

FINANCIAL MANAGEMENT ASSESSMENT REPORT

Ministry of Public Works and Program Management Office, Afghanistan

(Updated July 2017)

I. Executive Summary

1. Governance risks are prevalent in Afghanistan, in areas of public financial management, procurement and corruption. Despite the highly challenging country context, the Ministry of Public Works and its Program Management Office (PMO) have demonstrated sufficient competence to manage ADB financed projects in a financially sound manner. Especially since the restructuring of the PMO in 2015, the caliber and morale of staff in the PMO have drastically improved.
2. Inherent and control risks are existent, but are both rated *moderate*. With risk mitigation measures, the project will be implemented in a financially sound manner.
3. Through this proposed project, the capacity of the PMO in financial management will be further strengthened. An international financial management specialist recruited under the project will support day-to-day financial management activities of the PMO. This will benefit not only this project, but also all other projects being implemented by the PMO.

II. Country and Sector Financial Management Issues

4. As noted in the Interim Country Partnership Strategy for Afghanistan (2014–2015), Afghanistan continues to face numerous development challenges, compounded by the insecurity and political instability that affect most of the country. In addition to high poverty and low socioeconomic indicators, Afghanistan has inadequate infrastructure, weak policy and regulatory frameworks, capacity constraints, poor governance, a weak enabling environment for the private sector, and high underemployment. Widespread corruption and a large narcotics economy threaten the rule of law and stability. Weak human capacities and public sector institutions compound these difficulties. Afghanistan's challenges have made the implementation of projects more difficult and increased project costs.

5. As a part of a series of background assessments, diagnostics, and discussion papers commissioned by ADB to underpin the development of its Country Partnership Strategy (CPS), 2009-2013 for Afghanistan, ADB conducted a risk assessment of country level systems with a focus on public sector management, procurement, and corruption mitigation measures. Additionally, ADB contributed to the World Bank's report on vulnerabilities and corruption assessments, being responsible for sections of the report on the road and energy sectors. Based on these reports, as well as firsthand experience from ongoing projects, the key country issues include:¹

- A need to broaden the comprehensiveness of the core budget, and to improve the monitoring of other fiscal activities, such as state-owned enterprises, municipalities, and external assistance outside the core budget.
- Weak sector strategies, inadequate prioritization, and lack of information on results, which make it difficult to allocate resources across and within sectors appropriately.

¹ See CPS Afghanistan 2009-2013 <http://www.adb.org/sites/default/files/institutional-document/32267/files/cps-afg-2009-2013.pdf>

- Weaknesses in procurement, insufficient financial data given to line managers, and initial delays in making payments outside Kabul have led to hindered public expenditures.
- A lack of qualified and disciplined staff, with many civil servants still recruited through a system of patronage. The pay scale of civil servants is insufficient to attract, retain, or motivate skilled and qualified staff.
- Excessive centralization, with more than one third of ministry staff based in Kabul.
- A lack of coordinated decision making across government.
- Limited direct accountability to clients.
- State capture by illicit power-holders and armed groups.

6. The government has taken good governance as one of the three core pillars of its development strategy, the Afghanistan National Development Strategy (ANDS). ADB, together with the donor community, have actively supported such efforts and have learned key lessons on improving governance. These include;

- Capacity development: Long term support for building institutional capacity is essential, as compared to TA of shorter duration.
- Public administration reform: To be more sustainable, support for public administration reform should be selective and integrated into ADB sector programs, particularly in agriculture and natural resources. Stand-alone projects for public administration reform should not be considered.
- Public Financial Management, Procurement, and Contract Management: The capacity of the Ministry of Finance to undertake fiscal planning, expenditure policy making, and budget preparation has substantially improved but more attention needs to be focused on line ministries, where capacity to perform public financial management functions, including procurement and contract management, still needs significant improvement.
- Project Management Structures: The creation of PIUs has helped to improve public financial management performance, procurement and contract management functions in the Ministry of Public Works (MPW), Ministry of Energy and Water (MEW), and Ministry of Mines (MM). Over time, conscious efforts are to be taken to integrate PIU functions more fully into ministries.

III. Project Financial Management System

A. Overview of the executing agency, implementing agency, financial management system and institutional context

7. MPW is responsible for development, operation, and maintenance of the regional, national, and provincial road networks. MPW is a large organization with staff stationed in every major provincial capital. Currently, MPW employs about 200 engineers and administrative staff, and 2,000 laborers at the regional maintenance centers and provinces. MPW's main focus is on managing donor-financed projects and executing budget-financed minor O&M works.

8. Over the years of conflict, MPW lost many of its trained staff. MPW requires substantial skills enhancement to perform their current duties as project managers. In addition, a restructuring of the organization and a business plan are needed to upgrade MPW commensurate with the envisaged sector governance role. The USAID funded Road Sector Sustainability Program is offering vital support in this regard.

