

FINANCIAL MANAGEMENT ASSESSMENT REPORT

Project Number: 41076-048

**Philippines: Improving Growth Corridors in
Mindanao Road Sector Project**

EXECUTIVE SUMMARY

A. Project Description

1. The transport sector is a key sector in the Philippine economy, and the road subsector is the dominant subsector. An efficient road subsector is crucial for economic growth and poverty reduction in the Philippines. The Philippine road subsector faces several challenges, including underinvestment, inadequate financing of maintenance of existing infrastructure assets, governance, and a relatively weak institutional capacity of government sector agencies. In particular, Mindanao, being the second largest island, with a population of nearly 25 million has lagged behind its neighboring islands in terms of infrastructure thus contributing to a high rate of poverty incidence. The Project will assist the Government to address these issues, in cooperation with other development partners.

2. Investments under the project will be made in Mindanao. The main direct beneficiaries of the project will be road users and communities living in the areas of influence of the roads improved under the Project. Improved governance and stronger institutional capacity will benefit all road users in Mindanao and the Philippine economy in general.

3. The key outputs of the project are road improvement and institutional capacity development in the Department of Public Works and Highways (DPWH). The impact of the project will be improved mobility, connecting accessibility and safety, and reduced poverty in the project area. The outcome of the project is that transport on and investment in the national road network will become more efficient. The increased efficiency will be measured by reductions in travel time, vehicle operating costs, and road accident rates; improvements in the road surface condition; and improvements in governance in the transport sector and in DPWH's assessment, communications and administration capabilities.

B. Implementation Arrangements

4. The Government of the Republic of the Philippines will be the borrower and will be responsible for the repayment of the Loan. The DPWH will be the executing agency. The Roads Management Cluster II (Multilateral) will be the project implementing office. The DPWH and Roads Management Cluster II (Multilateral) are wholly responsible for the implementation of the ADB-financed project, as agreed jointly between the borrower and ADB, and in accordance with the policies and procedures of the government and ADB. ADB staff is responsible for supporting implementation including compliance by DPWH and Roads Management Cluster II (Multilateral) of their obligations and responsibilities for project implementation in accordance with ADB's policies and procedures.

C. Financial Management Risk Assessment

5. Fiduciary risks of the loan are related to the limited experience of the DPWH with the use of imprest account procedure under ADB-funded projects. Internal control within the DPWH is also relatively weak as evidenced by several audit findings reflected in the recent Commission on Audit opinions on the entity financial statements and project financial statements for ADB-financed projects involving accounting errors and deficiencies. These risks are considered manageable as the loan will finance the engagement of an individual consultant who will be based in the DPWH to undertake the financial monitoring and reporting requirements for the loan at the executing agency.

D. Conclusion

6. The assessment indicates that with several risk mitigation measures in place, the executing agency and implementing agency's financial management system is acceptable for the proposed project. The disbursements will be carried out using the direct payment procedure for civil works and consultancy contracts and the imprest fund procedure for small expenditures. With the provision of consultant support to the executing agency and implementing agency involved in the loan, overall, DPWH can be considered as capable of implementing the loan, with the overall project financial management risk being assessed as moderate.

I. INTRODUCTION

1. This assessment was prepared in accordance with ADB's Financial Management Technical Guidance Note: Financial Management Assessment May 2015 (the Note). The Financial Management Assessment (FMA) of the Department of Public Works and Highways (DPWH) was undertaken from June 2015 to March 2016 by PADECO Co. Ltd. under the regional technical assistance for Promoting Sustainable Energy for All in Asia and the Pacific – Project Development and Investment Facilitation.¹ Preparation activities included: (i) interviews with staff of DPWH; (ii) submission to DPWH of an FMA Questionnaire, as per Appendix 2 of the Note; (iii) interviews with staff of the Project Management Office (PMO) of the on-going Philippines Road Improvement and Institutional Development Project (RIIDP); (iv) a review of ADB, RIIDP and other related project documentation; and (v) a review of ADB's on-going experience. A follow-up assessment was undertaken by the ADB staff consultant in May 2016. The assessment included reviewing documents, ADB's on-going experience and interviews with the staff of the DPWH.

II. BRIEF PROJECT DESCRIPTION

A. Project Outcome and Outputs

2. The impact of the project will be improved mobility, connecting accessibility and safety, and reduced poverty in the project area. The outcome of the project is that transport on and investment in the national road network will become more efficient. The increased efficiency will be measured by reductions in travel time, vehicle operating costs, and road accident rates; improvements in the road surface condition; and improvements in governance in the transport sector and in DPWH's assessment, communications and administration capabilities.

1. Road Improvement

3. Under the project, road improvement will be carried out on about 300 km of national roads. These roads are mostly located in Western Mindanao. The roads proposed for inclusion in the project were selected through a prioritization exercise carried out by the project preparatory technical assistance (PPTA) consultants in collaboration with the Department of Public Works and Highways (DPWH). The selection was based on acceptable economic return and minimization of safeguard issues. The roads selected for the project are part of a major effort to improve the national road network and are part of a much larger group of roads chosen for improvement by donors including the World Bank and Japan International Cooperation Agency (JICA). Three roads sections identified by the PPTA consultants were termed the "core roads" based on the criteria on economic return and safeguards minimization and are shown in Table 1. There are other "non-core" subprojects that may be included in the project after they pass the basic criteria agreed upon by DPWH and ADB.

¹ ADB.2015. *Technical Assistance for Promoting Sustainable Energy for All in Asia and the Pacific – Project Development and Investment Facilitation (Subproject D) into Regional Cooperation*. Manila. (TA 8954-REG).

