

Financial Management Assessment

Project Number: 42177-024

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Bangladesh: Urban Primary Health Care Services
Delivery Project – Additional Financing

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ABBREVIATIONS

ADB	–	Asian Development Bank
BFR	–	biennial fiduciary review
CAG	–	Comptroller and Auditor General
CGA	–	Controller General of Accounts
FAPAD	–	Foreign Aided Project Audit Directorate
FMA	–	financial management assessment
FMAQ	–	financial management assessment questionnaire
FMM	–	financial management manual
IBAS	–	Integrated Budget and Accounting System
LGD	–	Local Government Division
LGED	–	Local Government Engineering Department
MOF	–	Ministry of Finance
MOLGRDC	–	Ministry of Local Government, Rural Development and Cooperatives
MTBF	–	medium-term budget framework
NPSC	–	National Project Steering Committee
PAM	–	project administration manual
PANGO	–	partnership area nongovernment organization
PFM	–	public financial management
PHC	–	primary health care
PIU	–	project implementation unit
PMU	–	project management unit
SFI	–	serious financial irregularity
SOE	–	statement of expenditure
ULB	–	urban local body

EXECUTIVE SUMMARY

The financial management assessment (FMA) has been prepared in accordance with the “Guideline for Financial Management and Analysis of Project” (2005), “Financial Due Diligence: A Methodology Note” (2009), and “Financial Management Assessment-Technical Guidance Note” (2015) of Asian Development Bank (ADB). The FMA was completed at the country-level, and for the Local Government Division (LGD) of the Ministry of Local Government, Rural Development and Cooperatives as the executing agency, and for urban local bodies (ULBs)—city corporations and municipalities—as implementing agencies using ADB’s FMA Questionnaire. The purpose has been to assess the functioning of the financial management systems of the implementing agency/project management unit (PMU) established for the Urban Primary Health Care Services Delivery Project and newly involved ULBs.

The LGD is implementing the current project and will be responsible for overall management, supervision, and execution of the additional financing. The LGD has already established a PMU headed by a full-time project director. The project director is supported by deputy project directors and health program officers of city corporations and municipalities. The LGD has considerable experience in implementing donor-funded projects, including the ongoing ADB-supported Third Urban Governance Infrastructure Improvement Project.

The PMU will be responsible for all day-to-day management of the additional financing, which includes (i) preparing an overall project implementation plan and detailed work program, (ii) providing monitoring and guidance on the implementation of project works, (iii) conducting all tendering process and execution of contracts, (iv) preparing project progress reports and the project completion report, and (v) ensuring full compliance with ADB’s safeguard policies.

Project implementation units located within city corporations and municipalities will be responsible for (i) project management and administration, (ii) technical support, (iii) providing health service and monitoring partnership agreement nongovernment organizations of respective partnership areas, and (iv) safeguards compliance.

The financial management, internal control, and risk assessment of the additional financing of Urban Primary Health Care Services Delivery Project focuses on two levels—inherent risk and control risk. The overall risk assessment for the additional financing period is *moderate* (pre-mitigation).

Key risks identified are (i) shortage of financial staff in the PMU, (ii) some gaps in the financial management skills of the existing finance staff in the PMU and PIUs, (iii) bank reconciliations are not carried on a monthly basis by the PMU, (iv) weak internal audit, and (v) the PMU and PIUs face challenges in undertaking comprehensive monthly and quarterly financial reporting.

Despite the risks, the financial management arrangement is deemed satisfactory due to dedicated staff with long experience in relevant project management. In addition, it is proposed that one senior accounts officer, one accounts officer, three accountants, and a financial management consultant is engaged as well as the biennial fiduciary review be undertaken to provide continued support during the additional financing period. The proposed mitigation actions include:

- (i) ensuring Tally accounting software is used throughout the project period;
- (ii) recruiting additional financial staff and a financial management consultant for the PMU and project implementation units;

- (iii) providing training on Tally accounting software, financial management, and ADB's procurement, financial management and disbursement procedures to existing and new ULBs, PMU, and partnership agreement nongovernment organizations;
- (iv) conducting biennial fiduciary reviews of the project;
- (v) conducting timely reporting through quarterly financial and physical progress reports as well as ensuring monthly bank reconciliations; and
- (vi) settling audit observations of the ongoing project.

I. INTRODUCTION

1. The financial management assessment (FMA) has been conducted in April–June 2017 in accordance with the “Guideline for Financial Management and Analysis of Project” (2005), “Financial Due Diligence: A Methodology Note” (2009), and “Financial Management Assessment-Technical Guidance Note” (2015) of Asian Development Bank (ADB).¹ The FMA was completed at the country-level, and for the Local Government Division (LGD) as the executing agency, and urban local bodies (ULBs) as implementing agencies using ADB’s FMA Questionnaire (FMAQ). The filled-in FMAQ is annexed to this report. Updates were incorporated to the FMA in July 2018 taking into consideration actions taken by the PMU/LGD to address originally identified financial management risks, including update of Tally software service contract, update of financial management manual (FMM), and settlement of major audit observations; in addition to substitution of selected implementing agencies.
2. The project management unit (PMU) will be placed at the LGD in its role as the executing agency, while city corporations and municipalities in their role as implementing agencies will have project implementation units (PIUs).
3. The FMA focuses on budgeting, staffing, accounting policies and procedures, internal controls, fund flows, financial reporting and monitoring, and internal and external audit. It draws on the experience gained from the ongoing Urban Primary Health Care Services Delivery Project, Urban Public and Environmental Health Sector Development Program (program loan), and the midterm review of the Urban Primary Health Care Services Delivery Project.² These reference documents provide lessons learned from projects implemented by the LGD and identify areas for strengthening financial management as well as overall sector practices. The application of the FMAQ considers responses by the LGD, Local Government Engineering Department (LGED), city corporations and municipalities, as well as recent ADB country and sector-level experiences.