9. The Program Management Office (PMO) was set up in 2009 under the MPW to manage ADB financed projects. Presently the PMO is implementing 13 investment projects financed by

ADB. ADB closely monitors the PMO to allow timely interventions where necessary.

10. The PMO reports through a Director to the Deputy Minister (Technical). The PMO's scope of work includes:

- Project technical management and reporting
- Project administration and financial management
- Implementation of environmental and social safeguards
- Procurement and contract management.

11. Earlier experience shows that the capacity of MPW and the PMO in project implementation was initially weak and there have been integrity issues. However, the recent (mid 2015) restructuring of the PMO and new leadership in MPW have significantly improved PMO performance and integrity.

12. MPW with its PMO is responsible for overall project financial management, i.e., planning, accounting, disbursement, replenishment, reporting, maintaining adequate control of the accounting information, and ensuring its timely, full, and proper registration in the accounting system. The PMO has an emerging degree of financial management capability and maintains separate project accounts and records by funding source for all expenditure incurred.

B. Strengths and weaknesses

13. The strengths and weaknesses of the MPW and in particular its PMO, with regard to financial management, is summarized in the table below.

Strengths	Weaknesses
<ul style="list-style-type: none">• Staff of increasing caliber and qualifications, especially post the 2015 restructuring of PMO• Submitted audited project financial statements (APFS) for past projects generally in compliance with grant agreements and their covenants.• PMO is highly cognizant of ADB processes and procedures, and has good knowledge of the ADB Loan Disbursement Handbook.	<ul style="list-style-type: none">• Observed delays in submitting audited project financial statements• Single entry accounting system still in use, but this is soon to be upgraded to a double entry bookkeeping system with professional accounting software.• Earlier challenges observed in keeping copies of original receipts and boarding passes (which are required to be submitted to MOF and therefore unavailable for submission to ADB)

C. Personnel, accounting policies and procedures, internal and external audit

14. **Personnel.** Staffing of the finance department of the PMO includes a manager, 5 accountants and one trainee, which is considered sufficient to manage this additional project. All staff members are on annual contracts following a 3-month probationary period. Staff members of the finance department all have relevant qualifications and were found to be highly motivated.

15. **Accounting policies and procedures.** The PMO has successfully maintained separate project accounts and records by funding source for all expenditures incurred on ongoing projects. Project accounts follow international accounting principles and practices.

16. Once a project grant agreement is in place, the PMO prepares an annual budget and sends a request to MoF for budget assignment/approval. With such approval in place, each project invoice can be managed for payment in about 12 days.

17. The PMO uses a single-entry accounting system currently, but is in the process of moving to a double entry bookkeeping system once the procurement of new accounting system software (Enterprise Resource Planning or similar) is completed. Introduction of this system will also establish a system of control access levels to all financial data.

18. Invoices are received in Interim Payment Certificate (IPC) format, compared against the contract, budget and Bill of Quantities (BOQ).

19. The PMO was able to explain in sufficient detail to establish that it has satisfactory systems in place for the preparation and approval of transactions, with the necessary separation of duties between approvals and payments. The PMO follow the procedures of the ADB Loan Disbursement Handbook.

20. **Internal and external audit.** The PMO has been subjected to external audit for each project it manages. A system of annual auditing with the firm Alliot Gulf Chartered Accountants & Management Consultants is in place. A review of audited project financial statements (APFS) shows that the PMO and its operations are in conformity with International Public Sector Accounting Standard, that MPW/PMO have utilized proceeds of grants in accordance with the grant agreement, and that financial covenants of the grant agreements were complied with.

21. PMO undertakes quarterly project reporting to ADB and monthly, quarterly and annual financial reporting to MPW. They are also requested to submit periodic reports to MOF, the Ministry of Economy and Parliament. There are also periodic audits by the government's Audit Office. The Project will be subject to similar internal audits and reporting.

22. **Financial reporting systems, including use of information technology.** The PMO uses a single entry accounting system currently, but is in the process (July 2017) of moving to a double entry bookkeeping system once the procurement of new accounting system software (Enterprise Resource Planning or similar) is completed (expected by fourth quarter 2017). Introduction of this system will also establish a system of control access levels to all financial data.

23. Project performance will be monitored based on quarterly and consolidated reports provided by the MPW. These reports will include: (a) progress achieved by activity as measured against the Implementation Schedule (Section II.A of the PAM), (b) key implementation issues

and solutions; (c) updated procurement plan and (d) updated implementation plan for the next 12 months. To ensure the Project continues to be both viable and sustainable, the Project's financial statements, together with the associated auditor's report, should be adequately reviewed.