Table 1: List of Core Road Projects

Name of Road	Province	Length (Kms)
PR06 Alicia - Malangas	ZamboangaSibugay	23
PR07 Tampisilan – Sindayong	Zamboanga del Norte	17
PR09 Lutiman - Guicam	ZamboangaSibugay	37

2. Institutional Capacity Development

4. A key output of the Project will be institutional capacity development (ICD) in DPWH. Strengthening of DPWH's institutional capacity will take place in regional offices and in headquarters. Training in multi-year planning carried out exclusively in DPWH regional offices, while the new human resource database system integrating all DPWH operations will be made operational in all DPWH offices. Making the new online system for budgeting and fiscal monitoring operational and the provision of support in supervising regional planning will take place in DPWH headquarters. To ensure that the investment in the new systems is sustainable, the project will provide operational training to DPWH staff.

3. Detailed Design

5. The Project also includes preparation of detailed engineering design of approximately 300 km of roads proposed to be improved as part of future projects to be proposed for ADB financing for road improvement. Feasibility studies will be performed on the road through a new PPTA.

III. IMPLEMENTATION ARRANGEMENTS

A. Executing and Implementing Agencies

6. The Government of the Republic of the Philippines will be the borrower and will be responsible for the repayment of the Loan. The DPWH will be the executing agency. The Roads Management Cluster II (Multilateral) will be the project implementing office. The DPWH and Roads Management Cluster II (Multilateral) are wholly responsible for the implementation of the ADB-financed project, as agreed jointly between the borrower and ADB, and in accordance with the policies and procedures of the government and ADB. ADB staff is responsible for supporting implementation including compliance by DPWH and Roads Management Cluster II (Multilateral) of their obligations and responsibilities for project implementation in accordance with ADB's policies and procedures.

7. The project is expected to be implemented from 2018 to 2022. Advance action to recruit the consultants will be carried out between October to December 2017. Project preparation activities will be carried out from loan effectiveness to the end of 2022.

B. Project Implementation Organizations–Roles and Responsibilities

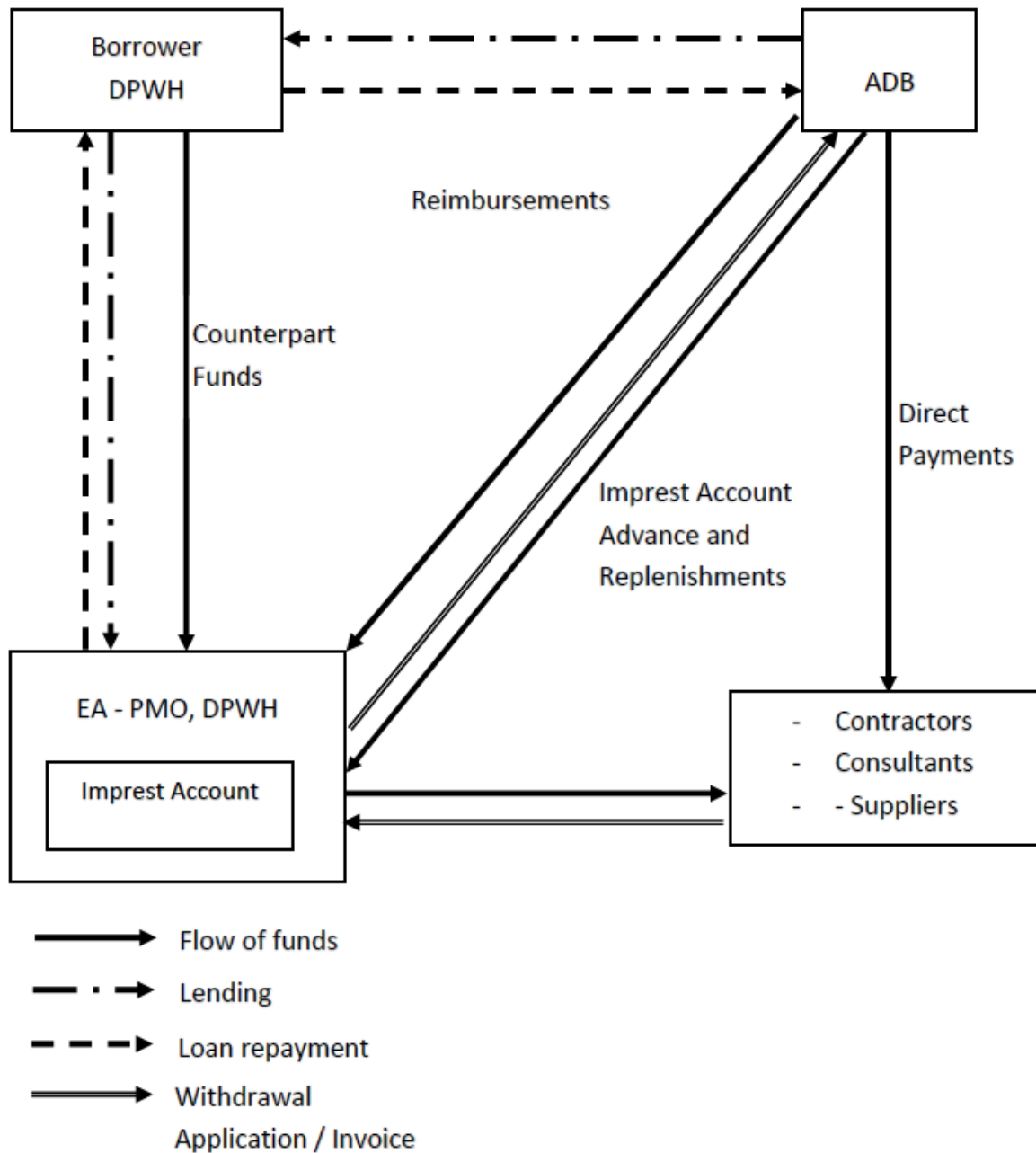
8. Stakeholders' roles and responsibilities in the loan are presented below.