II. BRIEF PROJECT DESCRIPTION

4. The proposed additional financing aims to strengthen and expand the ongoing third phase of the Urban Primary Health Care Services Delivery Project. It will build on the existing partnership with the LGD, under the Ministry of Local Government, Rural Development and Cooperatives (MOLGRDC), to strengthen and scale up provision of primary health care (PHC) services in urban areas, especially for the poor and vulnerable, and to address gaps in institutions and capacity for sustainable delivery of PHC services. It is proposed that one new city corporation and 10 new municipalities will be included in the project, and total partnership areas will increase from the existing 25 to 45.
5. The impact will be improved health, nutrition, and family planning status of the urban population, particularly the poor, women, and children aligned with the government’s National

¹ ADB. 2005. *Financial Management and Analysis of Projects*. Manila; ADB. 2009. *Due Diligence: A Methodology Note*. Manila; and ADB. 2015. *Financial Management Assessment – Financial Management Technical Guidance Note*. Manila.

² ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Loan, Technical Assistance Grant, and Administration of Grant to the People’s Republic of Bangladesh for the Urban Primary Health Care Services Delivery Project*. Manila; ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Sector Development Program Loans and Technical Assistance Grant to the People’s Republic of Bangladesh for the Urban Public and Environmental Health Sector Development Program*. Manila; and ADB. 2016. *Midterm Review of Urban Primary Health Care Services Delivery Project. Final Report of Independent Review Team*. Manila.

Urban Health Strategy (2014). The outcome will be sustainable, good quality urban PHC services provided in the project areas that target the poor and the needs of women and children. This will be achieved through the following three outputs:

- (i) Output 1: Institutional governance and local government capacity to deliver urban PHC services sustainably strengthened;
- (ii) Output 2: Accessibility, quality, and utilization of urban PHC services (with a focus on the poor, women and children) implemented through public–private partnerships; and
- (iii) Output 3: Effective support for decentralized project management provided.

6. The LGD will be the executing agency of the proposed project. The ULBs, city corporations, and municipalities will be the implementing agencies in their respective project areas.

7. A PMU under the LGD, headed by a full-time project director, will provide the required technical, administrative, and logistical support for project implementation. The project director will be at least a deputy secretary-level officer, preferably at the joint secretary-level, and will have project management experience, preferably related to the health sector.

8. An interministerial National Project Steering Committee (NPSC), established in the previous project and chaired by the secretary of the LGD, will oversee project implementation. The NPSC will meet no less than twice a year. A project coordination committee in the LGD—established in the previous project and chaired by the director general of the Monitoring, Inspection and Evaluation, as chief project coordinator—will meet quarterly to review project progress and implementation issues. The project coordination committee further comprises the chief health officers of ULBs, representatives from the Ministry of Health and Family Welfare, project director and deputy project directors of Urban Primary Health Care Services Delivery Project, and project managers of partnership area nongovernment organizations (PANGOs). The chief project coordinator will supervise the project director.

9. The LGED under the LGD will be responsible for implementing the construction program of the project. Accountability of the LGED will be ensured through a memorandum of understanding between the project and the LGED, which will include results-based payment and delivery.

III. COUNTRY AND SECTOR ISSUES

10. **Country-level financial management.** The country-level public financial management (PFM) system has been assessed based on the most recent PFM assessment report prepared for Bangladesh, which is a public expenditure and financial accountability assessment.³ It has been conducted by the government in 2016 with the support of the World Bank. The table below provides a component-level summary.

³ Government of Bangladesh. 2016. *Public Expenditure and Financial Accountability, Public Financial Management Performance Report*. Dhaka.

Table 1: Public Expenditure and Financial Accountability Assessment (2016)

SL	PFM Performance Dimension	Calculated Ratings	Risk Rating
1	Budget reliability	C	Substantial
2	Transparency of public finances	C	Substantial
3	Management of assets and liabilities	D	High
4	Policy-based fiscal strategy and budgeting	C	Substantial
5	Predictability and control in budget execution	B	Moderate
6	Accounting and reporting	C	Substantial
7	External scrutiny and audit	D	High
Overall risk		C	Substantial

PFM = public financial management.

Note: Calculated as an average based on quantification of the PEFA PI-level scores for each dimension using the following conversion: A = 4, B+ = 3.5, B = 3, C+ = 2.5, C = 2, D+ = 1.5, and D = 1.

