

FINANCIAL MANAGEMENT ASSESSMENT REPORT

A. Executive Summary

1. This Financial Management Assessment (FMA) has been prepared in accordance with Asian Development Bank (ADB) Guidelines for the *Financial Management and Analysis of Projects* (2005) and *Financial Due Diligence a Methodology Note* (2009) and focuses on fund flows, staffing, accounting policies and procedures, internal controls, financial reporting and monitoring, and internal and external audit. The FMA considered the following:

- a. Local Self Government Department (LSGD) (EA) and Rajasthan Urban Infrastructure Development Project (RUIDP) (IA) and
- b. State level as there is a program loan component.

2. A key aspect of the FMA is evaluating the risks associated with project financial management arrangements. ADB's principal concern is to ensure that project funds are used economically and efficiently for the purpose intended. In support of this, it seeks assurance that the EA and IA financial management systems can report on the source and use of project funds. This assessment is based on the results of a FMA questionnaire, discussions with officials of GOR, RUIDP, six municipal bodies (also referred to as urban local bodies (ULBs)) and information available through various reports, including state budgets, LSGD Annual Report (2013), RUIDP Annual Report (2013), and Local Fund Audit Department and Comptroller and Audit General (CAG) Audit Reports.

3. This FMA was conducted to (a) assess EA capacity to monitor, manage and support the overall program, (b) assess IA capacity to implement and manage investments and (c) propose ways and means to strengthen the capacity of EA and IA. Specifically, the objective is to enhance competence levels to achieve the government's goals of institutional development and urban governance improvement. The assessment, along with the forecast, outlines the financial environment of the IA and the financial risks that may affect the project impact and sustainability.

B. Risk Assessment:

- a. **Inherent Risk:** Assessed overall as moderate. Political will may destabilize the willingness to increase taxes and tariffs in the coming years, and possibly affect their development and financial situation. Close monitoring and resolving specific capacity gaps with technical support and incentives for governance improvements will be required.
- b. **Control Risk:** Assessed overall as moderate. RUIDP's financial management practices and procedures are considered to be adequate for management and control of project finances. The project funds will be managed and audited separately from other funds. However, lack of internal audit mechanism in RUIDP is an area of concern.

4. **Strengths and Weaknesses.** The main strength of the existing project financial management (FM) is that RUIDP has significant experience over the last thirteen years in financial management of ADB-funded projects. Although this has mitigated risk at the project

level, this experience has not always translated into effective financial management for the organization. The main weaknesses include the number of pending audit paras at the State level and RUIDP level and lack of internal audit in RUIDP till date.

C. Project Description

5. The proposed Rajasthan Urban Sector Development Program (SDP) will complement the past and ongoing efforts of the government of Rajasthan (GOR) to improve water supply and wastewater services to the residents of the state of Rajasthan. The SDP comprises (i) a program, financed by a policy-based loan, to support policy reforms, including institutional development and governance improvement in the urban sector in the state, and (ii) a project, financed by a project loan, to invest in water distribution network and sewerage systems in the six project cities in the state. Project envisages focused investments of US\$250 million in water supply and wastewater in six cities with population of more than 100,000 each (Census 2011): Sri Ganganagar, Hanumangarh, Jhunjhunu, Pali, Bhilwara and Tonk. Detailed Project Reports (DPRs) of all the six identified towns will be prepared under this project. The distribution network improvement works are being implemented with the objective of nonrevenue water reduction on district metering area approach to improve efficiency and maximize the impact of investments. In wastewater sector, the focus is on the sewerage network and wastewater treatment with energy generation from sludge and recycling of wastewater. The program loan of \$250 million will have policy reforms conditions based on which the funds will be released in two tranches.

D. Country Issues

6. The identification of country-level issues is based on the Diagnostic Studies of Accounting and Auditing, the World Bank Country Financial Accountability Assessments, Reports on the Observance of Standards and Codes and others. The country issues that potentially impact project financial management include a weak public financial management (PFM) environment and management and skills capacity issues.

7. **Public financial management environment.** The country policy and institutional assessment for transparency, accountability, and corruption in the public sector rating (1=low to 6=high) in India was last reported at 3.6 in 2012 (World Bank 2012).¹ Transparency, accountability, and corruption in the public sector assess the extent to which the executive can be held accountable for his use of funds and for the results of his actions by the electorate, the legislature, and the judiciary, and the extent to which public employees within the executive are required to account for administrative decisions, use of resources, and results obtained. The three main dimensions assessed here are (i) accountability of the executive to oversight institutions, (ii) accountability of public employees for their performance, and (iii) access of civil society to information on public affairs and state's capture by narrow vested interests.