Project Implementation Organizations	Management Roles and Responsibilities
Department of Public Works and Highways	<ul style="list-style-type: none"> ➤ Executing agency ➤ Approve procurement plans, procurement actions such as bid evaluation and contract awards ➤ Approve working drawings, design documents, engineering designs and cost estimates. ➤ Carry out consultant selections for detailed design and construction supervision consultants ➤ Procure civil works contracts ➤ Obtain necessary environmental approval(s) from Department of Environment and Natural Resources (DENR) and other relevant agencies/organizations prior to award of civil works contracts
Roads Management Cluster II (Multilateral)	<ul style="list-style-type: none"> ➤ Project implementing office ➤ Ensure that project implementation complies with Government environmental policies and regulations, ADB safeguard policy and provisions of the environmental management plan(EMP) included in the initial environmental examinations(IEEs) cleared by ADB. ➤ Ensure that environmental protection and mitigation measures in the EMP are incorporated in the detailed design, included in bid documents, implemented and monitored ➤ Submit disbursement projections, request budgetary allocations for counterpart funds, ➤ Ensure compliance with Government policies and loan covenants
ADB	<ul style="list-style-type: none"> ➤ Provides financing ➤ Project preparation ➤ Implementation monitoring

C. Funds Flow

9. The funds flow mechanism of the project is given in Figure 1 with: (i) ADB loan proceeds disbursed through the direct payment procedure for civil works and consultancy contracts and the imprest fund procedure for small expenditures and (ii) Government counterpart payments disbursed through Authorized Government Depository Banks.

Figure 1: Funds Flow Arrangements – DPWH Project



D. Disbursement Arrangements

10. The loan proceeds will be disbursed in accordance with ADB's *Loan Disbursement Handbook* (2015, as amended from time to time), and detailed arrangements agreed upon between the Government and ADB. The DPWH will maintain separate accounts and records for the loan. Project staff will avail of the ADB's disbursement training to help ensure efficient disbursement and fiduciary control.

11. The DPWH will be the budget user and will be responsible for managing the payment for all goods and consultant services procured under the loan.

12. The loan will use the direct payment procedure for civil works and consultancy contracts and the imprest fund procedure for small expenditures. The payments to the consultants will be made directly by ADB, based on the payment requests of the DPWH (in the form of withdrawal applications along with the necessary supporting documents) submitted to the ADB. The Government will cover the tax share of the consultant contracts through payment to the consultants or through other allowed means in line with the Philippine taxation framework.

13. Before the submission of the first withdrawal application request, the borrower will submit to ADB sufficient evidence of the authority of the persons who will sign the withdrawal applications on behalf of the borrower, together with the authenticated specimen signatures of each authorized person.

14. The PMU will be responsible for preparing the annual contract awards and disbursement projections; requesting budgetary allocations for counterpart funds, preparing of withdrawal applications, and sending the withdrawal applications to ADB. The PMU is responsible for collecting and maintaining supporting documents for the project expenditures they have incurred. The PMU shall submit regular financial reports to the executing agency for consolidation and submission to ADB.

IV. COUNTRY FINANCIAL MANAGEMENT ASSESSMENT

A. Overview

15. The Public Financial Management and Accountability Assessment of the Republic of the Philippines (June 2016) is embodied in the Public Expenditure and Financial Accountability (PEFA) performance assessment report. The PEFA performance assessment report evaluated the seven core pillars of the public financial management (PFM) system of the Government of the Philippines. The results indicate that transparency, policy-based budgeting, and asset and liability management are strong; predictability and control in budget execution are evenly balanced while budget reliability, accounting and reporting and external scrutiny are weak. Good performance at the beginning of the budget cycle in policy-based budgeting and transparency are not supported by the accounting and external scrutiny elements of the budget cycle leading to poor performance in budget reliability. The lack of capacity of the accounting system to assist budget managers with timely information is a primary cause of the poor results. The continued development of a comprehensive, integrated accounting and financial information system would enhance efficiency in budget execution and effectiveness in service delivery.²

16. The following main concerns will need to be addressed to improve the delivery of budget outcomes:

- i) Fiscal discipline – There are failures and delays in budget execution and accounting systems. They hamper budget delivery.

² Republic of the Philippines PFM Strategy Implementation Support Public (Financial Management and Accountability Assessment). *International Bank for Reconstruction and Development/The World Bank*. June 2016.

- ii) Resource allocation – A financial management information system is still in development. Budget allocations increased despite the limited absorptive capacity of executing departments.
- iii) Service delivery – Inadequacies in internal control exist while financial reporting and oversight are inadequate in terms of providing assurance of service delivery.³

B. Integrated Assessment of PFM Performance

1. Budget reliability

17. At the overall level, aggregate revenue prediction proved to be reliable but not for individual taxes. There was under-performance in collections of taxes on goods and services and taxes on income, profit and capital gains. Budget reliability at the overall level was reasonable although the difference between allotments and obligations incurred increased from 2012 to 2014. Expenditure outturn by function and by economic type varied substantially from budget. Using continuing appropriations that are difficult to identify separately in the accounting system reduces the clarity of the budget since the remaining expenditures are not disaggregated between those covered by current year appropriations and those incurred against continuing appropriations from previous years.⁴

2. Transparency of Public Finances

18. Information on public financial management is comprehensive, consistent and accessible to others and is characterized by the following: comprehensive budget classification, transparency of all government revenue and expenditures, publication of information on service delivery performance and ready public access to fiscal and budget documentation. The Unified Accounts Code Structure was initiated in 2014. This is a major step toward a classification system to track transactions through the budget cycle which is according to the Government Finance Statistics / Classification of the Functions of Government standards. Reporting by agencies is not fully compliant with the new system. The budget documentation provided to the legislature is comprehensive.⁵

19. The lack of an integrated computerized system contributes to the difficulty in consolidating and reporting information in a timely manner. Reconciliations between the records of the recipient unit and the downloading entity are often delayed. The Government makes available to the public information on government fiscal plans, positions and performance. However, the desired timeframes for in-year and annual budget execution reports are not met.⁶

3. Management of Assets and Liabilities

20. The annual audited reports of national government agencies, government-owned or-controlled corporations and local government units are published on a reasonably timely basis. Policies and procedures are in place. However, audits show that these are not implemented as evidenced by the absence of updated and reconciled asset registers. The procedures for

³ Ibid.