Source: Government of Bangladesh. 2016. *Public Expenditure and Financial Accountability, Public Financial Management Performance Report*. Dhaka.

11. The table shows that substantial risks exist. The highest risks are ‘management of assets and liabilities’ and ‘external scrutiny’, while the lowest risks relate to ‘predictability and control in budget execution’. Some of the risks are not applicable at the project level. The Government of Bangladesh’s current PFM strategy aims to reduce the risks at the country-level in various areas.⁴

12. **Medium-term budget framework.** The government’s medium-term budget framework (MTBF) provides linkages between overall strategic objectives in relation to policies and resource allocations, and between resource allocations and performance. It specifically seeks to integrate, in a phased manner, the development and nondevelopment (revenue) budgets, and thus helps to establish more consistency between policy, planning, and budgeting. The MTBF was initially introduced in 2007–2008 with 10 ministries and has since been extended to all 61 line ministries, divisions, and institutions. While the MTBF approach was well-received by line ministries, budgeting remains incremental, which leads to limited resources being stretched. Also, there continues to be two parallel budgets. The MTBF approach has furthermore helped to highlight the ineffectiveness of financial management functions in line ministries, where no single entity is charged with budget management and oversight. The main PFM reform project supporting the Finance Division of the Ministry of Finance (MOF) and line ministries from 2009–2014 “*had very limited success in “strengthening and modernizing budget management institutions”*.”⁵ Although new institutional arrangements were designed and partly implemented (budget management wings, budget working groups, and budget management committees), these were not sustainable as they mainly performed budget preparation tasks, while budget monitoring and execution control had low priority.

13. **Annual budget formulation.** Both the nondevelopment and development budgets are approved by the Parliament. For development budgeting, the process entails the preparation of

⁴ Government of Bangladesh. 2016. *Public Financial Management Reform Strategy, 2016–2021*. Dhaka.

⁵ World Bank. 2015. *Implementation Completion and Results Report, Deepening MTBF and Strengthening Financial Accountability Project*. Report No. ICR00002545, p. 21. Washington, DC. The multi-donor-funded and World Bank-managed Strengthening Public Expenditure Management Program, Project A – Deepening MTBF and Strengthening Financial Accountability.

an annual development program by each ministry and specific executing agencies. A programming committee is constituted in the Planning Commission with the participation of the Finance Division, Economic Relations and Implementation Division, and Monitoring and Evaluation Division. The committee undertakes a review of the annual development plan. The nondevelopment budget is formulated by the MOF based on the budget proposals submitted by line ministries following the annual budget call (circulars no. 1 and no. 2). Both the nondevelopment and the development budgets are used to finance recurrent or revenue expenditure as well as capital expenditures. Expenditure control rests with the secretary who acts as the principal accounting officer of his ministry/division, its attached departments and subordinate offices with respect to receipts and expenditures incurred from the budget controlled by the ministry/division.

14. **Accounting and internal control.** In addition to the operation of the Integrated Budget and Accounting System (IBAS)++, key functions of the Controller General of Accounts (CGA) are accounting, internal control and payment possessing, and pre-audit of government funds. It has accounting offices for all ministries at the divisional, district, and upazila levels. In addition, the CGA is responsible for preparation of monthly, finance, and appropriation accounts (yearly accounts). The accounting standards do not yet comply fully with the cash basis International Public Sector Accounting Standards due to a delay in the preparation of accounts, lack of accuracy of data, and reconciliation and delay of financial information from the various self-accounting entities.⁶ The introduction of new Budget and Accounting Classification System codes aim to overcome this challenge.⁷ In addition, the government, through its PFM reform strategy, is taking several steps to address weaknesses, including the comprehensiveness of financial statement and to improve reconciliation as well as the quality of financial statements. Internal controls are essentially similar for the development and nondevelopment budgets, although there are some exceptions about delegation of power and release of funds. The development budget has more flexibility than the nondevelopment budget.

15. **Financial reporting.** There are some delays in the CGA's preparation of monthly reports and, especially, for the annual accounts. This adversely affects the subsequent external audit of the accounts undertaken by the Comptroller and Auditor General (CAG). The delays are, among other things, caused by the reconciliation process between IBAS++ records and the manual accounts kept by ministries and agencies. Furthermore, budget variance reports with explanation of deviations between planned and actual spending are rarely prepared.

16. **Internal audit.** Ministries and agencies have appointed internal auditors who are to assess compliance with the governments' General Financial Rules. An internal audit manual was issued in 2005 to guide the work of internal auditors, but the internal audit functions generally lack capacity and staff. Also, no internal audit reports are issued and hence no management responses are prepared.

⁶ Bangladesh Railway, Defense, Roads and Highways Department; Public Works Department; Forest Department; Postal Department; Public Health Engineering Department; and Telecom Department.

⁷ The Budget and Accounting Classification System will facilitate more accurate financial transactions and recording as well as enhanced transparency through full-detail reporting and compatibility of classification as consistent with the international standard external reporting according to the Government Finance Statistics, International Public Sector Accounting Standards, and Classification of the Functions of Government. The new classification is maintained in IBAS++, which is a centralized internet- and oracle-based software that enables budget preparation, budget distribution in field-level offices, funds release, re-appropriations, and payment processing through electronic fund transfer and automated reconciliations.