8. Main findings of the assessment of India's public expenditure and financial accountability are:

- a. **Assessment of Impact of PFM Weakness.** When judged from the perspective of the three main objectives of an effective public financial management system—namely, aggregate fiscal discipline, strategic allocation and the efficient delivery of services—many problems exist in India. While efforts of the government and the role of legal and institutional mechanisms in strengthening

¹ Available at <http://data.worldbank.org/indicator/IQ.CPA.PUBS.XQ>.

the financial management systems are evident in many areas, the actual practice leaves much to be desired. The adoption of rule-based fiscal management by enacting the Fiscal Responsibility and Budget Management (FRBM) Act helped in monitoring aggregate fiscal indicators, but its impact on the actual practice of financial management is not clear. The budgeting system in India is conventional input-based and more concerned with basic financial compliance; but this has not resulted in establishing effective fiscal discipline. Absence of a multi-year perspective in expenditure planning, lack of robust macro-economic forecasting on which to base the budget, and inherent weaknesses in adhering to the procedures laid down in Constitutional and legal provisions have negatively affected PFM outcomes. The assessment of PFM practices at central level provides little opportunity to measure service delivery, as these are the responsibilities of sub-national government. While the PFM practice at both central and state governments are largely similar, the information on actual service delivery and resource availability to implementing agencies at field levels is limited at the central level leaving few flagship programs.

- b. **Aggregate Fiscal Discipline.** With respect to aggregate fiscal discipline, an elaborate expenditure control mechanism exists in India; debt strategy and debt management practices are reasonably well developed; rules and regulations are developed for procurement system; rule-based fiscal management is adopted through the FRBM to monitor and adhere to stipulated deficit indicators; and Parliamentary control over budgetary practice and expenditure control is established following the Constitutional provisions. At the same time, the absence of a multi-year perspective in the expenditure planning that indicates future year commitments, a lack of effective fiscal risk assessment at an aggregate level, the unevenness and the late spike in the annual spending pattern, surrender of money at the end of the fiscal year in an annual lapsable budget cycle due to a lack of effective program management in budget implementation, an absence of a hard budget constraint, and weak internal control and internal audit system are important weaknesses of the PFM system that limit fiscal discipline. While external audit in the country is well established and facilitates the legislature in exercising control over the executive, the process of scrutiny of the audit reports has deteriorated, adversely affecting its effectiveness.
- c. **Strategic Allocation of Resources.** Strategic resource allocation in India is affected by the lack of well-developed sector strategies based on government objectives, developing and costing of programs to achieve those objectives and linking the resource allocation to the priorities specified in sector strategies. Although the five year economic plans provide strategic resource allocations at an aggregate level, the five year plans and budgeting differ looking at their scope and time span. While plans provide a conceptual framework by focusing on various sectors in the economy, there are divergences between plan and budget in the resource mobilization and allocation and organizational structure. In the existing budgetary practice, the programs, referred to as schemes in Indian practice, are diffused and do not provide a comprehensive perspective as to their link with government policy objectives. The cash basis of accounting followed by the government does not have the capacity to reveal the full outlays either on a program or a project. In the existing budgeting system, performance is not included to improve strategic resource allocation.

- d. **Efficient Service Delivery.** In the federal arrangement the sub-national governments have wide ranging responsibilities with regard to service delivery. The central government, however, intervenes in the state subjects through specially designed central schemes to improve the front line service delivery. The role of central government in contributing to efficient service delivery through effective monitoring of transfers to implementing agencies, providing guidance through policy measures and evaluating the performance in these services become important. The overall financial management system including the efficient revenue collection, expenditure control, cash and debt management to address liquidity problems, and the efficient intergovernmental transfer system are all important elements to facilitate better program management and service delivery.
- e. **Prospects for Reform Planning and Implementation.** The institutional arrangement within the government provides support to initiate reform planning and implementation processes. The initiatives taken by the government in recent years has put PFM issues at the forefront. The role of PFM systems in contributing to fiscal discipline, strategic resource allocation through better program management and improving service delivery has gained attention in recent years. The government policies in expanding social sector spending has made it necessary to look at ways to improve program management and actual service delivery. Attention is being given to improve the PFM systems and processes including planning for budgeting, budgeting process, resource management, internal control and audit, accounting and reporting and external audit. The government has appointed important study groups to examine various aspects of PFM systems and to recommend reform measures. A comprehensive view needs to be taken to strengthen the financial management systems in the country, as it will be difficult to deliver through isolated reform initiatives.

E. State Issues

- 9. Since the World Bank Fiscal Accountability Assessment Report of November 2005, the Government of Rajasthan has taken the following initiatives:
 - a. prepared and adopted a revised budget manual in the year 2012-13;
 - b. amended the General and Financial & Accounting Rules in the year 2012-13;
 - c. introduced new Integrated Financial Management System (IFMS) since May 2011 across the state. More details of this are given below;
 - d. converted the manual budget preparation to computerized online budget preparation;
 - e. disclosure of information on all receipts and expenditure relating to programs and schemes executed through GOR entities;
 - f. sub-treasuries connected with treasuries electronically and on an online basis;
 - g. initiated steps to maintain a time series analysis of trends in monthly revenue and expenditure (through IFMS) to support better cash management;
 - h. enhanced fiscal transparency by providing public access to financial information on state budgets and performance on annual basis on the website of state government;
 - i. enable regular reconciliation of departmental figures with the books of

- j. Accountant General (Accounts and Entitlement) every month through IFMS; and initiated steps to clear the audit observations of CAG by requesting the concerned departments to submit compliance and action taken reports.

