Detailed Financial Management Report

April 2014

BAN: MFF Skills for Employment Investment Program (SEIP)

CONTENTS

APPENDIXES

ABBREVIATIONS

ADB	Asian Development Bank
AFR	annual fiduciary review
AGM	annual general meeting
AOP	annual operational plan
AWPB	annual work plan and budget
BACCO	Bangladesh Call Center Operators' Association
BACI	Bangladesh Association of Construction Industry
BAS	Bangladesh accounting standards
BASIS	Bangladesh Association of Software and Information Services
BEGP	Bangladesh economic growth program
BEIOA	Bangladesh Engineering Industry Owners’ Association
BGMEA	Bangladesh Garments Manufacturers and Exporter Association
BITAC	Bangladesh Industrial Technical Assistance Centre
BKMEA	Bangladesh Knitwear Manufacturers and Exporter Association
BMET	Bureau of Manpower Employment and Training
BSA	Bangladesh standards on auditing
BTEB	Bangladesh Technical Education Board
BTMA	Bangladesh Textile Mills Association
CAG	comptroller and auditor general
CAO	chief accounts officer
CGA	controller of general accounts
CMC	Cambridge Maritime College
CoEL	Center of Excellence for Leather Skill Bangladesh Limited
DDO	drawing and disbursement officer
DFID	Department for International Development
DTE	Directorate of Technical Education
EA	executing agency
ERP	enterprise resource planning
FAM	facility administration manual
FAPAD	Foreign Aided Projects Audit Directorate
FM	financial management
FMA	financial management assessment
FMAQ	financial management assessment questionnaire
FMRP	financial management reform programme
GoB	Government of Bangladesh
GFR	general financial rules
IA	implementing agency
IBAS	integrated budgeting and accounting system
ICAB	Institute of Chartered Accountants in Bangladesh
IFRS	international financial reporting standards
IPSAS	international public sector accounting standards
ISC	industry skill council
IT	information technology
IFR	interim financial report
ISA	international standards on auditing
LFMEAB	Leathergoods & Footwear Manufacturers & Exporters Association of Bangladesh
MEWOE	Ministry of Expatriates’ Welfare and Overseas Employment
MFF	multitranche financing facility
MoE	Ministry of Education

MOF	Ministry of Finance
MOI	Ministry of Industry
MoU	memorandum of understanding
MTBF	medium-term budget framework
NGO	nongovernmental organization
NPO	nonprofit organization
NSDC	National Skill Development Council
PEFA	public expenditure and financial accountability assessment
PFM	public financial management
PKSF	Palli Karma-Sahayak Foundation
PSC	program steering committee
RRP	report and recommendation of the president
SDC	Swiss Agency for Development and Cooperation
SDP	skills development project
SDCMU	skill development coordination and management unit
SEIP	skills for employment investment program
SESIP	secondary education sector investment program
SME	small and medium-sized enterprise
SoE	statements of expenditure
SPEMP	strengthening public expenditure management program
STEP	skill and training enhancement project
TA	technical assistance
TSC	technical school and college
TTC	technical training center

EXECUTIVE SUMMARY

1. This report presents the Financial Management Assessment (FMA) carried out for the Skill for Employment Investment Program (SEIP). The purpose has been to assess the functioning of the Financial Management (FM) systems of the 14 involved entities – Ministry of Finance (MoF), 3 Government of Bangladesh (GoB) entities, 8 industry sector associations, Bangladesh Bank's Small and Medium Enterprise (SME) Department and Palli-Karma Sahayak Foundation (PKSF),[1] so as to determine the extent to which they will be able to manage fiduciary risks and provide reasonable assurance that funds will be used according to their intended purposes. The assessment has been conducted in accordance with the ADB's *Financial Management and Analysis of Projects, 2005*, is based on the information available from and about the involved entities and focuses on Budgeting, Accounting, Financial Reporting, Internal Controls, Internal Audit, and External Audit.

2. ADB's funding for the SEIP will be channeled though the GoB's Consolidated Fund. SEIP's funding allocation will be based on output-based agreements between the Finance Division of MoF which serves as the executing agency through the Skill Development and Coordination Unit (SDCMU) which will bet with the different Implementing Agencies (IAs) as well as their Annual Work Plans and Budgets (AWPBs). These will be assessed by the Skill Development Coordination and Management Unit (SDCMU), to be set up within the Finance Division of the MoF, and approved by the Program Steering Committee (PSC). The funds flow arrangements for the IAs depends on their organizational status, i.e. whether they are GoB or non-GoB entities.[2] The resources for the 32 public training institutions will be budgeted under and channeled through the three GoB IAs (DTE, BMET and BITAC), while resources for the non-GoB entities will be budgeted under the MoF (in the GoB national annual budget). The IAs will receive pre-financing from the MoF in the form of quarterly advances, which will need to be liquidated and expenditure statements provided before subsequent advances are released. An imprest account shall be opened with the MoF, and advances shall be liquidated upon submission of withdrawal application by the MoF supported by evidence that milestones in the MoUs have been achieved.

3. Each IA shall maintain separate bank accounts for the purpose of this program, to provide an audit trail and allow the preparation of the SEIP consolidated financial statements. The GoB expenditures will be accounted for by the involved entities, and reconciled vis-à-vis the CGA's IBAS records, while each non-GoB entity will do its own accounting and reporting. The SDCMU will consolidate the entity-level financial reports for the SEIP as a whole, and prepare quarterly financial reports (to be checked as part of Annual Fiduciary Reviews (AFRs) as well as annual accounts (to undergo external audit). Two sets of financial statements shall be prepared for the purpose of the program (i) consolidated project financial statements for the 3 GoB entities audited by Foreign Aided Projects Audit Directorate (FAPAD), and (ii) consolidated

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1 FMAs for Bangladesh Bank's SME Department and PKSF has not yet been conducted. However, no funds shall be disbursed to these entities without completion of the FMA

2 The GoB entities consist of three entities – the Directorate of Technical Education (DTE), Bureau of Manpower Employment and Training (BMET) and Bangladesh Industrial Technical Assistance Center (BITAC) – through which public training will be provided for 32 institutions. The non-GoB entities consist of eight Sector Associations – Bangladesh Garments Manufacturers & Exporter Association (BGMEA), Leathergoods & Footwear Manufacturers & Exporters Association of Bangladesh (LFMEAB), Bangladesh Association of Construction Industry (BACI), Bangladesh Engineering Industry Owners' Association (BEIOA), Bangladesh Knitwear Manufacturers & Exporter Association (BKMEA), Bangladesh Association of Software and Information Services (BASIS), Bangladesh Textile Manufacturers' Association (BTMA), and Bangladesh Call Center Operators' Association (BACCO). Private sector training will be undertaken through these non-GoB entities.

financial statements for the 9 Associations audited by an independent external audit firm acceptable to ADB.

4. Alongside this FMA report, which includes filled-in FMA questionnaires and related FM capacity assessments, the following documents have been drafted: a) Statement of Audit Needs (SoAN) for the external audit to be done by the Comptroller and Auditor General (CAG) for GoB IAs; b) ToR for the external audit to be done by a private audit firm for non-GoB IAs; c) ToR for the AFR that will cover all entities; and, d) Sections and inputs for the SEIP RRP (including FM section in the Risk Assessment Management Plan, Governance Section, Accounting and Auditing section of the Facility Administration Manual (FAM), and SEIP reporting templates).

5. Five specific FMAs have been undertaken, the results of which are briefly described in the following together with the risks identified and some of the mitigation measures proposed.

6. The GoB 'core' PFM assessment covers the MoF's Finance Division, Controller of General Accounts (CGA) and CAG as well as FM procedures common for the GoB IAs.

7. The GoB's Public Financial Management (PFM) system is overall assessed as weak and, before application of mitigation measures, associated with substantial fiduciary risks.[3] The weakest PFM area is external scrutiny and audit, followed by predictability and control in budget execution, and then accounting, recording and reporting. While the PFM system is under transition, and a number of improvements have been made in recent years, specific weaknesses relevant to SEIP implementation exist in the following areas:

a. **Budget preparation** – The current approach is incremental based on past year's budget and excludes physical targets. This may result in imbalances in resource allocation (recurrent costs vs. investments), and hence a risk that insufficient resources may be allocated for maintenance of investments.
b. **Accounting –** Three main challenges are: a) Accumulation of un-cleared advances (not always cleared, or not based on evidence of actual expenses); b) Delays in payment processing (according to some studies this happens deliberately in order to extract 'rent' from beneficiary institutions); and, c) Lack of reconciliation between agency cash books (bills presented to the CGA for payment) and registrations in CGA's bookkeeping system (actual bills paid).[4]
c. **Internal control –**There is no system for automatic budgets checks before payments are processed, which constitutes an inherent systemic weakness. Also, there are risks related to the payroll system as it is decentralized, has a prevalence of manual systems and use of cash payments, and since regular reconciliation of personnel records with payroll data is lacking.
d. **Financial reporting –** There are some delays in the CGA's preparation of monthly reports and, especially, the annual accounts, which adversely affects the CAG's subsequent audits. Also, budget variance reports with explanation of deviations between planned and actual spending are rarely prepared.
e. **Internal audit** – While the function is set up in most ministries, it is in almost all cases inadequate due to weak staff capacity, for procedural reasons (often doing pre-audit rather than evaluating the adequacy and effectiveness of controls), and as they lack independence.

[3] The risk ratings applied are: Low, moderate, substantial, high.
[4] Integrated Budgeting and Accounting System (IBAS), which consists of separate stand-alone bookkeeping systems that are not integrated with budget information.

f. **External audit** – The CAG is constrained by a limited number of qualified staff, audit reports are not completed and published in a timely manner, and many audits focus on individual transactions rather than systems. It is noted though that audits undertaken by the Foreign Aided Projects Audit Directorate (FAPAD) generally are deemed satisfactory regarding both quality and timing.

8. The FM capacity assessment undertaken for the three GoB IAs – DTE, BMET and BITAC – finds that the overall fiduciary risks are substantial, and that there are shortcomings in the following areas relevant to the SEIP:

a. **Accounting** – The overall framework is similar to that of the GoB, but various procedural differences and weaknesses between the three entities have been observed. These include manual accounting; accrual basis of accounting not applied in preparing financial statements; bank reconciliation not prepared or, if done, not reviewed by management regularly; Subsidiary ledgers not kept, or these not being reconciled on a regular basis; and, balance sheets not being prepared at least annually to review the financial position.
b. **Financial reporting** – The entities do not prepare monthly variance reports with explanations for variances; expenditure reports from regional units are not actively used; financial statements comprise only receipts and payments accounts, and balance sheets are not prepared; and, cash flow analyses are not done. Furthermore, the reporting systems do not have the capacity to link financial information with non-financial data.
c. **Grant management** – While two of the three GoB IAs have technical experience with implementing externally funded projects, they all lack grant management practice, especially related to bookkeeping, accounting and financial reporting.
d. **Staffing** – All three entities have significant weaknesses regarding the educational and professional background (accounting and finance) of their staff, which constitutes a major fiduciary risk (and, to some extent, might explain the FM weaknesses observed). Only one of the three entities has an Accounts Department headed by an official with a degree in accounting.

9. Based on the FM capacity assessment undertaken for the eight Sector Associations, it is found that the overall fiduciary risks are substantial. The following shortcomings relevant to the SEIP have been observed:

a. **Planning and budgeting** – Most of the entities prepare annual budgets for their organization, but the applied procedures are generally weak, with budget figures developed using an incremental approach based on the previous year's budget and with physical targets not taken into account. Also, most entities lack a formal budget holder with responsibility for managing the budget. Furthermore, no entities prepare cash flow forecasts.
b. **Internal control** – Only two entities have written policies, while one is preparing a manual. The remaining six entities have little or no documentation of the internal control procedures applied, which is a major risk factor. The same seems to apply to procurement management. Another significant fiduciary risk is fixed asset management, which – although some entities have selected elements in place – is not fully functional in any of the entities.
c. **Grant management** – About half of the Sector Associations do not have prior experience with donor- and/or GoB-funded activities, which represents a

considerable risk factor given the observed weaknesses in the different FM areas, especially regarding accounting and financial reporting.

d. **Staffing –** The educational qualifications and professional experience of finance and accounting staff in the Sector Associations differs significantly between the entities. None of the Accounts Departments are led by a chartered accountant, but some have accountants with public accounting training. The background of other staff is likewise mixed. It does not appear though that the quality of the staff as such is a primary determinant for the FM performance of the entities (this is more likely to be corporate governance).

10. It is planned that a ninth sector association will be added later (Cambridge Maritime College (CMC)) as will Palli Karma-Sahayak Foundation (PKSF)[5] and Bangladesh Bank's SME Department. No disbursement shall be made to any entity, until a fiduciary assessment is completed, and ADB is satisfied that risks are tolerable based on identified mitigating measures.