⁴ Ibid.

⁵ Ibid.

⁶ Ibid.

competitive and transparent sale, transfer or disposal of non-financial assets are in place and are implemented. Debt management practices are effective.⁷

4. Policy-based Fiscal Strategy and Budgeting

21. The fiscal strategy and the budget are prepared based on government fiscal policies, strategic plans, and adequate macroeconomic and fiscal projections. Procedures for the legislative review of the budget are adequately implemented. However, mid-year and year-end reports on the progress of fiscal strategy are not submitted to the legislature.⁸

5. Predictability and Control in Budget Execution

22. Administrative and accounting procedures for revenue are effective. The system allows spending agencies to receive reliable information on the availability of funds. Controls over procurement, payroll expenditures, and non-salary expenditures are weak. The current processes need to be improved: internal controls over changes in personnel records and payroll, procurement monitoring, use of competitive procurement methods, public access to procurement information, expenditure commitment controls, payment controls, and timeliness and reporting of internal audit results. Internal audit programs are delayed. Management actions to address the concerns raised by the auditors are also delayed.⁹

6. Accounting and Reporting

23. Accounting systems and processes did not rate well. Financial data integrity processes and in-year budget reporting require substantial improvement. Basic processes such as the reconciliation of bank accounts and the proper and timely liquidation of cash advances are not properly implemented. Most financial reporting is compiled through spreadsheets which do not have the necessary controls to assure data integrity. There is a need for a comprehensive accounting system. The electronic New Government Accounting System provides computerized accounting solutions and has been rolled out to many agencies and is undergoing development and updating. Majority of the agency financial statements were issued qualified opinions by the Commission on Audit (COA). This makes it difficult to determine the reliability of the financial statements.¹⁰

7. External Scrutiny and Audit

24. The COA independently reviews and reports on public finances. External audit arrangements are satisfactory. Despite a strong external audit performance, there is the absence of a complete revenue audit. There is no Public Accounts Committee to follow up on the implementation of the audit recommendations. This functions fall on the head of the government agency. Generally, there is a formal management response to the audit recommendations and actions are taken on a majority of the recommendations.¹¹

⁷ Ibid.

⁸ Ibid.

⁹ Ibid.

¹⁰ Ibid.

¹¹ Ibid.

C. PFM Strengths and Weaknesses

1. Aggregate Fiscal Discipline

25. Compliance and fiscal discipline at the component level are inadequate. Aggregate expenditure outturn and expenditure composition outturn were rated poorly. There is a need for better information systems to support control and provide budget reliability. Aggregate revenue outturn was rated highly while revenue composition outturn was rated poorly due to problems with the collection of individual taxes which do not match targets. Financial data integrity, timing of in-year budget reports and annual financial reports were rated poorly. There is a need for improvement in the accounting system to ensure proper audit trails and reconciliations. Consolidation of cash balances was rated poorly since Official Development Assistance and trust funds have not have been incorporated in the consolidated cash balances. Payroll controls and non-salary expenditure controls are in place but are not providing sufficient control. External audit was rated medium to poor due to the deficiency in the audit of tax revenue. There is no legislative scrutiny of audit reports since no entity is assigned the function of scrutinizing the audit reports and ensuring that audit recommendations are implemented.¹²

2. Strategic Allocation of Resources

26. There is a strong budget development process which allows the setting of expenditure priorities in accordance with government objectives. However, program allocations are not satisfactorily implemented due to defects in in-year budget execution. Expenditure composition outturn was rated poorly since the final year-end result did not deliver the resource allocation intended at the beginning of the year. The weak scores in accounting and reporting indicate absence of tools that allow budget managers to monitor and manage their budgets. Fiscal risks, assets and liabilities are well managed.¹³

3. Efficient Service Delivery

27. There is a strong and effective budget development process. However, the budget is not executed in accordance with the plans. The budget execution fails at the aggregate level and the component level. Expenditure composition outturn is not functioning effectively. Transparency of information on public finances is rated well. Policy-based budgeting with a multi-year perspective provides a sound basis for the budget. Internal audit and external audit arrangements are in place but there is insufficient response to prevent continuing internal control deficiencies. In the area of procurement management, there is a need for a more stringent use of competition and for an independent review of complaints to ensure delivery of services at desired cost and quality.¹⁴

D. Recent and On-going Reform Initiatives to Improve PFM Performance

28. The Government of the Philippines pursues PFM reform through the following: (a) PFM Reform Roadmap; (b) Good Governance and Anti-Corruption Cluster Plan and (c) several stand-alone initiatives.

¹² Ibid.

¹³ Ibid.

¹⁴ Ibid.

1. The Updated PFM Reform Roadmap (2015–2016)

29. The updated PFM Reform Roadmap aims for the following reforms:

- i) **PFM Framework Law.** This is meant to institutionalize the reforms, strengthen the oversight function and clarify the budget and fiscal administration rules and processes. The PFM Framework Bill was crafted in 2014 and was filed both in the Senate and House in 2015;
- ii) **Government Comptroller General.** This function will oversee compliance with existing PFM rules and regulations. The office will also consolidate government-wide financial statements;
- iii) **Strengthening performance orientation of budget preparation and management.** This involves strengthening the medium-term budget and the monitoring and evaluation systems and the shift to a Program Expenditure Classification Budget Structure with appropriate performance indicators and targets; and
- iv) **PFM certificate program.** The Government has developed a PFM Competency Framework that lays out the necessary skills, knowledge, attitudes that must be developed in public financial managers. This was followed by a rollout of a PFM Certification Course and efforts to build a PFM Institute under the Department of Budget and Management to serve as the permanent body for PFM-related training and certification.¹⁵

2. The Good Governance and Anti-Corruption Cabinet Cluster Action Plan 2013-2016

30. The Good Governance and Anti-Corruption Cabinet Cluster Action Plan 2013–2016 includes several PFM-related activities:

- i) **Civil Society Organization (CSO) engagement in the National Budget Process.** Policy consultations regarding participatory budgeting and the drafting of guidelines on CSO accreditation and release of funds to CSOs are ongoing;
- ii) **Budget and Treasury Management System.** This is being developed for the operations of the Department of Budget and Management and the Bureau of Treasury;
- iii) **Comprehensive Human Resource Information System and National Payroll System.** This involves the updating of the Government Manpower Information System;
- iv) **Local Government Unit (LGU) PFM Project.** This involves the implementation of an LGU PFM improvement plan as a precondition for accessing funds through bottom-up budgeting and other national government assistance programs;

¹⁵ Ibid.