10. **Integrated Financial Management System.** The GOR has initiated web based solution, i.e., IFMS for complete government financial accounting. It includes budget planning, estimates preparations, distribution/ allocation and fund management, treasury functions, etc. IFMS has been conceptualized to address the shortcomings of earlier offline computerization pertaining to budget processes and treasury functions. Though the treasuries in the state (39 Treasuries and 222 sub Treasuries) were already using computers for scrutinizing and passing of bills for compilation of accounts, however, with IFMS, they are having all their functions online from 1 May 2011. As a paradigm shift in the GOR payment system, electronic payment has been introduced. The GOR has shifted all payments including salary payments on electronic mode. All employees, service providers, vendors, third parties are getting payments directly in their accounts.

11. Treasury module developed under IFMS covers all functions of treasuries like:
- a. online bill submission;
 - b. online bill passing;
 - c. online authorization of bills;
 - d. electronic payment of all government transactions;
 - e. online bank scrolls;
 - f. automatic generation of treasury voucher numbers;
 - g. monthly accounts compilation;
 - h. online submission of monthly accounts to Accountant General, Rajasthan;
 - i. reconciliation facility at the level of Drawing and Disbursing Officers (DDOs) and treasuries;
 - j. stamps management;
 - k. civil pension process;
 - l. social security pension;
 - m. public deposit accounts management;
 - n. payroll management; and
 - o. e-treasury system for online tax and revenue receipts

12. With a view to ensure faster remittances, the GOR has started online bill submission system wherein all DDOs are submitting online bills along with physical bills to treasuries and sub-treasuries for all government transactions. Treasuries are making online payments through agency banks directly in the bank account of beneficiaries. In this process all bills pertaining to electricity, telephone, etc., are also being paid electronically. Treasuries are making book transfers for water supply bills and income tax deductions. Various reports are being provided to DDOs on transaction basis. They can easily see their payment and receipt detail on the system and can reconcile with treasuries and sub-treasuries. Similarly payment reports have been provided to service providers.

13. **e-GRAS (Government Receipt Accounting System).** GOR has introduced e-GRAS for the purpose of online receipts. The main objective of e-GRAS is to facilitate taxpayer convenience in many ways including anywhere any time payment, extended time and a choice of banks. Similarly it is a place where all proper electronic accounting and reconciliation process can be maintained on real time basis. In the e-payment of taxes there is no direct customer interaction at the bank counter and hence no paper challan from the tax payer is required. The internet banking system captures the challan details for all e-receipts in the prescribed

templates. Since the challan details are being electronically captured, the e-challan data is being provided by the bank to the e-treasury for faster remittance of revenues to Government Account. This also facilitates reconciliation with the Banks/Department/Treasury because detailed accounting can be done based on the classifications appearing in the e-challans. All physical challans will also be captured on electronic mode through the system. e-GRAS system provides facility for generating challans through its site.

14. **E-Treasury.** The concept of e-treasury is based on trouble free tax collection and paperless accounting/reconciliation at one point for the state government. The e-treasury provides e-payment facility as well as the e-reconciliation facility for all online tax revenue of state government at single point. The e-treasury gets digitally signed e-scrolls on a day-to-day basis. Reconciliation of the gross monthly e-receipts with gross amount shown (head wise) in the Statement of e-receipts as sent by banks is done. This reconciled e-account is being submitted to Accountant General electronically from e-treasury. E-treasury functions under the supervision of Finance Department. Revenue refund is being handled by respective treasury and sub-treasury as per prevailing practices. Manual payments are being handled by the respective treasury and sub-treasuries.

15. Significant audit observations in the CAG audit report for the financial year 2011-12 on the state finances are as below:

- a. The actual revenue receipts and revenue expenditure increased by 9% and 3%, respectively as compared to the budget estimates for 2011-12. Resultantly, the revenue surplus showed an increase of Rs3,004 crore as compared to the budget estimates. The estimated primary deficit also turned into primary surplus. The actual fiscal deficit declined from the budget estimate by Rs4,437 crore; deficit was 1% of gross state domestic product (GSDP) as against 2.4% of budget estimates.
- b. The capital expenditure increased by 36% over the previous year and it was 17% lower than that projected in Medium Term Fiscal Policy Statement (MTFPS) for 2011-12. The progressive capital expenditure at the end of March 2012 includes Rs7,993 crore (11.7%) blocked on 160 incomplete projects. Government should give adequate priority to capital expenditure and should formulate guidelines for early completion of incomplete projects to avoid time and cost overruns with a view to take corrective action.
- c. During the year 2011-12, the state's revenue receipts showed an increase of 24.1% over the previous year. The state's revenue receipts as a percentage of GSDP marginally declined from 15.8% in 2007-08 to 15.5% in 2011-12. Government should mobilize additional resources through tax and non-tax revenue by expanding the tax base and rationalizing the user charges.
- d. During 2011-12, the revenue expenditure constituted 87% of the total expenditure while the non-plan revenue expenditure constituted 77% of revenue expenditure. Nearly 58% of the revenue receipts of the state was spent on committed expenditure. There is a necessity to contain the committed expenditure.
- e. The State had a huge surplus cash balance of Rs9,785 crore. Since, maintaining huge idle cash balance is not prudent cash management, appropriate steps

should be taken for spending on capital projects for creation of assets.