17. **External audit.** The CAG is responsible for auditing receipts and spending, and to ascertain whether expenditures have yielded value-for-money, in government offices, public bodies, and statutory organizations. External audit is undertaken through 10 separate audit directorates.⁸ Each directorate is headed by a director general who is responsible for specific functional areas of the public sector. Audit observations involving serious financial irregularities (SFIs) are initially developed into advance paras and subsequently draft paras, after taking into consideration replies received from auditees and the principal accounting officer (secretary of the ministry/division). The draft paras are incorporated into the audit reports. Alongside traditional approaches to carry out financial, compliance, or regularity audits, the CAG is now also conducting performance audits to determine economy, efficiency, and effectiveness in the management of public resources.

18. The CAG's Foreign Aided Project Audit Directorate (FAPAD) conducts external audits based on the terms of references agreed with development partners and the government.

19. **Public financial management reform.** The government's PFM reform strategy, 2016–2021 has five goals that focus on strengthening different aspects of the system across government. These include:

- (i) Goal 1: Maintain aggregate fiscal discipline compatible with macroeconomic stability and pro-poor growth;
- (ii) Goal 2: Allocate resources consistent with government priorities as reflected in the National Plan;
- (iii) Goal 3: Promote the efficient use of public resources and delivery of services through better budget execution;
- (iv) Goal 4: Promote accountability through external scrutiny and transparency of the budget; and
- (v) Goal 5: Enhance the enabling environment for improved PFM outcome.

20. The PFM reform strategy is being implemented with support from development partners.

IV. PROJECT FINANCIAL MANAGEMENT SYSTEM

A. Local Government Division – Project Management Unit

21. **Project management.** The LGD of the MOLGRDC will be the executing agency of the project. The LGD will lead overall coordination of the project. An interministerial NPSC will be established and be responsible for (i) project policy direction and formulation, (ii) reviewing project progress on a regular basis, (iii) approving annual budget, (iv) addressing critical interministerial policy and implementation issues to facilitate and ensure timely decisions, (vi) providing operational guidance, and (vii) addressing any constraints encountered by the project during implementation. In addition, the LGD will support the implementing agencies for smooth implementation of the project.

22. **Experience in managing development partner projects.** The LGD has significant experience in implementing donor-funded projects. The proposed additional financing will be implemented in 11 city corporations (including North and South Dhaka) and 14 municipalities. All

⁸ (i) Commercial Audit Directorate; (ii) Local and Revenue Audit Directorate; (iii) Civil Audit Directorate; (iv) Works Audit Directorate; (v) FAPAD; (vi) Railway Audit Directorate; (vii) Post, Telecommunication, Science and Technology Audit Directorate; (viii) Mission Audit Directorate; and (ix) Performance Audit Directorate.

city corporations have, through previous projects, experience in the management of disbursements from ADB and other development partners. Over the years, the management of LGD has gained sufficient experience in compliance with donor agencies' loan/grant covenants and procedures in terms of financial operations. The LGD is currently implementing similar projects.

23. **Staffing.** The application of the FMAQ revealed that the PMU lacks adequate finance staff. There is currently one deputy project director, one accounts officer, and one accountant in the PMU. The accountant handles both cashiering and recording functions, and internal control functions are inadequate. The financial management staffing should be strengthened by five additional staff: one senior accounts officer, one accounts officer, and three accountants. This would help to ensure effective financial management, including monitoring of expenditure and accounting of project funds, by enabling proper segregation of duties (cashiering, disbursing, monitoring, and record-keeping). The additional staffs must have relevant finance/accounting background and experience, preferably in urban PHC projects. Job descriptions should be prepared to include clearly defined duties, responsibilities, lines of supervision, and limits of authority.

24. Not only new staff, but also most of the existing financial management staff of the PMU require additional training specific to the government and ADB procedures. The latter should include ADB's loan administration procedures as per ADB's *Loan Disbursement Handbook* (2017, as amended from time to time), including withdrawal applications, statement of expenditures (SOE), and financial reporting. Implementing agency staff will be provided with training on financial and managerial accounting as well as on the preparation of SOEs and financial reports. The training should also cover the government's financial management regulations and reporting formats.

25. **Funds flow arrangement.** The proposed additional financing will follow the set procedures for fund disbursement under the ongoing third phase of Urban Primary Health Care Services Delivery Project as described in the project administration manual (PAM). The advance from ADB will be deposited in an advance account (in United States dollars) to be maintained by the PMU and used for the ADB loan portion of eligible cost of the project. The advance account funds will be released to a local currency bank account. The government counterpart contribution will be deposited in a separate bank account maintained in local currency. The PMU will disburse project expenditures from these accounts. Detailed fund flow procedures are given in the PAM.