- v) **Open Data.** The Department of Budget and Management improved transparency by making the Government budget and other documents available online;
- vi) **Bottom-up budgeting.** Municipalities will be involved in preparing community-level poverty reduction plans which are funded by the budget; and
- vii) **Philippine Government Electronic Procurement System (PhilGEPS).** The system requirement study has been completed and the detailed specifications document has been developed. System testing is ongoing.¹⁶

IV. PROJECT FINANCIAL MANAGEMENT ASSESSEMENT

31. The DPWH Financial Management Assessment Questionnaire (FMAQ) and its supporting appendices are shown in Appendix 1. The results of the interviews and data gathering are presented below.

A. Organization and Personnel

32. The DPWH has organization and staffing which are appropriate for a project executing agency. Duties are appropriately segregated. However, training and capacity will need to be strengthened especially in the area of ADB policy and procedures, and ADB requirements. In addition, procedural and documentation controls will need to be properly and consistently implemented.

33. The Accounting Division which is under the Financial Management Service (FMS) Division handles the main financial management system and is responsible for financial procedures and control, provides coordinated services on financial systems and procedures, budgets, cash disbursements and accounting and internal controls. The FMS organization of DPWH is structured to support effective financial management of projects with designated sections focused on monitoring and controlling project implementation. The multiple reviews and authorizations associated with monitoring and funding projects suggests a thorough process that should successfully manage financial implementation of the project.

34. The finance and accounting function is staffed adequately. These are permanent and contractual or project-based employees. The staff members are also required to attend a specific number of hours of relevant training.

35. The Internal Audit Service reports to the Secretary of the DPWH and conducts management and operations audits of DPWH activities and monitors compliance with policies and procedures.

36. Existing staff will be assigned to the project. This implies that existing staff will be given added tasks on top of their regular workload. This may result in delays in the preparation of and processing of documents and in the preparation of the annual project financial statements.

¹⁶ Ibid.

B. Information Systems

37. The FMS Division of the DPWH uses the COA's electronic New Government Accounting System (e-NGAS), an MS SQL server based accounting system, an electronic budgeting system (e-Budget) and a Project Life Cycle system to track physical activity and associate it with financial transactions. Staff members are adequately trained to maintain the computerized information system.

38. The use of e-NGAS and e-Budget ensures the accuracy and reliability of transactions. The financial accounting and reporting system is integrated and is used by the central, regional and district engineering offices of the DPWH.

39. The DPWH maintains separate project records and books.

40. For the DPWH, not all financial reports can be generated from the system. The preparation of the statement of cash flows requires manual intervention and use of Excel. The accounting information system follows the chart of accounts mandated by the COA. Thus, expenditures categories used are different from those indicated in the ADB loan agreement. In order to prepare the project financial statements following ADB's expenditure categories, data will have to be extracted from e-NGAS and transferred to Excel.

41. Management, organization and processes and systems safeguard the confidentiality, integrity and availability of the data. The backup procedures are done via online storage in a server and the data are annually transferred to another server. There is no offsite storage.

C. Accounting Policies and Procedures

42. The accrual basis of accounting is used by the DPWH. The DPWH follows the Philippines Public Sector Accounting Standards (PPSAS), which are consistent with the International Public Sector Accounting Standards.

43. The DPWH is guided by Financial Management Policies and Procedures Manual which provides specific and detailed instructions on the processing, recording and reporting of financial transactions. The manuals follow the COA prescribed requirements. The accounting policy and procedures manual is updated regularly. Procedures are in place to ensure that only authorized persons can alter or establish a new accounting policy or procedure to be used by the implementing agencies. The manual is distributed to appropriate personnel.

44. The DPWH has an accounting system that allows for the proper recording of project financial transactions, including the allocation of expenditures in accordance with the respective components, disbursement categories, and sources of funds.

45. The accounting system of the DPWH supports standardized and ad-hoc reporting, multi-user operations with built in data entry validation and audit trails by user.

49. All accounting and supporting documents pertaining to all processed claims are transmitted to the COA for post audit and safekeeping. All records and documents are retained for ten years while the general ledger and subsidiary ledgers are retained perpetually. The DPWH maintains contract-wise accounting records which are regularly reconciled with the physical outputs and deliverables of the contract. The DPWH reconciles the records with the contractors on a regular basis.

D. Internal and External Audit

50. The Internal Audit Service (IAS) of the DPWH reports to the Secretary of the DPWH and conducts management and operations audits of DPWH activities and monitors compliance with policies and procedures. The focus of the activities of the IAS is to conduct internal control evaluation, performance audits, and management audits of all the functions and all the organizational units within the DPWH, assess management deficiencies and recommend remedial actions.

51. The qualifications and experience of the internal audit staff of the DPWH is based on the Qualification Standards of the Civil Service Commission. The requirement is a bachelor's degree relevant to the job. The qualification standards do not mention or require any technical course. This is left to the discretion of the hiring entity. They are not required to have academic degrees in courses related to accounting or auditing.

52. The internal audit unit of the DPWH does not include the existing ADB project (Loan 2836-PHI: Road Improvement and Institutional Development Project) in its annual work program.

53. The external audit of the DPWH is conducted by the COA in accordance with Philippine Public Sector Standards on Auditing. In May 2016, COA issued Resolution No. 2016-007 adopting a revised framework of professional standards based on International Standards of Supreme Audit Institutions and which are in harmony with the International Organization of Supreme Audit Institutions framework of professional standards.