- f. During 2011-12, there was an overall saving of Rs6,537.27 crore over the total grants and appropriations indicating inaccurate budgeting. In all 55 grants/appropriations, 93% of total savings was surrendered on the last working day of the financial year leaving no scope for utilizing these funds for other development purposes. In 79 cases, lump sum provision of Rs1,742.31 crore was made violating provisions of State Budget Manual (SBM). Of this, 90% remained unutilized. Rush of expenditure at the end of the year is another chronic feature, which indicates weak budgetary control.
- g. Departments should submit more realistic budget estimates keeping in view the trends in expenditure and actual requirement of funds. Budgetary controls should be strictly observed. Anticipated savings should be surrendered well in time so that the funds are utilized for various development programs.
- h. Expenditure on New Service should be met from contingency fund and bear approval of the legislature. Functioning of treasuries should be monitored to avoid their deficient functioning.
- i. State government's compliance with various rules, procedures and directives was unsatisfactory as evident from delays in furnishing utilization certificates against the loans and grants, from various grantee institutions. Annual accounts in respect of 131 Autonomous Bodies/ Authorities for the year 2010-11 have not been received up to 31 March 2012. There were instances of losses and misappropriations of Government money amounting to Rs44.07 crore as of 31 March 2012. Departmental enquiries in such cases should be expedited to bring the defaulters to book.
- j. Internal controls in all the organizations should be strengthened to prevent recurrence of such cases in future. The Controlling Officers did not submit the Detailed Contingent Bills in respect of Rs62.70 crore against the advances drawn on 441 Abstract Contingent Bills up to 31 March 2012. Besides, unspent balance of Rs2,016.65 crore was lying in 1,877 Personal Deposit Accounts.
- k. A rigorous monitoring mechanism should be put in place by the DDOs to adjust the abstract contingent bills in time and maintain the PD Accounts properly, as required under the extant rules. Significant amounts of expenditure (Rs6,889.20 crore) and receipts (Rs2,030.32 crore) under Central and State schemes, booked under the Minor head '800-Other expenditure/other receipts' were not depicted in the appropriate head of account in Finance Accounts of 2011-12, affecting the transparency in financial reporting. Amounts received and expended under various schemes should be depicted distinctly in the State Accounts instead of clubbing those under the Minor head '800'.

F. Risk Analysis

16. The risk assessment is based on existing circumstances, staffing and procedures.
17. Inherent Risk is the susceptibility of the project financial management system to factors arising from the environment in which it operates, such as country rules and

regulations and entity working environment (assuming absence of any counter checks or internal control.

Table 1: Financial Management Internal Control and Risk Assessment

Risk	Risk Assessment	Risk Mitigation Measures
1. Country-Specific	Low	Not applicable.
2. Entity-Specific	Moderate	Currently, revenue generating operations (e.g., water supply) at the ULB level are not with the ULB but with PHED. Water supply distribution is proposed to be transferred to ULBs. The project requires ring fencing of water supply accounts as key performance criteria and tariff revisions at regular intervals.
3. Project-Specific	Low	Financial absorption capacity model of ULBs requires them to increase the level of Urban Development tax and increase tariff of revenue generating services (e.g., water supply). If revenues are not increased significantly and sustained then it will be difficult for ULBs to properly operate and maintain new investments. The competences and experience of EA and IA financial staff in computerized accounting and reporting systems are limited. Intensified FM training program is clearly required. It also applies for related MIS & Control systems. The project will invest in capacity support to enhance municipal financial systems through a performance based approach to incentivize governance improvements
Overall Inherent Risk	Low	

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

Risk Type	Risk Description	Risk Assessment	Proposed Mitigation
1. Executing Entity	RUIDP's Finance Section will be responsible for project FM, accounting and reporting. RUIDP will continue to follow project FM and accounting systems. RUIDP staff has donor project management experience, including ADB.	Low	Not applicable
2. Funds Flow	RUIDP will manage overall project funds. Direct payments by ADB may be used for all major contracts. A project imprest account will be used to cover other payments. RUIDP will have its own project	Low	Not applicable

Risk Type	Risk Description	Risk Assessment	Proposed Mitigation
	account.		
3. Staffing	RUIDP Finance Sections are adequately staffed with competent and experienced personnel. The Sections provide professional quality service. One qualified Chartered Accountant with minimum of five year experience and for Phase III – three Accounts Officers and five Accountants are proposed to be inducted into existing Finance and Accounts section of RUIDP	Moderate	RUIDP to induct one qualified chartered accountant and other proposed staff for RUSDP
4. Accounting Policies and Procedures	Policies and procedures are well documented. RUIDP uses GOR accounting standards.	Low	Not applicable
5. Internal Audit	RUIDP has no internal audit cell.	Substantial	RUIDP to appoint an Internal Auditor for ensuring compliance of rules and regulations
6. External Audit	CAG has constitutional mandate to conduct external audits of donor funded projects. Annual audit reports are typically produced within 6 months of the end of the financial year. Compliance reports are prepared and submitted in response to audit findings (paras) for disposal of the same.	Moderate	RUIDP to prepare an action plan for resolving of outstanding audit paras.
7. Reporting and Monitoring	Comprehensive monthly and quarterly FM reporting systems are in place. Routine reports are produced from the Accounting System – others are prepared on spreadsheets with figures extracted from the accounting system.	Low	Not Applicable
8. Information Systems	RUIDP's accounts are computerized under the Tally Accounting Software system.	Low	Not applicable
9. Overall Control Risk	RUIDP's financial management practices and procedures are considered to be adequate for management and control of project finances and project funds will be managed and audited separately from other funds.	Moderate	With the above mitigation measures the overall risk is assessed as moderate

G. Project FM System: Strengths and Weaknesses

19. **Strengths.** The main strength of the existing project FM is that RUIDP has significant experience over the last thirteen years in financial management of ADB funded projects. However, this experience has not always translated into effective financial management.