26. **Accounting policies and procedures.** The project accounting policy and procedures will be in line with cash basis accounting as per the national accounting standard. While the government's revenue budget-supported expenditures are obligated, executed, monitored, and reported through IBAS++, development budget-supported expenditures (e.g., development partner-financed projects) are not yet covered by IBAS++. Each project would follow its own financial management mechanism, and only aggregated amounts will be recorded in IBAS++. Under the Urban Primary Health Care Services Delivery Project (2012–present), all financial and accounting data were manually maintained using a computerized spreadsheet program making reconciliation of the general ledger and subsidiary ledgers as well as preparation of financial reports a slow and cumbersome process. Especially, bank and cash records were not reconciled monthly, and unusual items were not in all cases properly recorded and authorized by the responsible officer. Due to this, the ongoing Urban Primary Health Care Services Delivery Project (2012–present) faced some challenges regarding reconciliation at the PMU level, and an FMM was therefore developed to guide financial management procedures. The FMM has been updated for the additional financing period, including to be consistent with the government's General

Financial Rules.

27. The project will continue to apply the ongoing financial management system through computerization and streamlining of procedures. A financial management consultant will be hired to ensure proper adherence to the fiduciary and the risk requirements of ADB and the government, with proper chart of accounts, funds flow, disbursement procedures, and minimum required segregation of duties for improved transparency and accountability. The financial management consultant will also support the PMU in defining appropriate reporting templates for the PIUs and PANGOs to be more useful for management actions (e.g., financial data along with physical progress information). While implementing the new project, more advanced ULBs, mostly city corporations with recommendation of the project director and approval of the secretary of the LGD, will be given more responsibilities in financial management and procurement to build sustainable capacity to deliver urban PHC services.⁹ Such delegation of finance functions from the PMU to PIUs will require streamlined and clear policy guidelines on responsibility and authority. It is proposed that the PMU conduct biennial fiduciary reviews (BFRs) and submits the required documentation to ADB. The PIUs/implementing agencies will have full accountability for the delegated function with regular monitoring and post-audit by the PMU. Due to the delegated function, a regular monitoring function by the PMU is essential. The PIUs will be responsible for full financial recording and reporting for consolidation by the PMU.

28. **Segregation of duties.** LGD will ensure adequate segregation of duties, like in the ongoing project. Where the PMU's Administration and Training Unit issues the requisite for goods and service and custodian of assets, the Finance Unit will pay the bills for goods and services.

29. **Budget system.** The PMU will prepare the budget based on inputs from the PIUs and different units of the PMU. The PIUs will provide the actual needs of their own and PANGO costs. The PMU consolidates and forwards the budget to the LGD for further approval, following which it is sent to the MOF and Ministry of Planning for final approvals.

30. **Payments.** All payments will require adequate invoices with supporting documents and endorsement from the responsible departments.

31. **Cash and bank.** The project director of the PMU is the signatory of the bank account. The PMU maintains all records of the bank accounts, recording transaction of receipts, and payment to the suppliers, consultant, and contractors. Due to the shortage of manpower, the PMU is currently unable to conduct reconciliation monthly. As mentioned above, it is recommended that additional staff be engaged for the additional financing period.

32. **Safeguard of assets.** The LGD and the PMU maintain assets as per government rules. An asset register is available but not updated regularly.

33. **Internal audit.** Firstly, the LGD has an Internal Audit Department headed by a joint secretary (audit), with deputy secretary (audit), and other personnel. They review the PMU's responses to audit observations and send the recommendation to the FAPAD. Due to the PMU's delay in submitting the broad sheet reply for the most recent audit, it has no recent activity related to the project. Secondly, the project has conducted an independent internal audit in 2017 by a reputable accounting firm. Since the audit was only in the last year of the project, it is recommended that the additional financing make provisions for carrying out more frequent internal

⁹ As per the Delegation of Financial Powers for Development Projects issued from the Ministry of Finance on 22 December 2004.

audits such as the BFRs. These should cover the activities of the PMU, PIUs, and PANGOs. The BFRs may also review and monitor the settlement of external audit observations.

34. **External audit.** The CAG's FAPAD has the constitutional mandate to audit donor-funded project and related accounts, including all sub-accounts. The FAPAD has expertise regarding loan procedures and loan negation documents. It reviews compliance of actual procedures in relation to the approved loan agreements and reviews tax payments and disbursements.

35. During the Second Urban Primary Health Care Project (2005–2012), there were 67 audit observations, consisting of 23 SFIs (Part-A) and 44 ordinary observations (Part-B). As of November 2017, 20 SFIs and 44 ordinary observations had been resolved, i.e., there remain only three SFIs and 16 ordinary observations. The main reason for the delayed settlement of these observations was the absence of an effective mechanism to follow up on audit issues as well as late explanation from the project to the CAG/FAPAD on remedial actions initiated. In the ongoing Urban Primary Health Care Services Delivery Project from 2012–2013 to 2015–2016, there were 68 audit observations consisting of 16 SFIs and 52 ordinary observations, i.e., the relative share of SFIs has decreased (from 34% under the Second Urban Primary Health Care Project to 24% under the Urban Primary Health Care Services Delivery Project). The observations related mainly to internal control issues and non-compliance with financial rules, including irregular project fund transfer, cash payment instead of check payment, LGED service charge, inadequate transaction documentation, non-observance of delegation of financial power and authority, over-budget expenditures, inaccurate recording of financial transactions, and inappropriate procurement procedures. Some ordinary observations have been due to systemic issues that go beyond the control of the project, while the SFIs generally can be avoided by strengthening the financial management system for the proposed project. As of November 2017, all but two SFIs for 2012–2013 to 2014–2015 have been resolved. Most, if not all, had been resolved after initial broadsheet reply. The 10 SFIs and 16 ordinary observations relating to 2015–2016 are yet to be settled since the audit report was only made available by the FAPAD in early 2017, i.e., the observations are now being reviewed by the project and will thereafter be discussed in tripartite meetings with the MOLGRDC and FAPAD.

