of accounts and the overall financial management system, following finance and accounting procedures as has been done in implementing other Externally Aided Projects in the recent past have enabled streamlining of State government accounting system through Treasury Computerization, Treasury Network Management system for effective data transfer & financial reporting and coordination with the Treasury. These actions have effectively integrated the policies and procedures drawn from Finance and Accounts procedures of Government of Karnataka (SGOK), provisions in the Karnataka Finance Code, Karnataka Treasury Code & Manual, Public Works Department (PWD) Accounts Code, Manual of Contingent Expenditure, Stores Manual, Budget Manual, Karnataka Transparency in Public Procurement Act and Karnataka Right to Information Act. These efforts was followed up through extensive training and capacity building of the staff from the State Accounts service cadre, who are posted in all state government departments, agencies wholly owned by the state departments, parastal bodies etc., to maintain the books of accounts and ensure compliance to the procedures and policies laid down in the aforesaid rules and regulations of financial management.

8. There are no major issues with the accounting policies and procedures. Accounts are maintained professionally by KNNL and AC-IWRM as per PWD Accounts Code provisions, Karnataka River Valley code, KPPP Act, Karnataka Finance Code and As per Companies Act 1956 (using Tally ERP Software).

### **4. Budgetary Allocations**

9. An assessment of the budgetary allocations for activities of KNNL in the past three years indicate a consistent increase and dovetailing of funds from Central schemes to integrate and enhance the interventions envisaged by WRD and KNNL towards increasing productivity and active engagement in the field to ensure the policies and procedure Budgeting for the Project would involve adequate annual budget allocations for implementation of the Project Finance Components under the designated project specific budget heads.

### **5. Fund Flow**

10. Both organizations are financed through the annual budgetary allocations of Water Resources Department (WRD). The existing fund flow arrangements are treasury based transfers from SGOK to KNNL and AC-IWRM. KNNL thereafter does onward transfers to field units based on the verification and authorization of the requests for transfer of funds by the Chief Accounting Officer, who is the Drawing and Disbursing Officer (DDO) and the Joint Controller of State Accounts Department. This arrangement has adequate checks and balances to ensure compliance to Public Works Department Code provisions under the Karnataka Finance Code and Companies Act 1956.

11. In the case of AC-IWRM, funds are drawn from the Treasury and transferred to the current account of the agency with the local bank to facilitate withdrawals to meet the costs of project activities and day-to-day expenditure

12. The transfer of funds allocated to these agencies follows the Treasury transfer system in two to three tranches annually or more, depending upon the expenditure and fund requirements from time to time. All fund transfers are being carried out through “Real Time Gross Settlement (RTGS)” – local online Electronic Clearing System (ECS) approved under the Reserve Bank of India’s Banking guidelines.

## 6. Internal Audits

13. KNNL has established an internal auditing system for all transactions by independent Chartered Accountants recruited through a competitive process. AC-IWRM does not have an internal auditor as on date. Further AC-IWRM is still a nascent organization with not too many transactions as it is yet to reach its critical stage of operations.

## 7. External Audits

14. The Statutory auditors for KNNL are appointed by Comptroller & Auditors General (CAG) of India from their panel list once in 3-4 years, who at the advice of the CAG carries out random samples of transactional audits.. In addition to this, Audit by Office of the Accountant General of CAG in the State includes annual, propriety and review audits.

15. Although both the agencies have no prior experience in implementation of externally aided projects, the organizational structure, personnel, skills financial management system and procedures being followed by them are adequate to implement the program and are by and large compliant with the fiduciary requirements of ADB.

## D. Risk Analysis

16. Institutional, procurement and financial assessments of the executing and the implementing suggest that the PMU may face some minor risks that could affect timely program implementation. However, these risks may effectively be mitigated through agency-specific measures. Financial management risks for the program and the associated risk mitigation measures will be updated throughout the implementation of the KISWRMIP. The assessment findings are as follows:

Sl. No.	Risk Description	Risk Assessment	Mitigation Measures or Risk Management Plan
1.	Governance	L	<ul style="list-style-type: none"> <li>▪ Administrative systems and practices well established including procurement and financial management.</li> <li>▪ Separate Program Management Unit headed by a Program Director who is also the Managing Director of KNNL – the EA, and dedicated staff for day-to-day management. Project Implementation Offices (PIO) under the EA will be dedicated units in the field for project implementation</li> </ul>
2.	Limited capacity of AC-IWRM	M-H	<ul style="list-style-type: none"> <li>▪ Upfront actions completed to define policy, planning, and institutional framework with AC-IWRM</li> <li>▪ Extensive support to be provided by international and national sector experts</li> <li>▪ Initial procurement activities will be supported by consultants from PSC</li> <li>▪ Procurement support will be provided by program support consultants (PSC). In addition to PSC, capacity enhancement</li> </ul>

Sl. No.	Risk Description	Risk Assessment	Mitigation Measures or Risk Management Plan
			support will also be provided by ADB through its regular training programs.
3.	Slow procurement due to limited financial and approval powers	M	<ul style="list-style-type: none"> <li>▪ Program Director is MD KNNL and has approval authority for all procurement of works, goods and services following recommendation of technical sub-committee.</li> <li>▪ E-Procurement mandatory for all procurements estimated above \$4,000; ADB assessment of e-Procurement for ICB, NCB and shopping procedures underway.</li> <li>▪ Advance procurement and consultant engagement based on agreed procurement plan</li> <li>▪ Implementation support to be provided for pre-project activities</li> <li>▪ The procurements by AC-IWRM are small and will be approved by the Management Committee. Support will be provided by PSC and PMU</li> </ul>
4.	Potential for corruption and low quality of works	M	<ul style="list-style-type: none"> <li>▪ Existing Grievance Redress Mechanism will be enhanced and integrated with the Management Information System (MIS) to be established.</li> <li>▪ Interface with MIS data base to provide links for disclosure of key documentation and other related program information through KNNL website for public viewing.</li> <li>▪ Review by visiting ADB missions and senior officials of SGOK</li> <li>▪ Asset verification to be carried out by internal auditor and recorded in the MIS.</li> <li>▪ Stringent quality monitoring by Project Supervision Consultants and PIO engineers in the field;</li> </ul>
5.	Poor time and quality management of contractors	M-L	<ul style="list-style-type: none"> <li>▪ Practical bid pricing based on market rates, price adjustment mechanism during implementation</li> <li>▪ Procurement of civil works limited to one single large package.</li> <li>▪ Goods/services procurements will follow ADB's Procurement Guidelines (2013, as amended from time to time), and will be based on prior approval unless otherwise communicated in accordance with an agreed procurement plan.</li> <li>▪ Sound construction management following ADB standard bid documents (including FIDIC provisions)</li> <li>▪ Mobilization of PSC to support stringent quality monitoring and management using modern technologies</li> <li>▪ Participation of PIO engineers to monitor construction quality</li> </ul>
6.	Limited WUCS participation in Project activities	M	<ul style="list-style-type: none"> <li>▪ Sufficient awareness and motivation campaigns with the support of experienced and NGOs trained by consultants</li> <li>▪ Initial focus on highly vulnerable areas and demonstration of program quality</li> </ul>
7.	Limited application of safeguards by a) KNNL b) WUCS	M H	<ul style="list-style-type: none"> <li>▪ Special training programs both by ADB and PSC will be done at regular intervals to improve knowledge and application of safeguard measures by KNNL staff, PIO engineers and contractors.</li> <li>▪ Extensive information, education and communication activities will be carried out in the field to improve awareness of WUCS members.</li> </ul>
8.	Sustainability of KISWRMIP infrastructure	H	<ul style="list-style-type: none"> <li>▪ Asset inventory and MIS for infrastructure performance monitoring and maintenance planning will be established</li> <li>▪ Progressive increase of maintenance fund allocation by SGOK in public infrastructures (ongoing and to continue)</li> <li>▪ Improved technical management of O&amp;M of assets established at field level with higher transparency and accountability</li> <li>▪ Utilization of available SGOK/GOI funds for routine</li> </ul>