20. **Weaknesses.** Some of the major weaknesses listed below apply to RUIDP and ULBs.

Significant Weaknesses	Resolution
<p>Capacity: ULBs staff are trained in the government accounting system which is cash based. Though training has been provided to ULB staff in the double entry accounting system, maintenance of accounts under the double entry accounting system is outsourced to a qualified chartered accountant on yearly contract basis in all the ULBs excepting Bhilwara.</p>	<p>Training of staff of ULBs in double entry accounting system software to be developed and installed by Director, Local Bodies uniformly across ULBs.</p>
<p>Software: All ULBs have expressed that DLB should develop an accounting software and implement the same uniformly across all ULBs.</p> <p>In addition to proposed positions in PMU and PIUs, vacant positions in ULBs should be filled up and trained.</p>	<p>Training of staff of PIUs in Project Accounting Software and ADB procedures.</p> <p>Induction of qualified chartered accountant with five years' minimum experience at each ULB.</p> <p>Filling up of vacant positions at ULBs</p> <p>Induction of proposed staff at RUIDP and PIUs for RUSDP.</p>
<p>Accountability. There is no internal audit cell in RUIDP. No internal audit is being done at RUIDP.</p>	<p>Introduction of internal audit at RUIDP</p> <p>Resolution of audit funding paras of both Local Fund Audit Department audit and CAG audit</p>

H. Implementing Entity

21. The organization structure envisaged to manage and oversee project implementation has been designed to encourage accountability and minimize corruption risks. An inter-departmental project empowered committee at state level will provide overall policy guidance and oversight to the project. The committee will include key government stakeholders.² LGSD/RUIDP is the executing agency/implementing agency for the project. The Project Director, RUIDP who heads the PMU, will provide coordination of the project. RUIDP would establish one PIU for each of the ULBs where the project is implemented.

² Please refer to PAM for full list of Empowered Committee members.

22. The PMU will tender and manage all contracts. The PMU will also engage all consultants under the project, being (i) Design and Supervision Consultants, (ii) Project Management Consultants, and (iii) Institutional Strengthening and Awareness Building Consultants.

23. RUIDP will have treasury payment operating system as at present and the PIUs will receive the funds and release the payment to the contractor

24. Government procedures and documentation will be used in all implementation stages. In addition to direct implementation roles, consultants will build capacity in key technical and management functions by training PMU and PIU staff.