11. From the assessments it is clear that a targeted risk mitigation and capacity development approach that takes into account the specific circumstances of each entity is needed. This especially so for the Sector Associations where capacity and performance differs widely between the entities (whereas, for the three GoB IAs, a common approach can be applied).

12. The risk mitigation measures, proposed as part of the risk analysis, focus on management plans to address *inherent risks* (the susceptibility of the SEIP FM systems to factors arising from the environment in which it operates) and entity-specific *control risk* (the risk that the elements that constitute SEIP's FM framework are inadequate to ensure that funds are used economically, efficiently and for the intended purpose, and that their use is properly reported).

13. The <u>inherent risks</u> related to the GoB 'core' FM area are proposed addressed, *inter alia*, through the program design (establishing a governance structure and technical safeguards that can help to minimize specific risks) as well as using the PSC to ensure that transparent and accountable procedures for the SEIP-related activities are established for and followed by the involved institutions. The inherent risks related to the IAs, both GoB and non-GoB (Sector Associations) could possibly be addressed through the formulation and implementation of a FM framework for SEIP administration (e.g. FM manual and training) as well as setting standards for staffing. For the Sector Associations, it may also be relevant for the SDCMU to closely observe the work and functioning of the boards in terms of their corporate governance.

14. At the level of <u>control risks</u>, a number of specific safeguards are proposed as mitigation measures that match the observed FM weaknesses in different areas and hence intend to address and moderate the related fiduciary risks. While some of these would require Technical Assistance (TA) to be provided, e.g. to improve specific systems and procedures through procedural improvements (e.g. for planning and budgeting), others are based on capacity development of staff (e.g. for budget execution), developing new tools, frameworks and standards (e.g. for SEIP accounting, reporting and external audit), and still others simply focus on monitoring that existing procedural requirement are followed (e.g. accounts reconciliations), or that the scope of existing functions be widened (e.g. internal audit for GoB IAs). The details of

[5] PKSF was established by the GoB in 1990 as the apex organization with the mandate to alleviate poverty through generating employment. PKSF disburses fund to microfinance institutions that are its partner organizations to implement development programs.

the planned and agreed initiatives to improve FM and mitigate risks are outlined in the FM action plans (Appendix 5).

I. INTRODUCTION

1. This FMA of the SEIP is intended to determine the degree to which the FM system will be able to manage fiduciary risks and provide reasonable assurance that funds will be used according to its intended purpose. The assessment has been conducted with reference to the relevant ADB guidelines.[6] It focuses on accountability and transparency, and covers (i) internal controls, (ii) funds flow arrangements, (iii) accounting, (iv) financial reporting, and (v) external audit.

2. The funds flow arrangements for the IAs proposed for the program will depend on their organizational status, i.e. whether they are GoB entities, Sector Associations or others (PKSF and Bangladesh Bank's SME Department). This is discussed below in Chapter C (Program Description). However, the FM assessments presented in Chapter D in all cases focus on the ability of the IAs to properly manage funds by reviewing their FM capacity and procedures.

3. The FMA has been conducted based on existing information and data where available (mainly for the country-/GoB-level) as well as by applying the standard FMA questionnaire for the IAs. A Bibliography is included in Appendix 1 and a List of Persons Consulted in Appendix 2, while a list of the FMA questionnaires applied and the FM Capacity Assessments undertaken are listed in Appendix 3 and 4, respectively.

4. A ToR for the FMA outlined the detailed tasks and expected outputs (see Appendix 6). Due to the nature of the assignment and the information available, the following observations are made as regards some limitations experienced:

a. Since the SEIP includes a number of IAs (Sector Associations) that have not been covered by previous reviews, only limited reliance has for these been possible to place on existing analyses;
b. No specific accounting/reporting or auditing standards exist for NPOs in Bangladesh, and the audited financial statements of the associations obtained have instead been compared with Bangladesh Accounting Standards (BAS) used to identify any possible deviations;
c. Once the SDCMU is in place, detailed Financial Reports, mapped to the entities chart of accounts shall be prepared
d. The possibilities for determining the appropriate accounting controls required in order to account for ADB-funded expenditure is expected to be covered by a FM manual to be prepared for the use of non-GoB IAs; and,
e. In assessing the external auditing arrangements in place – including independence, qualification, experience and rating of the audit firms – focus has been on timeliness, categorization/rating and the audit conduct (in terms of applied standards) as evidenced by the auditors' reports.

5. In accordance with the revised ToR, the following documents have been prepared as part of the FMA assignment:

- **FMA Report**, including:
  - Filled-in FMA questionnaires

[6] ADB (2005): "Financial Management and Analysis of Projects", Knowledge Management – Addendum, pp.14-34.

- Template financial statements[7]
- **Draft Statement of Audit Needs (SoAN)** for the external audit to be done by the CAG of the GoB IAs
- **Draft ToR for the external audit** to be done by a private audit firm of the non-GoB IAs
- **Relevant detailed information to enable completion of:**
  - FM section of the Risk Assessment Management Plan
  - Governance Section of the RRP
  - Accounting and Auditing section of the Facility Administration Manual (FAM)
- **Draft ToR for Annual Fiduciary Review (AFR)**[8]

II. PROGRAM DESCRIPTION

6. The SEIP Concept Paper was approved on 14 December 2011 as a $100 million loan project. It was converted into a $350 million Multitranche Financing Facility (MFF) program following consultations between ADB and the GoB in order to take a long-term approach to support skills development. It is understood that the Swiss Agency for Development and Cooperation (SDC) will provide a grant of CHF 10 million (approximately $9.5 million) during the first tranche, and has indicated that its contributions to subsequent tranches will be confirmed later.

7. The SEIP's Executing Agency (EA) will be the MoF's Finance Division. A Program Steering Committee (PSC), chaired by Secretary Finance Division and with representatives from the National Skill Development Council's (NSDC's) Executive Committee as members, will be set up. A Skill Development Coordination and Management Unit (SDCMU) will be established within MoF's Finance Division as a Project Management Unit (PMU) to support implementation of the SEIP. It will be led by a Project Director (Additional Secretary level) and will be reporting to the PSC.

8. Key priority economic growth sectors identified by the GoB – garments, knitwear, leather, IT, building and construction, shipping and light engineering – are SEIP focus areas. The purpose will be to improve entry-level job skills along with up-skilling of the existing workforce to ensure that 'required skills to industry standards' are available. SEIP will support training providers to work with industry to address identified skills so as to enable industry growth and increased employment through provision of market responsive and inclusive skills training programs. 15 priority sectors will be covered during the 10-year period. Six priority sectors are selected under Tranche 1 through a demand-driven approach with inputs from Industry Skill Councils (ISCs) and employer associations: (i) Readymade Garments; (ii) Construction; (iii) Light Engineering/Manufacturing; (iv) IT; (v) Leather and Footwear; and, (vi) Shipping. Each of the six sectors will have an ISC legally incorporated (with more ISCs being set up if and when more priority sectors are added). The entities that will be engaged are the main industry associations and internationally recognized employer associations with substantial membership coverage, formal recognition by the GoB through NSDC.

9. SEIP will finance skills training of 260,000 trainees with 70% job placement (182,000) during tranche 1 and a total training of 1.5 million (1.05 million job placements) during the

[7] Based on the IAs' Chart of Accounts and taking into account requirements of relevant national accounting standards and eligible expenditure categories.
[8] This deliverable was not listed in the ToR, but agreed during a briefing meeting.

project period (2014-2023). Five types of institutions are expected to deliver these training targets with 70% job placements. These are:

(a) *Public Training Providers:*
- 9 Technical Schools and Colleges (TSCs) under the Directorate of Technical Education (DTE) of the Ministry of Education (MoE)
- 20 Technical Training Centers (TTCs) under the Bureau of Manpower Employment and Training (BMET)
- 3 Bangladesh Industrial Technical Assistance Center (BITAC) under the Ministry of Industry (MoI)

(b) *Sector Associations:*
- Bangladesh Garments Manufacturers & Exporter Association (BGMEA)
- Leathergoods & Footwear Manufacturers & Exporters Association of Bangladesh (LFMEAB)
- Bangladesh Association of Construction Industry (BACI)
- Bangladesh Engineering Industry Owners' Association (BEIOA)
- Bangladesh Knitwear Manufacturers & Exporter Association (BKMEA)
- Bangladesh Association of Software and Information Services (BASIS)
- Bangladesh Textile Manufacturers' Association (BTMA)
- Bangladesh Call Center Operators' Association (BACCO)

(c) *Private Training Providers*

10. It is planned that a ninth sector association will be added later (Cambridge Maritime College (CMC)) as will Palli Karma-Sahayak Foundation (PKSF)[9] and Bangladesh Bank's SME Department.

11. ADB will be supporting the program through disbursements contingent upon delivery of results as agreed with output-based agreements between the MoF's Finance Division through the SDCMU and the IAs. Unit costs shall be determined based on historical financial information assessed by ADB for reasonableness. Approximately 50 % of the cost relates to the costs incurred by training providers, which largely includes direct training costs like training overheads, salaries of teachers, training material etc. and equipment. The rest of the expenditure relates to stipends, surveys, workshops and studies etc. A 'unit cost method' is proposed to reimburse the training providers to cover their costs less their own contribution to the training. Unit Cost represents the average direct and indirect cost of training attributable to each student, (excluding cost of equipment), with no or minimal profit element or recovery from beneficiaries factored into the unit cost. It is expected that for Tranche 1, training providers will cover a small portion of the cost out of their own sources of funds, which primarily include members subscriptions and fees. To ensure reasonableness of unit costs claimed by trainers under the business plans, all IAs will be required to submit detailed computations of unit costs per trainee/per course which shall be (i) compared with similar training providers regionally (ii) required to be supported by audited financial statements and (iii) re-assessed annually. These unot costs shall be further reviewed prior to incorporating this into contracts with the Associations. Based on the unique positions of these Associations, they shall be contracted suing Single Source Selection, based on justification provided.

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[9] PKSF was established by the GoB in 1990 as the apex organization with the mandate to alleviate poverty through generating employment. PKSF disburses fund to microfinance institutions that are its partner organizations to implement development programs.

There will be four milestones in the output-based MoUs for new entrants: (i) 40% based on enrollment of targeted enrollees in identified priority sectors and for new entrants or up-skilling for existing workers; (ii) 40% based on successful completion of training programs by the trainees; (iii) 10% based on job placement of completers of training in jobs within 3-6 months; and, (iv) 10% for retention in jobs for 12 months. The weight for the four milestones for up-skilling existing workforce will be the following: (i) 20% for enrollment; (ii) 20% for completion; (iii) 40% for jobs; and, (iv) 20% for retention in jobs for 12 months. The unit costs for skilling new entrants and up-skilling existing workforce will be applied. That is, the total amount for a training provider will be based on the unit cost of the training program multiplied by the percentage for the milestone multiplied by number of trainees. The MoU between MoF and the IAs shall be pre-reviewed and drafted in close consultation with ADB's Office of General Council (OGC) to ensure their enforceability and mitigation of fiduciary risks.

12. Delivery of these agreements is contingent on efficient and effective budget management. Thus, the achievement of the output-based contracts by themselves serves as indicators of efficient and effective FM. In addition, fiduciary risks identified during this assessment are proposed to be managed by: (i) agreement of FM Action Plans annexed to the loan agreement; (ii) inclusions of financial assurances within the loan agreement; and, (iii) MoUs with output-based contracts. Together these different elements are expected to help ensuring that key institutional improvements and capacity development in FM are undertaken and that GoB budget allocation targets are met. Analysis of the existing physical outputs by the entities and the proposed outcomes indicate that the program will produce incremental outputs, and donor funds are not replacing GoB funds for the same expected outputs. In addition, absorption capacity of each IA was also assessed comparing their latest audited income with the proposed funding through the program.

13. These arrangements mean that all FM-related risks associated with program implementation, as identified with the FMA of GoB's and the systems and procedures of Sector Associations shall be managed based on their relative significance. Tranche 1 of ADB's contribution will be contingent on meeting a subset of the key targets.

14. It is noted that counterpart funding contributions of about 10% of total budget outlays are expected from the non-GoB IAs. However, these are not included in the overall cost estimates for sake of simplicity. For GoB IAs, all SEIP funding will be provided by ADB since SEIP is supporting incremental training as part of additional training needs, and the GoB for the first time engages Sector Associations directly in this.

III. FINANCIAL MANAGEMENT ASSESSMENTS

15. This chapter provides the Financial Management Assessments (FMAs) undertaken for the SEIP. A total of five assessments have been prepared, which reflects the different levels and organizational entities involved.

A. GoB 'Core FM' Level

16. This part of the assessment covers the MoF's Finance Division, CGA and CAG as well as a number of FM tasks and procedures that are common for all GoB entities participating in the SEIP.