54. The external auditor has sufficient knowledge of ADB's guidelines and procedures, including disbursements guidelines and procedures such as the *Loan Disbursement Handbook*.

E. Budgeting

55. Budgeting systems and procedures are adequate. The DPWH uses the e-Budget which integrates the National Expenditure Program and the General Appropriations Act with allotment and cash programs, release of allotments and generation of budget reports. The budget release procedures have been streamlined to facilitate the release of budgetary obligations and allotments from the Department of Budget and Management to individual government agencies.

56. The budget includes only financial targets. The physical targets are included in the statement of time elapsed. Budgets are prepared for all significant activities in sufficient detail to allow meaningful monitoring of subsequent performance. Actual expenditures are compared to the budget on a monthly and quarterly basis. Explanations are required for significant variations against the budget. Approvals for variations from the budget are required in advance. The ceiling up to which variations against the budget may be incurred without obtaining prior approval is up to 10% of the original cost.

57. The Philippines' National Budget allocation to the DPWH will be the source of counterpart funds.

F. Financial Reporting

58. Financial statements and reports are prepared for the DPWH and the project by the Accounting Division. Financial reports compare actual expenditures with budgeted and programmed allocations.

59. The COA issued adverse opinions on the fairness of the presentation of the consolidated financial statements of the DPWH for the years 2013, 2014, and 2015 due to accounting errors and deficiencies affecting cash and cash equivalents, receivables, inventory, other current assets, property, plant and equipment and liabilities. The external auditors asserted that because of the material significance of the accounting errors and deficiencies, the consolidated financial statements of the DPWH do not present fairly the financial position of the DPWH and its financial performance, changes in net assets or equity, cash flows and the comparison of budget and actual amounts for the years 2013, 2014 and 2015 in accordance with PPSAS. Therefore, the consolidated financial statements cannot be relied upon.¹⁷

G. Internal Control

60. The following functional responsibilities are performed by different units or persons: authorization to execute a transaction, recording of the transaction, custody of assets involved in the transaction and reconciliation of bank accounts and subsidiary ledgers. The functions of ordering, receiving, accounting for, and paying for goods and services are appropriately segregated.

61. Department Orders, Circulars, Memoranda and COA rules are generally followed in order to safeguard assets. Bank accounts are reconciled on a monthly basis. The Fixed Assets Register is maintained by the Supply and Property Management Division and is updated monthly. Fixed assets are properly tagged and labeled. Physical inventory counts are conducted by the Supply and Property Management Division personnel together with the COA auditor and Accounting personnel.

62. Compliance with policies and procedures are verified and monitored by the Internal Audit Service for DPWH which conducts management and operations audits of the activities of the implementing agencies. The COA likewise monitors compliance with policies and procedures.

63. There are arrangements for reporting fraud, corruption, waste and misuse of project resources. Complaints may be sent online, through a 24/7 hotline or through a 24/7 Help Desk to the Stakeholder Relations Service Unit which takes down all complaints and accepts all calls, conducts hearings and investigations.

64. However, the DPWH's internal control systems is deemed deficient in terms of its ability to ensure the accuracy and completeness of its accounting data, deter and detect errors, and produce reliable financial information. This is evidenced by the adverse opinions of the COA on the financial statements of the DPWH for the past three years, as cited in paragraph 59.

¹⁷ Consolidated Annual Audit Report (CAAR) on the Department of Public Works and Highways for the calendar years 2013, 2014 and 2015. Republic of the Philippines Commission on Audit, National Government Sector. Cluster 7 – Public Works, Transport and Energy.

H. Safeguard over Assets

65. Department Orders, Circulars, Memoranda, and COA rules are generally followed in order to safeguard assets. Bank accounts are reconciled on a monthly basis. The Fixed Assets Register is maintained by the Supply and Property Management Division and is updated monthly. Fixed assets are properly tagged and labeled. Physical inventory counts are conducted by the Supply and Property Management Division personnel together with the COA auditor and Accounting personnel.

V. EXPERIENCE WITH PROJECTS FUNDED BY ADB

66. The Road Improvement and Institutional Development Project (RIIDP) under ADB Loan 2836-PHI and OPEC Fund for International Development Loan 1446P is implemented by the DPWH. The key issues highlighted in the audited project financial statements and the management letters are listed below.

67. The COA issued a qualified opinion on the audited project financial statements for the year 2013 due to an excess of P2 million in the contract cost due to the erroneous transcription in the abstract of bids and an addition of P3.387 million in the contract cost due to the inclusion of the 12% VAT in the contractor's bid resulting in an excess in the contract cost by the same amount.¹⁸

68. The COA issued an unqualified opinion on the audited project financial statements for the year 2014 stating that the financial statements are free from material misstatements and that said financial statements were prepared in accordance with law, rules and regulations and in conformity with PPSAS.¹⁹

69. The COA issued a qualified opinion on the audited project financial statements for the year 2015 due to a P3.2 million overstatement of the Advances to Contractors account and a P251 million understatement of the Machinery and Equipment – Information and Communication Technology account.²⁰

70. The COA, in the management letters for the audits of the RIIDP of the DPWH for the fiscal years 2013, 2014, and 2015 pointed out the recurring and unresolved issue of the absence of official receipts for payments made through checks / advice to debit account (ADA) totaling P160 million. Since the payments are made directly to the suppliers' bank accounts in the authorized government depository bank, the suppliers do not feel the urgency to issue official receipts. The external auditors, in the audit recommendations for the year 2013 recommended that the DPWH request for the issuance of official receipts from the suppliers. This recommendation was reiterated in the management letters for the audit of the fiscal years 2014 and 2015 since the audit recommendation continues to remain unimplemented. The suppliers were subsequently asked to provide official receipts as required by accounting policies and procedures. However, no official receipts have been submitted so far. It is important that all payments are documented with official