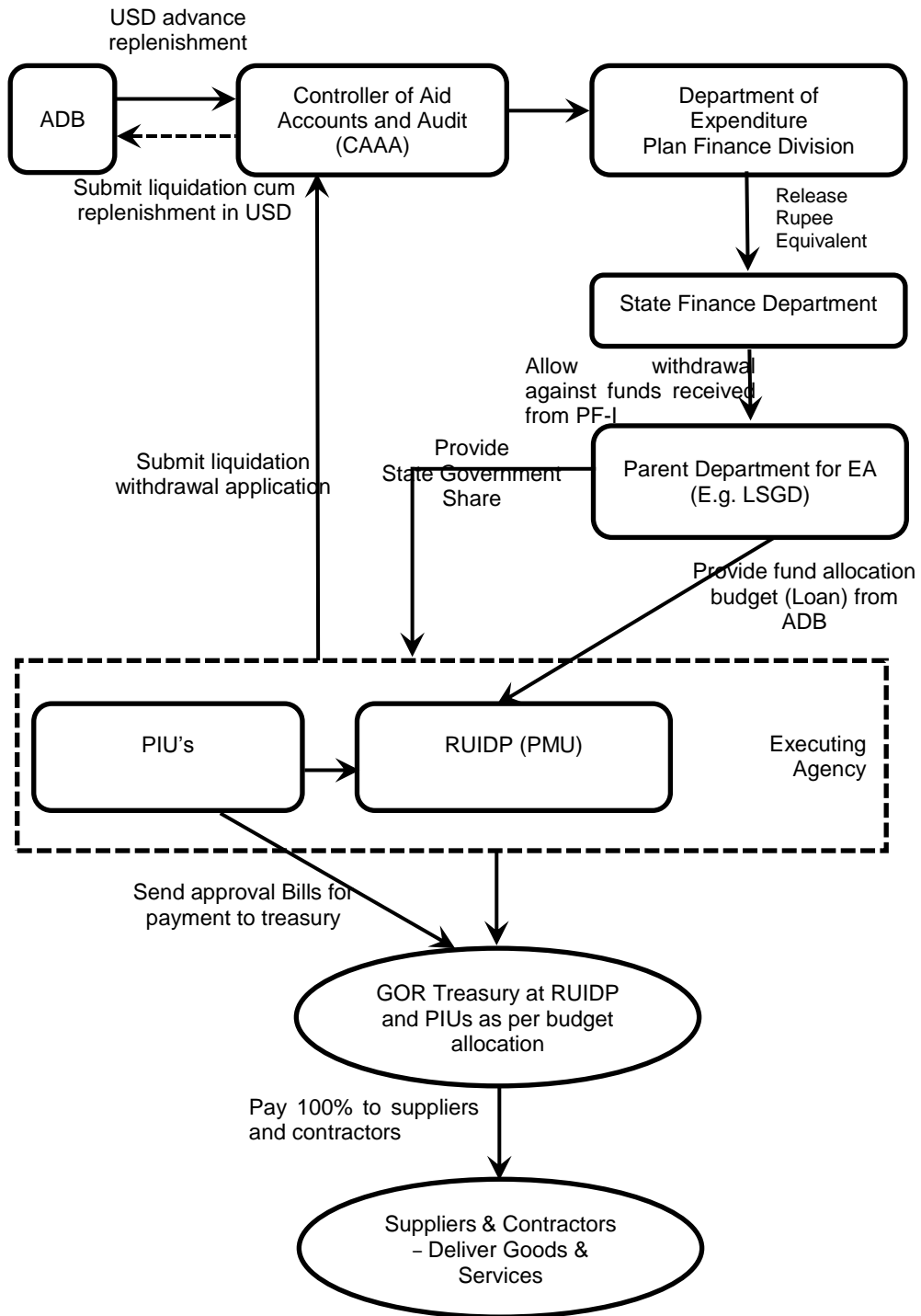
I. Funds Flow mechanism

25. The project specific fund flow mechanism is illustrated below. The government will be responsible for implementing the project according to the loan agreement and other agreements. ADB will monitor the project and review its progress to ensure that loan proceeds are spent as previously agreed. When a loan becomes effective, a loan account will be opened in ADB's books in the name of the borrower and the loan amount is credited to that account. All disbursements under the loan will be carried out in accordance with ADB's Loan Disbursement Handbook (2012, as amended from time to time).³

26. ADB disburses loan proceeds to the government of India account in the Reserve Bank of India. The government of India will make funds available to GOR. GOR will be required to create budgetary provision and make the funds available to LSGD/RUIDP. RUIDP, as the PMU, will manage loan proceeds through direct payment procedures for major contracts – i.e., international competitive bidding (ICB) contracts. Other payments will be covered through statement of expenditure procedures and reimbursement procedures from project imprest accounts and/or through online treasury operations. The PIUs will receive allocation of funds from the RUIDP and PIUs will manage and pay for national competitive bidding (NCB) contracts through online treasury operations. Expenditures are consolidated and reviewed on a monthly basis by the RUIDP (with inputs from PIUs) and reimbursement claims are submitted to ADB for review and approval.

³ Available at: <http://www.adb.org/documents/loan-disbursement-handbook>.

FUND FLOW DIAGRAM



J. Personnel

27. The RUIDP (PMU), in addition to the existing staff, will have to induct one qualified chartered accountant with minimum of five years of experience, five accountants (as proposed) and three accounts officers to be attached with three Superintending Engineers office. PMU FM staff will be drawn from finance department, line agencies and contract employees as required.

28. PIU staff will need to be trained on ADB disbursement procedures, along with improving their budgeting, expenditure and financial reporting activities. RUIDP is to maintain separate project accounts and records exclusively for the Project to ensure that the loan funds are used only for the objectives set out in the Loan Agreements. The project accounts comprise the following:

- a. statement of accounting/financing policies;
- b. statement of income/cash receipts;
- c. statement of expenses/cash payments;
- d. cash flow statements;
- e. imprest account statement;
- f. statement of expenditures (SOE); and
- g. notes to the financial statements

K. Accounting Policies and Procedures

29. The first set of audited project financial statements (APFS) to be submitted to ADB covers the fiscal year ending 31 March 2015. As stipulated in the project agreement, the APFS are to be submitted up to six months after the end of the fiscal year.

30. The accounts and records for the project are to be consistently maintained by using sound accounting principles. External auditor has to express an opinion on whether the financial report has been prepared using international or local generally accepted accounting standards and whether they have been applied consistently.

31. **Statement of Accounting or Financial Policies.** Irrespective of whether the cash or accrual basis of accounting is used, a clear statement of the accounting or financial policies that form the basis of the accounting statements must be provided.

32. **Statement of Income (or Cash Receipt).** Shows the year's complete financial information, and cumulative data from project start up to date. Where the cash basis of accounting is followed, the opening and closing balances should be shown. ADB financing should be subdivided as follows when ADB disburses via SOE procedures: (a) by expenses category in the loan agreement, RRP, revisions thereto; b) disbursements via SOE; and c) other methods.

33. **Statement of Expenses (or Cash Payment).** Shows the financial year's information and cumulative totals from project start up-to the current date. Where the accrual basis of accounting is used, this statement will include non-cash items, such as depreciation.