24. Grant covenants on policy, legal, financial, economic, environmental, labor standards and others will be monitored regularly through various reports (monthly progress reports, quarterly progress reports, and annual reports), and discussion during review missions.

25. **Disbursement arrangements, funds flow mechanism.** The Grant proceeds including the ADB administered funds from AITF will be disbursed in accordance with ADB's Loan Disbursement Handbook (2015, as amended from time to time),² and detailed arrangements agreed upon between the Government and ADB.

26. MPW's PMO will be responsible for (i) preparing disbursement projections, (ii) requesting budgetary allocations for counterpart funds from MOF (if any), (iii) collecting supporting documents, and (iv) preparing and sending withdrawal applications to ADB.

27. The direct payment procedures will generally be used for disbursement under the project. Payments for individual consultants and purchase of armored vehicles may be made from an imprest account. The PMO will establish an imprest account at Da Afghanistan Bank (central Bank of Afghanistan). The currency of the imprest account will be United States Dollars. The government may request for initial and additional advances to the imprest accounts based on 6 months' estimated expenditures. The imprest account will be established, managed, and liquidated in accordance with ADB's Loan Disbursement Handbook and detailed arrangements agreed by the Government and ADB. ADB's Loan Disbursement Handbook describes which supporting documents should be submitted to ADB and which should be retained by the government for liquidation and replenishment of an imprest account.

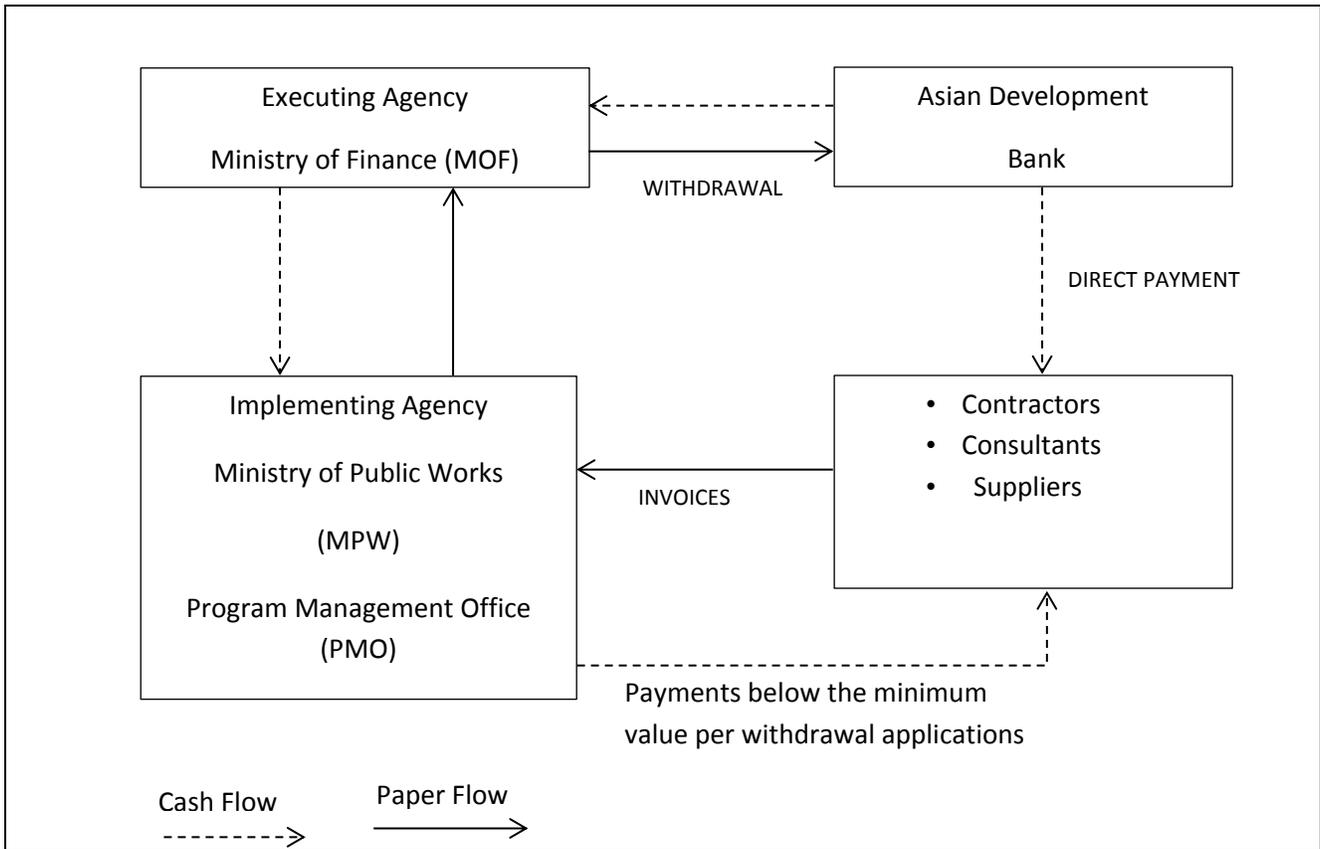
28. The statement of expenditure (SOE) procedure may be used for reimbursement of eligible expenditures and to liquidate and replenish the imprest account for individual payments. SOE records should be maintained and made readily available for review by ADB's disbursement and review mission or upon ADB's request for submission of supporting documents on a sampling basis, and for independent audit.³

