

## FINANCIAL MANAGEMENT ASSESSMENT

### A. Summary Assessment

1. The Druk Green Power Corporation (DGPC) is the executing agency. The Tangsibji Hydro Energy (THyE), the DGPC's wholly owned subsidiary is the executing and implementing agency with responsibility for day-to-day coordination, implementation, and administration. DGPC is a key player in the overall economy of Bhutan, where the power sector contributes around 30% of the annual revenues to the government in terms of dividends and taxes, the major percentage of which comes from the operations of DGPC.
2. The financial management assessment of DGPC and THyE were conducted in accordance with the Financial Management and Analysis of Projects Guidelines of the Asian Development Bank (ADB) (2005).<sup>1</sup> Both DGPC and THyE completed a financial management questionnaire.
3. DGPC was formed in 2008 through the merger of the four existing hydropower companies owned by the government. The Dagachhu Hydro Power Corporation was also added as DGPC's subsidiary with minority shares from the Tata Power Company of India, and the National Pension and Provident Fund of Bhutan. DGPC is also owned by the Druk Holding and Investments (DHI), the government's holding company of public enterprises. Both DGPC and DHI are professionally managed on a commercial basis at arm's length distance from the government. DGPC has a separate board of directors with a good mix of internal and external directors. In addition, DGPC has experienced professionals with sound track records and expertise as executive directors in key positions of managing director, projects, finance, and human resources. The external directors on the board of directors are from the shareholders, government, and private sector. The chairman and managing director positions are separate in line with international corporate governance practices.
4. THyE has been incorporated as the project's special purpose company, presently wholly owned by the DGPC, to implement the Nikachhu hydropower project. Since the company was established, THyE's financial management systems and procedures have been followed by the DGPC's ones like the merged other companies (plants) and subsidiaries.
5. DGPC and its subsidiaries are governed under the Companies Act of Bhutan and international practices in the areas of corporate governance, financial reporting and audits. They follow the Bhutan Accounting Standards (BAS) for its financial accounting and reporting. They have also been introducing the International Financial Reporting Standards (IFRS). They regularly prepare its annual accounts which are audited by external professional auditing firms appointed by the Royal Audit Authority of Bhutan. There have been no audit qualifications in their audit reports. The annual reports (including any audit observations) are presented and extensively deliberated in the meetings of the DGPC audit committee (consisting of external directors on its board of directors) and shareholders. The annual reports of DGPC including subsidiaries are also shared with the DHI, Ministry of Finance, Bhutan Registrar of Companies, and Bhutan Electricity Authority. Any legal cases pending in the courts for or against DGPC are also disclosed in the DGPC annual reports.

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<sup>1</sup> ADB. 2005. *Financial Management and Analysis of Projects*. Manila. Available: <http://www.adb.org/Documents/Guidelines/Financial/default.asp>

6. DGPC and its subsidiaries also follow the corporate governance (CG) code formulated by DHI. The code has been developed based on the Organization for Economic Cooperation and Development (OECD) Corporate Governance Principles and globally accepted corporate governance standards. The code provides guidelines on corporate governance practices and principles, board charter, audit committee charter and code of conduct for the directors and senior managers, among others. The CG code also defines the relationships and roles between the shareholders, management and board directors to promote transparency and accountability in the operation of DHI companies.

7. Since its formation, there has been wide ranging internal capacity building in DGPC to manage commercial hydropower projects in the areas of finance, operations, human resources, information technology, hydropower technical aspects, and more project preparation. Through the ADB capacity development technical assistance (CDTA) and DHI initiatives,<sup>2</sup> DGPC and its subsidiaries have well laid out and robust processes and manuals in the areas of financial management, budgeting, risk and controls, internal audits, and information technology security. They also have a well laid out and documented financial management and procurement policies and processes in line with international practices and the government's Good Governance code.

8. DGPC including its subsidiaries introduced the enterprise resource planning (ERP) from SAP in 2011, and successfully consolidated a majority of its business processes into the ERP system during 2012. With the ERP's implementation, all stand-alone systems have now been integrated to ERP, resulting in uniformity in the business policies and procedures and recording of financial transactions in a common format. All the business processes are documented and wherever possible, process improvements have been made. All the reporting requirements are handled through the ERP package.