17. The overall functioning of the GoB's PFM system can be assessed based on the PEFA-Based PFM Performance Assessment 2011.[10] The scores of the 28 performance indicators have in the table below been computed to provide the averages for the six high-level PFM dimensions as well as the overall score.

Table 1: 2011 PEFA Assessment for Bangladesh

Highest Rating: A, Lowest Rating: D		**Calculated Ratings**	**Change compared to 2006 PEFA**	**Equivalent Fiduciary Risk Level**
A	Credibility of the budget	C+	↑	Substantial
B	Comprehensiveness and transparency	C	↑	Substantial
C	Policy-based budgeting	B	↑	Moderate
D	Predictability and control in budget execution	C	↔	Substantial
E	Accounting, recording and reporting	C	↔	Substantial
F	External scrutiny and audit	D+	↔	High
	Calculated Overall Score	**C**	↑	**Substantial**

PEFA = public expenditure and financial accountability.

18. Table 1 shows that the overall score is "C". The weakest dimensions are 'External Scrutiny and Audit' followed by 'Predictability and control in budget execution' and 'Accounting, recording and reporting. At the project level, these risks are addressed through (i) a detailed Statement of Audit Needs (SoAN), which reflects the requirements for audited program financial statements prepared in line with Bangladesh Accounting Standards (BAS), and audited in line with International Auditing Standards (IAS), to be submitted within 6 months of the fiscal year, as well as (ii) Rigorous monitoring of working capital requirements and absorption capacity by the SDCMU and (iii) ensuring adequate government budgetary allocation in the DPP prior to loan effectiveness.

Legislative/Regulatory and Institutional Framework for PFM

19. The main legislative instruments for PFM in Bangladesh are the Constitution (part V, chapter II) and the Public Moneys & Budget Management (PMBM) Act, 2009. The PMBM Act defines the core elements of the PFM legal framework and functions as a 'Budget Systems Law'. The regulatory basis for PFM is outlined in presidential Executive Orders, which include the General Financial Rules (GFR), Treasury Rules and Subsidiary Rules as well as the Account Code. MoF's Finance Division issued a Public Expenditure Management Manual in 2005.

20. The GoB's Rules of Business (revised 2010) governs relations between ministries and departments/divisions/agencies. The MoF has several divisions, including the Finance Division (responsible for overall expenditure coordination, budgeting and control) and the Economic Relations Division (focal point for donors and coordination of foreign aid). The Controller General of Accounts (CGA), responsible for compilation and consolidation of government accounts, acts independently under the administrative control of the Finance Division. The

[10] GoB-SPEMP (2011a): "Public Expenditure and Financial Accountability (PEFA) Assessment", Public Financial Management Performance Report, Draft, March.

Planning Commission, under the Ministry of Planning, formulates policy planning and develops medium-term (five-year) macro plans, three-year rolling investment programs, and the Annual Development Program (ADP). The Central Procurement Technical Unit (CPTU), under the Ministry of Planning, is in charge of procurement policy and technical matters. External audit is done by the CAG.

21. It is noted that while the functional responsibilities for accounting since 2002 has rested with the CGA, determining the form of accounts remains the responsibility of the CAG (Article 131 of the Constitution).[11] Also, the CAG continues to be responsible for personnel administration of officers under the CGA, and officers of the combined cadre (Audit and Accounts) are eligible for posting in both audit and accounts positions (In theory, a cooling-off period is required before an individual can audit any area he himself audited, but in practice this may create a conflict with the principle of independent audit since officers can be conducting audit of accounts that they have been responsible for maintaining and preparing.). It is also noted that Chief Accounts Officers (CAOs) working for the CGA in line ministries have dual reporting lines because they with regard to personnel management refer to the CAG rather then the line ministry. Restructuring of the FM and accounting functions, including a separation of the audit and accounts cadre, has been recommended in a donor-funded review,[12] but does not appear to be part of the GoB's current PFM reform agenda.

Medium-Term Planning and Budgeting

22. The MTBF was introduced for 2007/08 with medium-term budget estimates for 10 ministries, and has since then been extended to all line ministries covering all spending areas. The MTBF serves as a linkage between multi-year fiscal and expenditure planning and the annual budgeting process, specifically seeks to integrate in a phased manner the development and non-development (revenue) budgets. It thus helps to establish more consistency between policy, planning and budgeting, but much work remains to be done in this area.[13]

23. While the MTBF approach was well received by line ministries, budgeting remains incremental leading to limited resources being stretched, and there remain two parallel budgets (further discussed below). However, the MTBF approach has helped to highlight the ineffectiveness of FM functions in line ministries, where no single entity is charged with budget management and oversight. A functional approach for forward expenditure estimates is yet to be adopted, but recent efforts to improve the process has been made by MoF's Finance and the Planning Commission.[14]

24. It is noted that the main PFM reform project supporting MoF's Finance Division and line ministries,[15] has prepared a new budget classification structure that is fully in line with international standards, which is to be endorsed by the MoF.

[11] World Bank (2010e): "Restructuring Public Financial Management Institutional Arrangements", Policy Note, Report No. 70359, June.
[12] Ibid.
[13] For example, the development and non-development budgets are yet to be unified and coordination between the responsible entities (MoF and Plan Commission) is weak, forward expenditure estimates are not in place, and the link between sector strategies and line ministry plans/budgets is still being prepared.
[14] SPEMP (2013): "Newsletter", November, pp. 1-2.
[15] The multi-donor funded and World Bank-managed Strengthening Public Expenditure Management Program (SPEMP), Project A – Deepening MTBF and Strengthening Financial Accountability (DMTBF).

Annual Budget Process

25. The GoB agencies in charge of budget management are the MoF and the Planning Commission. They are the main authorities concerned with budget formulation and release (authority to spend).

26. The GoB budget is divided into two parts. The non-development (revenue) budget is formulated by the MoF based on submission of budget proposals by the line ministries following the annual budget call circular. The other part is the development budget, which is approved by the Planning Commission and presented as a consolidated Annual Development Plan (ADP) following the submission of Annual Operation Plans (AOPs) by each ministry for each project. Both the non-development and the development budget are used to finance recurrent (termed "revenue expenditure") as well as capital expenditures.[16] The GoB thus in effect has two parallel budgets.

27. A project can be included in the ADP when a Development Project Proforma (DPP), a project document with a detailed expenditure plan, has been approved by the Planning Commission.[17] When the DPP and AOP are approved, the project budget can be released, which means that expenditures can be executed by submitting bills for payment to the CGA.

28. Regarding comprehensiveness and transparency, the GoB's score in the Open Budget Index (OBI) was 42% in 2008, indicating that it made "minimal information" available to the public on budget and financial activities.[18] The scores for 2010 and 2012 were 48% and 58%, respectively (indicating that "some information" was made available).[19] The latest scores show that GoB has made good progress in this area, but also that scope for further improvements remains.

Treasury Management

29. Bangladesh Bank and Sonali Bank manage the GoB's bank accounts where revenue is deposited and from which expenditure is funded. In total these bank accounts constitute the GoB's Treasury system, and the net of all balances is accounted for against one single account with Bangladesh Bank for cash management purposes (thus resembling a single treasury account system).

30. Cash flows are forecasted annually and updated monthly. However, progress in strengthening cash flow planning and management has been slow, and there is a need to improve the reliability of information from line ministries on budget implementation that impacts the cash flow requirement.[20]

[16] Historically, the practice arose from the ADP-driven development budget being used to budget for donor-funded projects, and the development budget was initially largely a capital budget.

[17] An allocation can be made for a non-approved project if it complies with projected resource allocations in the MTBF (i.e. an allocation is made while awaiting DPPs to be submitted with an AOP for approval).

[18] The OBI covers four budget-related publications (Pre-Budget Statement, Executive's Budget Proposal, Enacted Budget and Citizens Budget), two related to budget execution/accounting (Mid-Year Review and Year-End Report) and one related to external audit (Audit Report).

[19] International Budget Partnership (undated): "Bangladesh, Open Budget Index 2008"; International Budget Partnership (undated): "Bangladesh, Open Budget Index 2010"; International Budget Partnership (undated): "Bangladesh, Open Budget Index 2012".

[20] World Bank (2013): "Implementation Support Mission (June 23 - July 10) – Aide Memoire", SPEMP, p. 18.

31. While quarterly releases are made for the development budget, there are no cash release constraints on the non-development budget. Ministries/agencies can, within their total appropriations, re-allocate their budgets during the year, but overall increases require supplementary appropriations (i.e. parliamentary approval).

Accounting and Internal Control

32. The CGA is the key institution for processing of payments, internal control, and accounting. It serves as the treasurer (pay station), accountant, and pre-auditor of GoB funds. It has accounting offices for all ministries, districts, and upazilas. In addition to payment processing, CGA is responsible for compilation of the monthly and annual accounts (Finance Accounts) of the GoB as a whole.[21]

33. The GoB's accounting standards do not comply with the cash basis International Public Sector Accounting Standards (IPSAS), but it is noted that developing and adopting new standards could be done with authorization from the CAG (i.e. legislation would not be required).[22]

34. The chart of accounts is unified for both budgets and all GoB levels. Whether a payment is charged to the non-development or development budget is determined by its legal code entered on the bill (level 1 code). Each ministry and unit within a ministry is recognized by its functional code (level 2 and 3). The project to be charged is determined by its operational unit code (level 4). Finally, the expenditure type (wages, other operational costs, investments) is determined by the economic code (level 5).

35. The payment, accounting, and internal control process follows the same procedure for both the non-development and development budget. All bills submitted for payment are subject to review by CGA before they process the payment, i.e. with some few exceptions only CGA have access to cash.

36. The CGA uses the Integrated Budget and Accounting System (IBAS), a computerized software system, for budget management and accounting purposes.[23] The CGA records all expenditures (charges made against the GoB bank accounts) and checks that bills submitted for payment have been authorized through the budget process with total expenditure contained within budget ceilings.[24] All ministries rely on reports from IBAS for monitoring purposes, but also on accounts from their field offices. However, not all ministries/agencies have direct access to the system. For now, the 'Budgeting' module is also not integrated with the Accounting module of IBAS, and is expected to be integrated once IBAS++[25] is rolled out in 2015.

37. GoB spending is highest in the last quarter of the fiscal year (April-June), which indicates absence of commitment control (i.e. checks that limit commitments to actual cash availability

[21] Incorporating those of the Defense and Railway Departments, which are not under the CGA.
[22] World Bank-GoB (2007): "Bangladesh – Public Sector Accounting and Auditing, A Comparison to International Standards", May.
[23] IBAS records financial transactions on a post-facto basis, i.e. processing is first done manually and transaction summaries then recorded in IBAS.
[24] CGA's controls of bills submitted for payment and that payments are within budget ceilings differs from commitment control, which in fact is not undertaken and for which there is no module in IBAS.
[25] Under SPEMP, a WB and donor funded programe

and approved budget allocations). This 'rush of expenditure' has the attendant risk of attracting inferior quality and, at the same time, constrains budget credibility.[26]

Payroll Control

38. The GoB's payroll function is decentralized, and there is a prevalence of manual systems and use of cash salary payments. Also, regular reconciliation of personnel records with payroll data is lacking, which adversely affects the integrity of the payroll. The main PFM reform project (SPEMP, Project A) is overseeing a limited payroll data 'cleansing' exercise to be done by mid-2014, but so far no comprehensive payroll audit has been carried out for the GoB.

Internal Audit[27]

39. At the level of ministries and agencies, there are internal auditors appointed who are to assess compliance with financial regulations. In 2005, an internal audit manual was issued to guide the work of the internal auditors, but the guidelines therein have not been put into practice effectively.[28] While most ministries have internal audit units, they are generally considered inadequate in terms of capacity and staffing, and only to a limited extent conduct regular internal audit functions. More commonly performed tasks are routine voucher checking before payment (i.e. pre-audit). Also, no ordinary internal audit reports are issued and hence no management responses are prepared. Moreover, many internal audit functions lack independence and are responsible to the CAO (rather than the Secretary).[29] It appears that only one line ministry (Ministry of Health & Family Welfare (MoHFW)) has complied with GoB instructions to outsource internal audit to a private function. Overall there has so far been very limited demand for internal audit, buth this may change in future with the MoF's Expenditure Control Wing having been charged with developing internal audit as well as an Internal Audit Strategy having been developed.

Financial Reporting

40. The CGA is responsible for preparing financial statements of cash release and expenditure incurred as well as consolidated financial statements. Line ministries are responsible for maintaining the central accounts of all resources received and spent in cash and kind. The CAOs attached to each ministry are responsible for preparing ministries reports, which includes sub-national data.