34. **Cash Flow Statement.** The Cash Flow (or project funds) Statement should include:
- a. sources of project financing (e.g., ADB, Government contribution, etc.), and by methods of disbursement by ADB (e.g., direct payment, imprest account etc.);
 - b. uses of funds summarized under project disbursement categories as per the loan agreement (e.g., equipment, civil works, consultant services and training and “others” which will further be subdivided following start of project implementation);
 - c. the opening and closing cash balances; and
 - d. in accordance with IAS7, separate disclosure is required of funds that are not available for use, such as confirmed future commitments.
35. **Imprest Account Statement.** This statement summarizes ADB’s advances and replenishments, less amounts withdrawn by the EA, showing the remaining cash balance in the Imprest Account. Bank statements should be provided by each local bank that is selected to operate the imprest account, where these are in use for the project. Each bank statement should summarize the current year’s advances and replenishments, interest earned on balances, less withdrawals for project expenditures. The first account is used to receive money from ADB for the credit of the “Project Imprest Account” and the second may be used by the project for local operating purposes (“Second Generation Imprest Account” - SGIA). The Project Imprest Account is used to replenish the SGIA, when this is in use. It will be necessary to attach “Reconciliation Statements” to reflect in-transit items between ADB and Imprest Account and between Imprest Account and the SGIA (Replenishments made by ADB not yet received; and reimbursements to the SGIA from the Imprest Account not yet received by it). The third financial statement is a detailed statement of transactions of the Imprest Account’s Operating Account(s). This is to be generated by the EA, where the Imprest Account is used to make direct payments in local currency and foreign currency.
36. **Statement of Expenditure (SOE).** The SOE procedure is an ADB reimbursement procedure that does not require submission of supporting documentation. The SOE form should include certification, confirming existence of registration for mobilization and secured advances / deposits. The ADB Loan Disbursement Handbook describes the use of this method and associated reporting and auditing procedures.
37. **Income Statement and Balance Sheet.** These statements may not be necessary where cash accounting is used.
38. **Notes to Financial Statements.** EA should provide Notes to financial statements. These should be explanatory notes and/or supplementary financial statements that analyze or qualify important heads of account, or that present the information in conformity with generally accepted accounting principles of the country. For example, if Statements are prepared on a “cash basis”, information may be required from the EA to convert key items to an “obligation” or “accrual” basis and ADB, therefore, may seek details relating to obligations (unpaid commitments and accounts receivables) in supplementary statements. Similarly, details may also be required to distinguish between transactions relating to capital (development) investments and operating expenditures.
39. **Other Information.** Financial reports for a project, as per requirement of ADB, should illustrate both the performance in the fiscal year under review and accumulated

transactions from project commencement particularly with regard to sources of funds and expenditures for assets and inventories. Reporting practices in some government entities require only disclosure of annual financial transactions against annual budget authorizations. Therefore, in order to monitor performance from start up throughout the project's implementation period, the reported results of project transactions and financial performance data for previous fiscal years should be included as memorandum entries in the current year's statement of income (cash receipts) and statement of expenses (or cash payments). Alternatively, the reported results of prior years may be included in the annual financial statements as of the last day of the reporting fiscal year that summarizes and classifies all receipts and expenditures relating to the project from its commencement. In addition, the accumulated sources or provision of funds for the project in the ratio agreed upon between the borrower and ADB should be disclosed in the Notes to the financial statements.

40. Project financial statements shall be prepared to achieve maximum alignment with Cash-Basis International Public Sector Accounting Standards (IPSAS). The cash basis of accounting will be adopted, with additional disclosures.

L. Internal Audit

41. There is no internal audit done at RUIDP either in-house or by independent auditors. This should be initiated and be in place before the start of the Project.

M. External Audit

42. All state entities (including RUIDP and ULBs) are subject to external audit of the CAG of India. CAG reviews and comments on state entities' financial reporting and records on an annual basis and following Indian accounting and auditing rules. The external statutory Audit Report is required be submitted within six months from the end of each financial year.

43. In RUIDP, an independent chartered accountant empanelled with CAG is appointed to carry out the annual statutory audit. This audit has been completed up to 31 March 2013. Actions have been initiated to comply with audit findings with regard to the completion of fixed assets register, and project progress monitoring.

44. CAG's audit has been completed up to 31 March 2011 and the audit for the FY2012 and FY2013 is in progress. Number of outstanding audit issues (paras) till period up to FY 2011 are 94. Out of this, 29 audit paras relate to period April 2009 to March 2011. Compliance reports are prepared and submitted for disposal of audit paras and remedial actions taken.

45. The scope of the external audit includes:

- a. adequacy of the accounting and internal control systems,
- b. ability to maintain adequate documentation for transactions,
- c. eligibility of incurred expenditures,
- d. basis of estimates, and
- e. an opinion concerning the fairness of the accounts.

46. For the Project, one set of audited project financial statements shall be submitted by

the PMU to ADB annually within six months of the financial year end.

47. New formats for the project annual financial statements (PAFS) and audit reports as finalized and prescribed in joint consultation with CAG will be adopted for this Project. RUIDP has agreed to prepare the APFS in the new formats and also get the audit completed within six months of year end by the CAG.