9. DGPC has established a number of Centers of Excellence in core areas where it was dependent on expertise from outside of Bhutan for services. DGPC has a formal internal audit department which is headed by a chartered accountant, and reports directly to the audit committee (consisting of external directors on its Board of Directors). DGPC also has a corporate lawyer.

## **B. Due Diligence**

10. **Governance.** The principal board committees such as the Human Resources Committee, Audit Committee and Tender Committee are in place at DGPC. DGPC and its board also closely monitor the activities of its subsidiaries.

11. The ADB financing and loan agreements will require that DGPC retains majority shareholding and majority representation on the board of directors of THyE and a majority representation of DGPC are required for a quorum for any meeting of THyE's board of directors.

12. As required by the Companies Act of Kingdom of Bhutan 2000, the Board of DGPC meets eight times during the year and the quorum at each of these meetings are duly maintained. The annual general meeting, which has to be held before 31 July of each year as per the Companies Act, has been held on time. Among more notable corporate governance initiatives implemented since the formation of DGPC was the implementation of the

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<sup>2</sup> ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Loans, Asian Development Fund Grant, Technical Assistance Grant, and Administration of Grant to the Kingdom of Bhutan for the Green Power Development Project.* Manila.

Performance Linked Incentive Scheme (PLIS), which was introduced in 2009 to ensure that incentives at different levels are linked to measurable targets for the bonuses at the end of the year. At the time of implementing the PLIS, DGPC also initiated the Employee Appraisal System (EAS) from 2009 that sets targets at the beginning of the year even for individual performances to bring objectivity to the performance evaluations for individual employees.

13. The Board considered and approved among others, corporate strategy plans, financing strategies, investment plans, risk management frameworks, finance manuals and other manuals for more decentralized and effective management of DGPC. With a view that the Board should concentrate more of its time on strategies and policies, the Board approved a revised “Delegation of Power” in 2012 so that the day-to-day management responsibilities of the company rests more with DGPC management.

14. The Bhutan Electricity Authority (BEA) is the sector regulator and authority for approving domestic retail and bulk tariffs. DGPC carries out its tariff filings to BEA once in every three years to meet the multi-year tariff system of BEA. The DGPC tariff filings are put up through a rigorous process of public and consumer consultations by BEA with public hearings being conducted and consumer and industry associations provided opportunity for representation of their views on DGPC tariff proposals, cost structure, etc.

15. **Risk management.** Under the ADB CDTA, sound enterprise risk management processes were introduced and implemented in 2012 to strengthen its corporate governance and risk management. The framework has identified risks under four categories: (i) strategic, (ii) operational, (iii) financial, and (iv) others (e.g., human resources). Under the framework, risk registers have been prepared at the plant levels and the corporate level risk registers are under preparation. A chief risk officer is identified at the corporate level and risk management committees at plant levels are appointed to identify and monitor the risks. Staff training has been provided over the last two years to equip them with the requisite capacity.

16. **Budgeting.** The 2010 Public Financial Management Accountability Assessment found that the budgeting and accounting system in Bhutan was generally robust.<sup>3</sup> The government is also particularly committed to this sector and inadequate budget allocation from the government is not considered a risk; the sector’s enterprises are self-sustaining. DGPC follows a robust budgeting system with a well laid out budget manual. Budgets are prepared at the individual plant and corporate levels. The budgets are approved by the DGPC Board and any regular monitoring of the budget against actual performance is carried out.

17. **Fund Flows.** The loans from ADB have been paid directly to the contractors. There are no statements of expenditure or imprest account procedure in place. The fund flow from Indian commercial banks will be to the Trust and Retention Account maintained by THyE and then to the contractors.

18. **Accounting.** DGPC and its subsidiaries integrated all stand-alone systems to ERP, enabling the business policies and procedures and recording of financial transactions in a common format. All the business processes are documented and wherever possible, process improvements have been made. Further, with proper role authorization matrix, the assignment of conflicting roles has been avoided. All business policies and process changes have been centralized at the corporate office, enabling proper control, and check and balance. DGPC also implemented the “Business Intelligence” module of ERP during 2012 through which the

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<sup>3</sup> World Bank. 2010. *Bhutan: Public Financial Management Accountability Assessment*. Washington, D.C.

management is now able to get access to real time information for timely decision making. A dedicated core team for sustaining the ERP system has been created with the required expertise. DGPC has deputed experienced financial staff to manage THyE based on the DGPC centralized systems and the same practices.