41. The accounting system can produce monthly and annual expenditure reports comparing budget and actual expenditure at the level of detailed administrative and economic classification, but are seldom produced and used by executives.[30] An annual consolidated financial statement and report is prepared that covers all GoB expenditures (though some departmentalized entities produce separate reports and, also, foreign loan/grants are not reflected in the annual statements, as IBAS captures uses of funds, but not entirely the sources).

[26] GoB-SPEMP (2011a): op.cit., p. v.
[27] It is stressed that whereas internal control is the process by which an organization governs its activities to effectively and efficiently accomplish its mission/fulfill its objectives, internal audit is the evaluation of the adequacy and effectiveness of controls.
[28] GoB-SPEMP (2011a): op.cit., p. 44.
[29] It is furthermore noted that the CAOs have dual reporting lines in that while the CGA has the functional responsibilities for accounting, the CAG is charged with personnel management.
[30] Ibid, p. 47.

42. Monthly reports are generally prepared with a time lag of four to six weeks, but preliminary data from IBAS is available within 25 days. Preliminary annual accounts are available within a month of year-end. The fiscal year end in Bangladesh is June 30. The revised and final annual accounts should be available by October and submitted to the CAG by December (i.e. within six months of the year-end), but these dates are usually not met, which subsequently delays the audit carried out by the CAG.[31]

Procurement

43. The legislative (Public Procurement Act, 2006) and regulatory framework (Public Procurement Rules, 2008) for procurement is comprehensive. It applies to all procurement undertaken with GoB funds and covers all procuring entities. Open competitive procurement is the default method and situations where other methods may be used are clearly described. However, the use of competitive procurement methods cannot easily be assessed due to a lack of data, but there appears to be only few contracts where competitive procurement methods is being circumvented or bypassed.[32] Contract award information is in some cases incomplete and mandated procurement plans are not always being published.

44. The Local Consultative Group (LCG) PFM Task Team in has earlier noted some key challenges regarding efficiency and transparency in public procurement, including 1) Amendments to procurement legislation for small-value work contracts can undermine good procurement practices; 2) Delays in award of large value contracts; and, 3) Inadequate procurement management capacity and monitoring of performance by agencies, especially at decentralised levels.[33]

45. Two sector-/ministry-level PEFA assessments carried out in 2011 found a number of significant shortcomings regarding procurement, including persistent delays, irregularities, waste of procured items and a lack of supporting information for procurement decisions to justify the use of less competitive methods for the MoHFW[34] as well as indications of collusive and inappropriate practices, limited public information available in the annual procurement plans, and no contract awards information was placed on any websites (Ministry of Primary & Mass Education (MoPME)).[35] At the technical level, it thus appears that compliance with basic procurement rules and procedures is very poor.

External Audit

46. The CAG conducts external audit through nine separate audit directorates. Each Audit Directorate is headed by a Director General who is responsible for conducting external audits in a specific functional area of the public sector. The main directorates within the CAG are:

a) *Local and Revenue Audit Directorate* – Audits all civil government departments, local

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[31] For example, the 2011/12 accounts had as of August 2013 (14 months after year-end) not yet been submitted for audit, i.e. the delay was more than eight months as compared to the requirement.
[32] Ibid, p. 41.
[33] LCG PFM Task Team (2012): "Debrief on Key Challenges and Priorities", Development Partner Plenary Meeting, 12 July.
[34] GoB-SPEMP (2011b): "Public Expenditure and Financial Accountability (PEFA) Assessment", Ministry of Health & Family Welfare (MoHFW), Draft, March.
[35] GoB-SPEMP (2011c): "Public Expenditure and Financial Accountability (PEFA) Assessment", Ministry of Primary & Mass Education (MoPME), Draft, March.

and statutory bodies, including municipal/city corporations.

b) *Civil Audit Directorate* – Audits accounts of all CGA offices, thana/upazila accounts offices, district accounts offices, and regional accounts.

c) *Foreign-Aided Projects Audit Directorate (FAPAD)* – Audits all foreign-funded development, investment and TA programs/projects in the public sector. FAPAD conducts audits in accordance with ToRs jointly agreed between the GoB and donors. FAPAD audits are presented within six months of the end of the fiscal year, but only for foreign-aided expenditures.

47. The CAG's annual audit plan covers all large entities and a number of smaller units, the latter being audited over a cycle of three to five years.

48. Draft audit reports of the Directorates are sent to the CAG office for quality assurance and approval, and thereafter via the Prime Minister's Office to the President, who subsequently submits them to Parliament. There was earlier a large backlog of audit reports yet to be reviewed by Parliament, but the Public Accounts Committee (PAC) has since 2010 made efforts to expedite the review of back-logged annual reports,[36] but the exact details are not made public.

49. The CAG's audits are done using audit manual based on international standards.[37] Regularity audits are transaction-level compliance tests rather than focusing on systems, and recommendations are made on individual transactions rather than on systemic strengthening. However, issue-based and performance audits as well as audits of foreign-aided projects include control appraisal.[38] Follow- up on audit recommendations is generally weak and un-systematic (i.e. no established monitoring mechanism), which results in many issues raised by the CAG being repeated in subsequent reports with little evidence of progress.

50. Auditors and accountants are, as noted earlier, part of the same cadre, which as such is conflict-of-interest situation in that auditors may be auditing their own work or that of (former) colleagues. Another HR issue is the lack of staff.[39]

B. GoB Implementing Agencies

51. This part of the assessment covers the DTE, BMET and BITAC.[40]

52. Table 2 below shows the risk assessment for each assessed FM element as well as the overall/average risk assessment for each entity's FM.

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[36] SPEMP (2011): "SPEMP – Progress Report 4", August, p. 1.

[37] The CAG has Government Auditing Standards; manuals for civil audit, local audit, revenue audit and performance audit; Audit Code; and, Code of Ethics (see http://www.cagbd.org/in.php?cp=methd).

[38] GoB-SPEMP (2011c): op.cit., p. 50.

[39] The 2011 PEFA assessment report noted that 1,000 out of 5,000 approved posts were un-filled.

[40] A FM capacity assessment was also carried out for the Bangladesh Technical Education Board (BTEB) although it will not receive funds directly but rather consultancy support from the SDCMU.

Table 2: FM Risk Assessment for GoB Implementing Agencies

	DTE	BMET	BITAC
Planning & Budgeting	Medium	Medium	High
Accounting	Medium	High	High
Internal Control	Medium	Medium	Medium
Financial Reporting	High	High	High
Grant Management	Medium	High	High
External Audit	Medium	Medium	Medium
Staffing	High	High	High
Overall risk assessment	**Medium**	**High**	**High**

BITAC = Bangladesh Industrial Technical Assistance Centre, BMET = Bureau of Manpower Employment and Training, DTE = Directorate of Technical Education.
Note: The risk categories applied are: Low, Medium and High.

53. The table shows that the overall FM-related risk is assessed as ‘medium’ for DTE, but ‘high’ for BMET and BITAC. It is noted that, when considering the seven specific FM elements, while there are differences regarding procedures and performance, none are assessed as ‘low’ for any entity. Also, while all three entities have a ‘medium’ risk rating for internal control, it is ‘high’ for financial reporting and for staffing. Addressing these latter two FM elements will thus be particularly important as part of the risk mitigation and capacity development approach focusing on the GoB’s IAs.

54. The findings for the seven FM elements are briefly presented below. The filled-in FMA questionnaires for each entity are provided in Appendix 3, while detailed entity-level FM Capacity Assessments are provided in Appendix 4.

Planning and Budgeting

55. All GoB entities participate in the annual planning and budgeting processes. However, the annual budget is prepared using incremental rates over previous year’s budget, and does not consider physical and financial targets together. The entity-level budgets are always forwarded to the relevant line ministry and from there to the MoF, which after deliberations approves the budget. Only one entity (BITAC) prepares a revised budget based on the trend of actual expenditures, usually around five months after the start of the fiscal year.

Accounting

56. The accounting framework and procedures follows that of the GoB and is thus similar for all three entities (standard Account Code, cash basis accounting, CGA processing payments, dual recording system – entity and CGA – thus requiring reconciliation, etc.). However, differences between the three entities include that, for example, only one entity uses a computerized accounting system (DTE, in-house developed software), while the other two have manual bookkeeping. Also, only BITAC undertakes bank reconciliation for all accounts (DTE does so for project-related accounts), and is also the only entity that maintains a General Ledger and subsidiary ledgers.

Internal Control

57. Segregation of duties in ordering (procurement) and receiving of goods as well as for recording of transaction appears to be observed by all three entities. Only one entity (BMET) is preparing reconciliation statements when checking its records against those of the CGA. Likewise BMET is the only entity which has a fixed asset register and uses identification marks

for the assets (BITAC also has a register, but does not use identification marks; DTE only registers project assets). None of the three entities carry out physical verification of assets.

Internal Audit

58. It is understood that only one of the three GoB IAs (BITAC) has an internal audit unit, but it is part of the Accounts Department (i.e. lacks independence) and appears to do pre-audit (checking of payment transactions before processing by financial controllers) rather than internal audit.

Financial Reporting

59. Only one entity (DTE) prepares monthly variance reports, which are sent to the MoE, though do not explain variances. The other two entities do not undertake regular follow-up, but it is all three entities that can use their budget register to regularly calculate the balance budget. BITAC compares planned and actual expenditure about five months into the fiscal year (so as to revise its budget, if needed). Furthermore, all three entities regularly receive expenditure reports from their regional units, and these reports are being consolidated. Financial statements prepared by the three entities comprise only receipts and payments accounts. Balance sheets are not being prepared, and cash flow analyses also are not done. Furthermore, the reporting systems do not have the capacity to link financial information with non-financial data.

Grant Management

60. DTE and BMET have both implemented the World Bank-funded Skill and Training Enhancement Project (STEP) as well as the ADB- and SDC-funded Skills Development Project (SDP). While DTE has used separate software to record transactions and a Project Accountant has been charged with bookkeeping and reporting, BMET's Accounts Department has not dealt directly with project finances, and it therefore does not have such experience. BITAC has not received external support and thus does not have any such experience.

External Audit

61. External audit of GoB entities is done by the CAG. It is noted that the CAG does not provide an opinion on the financial statements of the auditees, and that financial statements are not annexed to the audit reports. However, for donor-funded projects, FAPAD does attach financial statements to its audit reports and provides an opinion on the financial statements.

Staffing

62. DTE's Accounts Department is managed by the DDO who, however, does not have any finance or accounting background, which also applies to the Accounts Officer working under his supervision. BMET's Accounts Department is headed by the Director Finance & Administration (Joint Secretary). The Accounts Officer is the DDO, who does not have any professional FM training, and there are furthermore six assistants. BITAC's Accounts Department is headed by the Chief Accounts Officer (CAO) who holds a post-graduate degree in accounting. There are an additional 12 staff, which have a mix of commerce and non-commerce backgrounds, but none have accounting professional qualifications.

C. Sector Associations Implementing Agencies

63. This part of the assessment covers eight Sector Associations IAs – BGMEA, LFMEAB, BACI, BEIOA, BKMEA, BASIS, BTMA and BACCO – with regard to their FM procedures and capacities.

64. It is noted that all the sector associations are registered under the Companies Act, 1913 or 1994, as Non-Profit Organizations (NPOs) with liability limited by guarantee.[41] Key positions in the associations are held by its members (business owners) who change often following regular elections, which possibly might affect the continuity of policies and activities, including for FM.

65. The table below shows the risk assessment for each assessed FM element as well as the overall/average risk assessment for each entity's FM.

Table 3: FM Risk Assessment for Sector Associations

	BGMEA	**LFMEAB**	**BACI**	**BEIOA**	**BKMEA**	**BASIS**	**BTMA**	**BACCO**
Planning & Budgeting	Medium	Medium	Medium	High	Medium	High	Medium	High
Accounting	Low	High	Low	High	Low	Low	High	High
Internal Control	Low	High	Medium	High	High	Medium	Medium	High
Financial Reporting	Low	Medium	Medium	High	Low	Medium	Medium	High
Grant Management	Medium	Medium	High	High	Medium	Medium	High	High
External Audit	Low	Low	Medium	Medium	Low	Medium	Medium	Medium
Staffing	Low	High	High	High	Low	Low	Medium	High
Overall risk assessment	**Low**	**Medium**	**Medium**	**High**	**Medium**	**Medium**	**Medium**	**High**

BACCO = Bangladesh Call Center Operators' Association, BACI = Bangladesh Association of Construction Industry, BASIS = Bangladesh Association of Software and Information Services, BEIOA = Bangladesh Engineering Industry Owners' Association, BGMEA = Bangladesh Garment Manufacturers and Exporters Association, BKMEA = Bangladesh Knitwear Manufacturers and Exporters Association, BTMA = Bangladesh Textile Mills Association, LFMEA = Leathergoods & Footwear Manufacturers & Exporters Association of Bangladesh.
Note: The risk categories applied are: Low, Medium and High.