Sl. No.	Risk Description	Risk Assessment	Mitigation Measures or Risk Management Plan
			maintenance works <ul style="list-style-type: none"> <li>▪ WUCS capacity building in O&amp;M</li> <li>▪ Increased application of IWRM practices in operation of assets established under the MFF and other schemes</li> </ul>
9.	Unavailability of Timely fund flow	M-L	<ul style="list-style-type: none"> <li>▪ SGOK to ensure timely release of project and counterpart fund to KNNL's and AC-IWRM PD Accounts for transfer to dedicated project bank account maintained by each of these entities.</li> <li>▪ Establishment of dedicated project bank account to ensure timely payments to contractors/supplier/service providers and IAs.</li> <li>▪ Transfer of approved budgetary allocations to PD Accounts within 15 days of receipt of Request for Funds</li> </ul>
10.	Varying performance in financial and procurement management	L	<ul style="list-style-type: none"> <li>▪ KNNL's MIS system to be upgraded to real time-based operational system linked to Chief Accounts Officer (CAO) of SGOK and PIO offices<sup>1</sup> through Karnataka State Wide Area Network (KSWAN)</li> <li>▪ Similar arrangements will also be installed in AC-IWRM to support integrated data management.</li> <li>▪ Specially assigned finance and accounts staff for the project in PMU, and PIO offices. In view of the limited financial transactions by AC-IWRM during the life of the project, the existing FM staff in the agency will continue to manage the project funds</li> <li>▪ Sufficient training of FA staff by consultants and MIS service provider</li> <li>▪ Advance Training on Financial Management, Procurement and Performance Monitoring for PMU, IA and PIO staff</li> </ul>
11.	Accounting and Audit capacities	L	<ul style="list-style-type: none"> <li>▪ SGOK's approved accounting regulations will be followed in addition to maintenance of accounts and records as required by ADB</li> <li>▪ Establishment of MIS for improvement of financial management, to enhance accounting standards and capacities in KNNL, AC-IWRM and PIO offices</li> <li>▪ Sound internal and external auditing mechanism with the latter following the standards for audit issued by Indian Chartered Accountant Institute -Comptroller and Auditor General</li> <li>▪ Independent firms will be hired for carrying out internal and external audits under an agreed ToR with ADB</li> </ul>
<b>Overall Risk Rating</b>		<b>Medium</b>	

## E. Project Financial Management Systems

17. Following are the Financial Management arrangements proposed to be established for timely implementation of the program:

### 1. Staffing

18. The PMU will be staffed with (at the State level) the existing General Manager (Finance) and Finance Manager of KNNL who will be assigned with additional responsibility for oversight of financial management of the program during implementation. One existing Deputy Manager (Finance) and Accounts Officer of KNNL will be assigned to the PMU with additional charge for: (i) coordination of all financial management requirements of the program in the State, (ii) maintenance of all program accounts, (iii) preparing financial progress and monitoring reports, (iv) follow up with the State for the release of funds,

<sup>1</sup> PIO– units implementing KNNL activities in the field.

processing fund transfer requests from implementing agencies, Chief Accounts Officers (CAOs) and subproject (v) implementing divisions, (vi) preparation and submission of withdrawal applications to Controller of Audit and Aid Accounts (CAAA) of the Ministry of Finance for reimbursement from ADB (vii) operationalization of MIS based Financial Management System in KNNL head office and field divisions, (viii) asset-inventory management, (ix) overseeing the work of the internal auditors and coordinating the work of external auditors. These two officers will be assisted by two accounts assistants either drawn on deputation from other departments or contracted from open market. Assignment of Deputy Manager (Finance) and Accounts Officer in PMU will be completed before loan approval.

19. The existing staff of AC-IWRM incharge of the financial management shall continue to provide their services for this project. The Accounts Superintendent is the head of the finance division who is supported by a Chief Accounts Officer, and two accountants – all on part time basis although they are regular SGoK staff drawn from the accounting cadre of the state. As the operations under the project increase, full time staff would be posted in AC-IWRM.

20. In the office of the CAO, one existing Accounts Officer (AO) will be assigned with additional charge to verify, supervise and monitor the financial transactions of KNNL irrigation zones implementing the subprojects under this MFF. The AO will be assisted by one existing audit officer and one accounts assistant. At the zonal level, the existing accountant will be given additional charge to maintain the books of accounts and finance for the approved subproject activities in the respective irrigation zone.