36. **Reporting and monitoring.** All projects under implementation are under overall LGD supervision. Reports are prepared with details of physical progress and financial expenditures, comparing actual results with the budgets. The reports are reviewed in a monthly coordination meeting of the MOLGRDC. In addition, the Implementation Monitoring and Evaluation Division, Planning Commission, and the MOF monitor project progress.

37. During the implementation of Urban Primary Health Care Services Delivery Project (2012–present), delays in submission of the SOE to ADB was a major bottleneck as the financial reporting had several layers (from the PANGOs via PIUs to the PMU). Necessary reporting and monitoring features were not adequately built into the existing financial management systems of the implementing agencies for them to track the use of project proceeds by the PANGOs. Also, there were frequent delays in the payment release to the PANGOs due to the long approval process of payment requests.

38. **Information system.** The PMU uses Tally accounting system. As the PMU, PIUs, and PANGOs have already gained useful experience with the Tally accounting system, it is recommended to continue using Tally for additional financing period.

B. City Corporations and Municipalities – Project Implementation Units

39. **Project Management.** Additional financing for Urban Primary Health Care Services Delivery Project, including the PMU under the executing agency and PIUs under the implementing agencies and PANGOs, are covered by the financial rules issued by the MOF. The budgeting process is based on the annual implementation plan submitted by the PIUs, considering the budget guidelines issued by the executing agency. The PMU reviews the PIUs' budget and consolidates these into a project budget for approval by the LGD. In terms of recording expenditures, separate books of accounts are maintained by each PIU and PANGO. A quarterly disbursement report is submitted by each PANGO to the PIU, which is submitted, in turn, by the PIU to the PMU. The PIU staff are well-trained and organized to manage the project in the city corporations and municipalities.

40. **Experience in managing development partners' projects.** The proposed additional financing will be implemented in all 11 city corporations (including North and South Dhaka) and 14 selected municipalities. All existing 10 city corporations and four municipalities under the ongoing project have experience in the management of disbursements from ADB and other development partners that have previously implemented internationally-funded projects. Over the years, these city corporations and municipalities have gained sufficient experience in compliance with donor agencies' loan/grant covenants and procedures in terms of financial operations. City corporations and municipalities are currently implementing similar externally-funded projects.

41. **Staffing.** The finance and accounts sections of the city corporations and municipalities are adequately staffed given the current level of operations. In each PIU, the project provides for one additional accountant to review the PANGO invoices and day-to-day maintenance of the PIU accounts. Additional PIU staff, as well as existing staff require training on financial management, accounting system, and ADB loan disbursement guidelines.

42. **Accounting policies and procedures.** The city corporations and municipalities follow cash basis accounting procedures in accordance with the national accounting standards. They retain documentation as per government rules.

43. **Funds flow arrangement.** All the PIUs in the city corporations and municipalities will follow the set procedures for fund disbursement under the ongoing Urban Primary Health Care Services Delivery Project as described in the PAM.

44. **Segregation of duties.** City corporations and municipalities have adequate segregation of duties. The current PIUs of the ongoing project have clear segregation of duties that the program officer issues the request for goods and service and is custodian of assets, while the PIU accountant is charged with the payment of bills for goods and services.

45. **Budget system.** The Accounts Section in the city corporations and municipalities submits a consolidated budget to the Budget Committee/Finance and the relevant Standing Committee. The committee reviews the estimated budget and forwards it to the mayor for approval. After approval by the mayor, it is sent to the special budget meeting of the councilors. The budget as approved by the councilors and then submitted to the MOLGRDC for final approval.

46. **Payments.** All payments require adequate invoices with supporting documents and endorsement from the mayor.

47. **Cash and bank.** Mayors are the signatories of the bank account. The PIUs maintain all

records of bank accounts, and record transaction of receipts and payment to suppliers, consultant, and contractors.

48. **Safeguard of assets.** The PIUs maintain assets safeguard as per government rules. Assets registers are available although not updated regularly.

49. **Internal audit.** All city corporations have an internal audit unit but is not functioning at the project level due to lack of capacity. There is no internal audit unit in the municipalities. An Audit Standing Committee prepares the audit report which is submitted to the mayor. It is therefore recommended that independent BFRs are carried out by the project to assess financial transactions as well as to create awareness within the PIUs and PANGOs of the importance of minimizing risks.

50. **External audit.** The CAG's FAPAD is constitutionally mandated to conduct the external audit of donor-funded project and related accounts, including all sub-accounts. The FAPAD has expertise regarding loan procedures and loan negotiations documents, and it reviews compliance of actual procedures with loan agreements as well as tax payments and disbursements. The PIUs of city corporations and municipalities have expertise in managing such accounts.