66. The table shows that the overall FM-related risk for the sector associations in most cases is assessed as 'medium'. However, when considering the seven specific FM elements, it is clear that procedures and performance differ widely within most entities (BEIOA and BACCO being the only entities that have the same ratings for all but one of the FM elements) as well as between the entities. It is thus clear that a targeted risk mitigation and capacity development approach is needed that takes into account the specific capacity and performance of each entity – a one-size-fits-all approach would not be suitable.

[41] Under section 28 of Companies Act, 1994, NPOs are so-called companies limited by guarantee as they do not have share capital and do not apply the term "Limited" to their name.

67. The findings for the seven FM elements are briefly presented below. The filled-in FMA questionnaires for each entity are provided in Appendix 3, while detailed entity-level FM Capacity Assessments are provided in Appendix 4.

Planning and Budgeting

68. With the exception of BEIOA and BACCO, all entities prepare annual budgets for their organization, generally using an incremental approach based on the previous year's budget. The budgets are typically approved by the board or executive committee, and then confirmed at the Annual General Meeting (AGM). The organizational responsibility for implementing the budget is for several entities not specified. None of the entities prepare cash flow forecasts of any kind (annually, quarterly or monthly).

Accounting[42]

69. There is no standard Chart of Accounts applied across the entities, but the books of accounts in which financial transactions are recorded in all cases correspond to the budget line items (i.e. the entities are in principle able to compare planned and actual spending). Computerized accounting systems are used by four entities (applying three different software), while the remainder maintain their books manually (some supporting this with spreadsheets). Bank reconciliations are done by most though not all entities, and generally with some delays and without being reviewed by management. Several entities minimize the handling of cash by requiring payments to be deposited directly into their respective bank account. Many entities do not monitor accounts payable or receivable during the year, but only at year-end. Balance sheets are prepared at year-end by all entities (except BEIOA and BACCO) to review the financial position.

Internal Control

70. Only two entities (BGMEA and BASIS) have written policies that state its internal control procedures, while another (LFMEAB) has a manual under preparation. Most of the other entities have various relevant procedures in place, but these are not documented. Procurement procedures appear to differ significantly between the entities, and seem generally not to be documented. Fixed asset management likewise differs between entities; while some entities apply a register, mark assets and undertake regular physical verification, none have all of these safeguards in place. Most entities do not have insurance for their assets.

Financial Reporting[43]

71. Financial reports are prepared during the year by all entities, but their format and usage differs widely. Only BGMEA and LFMEAB prepare monthly reports that include comparisons planned and actual spending as well as explanations for deviations. Others prepare such comparative reports only at year-end, or not at all. Only for two of the entities (LFMEAB and BACI) is the board/executive committee involved in reviewing the monthly financial reports, for the other entities it is only selected managers. Members receive financial information via the annual reports at the AGMs. Only one entity (BACI) files income tax return.

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[42] It is understood that the Bangladesh Financial Reporting Standards (BFRS), which are prescribed by the Institute of Chartered Accountants in Bangladesh (ICAB) and are closely modeled on the International Financial Reporting Standards (IFRS), do not apply to NPOs.

[43] It is understood that the Bangladesh Accounting Standards (BAS), which are prescribed by ICAB and are closely modeled on the International Accounting Standards (ISAs), do not apply to NPOs.

Grant Management

72. While none of the entities have prior experience with ADB-funded programs/projects, only one (BACI) does not have at least some experience with externally funded activities from other international organizations or from the GoB. Several entities are familiar with the need to maintain separate accounting and reporting for externally funded activities. However, focused training appears required for all entities nonetheless.

External Audit

73. Annual audits are undertaken by all entities, usually within six months of year-end, i.e. with some delay. The audit firms undertaking the external audit are registered, but only three entities (BGMEA, LFMEAB and BKMEA) have selected an “A” category firm. It is understood that all audit reports reviewed state that the external audit was done as per the Bangladesh Standards on Auditing (BSA), which conform to the International Standards on Auditing (ISA).

74. There is no statutory requirement that external audits include a management letter, and so – unless specifically requested by the auditees – the auditors do not provide recommendations on how to improve internal controls or the efficiency and effectiveness of operations that may have been noticed during the audit. Statutory audited financial statements are generally available within _three months of the fiscal year-end. In the case of _two associations, the audited financial statements for 2012 are not yet available. Further information is shown in Table 4 below.

Table 4: External Audit Information regarding the Sector Associations

	Entity	Latest Year Audited	Latest Auditors' Report Dated	Approx. Time to undertake Audit	Audit Firm Category
1	BGMEA	2012	07/03/2013	2 months	"A"
2	LFMEAB	2012	28/04/2013	4 months	"A"
3	BACI	2011/12	09/09/2012	2 months	"B"
4	BEIOA	2011	10/06/2012	6 months	"B"
5	BKMEA	2012	10/04/2013	3 months	"A"
6	BASIS	2011/12	21/10/2012	4 months	"B"
7	BTMA	2011/12	11/10/2012	3 months	"B"
8	BACCO	2011	02/02/2012	1 month	"B"

BACCO = Bangladesh Call Center Operators' Association, BACI = Bangladesh Association of Construction Industry, BASIS = Bangladesh Association of Software and Information Services, BEIOA = Bangladesh Engineering Industry Owners’ Association, BGMEA = Bangladesh Garment Manufacturers and Exporters Association, BKMEA = Bangladesh Knitwear Manufacturers and Exporters Association, BTMA = Bangladesh Textile Mills Association, LFMEA = Leathergoods & Footwear Manufacturers & Exporters Association of Bangladesh.

Staffing

75. The educational qualifications and professional experience of finance and accounting staff differs significantly between the entities. None of the Accounts Departments are led by a chartered accountant. Some of the Accounts Department are led by accountants with public accounting training, i.e. chartered accounting articleship completed, (BGMEA, BKMEA, BASIS, BTMA) and have staff with relevant backgrounds for the different tasks (BGMEA, BASIS, BTMA), while others have staff without such relevant qualifications and experience (LFMEAB, BACI, BEIOA, BACCO).

76. It should be noted though that there – with the possible exception of BGMEA and BASIS – does not appear to be any direct relationship between staffing quality (measured as educational background and professional experience) and the FM-related risk assessments for the different areas. In other words, staffing quality is not per se a determinant for the FM performance of the entities

IV. RISK FACTORS IDENTIFIED

77. This chapter presents, based on the FMA above, the risk factors identified for the different levels and organizational entities involved in the SEIP.

A. GoB 'Core' FM Level

78. This part covers risk factors identified for MoF's Finance Division, CGA and CAG as well as those FM tasks and procedures that are common for all GoB entities participating in the SEIP.

79. The GoB's framework for PFM is under transition and a number of improvements have, as outlined above, been made in recent years. However, a number of PFM weaknesses exist in areas relevant for the SEIP, including: (i) budget preparation; (ii) accounting and internal control; (iii) financial reporting; (iv) internal audit; and, (v) external audit. Each of these is discussed briefly below.

80. The current <u>budget preparation</u> approach is incremental based on past year's budget and, also, does not include physical targets. The current approach to planning and budgeting might results in imbalance in resource allocation (recurrent costs vs. investments), thus creating a risk that insufficient budgetary resources are allocated to properly maintain investments.

81. With regard to <u>accounting</u>, there are currently three main challenges:

a) **Accumulation of un-cleared advances** – If an advance is not cleared based on evidence of actual expenses, it may represent a cash leakage since no actual activities may have been carried out or services received.
b) **Delays in payment processing** – Studies have found that payment delays are deliberately made until the payment beneficiary surrenders part of the payment to the CGA office doing the processing ("speed money").[44]
c) **Lack of reconciliation between GoB agency cash books (bills presented to the CGA for payment) and IBAS (actual bills paid)** – The financial regulation requires reconciliation to be done monthly and within 15 days, but CAG audit reports frequent document lack of compliance This impacts on the level of assurance provided by the IBAS-generated financial statements and represents risks for leakage and misappropriation of funds.

82. Furthermore, there is an inherent weakness in the <u>internal control</u> system in that there is no direct linkage between budgets and the accounting process as no system exists for

[44] World Bank (2010a): "Bangladesh, Public Expenditure and Institutional Review", Volume II: Sector Analysis, Report No. 47767-BD, June; FMRP (2007): "Governance, Management and Performance in Health and Education Facilities in Bangladesh: Findings from the Social Sector Performance Qualitative Study", January.

automatic budgets checks before payments is processed.[45] For *development expenditure*, budget utilization reports include only actual expenditures and there is no budget comparison. Since payments can be made as long as there is an account code, and with variance checks between budget and actual expenditure only done after payment is made, there is a risk for over spending of budgeted appropriation. However, this risk is generally low as the CGA maintains strict control over budget releases. For *non-development expenditure*, responsibility for budget check before commitment or payment rests with the departments/agencies/units who maintain budget and expenditure records, and send regular reports to the line ministry. This practice is problematic in terms of expenditure management when districts and upazilas account for 70% of total spending. IBAS actually consists of separate stand-alone accounting systems, which are not integrated with budget information. In particular, IBAS does not have budget checks before expenditure processing is done, i.e. IBAS cannot be used for budget monitoring at the operational level.[46] Furthermore, with regard to the *payroll* be mentioned the current system creates risk of errors and fraud.

83. With regard to <u>financial reporting</u>, there are some delays in the preparation of monthly reports and, especially, for the annual accounts by the CGA (adversely affecting the CAG's subsequent audit of the accounts). These delays are among other things caused by the aforementioned reconciliation process between IBAS records and the manual accounts of the ministries and agencies. Furthermore, budget variance reports with explanation of deviations between planned and actual spending are rarely prepared, and these aspects hence not monitored.

84. The <u>internal audit</u> function in ministries is generally inadequate due to weak staff capacity and for procedural reasons (internal audit is often doing pre-audit rather than evaluating the adequacy and effectiveness of controls). Also, many internal audit functions lack independence (referring to the CAO rather than the Secretary). Very few internal audit reports are thus being prepared by the GoB.

85. The <u>external audit</u> done by the CAG remains constrained by a limited number of qualified staff, audit reports are not completed and published in a timely manner, regularity audits do not focus on systems, and recommendations are made on individual transactions rather than on the strengthening of systems. It is noted though that audits undertaken by FAPAD generally are deemed satisfactory in terms of both quality and timing. However, the incorporation under SEIP of both development and non-development expenditures will need to addressed and clarified with the CAG since FAPAD traditionally focuses only on expenditures under the development budget.[47]

B. GoB Implementing Agencies

86. The FM assessment carried out for the DTE, BMET and BITAC shows that all three entities have weaknesses with regard to financial reporting and staffing. The assessment also found that in particular BMET and BITAC are facing significant challenges regarding several other FM aspects. The specific areas that thus require attention are: (i) accounting; (ii) financial reporting; (iii) grant management; and, (iv) staffing. Each of these is discussed briefly below.

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[45] GoB-SPEMP (2011): op.cit., p. 43.

[46] It is noted that the establishment of proper commitment control depends on the roll-out of IBAS++, which is unlikely to be fully operational until 2015.

[47] Under another donor-funded program, the multi-donor Primary Education Development Programme (PEDP) 3, this issue was satisfactorily dealt with based on an agreed SoAN and an audit report for 2011/12 covering both the development and the non-development budget been prepared in early 2013.

87. While the accounting framework and procedures overall follows that of the GoB, various procedural differences between the three entities as well as weaknesses have been observed. These latter include manual accounting; accrual basis of accounting not being applied in preparing financial statements; bank reconciliation not being prepared or, if done, not reviewed by management; General Ledger and subsidiary ledgers not kept, or not these not being reconciled on a regular basis; and, balance sheet not being prepared at least annually to review the financial position.

88. Financial reporting is very weak for all three GoB IAs in terms of preparing monthly variance reports with explanations for variances, actively using the expenditure reports received from regional units, financial statements comprising only receipts and payments accounts, balance sheets not being prepared, and cash flow analyses also are not done. Furthermore, the reporting systems do not have the capacity to link financial information with non-financial data.

89. Although two of the three entities have technical experience with implementing externally funded projects, they lack grant management practice. This specifically relates to bookkeeping, accounting and financial reporting. It is noted that BITAC so far has not received external support and thus lacks relevant experience.

90. The staffing of the three GoB IAs in terms of accounting and finance professionals is very weak, which constitutes a major fiduciary risk, and to some extent might explain the many FM weaknesses observed. .Only one of the three entities has an Accounts Department that is headed by an official who holds a degree in accounting. It is also noted that many of the staff do not have any specific or qualifying backgrounds, and also that they have not received relevant training.