19. **Financial Reporting.** Bhutan has not fully adopted international financial reporting standards (IFRS). However, it has begun a process of adopting IFRS in three phases with the goal of achieving complete adoption by 2021. In July 2010, the government approved the formation of the Accounting and Auditing Standards Board of Bhutan (AASBB). The AASBB has authority to set Bhutanese accounting and auditing standards in line with international standards. The AASBB has decided to adopt IFRS and has signed copyright waiver agreement with the IFRS Foundation to adopt IFRS in a phased manner aiming for full adoption and compliance by the year 2021. The standards are called Bhutanese Accounting Standards (BAS) towards the full transition period. The AASBB expects to release the standards in three phases. In the first phase, 18 standards have been issued to be implemented from January 2013 until the end of 2015. DGPC has also been following the IFRS.

20. DGPC including its subsidiaries maintains financial records and prepares their financial statements on an accrual basis of accounting as per provisions of its governing statutes and the above BAS.

21. DGPC including its subsidiaries provides quarterly reports to BEA and submits quarterly reports to the Royal Monetary Authority for foreign currency receipts and payments.

22. In addition to this, DGPC including its subsidiaries is also subject to a revenue audit by the Income Tax Department, a regulatory audit by the BEA and a compliance audit under the Companies Act of Bhutan.

23. **External Audit.** Being a corporate entity and a government owned company, DGPC is subject to annual audit under the Companies Act of the Kingdom of Bhutan, 2000 by the Royal Audit Authority (RAA) and external auditor(s) appointed by the RAA. THyE is also subject to the external audit in the same manner.

24. The financial year end is December 31 for DGPC and THyE. In accordance with ADB financing and loan agreements, financial statements will be required to be submitted for DGPC and THyE. Since the ADB funded project will represent the only activity of THyE, the overall financial statements will be taken to be the project financial statements. Detailed requirement for accounting and auditing requirements are laid out in the project administration manual (PAM).

25. An Indian chartered accountants firm was appointed as the statutory auditors of DGPC by RAA for the latest audit. The audit firm is on the approved panel of statutory auditors of the RAA. DGPC does not have any major audit issues highlighted in the audited accounts for 2013.

26. The auditors' report did not have any qualifications on DGPC's accounts. The auditors concur that the accounts along with schedules, significant accounting policies, and notes to accounts are in compliance with the requirements of the Companies Act of the Kingdom of Bhutan. However, the auditor provided some recommendations to DGPC, and DGPC highlighted them to be resolved within 2014 in the director's report 2013. They include (i) non-ascertainment of ageing of the stock lying prior to 1 June 2011, (ii) no provisioning for non-moving and slow moving items, (iii) granting of loan to the holding company of Nu900 million is against the articles of incorporation of the company, which does not allow granting loan for

purpose other than hydropower projects, (iv) an independent audit/review of IT environment/compliances of the company to be carried out, and (v) management of the company to establish proper and comprehensive compliance assurance systems for all such other applicable acts.<sup>4</sup>

27. The ADB financing and loan agreements will require DGPC and THyE to maintain a debt service coverage ratio (DSCR) of a minimum of 1:2 from the date of commercial operations of the project. From 2020, when commercial operations are expected to commence, DGPC and THyE should ensure that the DSCR is met, and that the auditor specifically provides an opinion in this regard.

28. Moving forward, DGPC and THyE should also request the auditor to provide an opinion on the use of the loan proceeds.

29. **Internal Controls.** DGPC has significant support and commitment from the government and its shareholders. The independent external auditor has also stated as part of the 'minimum audit examination and reporting requirements' certificate annexed to their audit opinion of the financial statements of DGPC for the year ended December 31, 2013 that there is a reasonable system of authorization at proper levels and adequate systems of internal control commensurate with the size of the company and the nature of its business. THyE follows the same systems.