51. **Reporting and monitoring.** All city corporations and municipalities prepare reports as per government rules. However, at the project-level, financial statements are prepared as per the national requirements. The accounting system is required to update and generate the integrated financial statement of each PIU.

52. **Information system.** The PIUs of city corporations and municipalities use the Tally accounting system. As the PMU, PIUs and PANGOs are already familiar with the Tally accounting system, it is recommended to continue using Tally throughout the additional financing period.

C. Strengths

53. The following strengths were identified based on the FMA:

- (i) Most staff of the ongoing project are engaged on a long-term basis. The staff are dedicated for their respective areas, especially the finance and procurement units. The staff are well-informed about project management, budgeting, funds release procedures, etc.
- (ii) The ongoing project developed an FMM which is also available to the PIUs and PANGOs. This system allows the PMU to prepare consolidated financial statements.
- (iii) The LGD, LGED, and city corporations and municipalities are implementing several projects financed by development partners (ADB, World Bank, Japan International Cooperation Agency, and Deutsche Gesellschaft für Internationale Zusammenarbeit [GIZ]) and thus have experience with relevant financial management procedures.

D. Weaknesses

54. Several weaknesses were identified during the FMA including:

- (i) Internal audit is very weak and not available at the project-level, hence internal audit of all partnership areas is not carried out annually.

- (ii) The PMU's Finance Unit has an insufficient number of staff.
- (iii) The financial reporting procedures are weak.

V. RISK ASSESSMENT

55. The financial management, internal control, and risk assessment of the additional financing for Urban Primary Health Care Services Delivery Project examines two risk levels: inherent risk (risks that are inherent to the project focuses on rules and regulations, capacity building and country PFM system); and control risk (internal controls, accounting, financial reporting, auditing arrangements, etc.). The table below summarizes the identified risks and outlines proposed mitigation measures.

Table 2: Financial Management and Internal Control Risk Assessment

Risk Description	Risk Assessment ^a			Mitigation Measures / Risk Management Plan
	Impact	Likelihood	Assessment	
A. Inherent Risk ^b				
Country Specific – Weak performance of ‘External Scrutiny and Audit’.	Moderate	Likely	Moderate	Continuous dialogue between ADB and the CAG will focus on further developing external audit capacity.
Entity-specific – Weak internal audit.	Moderate	Likely	Moderate	Continuous dialogue between ADB and the LGD will focus on strengthening the internal audit function.
Overall Inherent Risk	Moderate			
B. Control Risk LGD-PMU ^c				
Project Management The PMU is charged with overall control and supervision of the project.	Low	Less likely	Low	The PMU will be assisted through the engagement of individual consultants.
Fund Flow The LGD has administered several ADB and other externally-funded projects without major problems, and the PMU are acquainted with funds release procedures.	Low	Less Likely	Low	No mitigation measures required.
Staffing The PMU's Finance Unit is insufficiently staffed for expanded scope under additional financing.	Moderate	Likely	Moderate	Due to proposed expansion of project coverage, additional staff will be engaged: one senior accounts officer, one accounts officer, and three accountants. Also, an FM consultant has been engaged and training will be provided to the PMU staff as relevant.
Accounting policy and procedure The PMU follows national accounting standards and international financial reporting standards.	Low	Likely	Low	No mitigation measures required.

Risk Description	Risk Assessment ^a			Mitigation Measures / Risk Management Plan
	Impact	Likelihood	Assessment	
Policies and procedure The ongoing project has developed an FM manual, which has now been updated for the additional financing period.	Low	Less Likely	Low	The project has updated the FM manual and will ensure it is followed and applied.
Cash and bank Bank reconciliation is not carried out monthly.	Moderate	Likely	Moderate	The engagement of additional staff in the PMU's Finance Unit will ensure that reconciliation is carried out as required.
Internal audit The LGD has an internal audit unit that supports the PMU to reconcile audit observations with the FAPAD.	Moderate	Likely	Moderate	Independent BFRs will be carried out regularly.
External audit The FAPAD conducts external audit. There are several pending audit observations in the ongoing project.	Moderate	Likely	Moderate	The FAPAD will continue to carry out external audits. The FM consultant will support the PMU in ensuring that audit observations are settled promptly.
Reporting and monitoring The PMU and PIUs face challenges in undertaking comprehensive monthly and quarterly financial reporting.	Moderate	Likely	Moderate	The FM consultant will support the PMU in preparing financial reports on a timely basis for the project. Also, the Tally accounting software will be customized for reporting purposes.
Information system The Tally accounting software is functioning.	Low	Likely	Low	The PMU will ensure that the Tally software maintenance and service contract is in place throughout the project period.
Overall Control Risk	Moderate			
C. City Corporations and Municipalities – PIU ^c				
Project Management The PMU has overall control and supervision of partnership areas of the CCMs.	Low	Less likely	Low	The PIUs will be assisted by the PMU as well as individual consultants and firm consultants.
Fund Flow The PIUs of the CCMs are implementing several externally-funded projects without any major problems.	Low	Less Likely	Low	No mitigation measures required.
Staffing Existing PIU staff are experienced, but additional staff as well as capacity building is needed to further strengthen FM.	Moderate	Likely	Moderate	Additional staff as well as training will be provided for the PIUs.
Accounting policy and procedure The PIUs follow national accounting standards and requirements.	Low	Likely	Low	No mitigation measures required.
Cash and bank Bank reconciliation is not	Moderate	Likely	Moderate	The FM consultant of the PMU will support the PIUs in