C. Sector Associations Implementing Agencies

91. The FM assessment carried out for the Sector Associations shows that FM procedures and performance differ widely within as well as between most entities most entities have weaknesses with regard to financial reporting and staffing. While it thus is clear that a targeted risk mitigation and capacity development approach is needed, which takes into account the specific circumstances of each entity, across all the entities the following areas will require specific attention due to the observed weaknesses: (i) Planning and budgeting; (ii) internal control; (iii) grant management; and, (iv) staffing. Each of these is discussed briefly below.

92. While all entities except one prepare annual budgets for their organization, the planning and budgeting procedures are generally poor. The budget is usually developed using an incremental approach based on the previous year's budget, and thus does not take into account both physical and financial targets. It is also noted that most entities lack a formal budget holder with responsibility for managing the budget. Furthermore, no entities prepare cash flow forecasts.

93. Only two entities have written policies that state its internal control procedures, while one has a manual under preparation. The remaining entities have little or no documentation as to their internal control procedures, which is a major risk factor. The same applies to procurement management. Another significant fiduciary risk is fixed asset management, which – although some have specific elements in place – is not fully functional in any of the entities.

94. Most of the Sector Associations do not have any prior experience with externally funded activities from international organizations or even from the GoB. This lack of grant management experience is a considerable risk factor given the observed weaknesses in the different FM areas, but it is noted though that some entities have an understanding for the need to maintain separate accounting and reporting.

95. The quality of staffing for finance and accounting positions in terms of educational qualifications and professional experience differs significantly between the entities. This is likewise a major risk factor. It is observed that no Accounts Departments are led by a chartered accountant, while some are managed by accountants with public accounting training. The background of other staff with regard to qualification and experience is likewise quite mixed. Unlike for the GoB IAs though, it does not appear that staffing quality as such is a primary determinant for the FM performance of the entities (this may more likely be, for example, corporate governance and the existence of written instructions).

D. Mitigating Fiduciary Risk

96. Based on the identified FM weaknesses and fiduciary risks, it must be considered how fiduciary risks can best be mitigated, which then need to be balanced against the potential development benefits of different options. Approaches to mitigating individual risks include transfer, treat, tolerate or terminate. Aggregate risks can be managed more effectively by risk-spreading.

97. Fiduciary risks can be treated in the short term by the use of safeguards and in the longer term through effective FM (and anti-corruption) reform programs. The time for reforms to reduce risk levels is likely to be medium- to long-term (five to ten years), which corresponds with the planned time frame for the SEIP. In the shorter term, it will be necessary to evaluate whether additional short-term safeguards are appropriate to mitigate key fiduciary risks. In doing so, a trade-off between short term safeguards and longer term development of PFM capacity should be considered. This implies that projects with a shorter life cycle should include control mechanisms and support for enhancing FM capacity, which will prepare for more sustainable and longer term reforms.

98. Some level of fiduciary risk will need to be tolerated whenever financial aid is provided, and the level of tolerance acceptable will depend on the expected development benefits from providing the support. The purpose of fiduciary risk assessments is not to eliminate fiduciary risk, but to ensure that risks taken are understood, accepted and owned, and that risks are managed effectively.

99. Risk-spreading can be used to reduce overall risk, for example by implementing a large program through a number of IAs as is the case for the SEIP. This is of course based on the assumption that the risk factors for the different IAs are not closely related (e.g. are not all determined by the same trigger).

100. A structured approach to regular fiduciary risk assessment and management provides a proactive mechanism to mitigate identified risks. An Annual Fiduciary Review (AFR) is planned for the SEIP, which includes an assessment of FM performance of the various involved entities (both GoB and non-GoB IAs), for example based on reports of payment processing, reconciliation and advances. The AFR will identify areas and units within the implementation system with a low level of compliance and recommend subsequent actions to address the problem.

101. Furthermore, TA should be provided to improve capacity in FM, including internal audit, financial reporting and monitoring in the IAs.

102. A detailed FM Action Plan has been developed for each of the different entity-groups that are part of the SEIP (see Appendix 5).

E. Risk Analysis

103. As outlined above, a number of FM-related weaknesses and shortcomings exist for the involved entities. The resulting FM risks are summarized and presented the table below for the different entity groups.

Table 5: Financial Management Risks

Risk Type	Risk Description	Risk Assessment (w/o mitigation)[a]	Management Plan / Mitigation Measures
Inherent Risk [b]			
1. Country-specific risks	**GoB:** The governance system is characterized by significant shortcomings in the GoB's capacity to formulate and, especially, effectively implement policies, low transparency and weak accountability, and a perceived high and unchanged corruption level, but also an ability to foster strong economic growth and some socio-economic developments.	High	Through the program design establish a governance structure and technical-level safeguard measures that can help to minimize specific risks that are pre-identifiable. Use the PSC to ensure that transparent and accountable procedures are established for and followed by the involved institutions for the SEIP-related activities.
	NPO / NGO sector: The functioning of NPOs and NGOs in terms of transparency and accountability is closely linked to their corporate governance, and hence vulnerable to adverse changes in leadership.	Substantial	The work and functioning of the boards should be closely observed by the SDCMU, and any adverse developments reported to the PSC.
2a. Agency-specific risks – GoB 'Core' FM Level	The PFM system, although slowly improving over time, is characterized by significant systemic and procedural weaknesses as well as an apparent lack of willingness to undertake certain key reforms (dual budget structure, internal control and internal audit).	High	Continued conceptual and technical-level implementation support for PFM reforms – at overall as well as sectoral and program/project levels – and providing additional focus on reform bottlenecks through identification of and support to catalytic reform initiatives.

Risk Type	Risk Description	Risk Assessment (w/o mitigation)[a]	Management Plan / Mitigation Measures
2b. Agency-specific risks – GoB IAs	FM capacity and performance is generally very weak, which leads to inefficiencies and non-compliance with rules and regulations.	High	A FM framework for SEIP administration needs to be formulated, documented and implemented by the entities (e.g. FM manual and training), and monitoring undertaken. Staffing standards for SEIP to be set and met.
2c. Agency-specific risks – Sector Associations IAs	The FM-related systems and procedures are poorly functioning, and the capability of staff involved with FM in many cases low.	Substantial	A FM framework for SEIP administration needs to be formulated, documented and implemented by the entities (e.g. FM manual and training), and monitoring undertaken. Staffing standards for SEIP to be set and met.
Overall Inherent Risk		*High*	
Control Risk [c] – GoB 'Core' FM Level			
1. Planning and budgeting	Despite the MTBFs, annual budgeting remains fragmented and incremental, as well as with ineffective management and oversight on the institutional level.	Substantial	SEIP funding will be incorporated into MTBFs of GoB entities / ministries.
2. Budget Execution	GoB spending is highest in the last quarter of the fiscal year, which indicates the absence of commitment control. In procurement, transparency and efficiency is to some extent lacking, award of high-value contracts is often delayed, and management capacity and performance monitoring is inadequate. Some ministries have significant procedural shortcomings in procurement and low regulatory compliance.	Substantial	TA requirement will be identified, if and as relevant, and included as part of the FM action plans.

Risk Type	Risk Description	Risk Assessment (w/o mitigation)[a]	Management Plan / Mitigation Measures
3. Accounting and internal control	GoB procedures are very weak regarding the clearing of advances, ensuring timely payment processing, and enforcing accounts reconciliation (CGA and agencies). Also, GoB's accounting does not comply with international standards. The internal control system has an inherent weakness since there is no direct linkage between budgets and the accounting process (risk of over-spending). IBAS does not have budget checks before expenditure processing, i.e. cannot be used for budget monitoring. Reconciliation between personnel records and payroll data is lacking, and payroll audits are not undertaken.	High	FM framework for SEIP management to be prepared and implemented for relevant entities and staff, specifically within CGA. Reconciliation of accounts records between the relevant SEIP entities and the CGA to be monitored.
4. Financial reporting	Monthly reports are usually somewhat delayed, while annual reports can be delayed by more than six months.	Substantial	FM framework for SEIP management to be prepared and implemented for relevant entities and staff, specifically within CGA.
5. Internal audit	Many internal audit units have been set up, but they often lack independence, in most cases have inadequate capacity and staffing, and generally conduct pre-audit rather than internal audit.	High	Assess the possibilities for the internal audit units in MoE (for DTE), MEWOE (for BMET) and MoI (for BITAC) to widen the scope of the function to cover their subordinate institutions.
6. External audit	The CAG is constrained by a limited number of qualified staff, audit reports are not completed in a timely manner, regularity audits focus on individual transactions rather than on system strengthening. However, FAPAD's audits are generally deemed satisfactory in terms of quality and timing.	Medium	Ensure through a SoAN that the CAG's FAPAD conducts the external audit of the SEIP-relevant entities in accordance with acceptable standards and in a timely manner.

Risk Type	Risk Description	Risk Assessment (w/o mitigation)[a]	Management Plan / Mitigation Measures
7. FM staffing	Many FM-related functions lack staff and/or staff with appropriate competencies. Auditors and accountants are part of the same cadre, which is conflict-of-interest.	High	Encourage the hiring of qualified and competent staff for accounts and finance functions.
Overall Control Risk		*Substantial*	
Control Risk [c] – GoB Implementing Agencies			
1. Planning and budgeting	The annual budget process is based on an incremental approach, and does not consider physical and financial targets together.	Substantial	Entity-level TA to be provided to support and improve the annual budgeting process.
2. Budget Execution / Grant Management	Only one of the three GoB IAs has prior FM-related experience with externally funded projects.	High	Guidance and training on project management to be provided based on a capacity development plan, and close monitoring of implementation.
3a. Accounting	Two of the three entities have only manual accounting. Procedural shortcomings include lack of bank reconciliation and General Ledger, subsidiary ledgers not being maintained, and records not being reconciled with those of the CGA.	High	A common approach to SEIP accounting to be agreed with entities and CGA based on the GoB's existing Accounts Code.
3b. Internal control	Only one entity reconciles its records against those of the CGA. Only one entity has a fixed asset register and uses identification marks for the assets, but none of the three entities carry out physical verification of assets.	Substantial	Training to be imparted to entity staff on GoB internal control framework and procedures, including GFR. Fixed asset management to be reviewed and improvements implemented, if/as required. The AFR to cover GoB IAs.
4. Financial reporting	None of the three entities prepare reports to explain monthly variances between planned and actual spending. Also, balance sheets are not being prepared, and cash flow analyses also are not done. Furthermore, the reporting systems do link financial and non-financial information.	High	The need for SEIP-specific reporting to be reviewed and, if deemed required, developed and implemented. The possibilities for providing the three entities with read-only access to IBAS to be reviewed.

Risk Type	Risk Description	Risk Assessment (w/o mitigation)[a]	Management Plan / Mitigation Measures
5. Internal audit	Only one of the three entities (BITAC) has an internal audit unit, but appears to do pre-audit rather than internal audit.	High	Assess the possibilities for the internal audit units in MoE, MEWOE and MoI to widen the scope of the function to cover their subordinate institutions. The AFR to cover the GoB IAs.
6. External audit	The CAG does not provide an opinion on the financial statements of the entities, and their financial statements are not annexed to audit reports. It is noted though that external funding would be audited by FAPAD, which has better procedures in place.	Medium	Ensure through a SoAN that the CAG's FAPAD conducts the external audit of the SEIP-relevant entities in accordance with acceptable standards and in a timely manner.
7. FM staffing	The staff of the accounting departments in many cases lack formal education relevant to the tasks, which also applies to two of the three department heads. It also appears that little or no training has been imparted.	High	Specific staffing requirements for SEIP implementation to be formulated and implemented, e.g. through the appointment of a qualified SEIP focal point at the Accounts Department of each entity.
	Overall Control Risk	*High*	
Control Risk [c] – Sector Associations Implementing Agencies			
1. Planning and budgeting	Not all entities prepare annual budgets for their organization. While an incremental budget formulation approach is used by most, there is no common template. Most entities do not specify organizational responsibility for budget implementation.	High	A common budgeting approach with standard templates should be outlined and implemented (e.g. business plans reviewed by SDCMU based on criteria). Approved business plans to be included in the AWPB for approval by the PSC.
2. Grant management	None of the entities have prior experience with ADB-funded programs/projects, but many have experience with other externally funded activities and related FM.	High	Guidance to be provided through tools (e.g. FM manual) and training undertaken based on capacity development plan. Performance to be closely and regularly monitored.