## 2. Budget

21. **Budget Line Item in SGOK Budget:** The project will be pre-financed by SGOK through a dedicated budget head, separately identifiable line item under the Major Head no. **xxxxxx**, for the ADB project in the Demand for Grants of the State Water Resources Department (WRD) and allocate funds under this budget head for the Financial Year 2013-14 based on the projected expenditure for the program for FY2013-14. This budget head will be distinct from other budget lines under this Major Head. This exercise of establishment of a distinct budget head will be initiated as part of the budget exercise for the current financial year scheduled to commence in July 2013 for FY 2013-14. The budget submitted shall include both ADB's share and counterpart (State) contribution agreed to finance approved activities planned under the Program. Upon approval of budget by the State legislature, WRD would release funds under this subhead to the Personal Deposit (PD) account of KNNL and AC-IWRM (as requested), to allow these agencies to effect need based draw down of funds to finance approved Program activities.

## 3. Fund Flow Arrangements

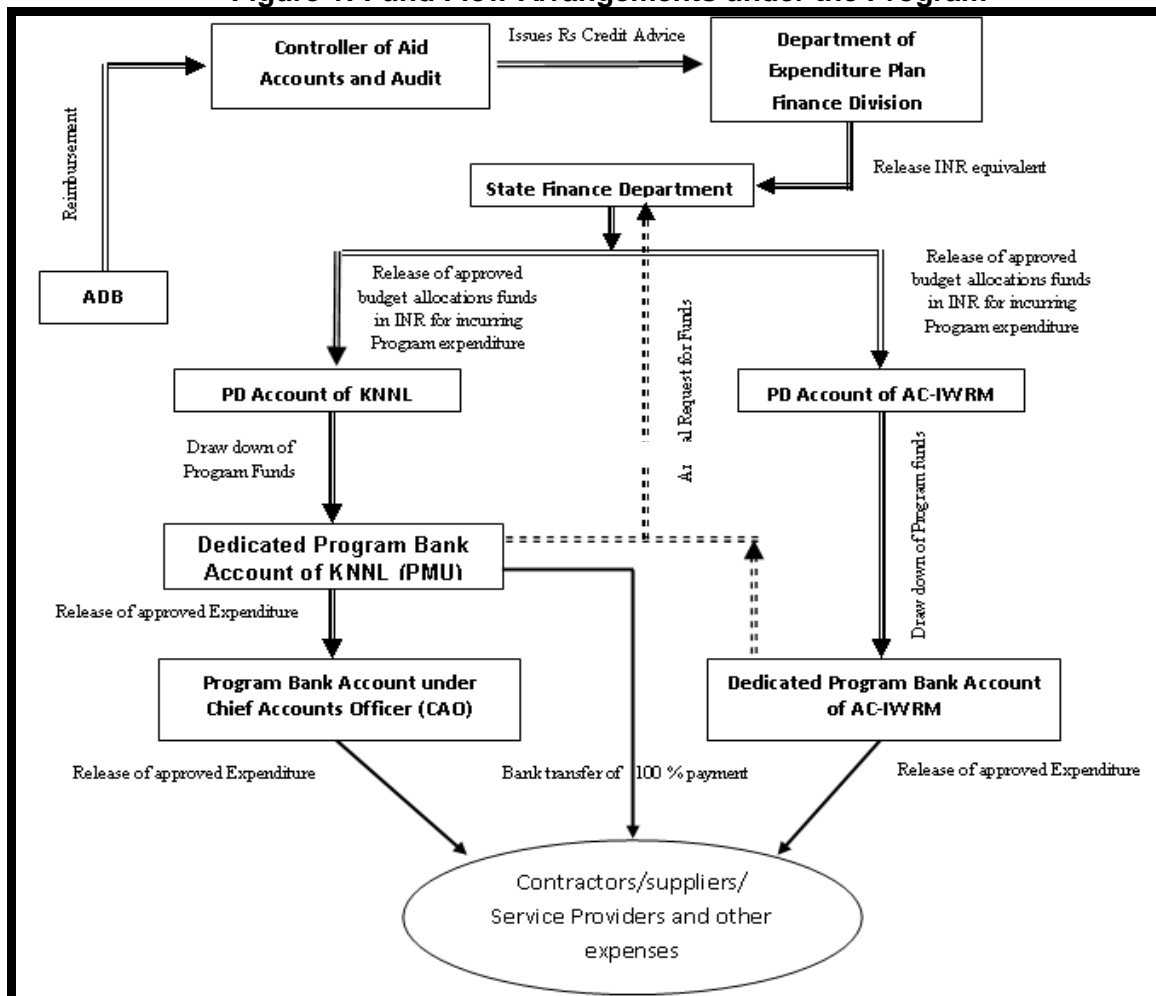
22. **Bank Account:** KNNL and AC-IWRM will open separate project Bank Accounts with State Bank of Mysore to receive and disburse funds allocated for the program from their respective Personal Deposit Accounts, to avoid co-mingling with overall funds received by KNNL and to facilitate withdrawals/onward transfers to IAs, CAO and PIO thereof for effecting payments to contractors/ service providers, etc. The IAs and CAO-PIO shall open individual Program Bank Accounts to receive funds from KNNL to finance approved sub-projects/ activities only under the Program. The Program funds will not be transferred to any bank accounts maintained for receipt of other funds and or be used for temporary bridging of resource gaps for other activities outside the scope of this program.