¹⁸ Independent Auditor's Certificate, Audited Project Financial Statements and Management Letter on the Audit of ADB Loan No. 2836-PHI for the year ended 31 December 2013. Republic of the Philippines Commission on Audit: Office of the Auditor. Department of Public Works and Highways

¹⁹ Independent Auditor's Certificate, Audited Project Financial Statements and Management Letter on the Audit of ADB Loan No. 2836-PHI for the year ended 31 December 2014. Republic of the Philippines Commission on Audit: Office of the Auditor. Department of Public Works and Highways

²⁰ Independent Auditor's Certificate, Audited Project Financial Statements and Management Letter on the Audit of ADB Loan No. 2836-PHI for the year ended 31 December 2015. Republic of the Philippines Commission on Audit: Office of the Auditor. Department of Public Works and Highways

receipts to allow the auditor to verify whether the funds were used for the intended purpose and the disbursements were made in accordance with approved expenditure categories.²¹

71. The COA, in the management letter for the year ended 2015 made the following recommendations:

- i) Refrain from the imposition of VAT and profit margin on the procurement of various pay items under the Provision for the Facilities for the DPWH Engineer and Staff;
- ii) Account for all the facilities purchased before any payment is made to the contractor;
- iii) Conduct a study on the possible amendment and modification of the terms and conditions of the contract regarding the provision of service vehicles for the engineers;
- iv) Consider the inclusion of provisions in the contract for the turn-over to the DPWH of service vehicles purchased by the contractors after the completion of the project, then record the said vehicles in the books of the agency;
- v) Require the contractor to refund the excess amount of P378,840 or deduct the amounts from any money due the contractor, whichever is practicable;
- vi) Require the officials to be extra cautious in the preparation of the cost estimate and based on rules and regulations; and
- vii) Require the Accounting Division to draw the necessary journal entry voucher to correct the erroneous entries which resulted in the understatement of the advances to contractors account by P3.16 million and correct the erroneous recording which resulted in the understatement of machinery and equipment – information and communication technology equipment amount by P251.49 million.

72. The prior year's recommendations which have not been implemented are listed below:

- i) Improper imposition of Overhead, Contingencies and Miscellaneous and profit margin as mark-up to direct cost of the pay items under Part A – Facilities of the Engineer resulting in an overestimate of the Approved Budget for the Contract of P2.5 million and overprice of the contract cost of P3 million. The auditors recommended that billings for the procurement of various pay items under the "Provision for the Facilities for the DPWH Engineer and Staff" should be based on actual procurement price and supported by documents;
- ii) Improper imposition of 12% VAT to direct cost of the pay items under Part A – Facilities of the Engineer resulting in the overestimate of Approved Budget for the Contract of P4.6 million and overprice of the contract cost of P4.4 million. The auditors recommended that the project management compute for the procurement of various pay items based on actual procurement price and supported by complete documents; account for all facilities purchased prior to making any payment to the contractor and revisit the provisions of DO 72 regarding the imposition of 12% VAT on non-civil work items; and
- iii) No official receipts were issued on payment made through checks/ADA amounting to P160 million. The auditors recommended that the project management ensures that official receipts are properly issued by the suppliers.²²

²¹ Independent Auditor's Certificate, Audited Project Financial Statements and Management Letter on the Audit of ADB Loan No. 2836-PHI for the years ended 31 December 2013, 2014, and 2015. Republic of the Philippines Commission on Audit: Office of the Auditor. Department of Public Works and Highways.

²² Ibid.

73. The Audited Project Financial Statements (APFS) did not present the break-down of project funds and expenditures by financier. The APFS also used expenditure categories which are different from the categories indicated in the loan agreement (DPWH uses chart of accounts mandated by COA). Thus, the information in the APFS could not be compared with the information from the ADB Loan Financial Information System (LFIS) due to differences in the expenditure categories used. However, a comparison of the withdrawal application amounts with the disbursement amounts in the LFIS show consistency.

74. DPWH was in breach of the loan covenant which requires the submission of the APFS within 6 months from the close of the fiscal year. The COA issued the audit report on the project financial statements on time for the fiscal years 2014 and 2015. However, there was a delay in the transmittal of the APFS by the DPWH to the ADB ranging from six months for the APFS for 2013, 12 months for the APFS for 2014 and one month for the APFS for 2015. According to DPWH, there was a lack of coordination in that the persons assigned to forward the APFS to ADB were not informed that the APFS has already been submitted to the office of the Secretary of the DPWH.

APFS	Date of Audit Report	Date Received by ADB	No. of Months between Date of Audit Report and Date Received by ADB	Number of Months between Due Date and Date Received by ADB
FY Ended 31 December 2013	30 September 2014	27 March 2015	6 months	9 months
FY Ended 31 December 2014	30 June 2015	22 July 2016	12 months	12 months
FY Ended 31 December 2015	27 June 2016	22 July 2016	1 month	1 month

VI. RISK DESCRIPTION AND RATING

75. The financial management assessment was conducted to determine the appropriateness of the accounting policies, financial controls, internal and external audit arrangements. The assessment concludes that the overall resulting financial management risk with mitigation measures in place is moderate as summarized in the financial management, internal control and risk assessment (FMICRA) table below.