29. Before submitting the first withdrawal application, MPW will submit to ADB sufficient evidence of the authority of the person(s) who will sign the withdrawal applications on behalf of the government, together with the authenticated specimen signatures of each authorized person. The minimum value per withdrawal application is set in accordance with the Loan Disbursement Handbook. Individual payments below this amount should be paid by the EA/IA and subsequently claimed to ADB through reimbursement or from the imprest accounts, unless otherwise accepted by ADB.

² Available at: http://www.adb.org/Documents/Handbooks/Loan_Disbursement/loan-disbursement-final.pdf

³ Checklist for SOE procedures and formats are available at:
http://www.adb.org/documents/handbooks/loan_disbursement/chap-09.pdf
http://www.adb.org/documents/handbooks/loan_disbursement/SOE-Contracts-100-Below.xls
http://www.adb.org/documents/handbooks/loan_disbursement/SOE-Contracts-Over-100.xls
http://www.adb.org/documents/handbooks/loan_disbursement/SOE-Operating-Costs.xls
http://www.adb.org/documents/handbooks/loan_disbursement/SOE-Free-Format.xls

30. The proposed fund-flow mechanism is described in the figure below.



IV. Risk description and rating

31. The table overleaf summarizes the result of the financial risk analysis, covering both (i) inherent risk related to the country, entity and project, as well as (ii) control risks from a financial management perspective.

	Risk	Risk Assessment*	Risk-Mitigation Measures
	Inherent Risk		
1.	Country-Specific Risks	H	Use of the PMO to offset the relatively weak general capacity of ministries for financial management.
2.	Entity-Specific Risks	M	Competitive salary structure with long-term contracts (at least yearly) financed through ADB projects.
3.	Project-Specific Risks	N	The project itself will not involve any civil works, but rather consulting services. ADB will select the consultants on behalf of government, and play an active facilitation role in managing the project.
	Overall Inherent Risk	M	
	Control Risk		
1.	Implementing Entity	M	PMO with proven and increasing capacity to implement ADB financed projects.
2.	Funds Flow	M	PMO is experienced in direct payment and imprest fund procedure and has managed them well in ongoing

	Risk	Risk Assessment*	Risk-Mitigation Measures
			projects.
3.	Staffing	M	Sufficient number and caliber of staff, and with provision for additional consultant support to augment any gaps. Some remaining risk of staff turnover.
4.	Accounting Policies and Procedures	S	Single book system still in place. Modern accounting software and practices now being procured.
5.	Internal Audit	M	Periodic internal audits conducted by MPW.
6.	External Audit	M	External audits being conducted annually, with recent satisfactory results.
7.	Reporting and Monitoring	S	PMO has demonstrated capacity to report and monitor project finances based on ADB requirements. However, there have been major delays in the submission of APFSs
8.	Information Systems	M	Computerized accounting system under procurement.
	Overall Control Risk	M	

* H = High, S = Substantial, M = Moderate, N = Negligible or Low.

V. Proposed Action Plan

32. In view of the findings of this financial management assessment, it is proposed that the following actions be taken.

Action	By when
Expedite the procurement and installation of modern accounting software and train relevant PMO staff in its use.	End of 2017
Attach an international financial management specialist, recruited under the project, to support PMO staff in the conduct of financial management. Support to focus on improving the timeliness of submission of APFSs of the project	Entire duration of project

VI. Conclusion

33. Despite the highly challenging country context, the MPW and its PMO have demonstrated sufficient competence to manage ADB financed projects in a financially sound manner. Especially since the restructuring of the PMO in 2015, the caliber and morale of staff in the PMO have drastically improved.

34. Inherent and control risks are existent, but are both rated at moderate. With risk mitigation measures, the project will be implemented in a financially sound manner.

35. Through this proposed project, the capacity of the PMO in financial management will be further strengthened. An international financial management specialist recruited under the project will support day-to-day financial management activities of the PMO. This will benefit not only this project, but also all other projects being implemented by the PMO.