23. **Fund Flow Arrangements:** The fund flow arrangements for the project will be on a reimbursement basis, wherein eligible expenditures (inclusive of ADB's share and

counterpart contributions) will be pre-financed by the State from its consolidated account to the Personal Deposit accounts of KNNL and AC-IWRM, respectively. Funds flow from the treasury account to KNNL's and AC-IWRM's Personal Deposit accounts will be either on a quarterly/monthly basis and or more frequently based on the expenditure incurred by the program. KNNL will transfer funds to the separate program bank accounts in the respective CAO based on the indent raised for disbursement against verified and approved bills/invoices, and or other expenditure duly approved by the CAO.

24. On receipt of confirmation of transfer of funds by KNNL, the CAO shall authorize payments through bank transfers from the program bank account to the respective contractors/ service providers. The PIO shall submit the utilization certificates for the expenditure duly authorized by CAO to KNNL after completion of the transaction against each bill/invoice certified for payment by the CAO. Similarly, the CAO in AC-IWRM shall submit utilisation certificates for the expenditure duly authorized by th Accounts Superintendent to PMU for the later to consolidate the expenditure claims for submission to CAAA-ADB for reimbursement. The detail fund flow arrangements are given in Figure 1 for clarity.

**Figure 1: Fund Flow Arrangements under the Program**



25. Upon receipt of documentation of completion of the financial transaction, KNNL will submit to CAAA withdrawal application with the Statement of Expenditures (SoE) eligible for ADB financing under various categories and corresponding percentage of financing as detailed in the Allocation and Withdrawal of Loan Proceeds (Section IV-C above), as agreed in the Framework Financing Agreement (FFA) under this Multi-tranche Financing Facility (MFF).

#### 4. Disbursement Procedures

26. Disbursement of loan proceeds under the MFF will be in accordance with ADB's *Loan Disbursement Handbook* (2012, as amended from time to time)<sup>2</sup> and the detailed arrangements agreed upon between the government and ADB

27. Each loan under the MFF may have its own imprest account in CAAA, Department of Economic Affairs, Ministry of Finance. The SGOK has opted to pre-finance the expenditure under KISWRMIP and seek reimbursement of eligible expenditure from ADB. A communication to the effect has been submitted by the State to DEA, Ministry of Finance, Government of India. The disbursement arrangements for the Program will be on a reimbursement basis. Therefore, this FAM will not detail the procedures and requirements for maintenance of imprest Account with CAAA and the sub accounts by KNNL. However, the option for SGOK-KNNL to access this facility anytime during the program implementation period will continue to remain open and the procedures for the same may be accessed in ADB's *Loan Disbursement Handbook* available at [www.adb.org](http://www.adb.org).