30. There are adequate payment, delegation of responsibilities, segregation of duties and physical controls in place.

31. ADB's disbursement arrangements which will include payments directly to contractors also will mitigate risks over payments.

32. **Internal Audit.** DGPC has a formal internal audit department which is headed by a chartered accountant, and reports directly to the Audit Committee.

33. **Staffing.** THyE's number of staff is 80 (mostly on deputation from DGPC) during the initial phase. DGPC continues to invest substantially in and develop its human resources at all levels through trainings, seminars, workshops, skills up-gradation programs, and attachments to other utilities. DGPC also continues to support officers in undertaking master's degree programs either through DGPC sponsored scholarships in critical areas of skill set requirements or where the officers want to take up such higher studies outside of corporate financing. Over the years, the number of in-house training programs being conducted by DGPC has also increased substantially. Further, DGPC continues to commit senior officers in the fields of engineering, human resources and finance to major hydroelectric projects under construction within Bhutan not only to meet the shortages in human resources in a series of coming projects but also in order for DGPC to avail of the opportunities to acquire expertise and experience to develop further competencies in all aspects of hydropower development.

34. DGPC has established a number of Centers of Excellence (COE) in various core areas such as vibration and thermodynamic analysis, dielectric and material analysis, control and

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<sup>4</sup> DGPC is sorting out the above items (i) and (ii), along with the ERP accounting systems. To resolve the item (iii), DGPC has already liquidated Nu.550 million, and the balance will be done by March 2015. For the item (iv), DPGC assured that an independent review would be done within 4<sup>th</sup> quarter of 2014. To respond to the item (v), the company secretary (i.e., corporate lawyer) has been working though and compiling applicable acts, rules, and regulations.

protection, gates and instrumentation (civil structures), etc. where it was dependent on expertise from outside of Bhutan for services. DGPC intends to merge many of these COEs in the near future to set up a Research and Development Center with competencies relevant to all aspects of hydropower that would initially cater to Bhutan's requirements.

35. **Risk Assessment.** A summary of the risks identified, and risk mitigating measures, if any are given below.

<b>Control Risk Type</b>	<b>Risk Assessment</b>	<b>Risk Description</b>	<b>Risk Mitigation Measures</b>
1. Executing and implementing Entities	Low	No significant risk.	DGPC has good track record to implement the Green Power Development Project (i.e., Dagachhu hydropower development). Many staff from the project are shifted to THyE.
2. Funds Flow	Low	No significant risk.	The EA is familiar with the ADB procedures through the previous project. Fund from ADB is managed primarily by direct payments.
3. Staffing	Low	THyE is a new organization but experienced management and staff are shifted from the previous project(s).	THyE is staffed with individuals from DGPC in both management and staff level, the majority of which are shifted from the Dagachhu project.
4. Accounting Policies and Procedures	Low	No significant risk.	Accounting policies and procedures are in place based on international best practice and are also being reviewed and improved.
5. Internal Audit	Low	Although the Internal Audit capacity of the Government of Bhutan is weak, DGPC has an Internal Audit Department which is headed by a qualified accountant, reports to the Audit Committee.	The Internal Audit Committee will also periodically audit the activities of THyE.
6. External Audit	Low	RAA appoints an external auditor from its panel to audit DGPC on an annual basis. However, ADB specific audit requirements will be communicated to the auditor if any.	PAM includes detailed audit requirements.
7. Reporting and Monitoring	Low	No significant risk.	DGPC experienced staff are assigned to THyE.
8. Information Systems	Medium to Low	THyE is in distance from the DGPC's head office. Within 2014, DGPC is expected to incorporate the external auditor's recommendations, such as aging stock and independent IT review.	An integrated computerized system has already been introduced. Continuous training in the use of the ERP (SAP) by DGPC has been provided to concerned staff.
<b>Overall Control Risk</b>	Low		

ADB = Asian Development Bank, DGPC = Druk Green Power Corporation, EA = executing agency, ERP = enterprise resource system, IT = information technology, PAM = project administration manual, RAA = Royal Audit Authority, THyE = Tangsibji Hydro Energy.