Risk Type	Risk Description	Risk Assessment (w/o mitigation)[a]	Management Plan / Mitigation Measures
3a. Accounting	No standard Chart of Accounts applied across the entities. Many entities have a manual accounting system. Not all do bank reconciliations and most do so with delays and without review by management.	Substantial	A standard SEIP Chart of Accounts to be developed (matching the budget classification). Guidelines for SEIP accounting to be developed and implemented.
3b. Internal control	Most entities do not have documented their internal control procedures. Fixed asset management differs between entities, and none have a full set of safeguards in place. Most entities do not have insurance for their assets.	High	A FM manual should be formulated and implemented to ensure better internal control, including for SEIP funding and assets. The AFR to cover Sector Associations.
4. Financial reporting	The format and usage of in-year financial reports vary significantly between the entities, most do not have monthly reporting that compares planned and actual spending, and only few present financial reports regular to their board. Only one entity files required income tax return.	Substantial	A common reporting framework is to be developed, including templates and procedural guidance. Implementation and usage should be monitored. The entities' tax filing requirements should be clarified and implemented, if/as applicable.
5. Internal audit	None of the entities have an internal audit function.	High	An internal audit function to evaluate the adequacy and effectiveness of internal control in the entities to be considered based at SDCMU. The AFR to cover Sector Associations.
6. External audit	Annual audits are for some done with several months delay. Not all entities have selected an "A" category audit firm.	Substantial	External audit of SEIP funding to be undertaken based on a ToR acceptable to ADB, which will include management letter.
7. FM staffing	The qualifications and experience of staff in the Accounts Departments differ significantly between the entities, and none are led by a chartered accountant.	Substantial	Each entity will be required to appoint a full-time SEIP coordinator/manager with relevant background to oversee all SEIP financial and administrative affairs.
	Overall Control Risk	*Substantial*	
	Overall SEIP Risk	**Substantial**	

ADB = Asian Development Bank, AFR = annual fiduciary review, AWPB = annual work plan and budget, BITAC = Bangladesh Industrial Technical Assistance Centre, BMET = Bureau of Manpower Employment and Training, CAG = comptroller and auditor general, CGA = controller of general accounts, DTE = Directorate of Technical Education, FAPAD = Foreign Aided Projects Audit Directorate, FM = financial management, GFR = general financial rules, GoB = Government of Bangladesh, IA = implementing agency, IBAS = integrated budgeting and accounting, MEWOE = Ministry of Expatriates' Welfare and Overseas Employment, MOE = Ministry of Education, MOI = Ministry of Industry, MTBF = medium-term budget framework, NGO = nongovernment organization, NPO = nonprofit organization, PFM = public financial management, PSC = program steering committee, SDCMU = skill development coordination and monitoring unit, SEIP = skills for employment investment program, SoAN = statement of audit needs, TA = technical assistance, TOR = terms of reference.

[a] Low, moderate, substantial, high.

[b] Inherent Risk is the susceptibility of the program financial management system to factors arising from the environment in which it operates, such as country rules and regulations and the agency's working environment (assuming absence of any counter checks or internal controls).

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

F. Program Financial Management System

104. This chapter outlines the planned FM system for the SEIP.

Executing Agency (EA) and Implementing Agencies (IAs)

105. MoF's Finance Division will be the Executing Agency (EA) for the SEIP. A Project Management Unit (PMU) – the Skill Development Coordination and Management Unit (SDCMU) – will be established within the MoF to ensure effective implementation of the SEIP, including through coordination of all SEIP Technical Assistance (TA) support.

106. Table 6 summarizes the entities involved, including the Implementing Agencies (IAs), as well as the formal basis for their FM system and the approach taken to assess the work and functioning of their FM.

Table 6: Entities that will receive/manage SEIP Funding

Entities	FM System Basis	FMA Approach
Executing Agency		
MoF' s Finance Division (SDCMU to be set up)	GoB	Existing documentation
Implementing Agencies – Public Sector Program *, **		
1. Directorate of Technical Education (DTE)	GoB	FMAQ and FM capacity assessment
2. Bureau of Manpower Employment and Training (BMET)	GoB	FMAQ and FM capacity assessment
3. Bangladesh Industrial Technical Assistance Center (BITAC)	GoB	FMAQ and FM capacity assessment
Implementing Agencies – Sector Associations		
1. Bangladesh Garments Manufacturers & Exporter Association (BGMEA)	Companies Act / NPO	FMAQ and FM capacity assessment
2. Leather Goods Manufacturer & Exporter Association of Bangladesh (LMEAB)	Companies Act / NPO	FMAQ and FM capacity assessment
3. Bangladesh Association of Construction Industry (BACI)	Companies Act / NPO	FMAQ and FM capacity assessment

Entities	FM System Basis	FMA Approach
4. Bangladesh Engineering Industry Owners' Association (BEIOA)	Companies Act / NPO	FMAQ and FM capacity assessment
5. Bangladesh Knitwear Manufacturers & Exporter Association (BKMEA)	Companies Act / NPO	FMAQ and FM capacity assessment
6. Bangladesh Association of Software and Information Services (BASIS)	Companies Act / NPO	FMAQ and FM capacity assessment
7. Bangladesh Textile Manufacturers' Association (BTMA)	Companies Act / NPO	FMAQ and FM capacity assessment
8. Bangladesh Call Center Operators' Association (BACCO)	Companies Act / NPO	FMAQ and FM capacity assessment

FM = financial management, FMA = financial management assessment, FMAQ = financial management assessment questionnaire, GoB = Government of Bangladesh, MOF = Ministry of Finance, NPO = nonprofit organization, SDCMU = skill development coordination and monitoring unit.

* The Ministry of Labor (MoL) and the Ministry of Information & Communication Technology (MoICT) are involved for greater coordination of activities, but funding is in this regard managed by MoF's Finance Division and service providers dealt with directly through the SDCMU.

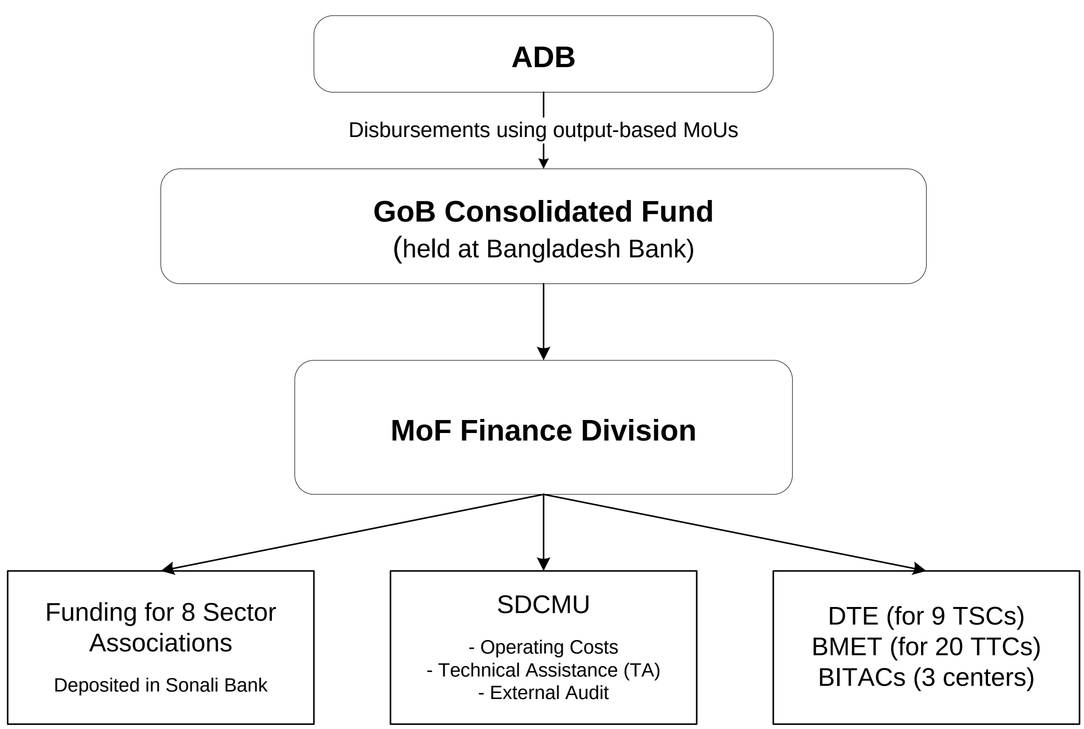
** The Bangladesh Technical Education Board (BTEB) will receive consultancy support from the SDCMU, but not receive funds directly, but an FMA has been carried out for the BTEB nonetheless.

Funds Flow Arrangement

107. ADB's financing will be recorded in a sub-account of the Bangladesh Bank from which all funds will go through the GoB's Consolidated Funds, and will be shown in the budget line for MoF's Finance Division. Advances will be provided directly to the 32 public training institutions under the GoB's three IAs as well as to the eight Sector Associations.

108. The diagram below shows the main elements of the funds flow arrangements.

Figure 1: SEIP Funds Flow Arrangement



109. The SDCMU will approve each IA's Annual Work Plan and Budget (AWPB). Upon the parliamentary approval of the annual national budget by 30 June, MoF's Finance Division will submit an advance bill to the CGA for transfer of a quarterly advance to each IA's designated bank account with Sonali Bank. Also, following the approval of the AWPBs, MoF's Finance Division will issue allotment letters (budget authorizations against which payments can be raised and expenditures recorded) to the IAs with copy to the CGA.

110. Each IA implements its AWPB by utilizing these advance funds, and the IAs will after each quarter submit Statements of Expenditure (SoEs) to MoF's Finance Division/SDCMU. For subsequent advances, the previous advance has to be liquidated.

111. An operational unit code will be assigned under MoF with budget allocated in total to the code, or one code for each sub-component or entity (IA) to be subcontracted for delivering the service. An additional code can be assigned for MoF management/oversight costs related to the SDCMU.

Accounting and Internal Control

112. The CGA is responsible for the accounts of the GoB, and has accounting offices for all GoB entities at national as well as sub-national levels. CGA is responsible for compilation of the monthly and annual accounts (finance accounts). Due to the centralized control of the CGA, duties are fairly segregated and there is a control framework for payment processing and accounting. In addition to checking vouchers at the time of processing, the CGA monitors entries into IBAS by different Account Officers (i.e. it undertakes pre-audit).

Financial Reporting and Monitoring

113. The GoB budget classification system is comprehensive and allows analysis of budget and expenditures along several dimensions. The classification system enables segregation of allocations and expenditures by legal provisions (non-development and development), administrative units in the form of functional codes (ministries, departments and agencies), operational unit codes (sub-units for non-development expenditures and projects for development expenditure), and Government Finance Statistics (GFS) codes (recurrent and capital expenditures by detailed economic classification codes).

114. GoB will present its annual budget and subsequent quarterly financial progress reports (accounts) for financial monitoring purposes. These are the regular IBAS-generated budget management and monitoring reports used by GoB. The reports will be presented with a separate schedule showing the amount of advances included under the respective budget heads. In addition, GoB will be presenting a report on payment processing by CGA accounting offices. They will also present a report on reconciliation of accounts between CGA accounting offices and DDOs.

115. Ministries rely on IBAS reports for budget management and monitoring purposes, however, not all have direct access to the system. The reports show expenditure charged to the non-development and development budgets for each functional unit distributed by operational and economic classification codes. They serve to inform on the level of budget execution and as basis for reconciliation of charged expenditures with bills recorded by the respective DDO for payment. The SDCMU should have direct IBAS access so as enables it to adequately monitor budget execution.

116. It needs to be ensured via a common FM approach that the non-GoB IAs (i.e. the eight Sector Associations) will be able to provide financial reports in the form of SoEs that are directly comparable with those of the GoB IAs. This not only to allow for the same level of scrutiny regarding the non-GoB IAs' budget execution, but also to facilitate the preparation of SEIP-level monitoring reports and year-end financial statements.

Personnel

117. With regard to the GoB IAs, CGA will be in charge of managing cash, processing bills for payments and accounting for the payments in IBAS. The main challenge for CGA is related to retaining staff with adequate qualifications at its offices, although this is mainly an issue at the sub-national level.

118. Each GoB entity has a Drawing and Disbursement Officer (DDO) that approves bills for processing through the CGA. All DDOs are supposed to reconcile their accounts with the CGA accounting offices. However, this is currently not done on a regular basis by all GoB IAs (e.g. BMET).

119. Many key FM personnel in the GoB IAs – DTE, BMET and BITAC – have been in their positions for several years. However, most of personnel do not have accounting background or professional training, and thus lack sufficient experience in accounting related to program/project financing.

Internal Audit

120. It appears that most GoB ministries and some agencies have set up internal audit units, which are to assess compliance with financial regulations. None of the non-GoB IAs have an internal audit department, but BKMEA has outsourced its internal audit function.

121. It is planned for the SEIP to undertake checks of internal controls via the SDCMU as well as through the Annual Fiduciary Reviews (AFRs). The purpose will be to review SEIP-funded activities and the related internal controls and operational policies so as to ensure that these comply with relevant rules and guidelines. This will also evaluate financial reporting tools to help ensure that the SDCMU prepares accounting records and financial statements in accordance with generally accepted accounting principles.