28. **Types of Disbursement Arrangements.** There are three major types of disbursement:

- (i) Direct payment procedure where ADB, at the borrower's request, pays a designated beneficiary directly;
- (ii) Commitment procedure where ADB, at the borrower's request, provides an irrevocable undertaking to reimburse a commercial bank for payments made or to be made to a supplier against a letter of credit financed from the loan account;
- (iii) Reimbursement procedure (with or without full supporting documents) where ADB pays from the loan account to the borrower's account, or in some cases, to the project account for eligible expenditures which have been incurred and paid for by the project out of its budget allocation or its own resources; and

29. Required actions prior to submission of withdrawal application includes but not limited<sup>3</sup> to the following:

- (i) Authorized signatory letter from SGOK authorizing signatories and authentication of their signatures addressed to DEA, CAAA and ADB;
- (ii) Submission of Treasury Account details to DEA and CAAA for transfer of reimbursements from ADB to SGOK against eligible expenditures under the project.;

30. **Statement of Expenditure (SOE) Procedure.** The SOE procedure will be used to reimburse/liquidate eligible expenditures not exceeding \$100,000 equivalent for any individual payment. For all individual payments exceeding \$100,000 equivalent, documented claim procedure<sup>4</sup> will be followed. Withdrawal applications for payments made to contractors/consultants in currencies other than Indian Rupees if any, will be submitted for reimbursement to CAAA-ADB will follow documented claim procedure and will be in the currency paid to contractors/consultants. Claims in the SOE sheets must carry on the corresponding Procurement Contract Summary Sheet (PCSS) number provided for each contract under the Program. SOE records should be maintained and made readily available

<sup>2</sup> Available at: [http://www.adb.org/Documents/Handbooks/Loan\\_Disbursement/loan-disbursement-final.pdf](http://www.adb.org/Documents/Handbooks/Loan_Disbursement/loan-disbursement-final.pdf)

<sup>3</sup> Any additional requirements by Gol/CAAA enforced from time to time needs to be complied with by the State and EA.

<sup>4</sup> All supporting approved invoices, bills, receipts of payment



for review by ADB's disbursement and review missions or upon ADB's request for submission of supporting documents on a sampling basis, and independent audit.

31. Before the submission of the first withdrawal application, the government or the EA should submit to ADB sufficient evidence of the authority of the person(s) who will sign the withdrawal applications on behalf of the borrower, together with the authenticated specimen signatures of each authorized person.

32. **Minimum value per Withdrawal Application.** The minimum value per withdrawal application is US\$100,000, unless otherwise approved by ADB. KNNL will consolidate expenditure claims of PMU, AC-IWRM and others received from the PIOs, to meet this limit for reimbursement claims. Withdrawal applications along with the SOEs and supporting documents will demonstrate, among other things that the goods, and/or services were produced in or from ADB member countries, and are eligible for ADB financing. Similar eligibility condition will be detailed in the SOE should civil work contracts if any is awarded to a foreign contractor/company or joint venture.

33. All disbursements under government financing will be carried out in accordance with regulations of Government of India relevant to co-financing of the projects financed by the Multilateral Financing Organizations.

34. **Asset Inventory Management:** The internal auditor appointed for the Program will be assigned with the responsibility of providing the assurance and details of the end use of funds for creation of assets under KISWRMIP, by conducting a physical verification of the assets created before final payments for the same is released to the contractor. The internal auditor shall draw the assistance and reports of Project Supervision Consultants and PIO engineers on the technical quality, effective use and durability of the assets established and incorporate the findings in its consolidated report. The internal auditor will regularly review the records and documentation maintained by AC-IWRM and Program implementing PIO and will seek to link these with the physical assets created. The report of the internal auditor will be feed into the asset inventory management register of the MIS maintained and operated by KNNL.

## 5. Finance Accounting and Auditing Requirements

35. KNNL, through the PMU and PIOs, will:

- (i) KNNL and AC-IWRM shall for this project maintain separate books and accounts relating to expenditure from all sources.
- (ii) KNNL and AC-IWRM shall separately prepare and submit audited project financial statements to ADB in the English language within 6 months of the end of the fiscal year.
- (iii) Project financial statements shall include at a minimum, a statement of receipts and payments with accompanying notes and schedules. These shall be prepared to ensure maximum alignment to international accounting standards<sup>5</sup> and Government of India financial regulations. Template financial statements shall be used as a guide, will be provided by ADB.
- (iv) prepare and submit to ADB, annual contract awards and disbursement projections at least one month before the start of each calendar year;
- (v) record in a transparent manner all funds received from the SGOK and ADB;

36. **Internal Audit arrangements:** The internal audit of all expenditure under the program will be conducted by an independent auditing firm recruited by KNNL following