Risk Description	Risk Assessment ^a			Mitigation Measures / Risk Management Plan
	Impact	Likelihood	Assessment	
carried out monthly.				undertaking monthly reconciliation.
Internal audit Most CCs have an internal audit unit, but these are not functional due to low capacity. Municipalities do not have an internal audit unit.	Moderate	Likely	Moderate	Independent BFR will be carried out regularly.
External audit The FAPAD has a clear assignment and adequate capacity.	Low	Less Likely	Low	External audits will be conducted annually by FAPAD.
Reporting and monitoring The PIUs have challenges in undertaking comprehensive monthly and quarterly financial reporting.	Moderate	Likely	Moderate	The FM consultant will support the PIUs in preparing financial reports on a timely basis for the project. Also, the Tally accounting software will be customized for reporting purposes.
Information system The Tally accounting software is functioning.	Low	Likely	Low	The PMU will ensure that the maintenance and service contract is in place throughout the project period.
Overall Control Risk	Moderate			
Overall Risk	Moderate			

ADB = Asian Development Bank, BFR = biennial fiduciary review, CAG = Comptroller and Auditor General, CC = city corporation, CCM = city corporation and municipality, FAPAD = Foreign Aided Project Audit Directorate, FM = financial management, LGD = Local Government Division, PIU = project implementation unit, PMU = project management unit.

- ^a Low, moderate, substantial, high. The assessment is based on the likelihood of occurrence and degree of impact.
- ^b Inherent risk is the susceptibility of the FM systems to factors arising from the environment in which they operate, such as country- or sector-level rules and regulations as well as the entities' working environment (assuming absence of any counter-checks or internal controls).
- ^c Project risk is the risk that the PIU accounting and internal control frameworks are inadequate to ensure subproject funds are used economically and efficiently and for the purpose intended, and that the use of funds is properly reported.

Source: Asian Development Bank.

VI. PROPOSED ACTION PLAN

56. The proposed financial management action plan is outlined in Table 3 below.

Table 3: Financial Management Action Plan

SL	Description	Time line	Responsibility
1	Recruiting additional staff for the PMU's Finance Unit.	By loan effectiveness	PMU/LGD
2	Recruiting a FM consultant for the PMU.	By loan effectiveness	PMU/LGD
3	Recruiting additional FM support for new ULBs by consulting firm.	By loan effectiveness	PMU/LGD
4	Providing training on Tally accounting software and FM training to existing and new ULBs, PMU, and PANGOs.	Ongoing	PMU
5	Conducting training in ADB's procurement, FM, and disbursement procedures and requirements.	Ongoing	PMU/ADB

SL	Description	Time line	Responsibility
6	Settling audit observation of the ongoing project and previous phase project.	Ongoing (within 6 months of FAPAD report availability)	PMU/LGD
7	Ensuring that bank reconciliation is undertaken monthly for the project.	Monthly	PMU/PIU/ partner service providers
8	Carrying out biennial fiduciary reviews.	Year 1 and Year 3	PMU/ DB

ADB = Asian Development Bank, FAPAD = Foreign Aided Project Audit Directorate, FM = financial management, LGD = Local Government Division, PIU = project implementation unit, PMU = project management unit, ULB = urban local body.

Source: Asian Development Bank.

VII. SUGGESTED COVENANTS

57. **Financial management action plan.** Schedule 5 of the legal agreement shall require the implementation of the financial management action plan as stipulated in the PAM.

58. **Right of audit.** The LGD and city corporations and municipalities will ensure that contracts financed by ADB will include provisions specifying the right of ADB to audit and examine the records and accounts of the LGD, city corporations and municipalities, contractors, suppliers, consultants, and other service providers as they relate to the additional financing (included in the Loan Agreement, Schedule 5, Governance and Corruption).

59. **Audit of project account.** The FAPAD will audit the PMU and PIUs annually with a focus on project funds. Audit reports shall be available within 6 months of the end of the financial year. The PMU will build the capacity of the PIUs to ensure, among other things, timely and rigorous reconciliations, orderly record keeping, and strict adherence to financial management policies and internal controls, and to ensure an orderly and timely year-end process for the preparation and audit of annual project accounts (included in the Loan Agreement, Section 4.02)

60. **Governance and anticorruption.** The government will ensure that (i) the overall project is carried out in compliance with all applicable government’s anticorruption regulations and ADB’s Anticorruption Policy (1998, as amended to date); (ii) all PMU and PIU staff actively participate in the training in the government’s anticorruption regulations and ADB’s Anticorruption Policy; (iii) a website is developed and maintained to disclose the audited annual project accounts, project progress, and procurement activities; and (iv) to supplement web disclosure, procurement plans and activities will be discussed in public meetings in each city corporation and municipality (included in the Loan Agreement, Schedule 5 Project Website, and Governance and Corruption).