N. Financial Reporting and Monitoring

48. Present system of consolidation of all financial information at RUIDP (PMU) is proposed to be continued in RUSDP as well. Accounting information is sought from each PIU in the prescribed formats on monthly basis.

49. Monthly accounting information is consolidated in RUIDP in "Tally" accounting software. After entering these data, expenditure details for the month, previous six months and cumulative up to the current month are generated and forwarded to the monitoring section.

50. This information is used by the monitoring section to prepare the package-wise details of physical and financial progress. Physical progress details are entered online in the software developed for Project Performance Monitoring System (PPMS) at PIU level. Physical and financial progress details are collated and a combined report is generated on quarterly basis by monitoring section.

51. Other reports as and when required are prepared in MS Excel using the information generated from PPMS and additional data collated through interactions with the PIUs and other staff.

O. Information Systems

52. Present information system is mostly automated. Accounting information is generated in computerized accounting software named "Tally".

53. PPMS maintained online at PMU and PIUs level through use of a customized software. Physical progress details are entered at PIUs and PMU. Physical and financial report provides the details, package wise, providing information inter alia on: a) package name; b) contractor's name; c) contract price; d) cumulative gross expenditure; e) last six months' financial progress; f) stipulate date of start and completion; g) likely date of completion; h) time lapsed; i) scope of work; j) cumulative achievement; and k) physical status as on the date of report.

54. Other reports as and when required are prepared using MS Excel and MS Office software.

55. For this project also the same system will be adopted.

P. Procurement Arrangements

56. RUIDP (PMU) and project PIUs need to comply with both government and ADB procurement rules and guidelines applicable for all procurements of goods, works, and services. The PMU and PIU will receive relevant training on ADB requirements.

57. Procurement of goods and services under government financing is conducted under the Rajasthan Transparency in Public Procurement Act, 2012 following a competitive bidding process.

58. Tenders for works and services follow a two-stage process of shortlisting by evaluating qualifications and capacity of interested bidders and with review of technical and financial positions of bids.

59. IA accountant will review the following financial issues related to procurement:

- a. whether the PPR has been followed
- b. suppliers' bills
- c. material receiving reports (MRR) from store keeper
- d. quantity/quality of materials in relation to specifications
- e. whether quality has been certified by concerned experts
- f. whether any earlier payments already have been made
- g. security deposits
- h. whether deductions at sources have been made (VAT-Taxes-IT)

Q. Disbursement Arrangements

60. The Loan proceeds will be disbursed in accordance with ADB's Loan Disbursement Handbook (2012, as amended from time to time), and detailed arrangements agreed upon between the Government and ADB. Pursuant to ADB's Safeguard Policy Statement (2009) (SPS)⁴, ADB funds may not be applied to the activities described on the ADB Prohibited Investment Activities List set forth at Appendix 5 of the SPS. All financial institutions will ensure that their investments are in compliance with applicable national laws and regulations and will apply the prohibited investment activities list to subprojects financed by ADB. The different financing and disbursement arrangement,⁵ i.e., direct payment by ADB, reimbursement, imprest fund procedures, liquidation and replenishment, SOEs, and any other special procedures will necessarily be in accordance with ADB guidelines and procedures.

61. RUIDP should submit to ADB annual contract awards and disbursement projections at least a month before the start of each calendar year. RUIDP is responsible for: (i) requesting budgetary allocations for counterpart funds, (ii) collecting supporting documents, and (iii) preparing and sending withdrawal applications to ADB.

62. The maximum ceiling of the imprest account(s) "in aggregate", will not at any time exceed the estimated ADB financed expenditures to be paid from the imprest account for the next 6 months or 10% of the respective loan amount, whichever is lower.

63. RUIDP has discontinued with the Second Generation Imprest Account (SGIA) since 1 April 2007. All project payments are being made through Online Treasury Operations. The SOE procedure will be adopted for reimbursing and liquidating the imprest accounts for eligible expenditures not exceeding \$100,000 per payment. SOE records should be maintained and made readily available for review by ADB's

⁴ Available at: <http://www.adb.org/site/safeguards/policy-statement>.

⁵ Available at: http://www.adb.org/documents/handbooks/loan_disbursement/chap-06.pdf.

disbursement and review mission or upon ADB's request for submission of supporting documents on a sampling basis, and for independent audit.⁶

64. Before the submission of the first withdrawal application, RUIDP should submit to ADB sufficient evidence of the authority of the person(s) who will sign the withdrawal applications on behalf of the borrower, together with the authenticated specimen signatures of each authorized person. The minimum value per withdrawal application is US\$100,000, unless otherwise approved by ADB. RUIDP is to consolidate claims to meet this limit for reimbursement and imprest account claims. Withdrawal applications and supporting documents will demonstrate, among other things that the goods, and/or services were produced in or from ADB members, and are eligible for ADB financing.

R. Financial Management Action Plan

65. Summary of the actions to be taken:

- a. Appoint one qualified chartered accountant in RUIDP
- b. Appoint three Accounts Officers and five Accountants in RUIDP for the RUSDP
- c. Appoint Internal auditor for RUIDP
- d. Audit of project financial statements in accordance with TORs agreed with the CAG, India
- e. Resolve all CAG audit paras by RUIDP.

⁶ 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.