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<sup>5</sup> Cash Basis International Public Sector Accounting Standards

ADB's procurement guidelines, under an agreed terms of reference. The objective of the internal audit is to strengthen the internal control framework and provide Program management with timely fiduciary assurance that: (i) the financial management, the procurement systems and the internal control procedures as applicable to the activities under the program are being adhered to by the PMU, AC-IWRM, PIOs and the support entities; and (ii) the financial information being submitted to and by the PMU is in agreement with the financial records, and agreements in the MFF, and can be relied upon to support the disbursements made by the Bank as reimbursement of eligible expenditures. Release of final installments to AC-IWRM, PIOs and the Program implementing PIO of KNNL for the assets created under the Program will be based on the verification by the internal auditor and upon receipt of the utilization certificates and verification report from the auditor. The internal auditor will submit a quarterly internal audit report to the PMU. An executive summary of the key findings of the internal audit will also be submitted with the internal audit report to PMU for sharing the same with ADB, for the latter's information.

37. **External Auditors:** Project financial statements shall be subject to audit by an independent auditor appointed by the CAG, and acceptable to ADB. The audit shall be conducted audited in accordance with the International Standards of Supreme Audit Institutions INTOSAI, as appropriate and the guidelines and procedures set out by the CAG of India. The annual audit report will include an audit management letter and audit opinions which cover (i) whether the project financial statements present a true and fair view or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework; (ii) whether loan and grant proceeds were used only for the purposes of the project or not; (iii) the level of compliance for each financial covenant contained in the legal agreements for the project; (iv) use of the imprest fund procedure; and (v) the use of the statement of expenditure procedure certifying to the eligibility of those expenditures claimed under SOE procedures, and proper use of the SOE and imprest procedures in accordance with ADB's Loan Disbursement Handbook and the project documents.

38. To ensure the timely submission of audited project financial statements, KNNL and AC-IWRM shall formally request the CAG to include KNNL and AC-IWRM project audits in their yearly work plan through the DEA, at the time of loan negotiations. In addition, unaudited project financial statements should be submitted to for audit within 3 months of the end of the fiscal year.

39. In addition, KNNL and AC-IWRM shall also submit a copy of their own entity level audited financial statements within one month of their approval by their respective governing body. Compliance with financial reporting and auditing requirements will be monitored by review missions and during normal program supervision, and followed up regularly with all concerned, including the external auditor.

40. The government, KNNL and AC-IWRM have been made aware of ADB's policy on delayed submission, and the requirements for satisfactory and acceptable quality of the audited financial statements<sup>6</sup>. ADB reserves the right to require a change in the auditor (in a

<sup>6</sup> ADB Policy on delayed submission of audited project financial statements:

- When audited project financial statements are not received by the due date, ADB will write to the executing agency advising that (i) the audit documents are overdue; and (ii) if they are not received within the next six months, requests for new contract awards and disbursement such as new replenishment of imprest accounts, processing of new reimbursement, and issuance of new commitment letters will not be processed.
- When audited project financial statements have not been received within 6 months after the due date, ADB will withhold processing of requests for new contract awards and disbursement such as new replenishment of imprest accounts, processing of new reimbursement, and issuance of new commitment letters. ADB will (i) inform the executing agency of ADB's actions; and (ii) advise that the loan may be suspended if the audit documents are not received within the next six months.
- When audited project financial statements have not been received within 12 months after the due date, ADB may suspend the loan.

manner consistent with the constitution of the recipient, or for additional support to be provided to the auditor, if the audits required are not conducted in a manner satisfactory to ADB, or if the audits are substantially delayed. ADB reserves the right to verify the project's financial accounts to confirm that the share of ADB's financing is used in accordance with ADB's policies and procedures.

41. Public disclosure of the project financial statements, including the audit report on the project financial statements, will be guided by ADB's Public Communications Policy (2011)<sup>7</sup>. After review, ADB will disclose the project financial statements for the project and the opinion of the auditors on the financial statements within 30 days of the date of their receipt by posting them on ADB's website. The Audit Management Letter and the entity level Audited Financial Statements will not be disclosed.

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<sup>7</sup> Available from <http://www.adb.org/documents/pcp-2011?ref=site/disclosure/publications>