External Audit

122. GoB entities are generally audited by the relevant directorates under the CAG. However, for donor funding the external audit will be undertaken by CAG's FAPAD and this will cover the SEIP funding spent by the GoB's IAs as well as the expenditures incurred by the SDCMU.

123. The external audit of the non-GoB IAs (Sector Associations) will be done by an external auditor (private audit firm) and funded from the SEIP. This will, considering the current approaches taken by the entities regarding external audit, help to establish a standardized audit procedure across all non-GoB IAs, and thus help to substantially mitigate potential risks in this area.

124. The external audit undertaken by the CAG's FAPAD will be based on a Statement of Audit Needs (SoAN) to be agreed between ADB and the GoB. The external audit for the non-GoB IAs will be based on a ToR to be agreed between ADB and the GoB.

125. The ToR and SoAN shall incorporate requirements to ensure that audit is conducted and financial statements are prepared in accordance with international accounting and auditing best practice.

Financial Covenant

126. As an assurance that ADB's funding are supporting SEIP budgetary allocations, a proposed covenant in the loan agreement will address the requirement for sufficient budgetary resources to be provided by the GoB.

Supervision and Monitoring

127. As an added assurance and in order to guide supervision, an Annual Fiduciary Review (AFR) process will be established to assess key risk areas. Fiduciary reviews will be conducted quarterly in the first year, then semi-annually in the second year, and annually subsequent to that. A ToR is to be prepared and agreed with the GoB for this purpose.

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- World Bank (2010b): "Restructuring Public Financial Management Institutional Arrangements", Policy Note, 70359, June.
- World Bank (2013): "Implementation Support Mission (June 23 - July 10) – Aide Memoire", SPEMP.

<u>The following documents were collected from the Sector Associations</u>:

- Memorandum and Articles of Association
- Certificate of Incorporation
- License copy from the Ministry of Commerce
- Organogram with brief explanation of functions
- List of externally funded programs/projects
- List of Board Members
- List of member of Sector Industry Skill Council
- Latest Financial Statements
- Latest available bank reconciliation with bank statement
- Finance and Accounts Manual
- Personal file with CV of accounting personnel
- Board meeting minutes to check the frequency of board meeting
- Fixed assets register, if maintained
- Last three years audit report / annual report
- Internal audit report, if any
- Statutory Regulatory Order (SRO) copy for tax exemption
- Annual Return to Register of Joint Stock Companies

- Annual Return to the Ministry of Commerce as per requirement of Trade Organization Ordinance, 1961

The following documentation was assessed during the consultations with the Sector Associations:

- General Ledger/ Cash book /Bank book / Subsidiary ledger
- Salary statement of the previous two months
- Vouchers with supporting documents of the previous two-three months

Websites:

- MoF, Finance Division – www.mof.gov.bd/en/
- CGA – www.cga.gov.bd
- CAG – www.cagbd.org
- SPEMP – www.spemp.com
- DTE – www.techedu.gov.bd
- BMET – www.bmet.org.bd
- BITAC – www.bitac.gov.bd
- BTEB – www.bteb.gov.bd
- BGMEA – www.bgmea.com.bd
- LFMEAB – www.lfmeab.org
- BACI – www.baci-bd.org
- BEIOA – www.beioa.org.bd
- BKMEA – www.bkmea.com
- BASIS – www.basis.org.bd
- BTMA – www.btmadhaka.com
- BACCO – www.bacco.org.bd

LIST OF PERSONS CONSULTED

ADB	• Brajesh Panth – Lead Education Specialist
MoF, Finance Division	• Abdur Rouf Talukder – Joint Secretary
Directorate of Technical Education (DTE)	• Engr. Ruhul Amin – Assistant Director
Bureau of Manpower Employment & Training (BMET)	• Mr. Khalilur Rahman – Director (Training) • Rezaul Haque – Accounts Officer
Bangladesh Industrial Technical Assistance Center (BITAC)	• Md. Jalal Uddin – Executive Engineer • Md. Mofizul Islam – Chief Accounts Officer
Bangladesh Technical Education Board (BTEB)	• Md. Abul Kashem – Director General • Dr. Abdul Haque Talkuder – Secretary
Bangladesh Garments Manufacturers & Exporter Association (BGMEA)	• Md. Mostafizur Rahman – Secretary • Umme Saira – Sr. Deputy Secretary • Md. Shamsul Arefin – Additional Chief Accountant • Sanjib Prosad Ghosh – Assistant Chief Accountant
Leathergoods & Footwear Manufacturers & Exporters Association of Bangladesh (LFMEAB)	• Mir Muniruzzaman – Secretary General • Kazi rowshan ara sumi – Executive Director • Md. Rabiul Alam – Business Development Manager
Bangladesh Association of Construction Industry (BACI)	• Engr. Aftabuddin Ahmed – President • Fakruddin Mobarak Khan – Secretary
Bangladesh Engineering Industry Owners' Association (BEIOA)	• Abdur Razzaque – President • Mosharrof Hossain Mir – Office Secretary
Bangladesh Knitwear Manufacturers & Exporter Association (BKMEA)	• Md. Mahbubur Rahman - Chief Accounts Officer • Md. Mahbubul Bashar - Assistant Chief Accounts Officer • Engr. Rupali Biswas – Chief Coordinator • Engr. Monindra Chandra Das – Deputy Coordinator
Bangladesh Textile Manufacturers' Association (BTMA)	• Feroz Ahmed – Secretary General • Md. Motaher Hossain – Senior Accounts Officer
Bangladesh Association of Software & Information Services (BASIS)	• Hashim Ahmed – Acting Secretary • Mr. Shah Imrul Kaeesh – Treasurer • Md. Ferdousul Alam – Manager Accounts • Sumaiya Mahin – Accounts Officer
Bangladesh Call Center Operators' Association (BACCO)	• Towhid Hossain – Finance Secretary • Abdur Rahman Shawon – Executive Coordinator

FMA QUESTIONNAIRES

1. FMA questionnaires have been applied and filled-in for the following entities as part of the assessment:

GoB IAs:

1. Directorate of Technical Education (DTE)
2. Bureau of Manpower Employment and Training (BMET)
3. Bangladesh Industrial Technical Assistance Center (BITAC)

- Bangladesh Technical Education Board (BTEB)[48]

Sector Associations IAs:

1. Bangladesh Garments Manufacturers & Exporter Association (BGMEA)
2. Leathergoods & Footwear Manufacturers & Exporters Association of Bangladesh (LFMEAB)
3. Bangladesh Association of Construction Industry (BACI)
4. Bangladesh Engineering Industry Owners' Association (BEIOA)
5. Bangladesh Knitwear Manufacturers & Exporter Association (BKMEA)
6. Bangladesh Association of Software and Information Services (BASIS)
7. Bangladesh Textile Manufacturers' Association (BTMA)
8. Bangladesh Call Center Operators' Association (BACCO

2. Kindly refer to the separate files for the questionnaires.

[48] The BTEB will not be receiving SEIP funding, but rather consultancy support from SDCMU.

FINANCE MANAGEMENT CAPACITY ASSESSMENTS

1. FM capacity assessments have been prepared for the following entities as part of the assessment:

GoB IAs:

1. Directorate of Technical Education (DTE)
2. Bureau of Manpower Employment and Training (BMET)
3. Bangladesh Industrial Technical Assistance Center (BITAC)

- Bangladesh Technical Education Board (BTEB)[49]

Sector Associations IAs:

1. Bangladesh Garments Manufacturers & Exporter Association (BGMEA)
2. Leathergoods & Footwear Manufacturers & Exporters Association of Bangladesh (LFMEAB)
3. Bangladesh Association of Construction Industry (BACI)
4. Bangladesh Engineering Industry Owners' Association (BEIOA)
5. Bangladesh Knitwear Manufacturers & Exporter Association (BKMEA)
6. Bangladesh Association of Software and Information Services (BASIS)
7. Bangladesh Textile Manufacturers' Association (BTMA)
8. Bangladesh Call Center Operators' Association (BACCO

2. Kindly refer to the separate file for the assessments.

[49] The BTEB will not be receiving SEIP funding, but rather consultancy support from SDCMU.

FINANCIAL MANAGEMENT ACTION PLANS

1. The following two financial management (FM) action plans have been prepared as part of the assessment:

- **GoB Entities** (i.e. MoF's Finance Division, CGA, CAG as well as DTE, BMET and BITAC)
- **Non-GoB Entities** (i.e. sector associations)

2. Kindly refer to the separate file for the FM Action Plans.

TERMS OF REFERENCE (TOR) – TASKS AND OUTPUTS

Project	**TA-7989 BAN: Skills for Employment – FM Specialist (42466-012)**
Date	8 August 2013

Detailed Tasks and/or Expected Outputs:

(i) the Financial Management Specialist (FMS) should conduct the assessment of the institutions indicated above. (refer to FMA guidelines 2010);

(ii) Assess relevant previous experience and assess how much reliance can be placed on PFM systems by reference to:

- the Country Program Strategy (CPS) which will include the information on status of PFM systems and capacity building initiatives (this can be drawn from ADB and WB analysis);
- FM performance on recent relevant ADB projects, e.g. the ones listed in footnote 1. Review any recent FMAs done for the same EA for other ADB funded projects.
- Analysis of historical financial performance of EA with other donor financed projects (e.g. World Bank) as noted.
- Any other country-wide assessments, such as Study of Accounting and Auditing Practices or PEFA Assessments or assessments done by other multilateral banks.

(iii) Using the Financial Management Assessment Questionnaire (FMAQ) in Attachment, collect the information and assess the strengths and weaknesses of financial management systems and controls and financial reporting systems which will relate to financial management and control of project funds;

(iv) The assessment should include a review of the tone at the top, quality of Internal Audit (if any), staffing, fund flows mechanism, financial accounting and reporting, management information systems, and detailed internal control activities (over payments, payroll, maintenance of bank balances, imprest accounts, advances, fixed assets, completeness of liabilities, etc.);

(v) Identify the project cash flow requirements and recommend appropriate funds flow mechanism and disbursement schedule;

(vi) Clearly state what accounting controls will be in place to account for ADB funded expenditure;

(vii) Understand, document and assess the budgetary framework in place;

(viii) Prepare a Risk Analysis summary. Identifying risks arising from material deficiencies and propose practical recommendations for improving financial management functions and/or staffing for financial operations that are needed to mitigate risk;

(ix) As necessary, consider means of upgrading staff capacity to manage the financial systems. And indicate training requirements on project financial management issues for EA staff, EA and other concerned parties;

(x) Draft the FMA report using the Financial Management Assessment Report Template given on page 31 of 96 of the Knowledge Addendum of the Financial Management and Analysis of Projects 2005. The questionnaire and its responses should be attached as an Annexure to the Report;

(xi) Obtain financial statements prepared by the implementing agencies (IAs) on an entity – level and/or for previous similar projects (for example, Skills Development Project funded

	by ADB and STEP funded by World Bank) and assess (a) whether these are in compliance with [national accounting standards or Cash Basis International Public Sector Accounting Standards or IFRS or relevant accounting standards or framework as appropriate] (b) identify any gaps which should be highlighted and addressed. Attach as Annexure to the FM Assessment a Template of the expected financial statements which are based on the entities chart of accounts, take into account requirements of relevant national accounting standards and eligible expenditure categories;
(xii)	Ascertain compliance with auditing requirements including identification of who is doing the audit and the adequacy of and compliance with available auditing requirements;
(xiii)	In case of audit by the SAI, provide an updated assessment of the capacity of the auditor general, and conclude on whether an external audit firm should be engaged;
(xiv)	Obtain the chart of accounts, and ensure that eligible expenditure categories and investment plan as envisaged for the project can be mapped into the agency's original chart of accounts.
(xv)	Understand the key risk to the proposed project and for the entity itself. Based on those risks, determine which existing key controls are already in place to mitigate these risks. Not only understand and document these key controls, but also check compliance with the stated regulations of the entity in the major areas of ADB's expected expenditure, on a sample basis. Consultant's working papers should include all relevant evidence and information to support this, if required later;
(xvi)	Obtain copies of key documents as relevant, exercising professional judgment (including sample bank reconciliation statement, extracts from fixed assets register, chart of accounts, organizational chart, policy documents etc.);
(xvii)	If an external audit firm has already been identified by the agency to audit the project, assess the independence, qualification, experience, national rating of the proposed auditor;
(xviii)	Provide details of the organizational structure as part of the final report; and,
(xix)	Provide draft TORs for the external auditor as part of final report, in case of external auditor. In case of Supreme Audit Institutions, a draft statement of Audit Needs should be provided to clarify ADB's audit requirements.

*It is noted that a revised version of the ToR as regards tasks and outputs was prepared in early November 2013 (SC 103115 BAN: Skills for Employment and Investment Program), which included 13 of the above 19 tasks.