Risk Description	Risk Assessment Without Mitigation	Mitigation Measures	Risk Assessment With Mitigation
Inherent Risk			
1. Country Specific – Budget reliability, accounting and reporting and external scrutiny are weak.	Moderate	Continuation of PFM reforms by the Government of the Philippines through the following: (a) PFM Reform Roadmap; (b) Good Governance and Anti-Corruption Cluster Plan and (c) several stand-alone initiatives.	Moderate-Low
Overall Inherent Risk			Moderate
Project Risk			
1. Implementing Entity – DPWH has an on-going project with ADB. However, DPWH has no experience with the use of the imprest fund procedure of the ADB	Moderate	One consultant will be recruited under the loan to undertake the financial monitoring and reporting requirements for the loan at the executing agency. In addition, ADB will provide training on ADB's disbursement guidelines and procedures to the relevant staff of the DPWH.	Moderate
2. Funds Flow– No experience with the use of the imprest fund procedure of the ADB. The ongoing project with ADB uses the direct payment procedure. This will be the first time the DPWH will use the imprest fund procedure.	High	The disbursements process will be make use of the direct payment procedure for civil works and consultancy contracts and the imprest fund procedure for small expenditures. In addition, a consultant will be based at the PMU and the DPWH to provide guidance. ADB will provide training on ADB's disbursement guidelines and procedures to the relevant staff of the DPWH.	Moderate
3. Staffing – Existing staff members of the Accounting Division of the DPWH will be assigned to handle the financial management of the project in addition to their regular workload. There is a possibility that the preparation of the project financial statements may be delayed. Staff may not be well-versed in ADB policies and procedures, and reporting requirements.	Moderate	A consultant will be engaged to assist in the financial monitoring and reporting requirements for the loan and will be based at the PMU and the DPWH. ADB will provide training on ADB's disbursement guidelines and procedures to the relevant staff of the DPWH.	Low
4. Accounting Policies and Procedures – The expenditure categories under the DPWH chart of account are different from those used in ADB	Moderate	ADB will inform DPWH on ADB's reporting requirements. A consultant will also be engaged to	Low

Risk Description	Risk Assessment Without Mitigation	Mitigation Measures	Risk Assessment With Mitigation
projects. The accounting staff of the DPWH will not prepare the project financial statements according to ADB's expenditure categories unless formally notified and oriented on the need to do so.		assist the PMUs in the financial monitoring and reporting function.	
5. Internal Audit –The internal audit staff members are graduates of any bachelor's degree relevant to the job. They do not have formal training in internal audit. They do not do pre-audit of transactions, only post-audit. There is a possibility that irregularities and fraud may not be detected.	Moderate	The internal audit staff members do not audit the transactions of the ADB project.	Moderate
6. External Audit – COA is the external auditor. COA conducts its audits in accordance with Philippine Public Sector Standards on Auditing. In May 2016, COA issued Resolution No. 2016-007 adopting a revised framework of professional standards based on International Standards of Supreme Audit Institutions and which are in harmony with the International Organization of Supreme Audit Institutions framework of professional standards. COA has sufficient knowledge of ADB's guidelines and procedures, including disbursements guidelines and procedures such as the <i>Loan Disbursement Handbook</i> .	Low	A consultant will assist the PMU and DPWH in reporting activities	Low
7. Reporting and Monitoring 7.1. The COA issued adverse opinions on the fairness of the presentation of the consolidated financial statements of the DPWH for the years 2013, 2014, and 2015 due to accounting errors and deficiencies affecting cash and cash equivalents, receivables, inventory, other current assets, property, plant and equipment	High	The disbursements process will include the direct payment procedure for civil works and consultancy contracts and the imprest fund procedure for small expenditures. ADB will inform DPWH of the need to report/identify expenditures funded by the ADB loan in the APFS. A consultant will also assist the PMU and DPWH in ensuring timely and proper submissions of the APFS.	Moderate

Risk Description	Risk Assessment Without Mitigation	Mitigation Measures	Risk Assessment With Mitigation
<p>and liabilities. Therefore, the consolidated financial statements cannot be relied upon.</p> <p>7.2. There have been substantial delays in the APFS submission for the Road Improvement and Institutional Development Project.</p> <p>7.3. The latest APFS (2015) presents the consolidated results of the project; it does not present the information on a per financier basis. The accounting system follows the chart of accounts mandated by the COA. Thus, expenditures categories used are different from those indicated in the ADB loan agreement. Therefore, the expenditures funded by the ADB loan cannot be determined from the APFS as required by the ADB.</p>			
<p>8. Information Systems– Not all financial reports can be generated from the system. The preparation of the statement of cash flows requires manual intervention and the use of Excel, which may result in errors.</p>	Moderate	A consultant will assist the PMU and DPWH in ensuring timely and proper submissions of the APFS.	Low
<p>Overall Project Risk</p>	Moderate		Moderate
<p>Overall (Combined) Risk</p>	Moderate		Moderate

ADB = Asian Development Bank; APFS = audited project financial statement; COA = Commission on Audit; DPWH = Department of Public Works and Highways; PFM = public financial management; PMU = project management unit.

VII. PROPOSED TIME-BOUND ACTION PLAN

81. A proposed time-bound action plan to mitigate risk is given below.

Mitigation Actions	Responsible Parties	Timeframe
Given the limited experience of DPWH in the use of the imprest fund procedure, a consultant will be recruited under the loan. The consultant will be based in the PMU office and act as the project accountant providing support to the PMU in undertaking the loan, including assisting with the financial monitoring and reporting requirements of the loan. In addition, ADB will provide training on ADB's disbursement guidelines and procedures to the relevant staff of the DPWH.	ADB, PMU and DPWH and consultant	Prior to and during the project implementation phase
The risks of accounting errors, reporting deficiencies and late submission of the APFS will be mitigated by the fact that the disbursements process will use the direct payment procedure for civil works and consultancy contracts and the imprest fund procedure for small expenditures. In addition, the loan will finance the engagement of a consultant in the PMU and DPWH to provide guidance on ADB requirements and procedures to the relevant staff of the DPWH.	ADB, PMU and DPWH and consultant	Prior to loan effectiveness and throughout project implementation
Potential delays in the submission of the project financial statements will be addressed through the recruitment of a consultant to provide assistance to DPWH in making timely submissions of the audited project financial statements.	PMU and DPWH consultant	Annually, on or before June 30 of the succeeding fiscal year

ADB = Asian Development Bank; APFS = audited project financial statement; DPWH = Department of Public Works and Highways; PMU = project management unit.

APPENDIXES

Appendix 1.	FMAQ-DPWH
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Appendix 1.8.	Organizational Chart of the DPWH Budget Division
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