

FINANCIAL MANAGEMENT ASSESSMENT OF THE DEPARTMENT OF IRRIGATION AND THE DEPARTMENT OF AGRICULTURE/DIRECTORATE OF AGRICULTURAL EXTENSION

A. Executive Summary

1. Financial Management Assessment (FMA) was undertaken regarding the country public sector financial management system, financial management system of implementing entities, project financial management system, fund flow mechanism, accounting system and financial reporting, internal control systems and external audit to ensure appropriate funds flow system and avoid misuse of budget and safe guard of assets. The FMA concluded that the agencies concerned (the Department of Irrigation [DOI] and Department of Agriculture [DOA] Directorate of Agriculture Extension [DAE]) are experienced in implementing externally-financed projects and have an institutional set-up appropriate to the implementation of the Community Managed Irrigated Agriculture Sector Project – Additional Financing (CMIASP-AF). Although certain risks have been identified including (i) delays in implementation due to lack of understanding of CPMO of ADB guidelines (ii) frequent staff transfers (iii) manual accounting system at the CPMO, suitable risk mitigating measures have been incorporated as part of the FM Action Plan (Table 5 below). Accordingly, the overall financial management capacity of both agencies to implement the project is generally adequate, and adequate legal provisions exist under the public sector system for financial management. This assessment has been informed by discussions with concerned officials of CPMO – DOI and PIU – DAE and also draws from lessons learnt during the implementation of the original loan for CMIASP. The FMA of DOI is in Annex A, and the FMA of DOA is in Annex B.

Table 1: Summary of Financial Management Assessment

Department of Irrigation	Department of Agriculture / Directorate of Agriculture Extension
1. Executing and Implementing Agencies	
DOI is a government entity under the Ministry of Irrigation.	The DOA is a government entity under the Ministry of Agricultural Development (MOAD). Under DOA, DAE will be responsible for managing the project.
2. Major Experience of Managing Externally-financed Projects	
Asian Development Bank (ADB) - Community-Managed Irrigated Agriculture Sector Project (CMIASP) World Bank - Irrigation and Water Resources Management Project (IWRMP)	ADB: - Commercial Agriculture Development Project - Raising Incomes of Small and Medium Farmer's Project - CMIASP World Bank - IWRMP
3. Funds Flow Arrangements	
The Government will establish a US dollar imprest account at Nepal Rastra Bank (NRB, the Central Bank of Nepal) to receive ADB funds. The existing Central Project Management Office (CPMO) will operate the account. The Government will pre-finance the ADB share of project costs in accordance with Government budgeting (Red Book) and expenditure management (Treasury System) through MOI. After making project expenditures CPMO/DOI will claim reimbursement from ADB (and other financiers as appropriate) who	The Government will pre-finance the ADB share of project costs according to government budgeting (Red Book) and expenditure management (Treasury System) through MOAD. The existing Project Implementation Unit (PIU) will submit statements of actual expenditure to the CPMO.

will replenish funds in accordance with Statements of Expenditure (SOEs) to the Financial Comptroller General's Office (FCGO) under the Ministry of Finance (MOF).	
4. Organization and Staffing	
<p>The CPMO Accounts Section has two dedicated staff (one Accounts Officer and one Accountant). Accounts staff at the district level in Irrigation Development Divisions (IDDs) and Irrigation Development Subdivisions (IDSDs) comprise one Accounts Officer and one Assistant Accountant.</p> <p>Accounts staff are permanent civil service employees.</p>	<p>There is no separate accounts department for the project. The Accounts Section of DAE is responsible for financial management of the project. At the district level, the accounts section of the District Agricultural Development Office (DADO) is responsible for accounting and financial management.</p> <p>Accounts staff are permanent civil service employees.</p>
5. Accounting Policy and Procedures	
<p>The project will follow Government procedures as directed by the FCGO. The CPMO prepares two types of reports: one for the Government and another for ADB (and other financiers as appropriate).</p>	<p>The project will follow Government procedures as directed by the FCGO. The PIU prepares two types of reports: one for the Government and another for the CPMO to forward to ADB (and other financiers as appropriate).</p>
6. Segregation of Duties	
<p>The Project Director, Division Heads of IDDs are responsible for authorization of payments. Accounts Officers are responsible for accounting and reporting. The head of the Store Unit is responsible for custody of assets.</p>	<p>The Director of DAE and DADO heads are responsible for authorization of payments. The heads of the accounts sections are responsible for accounting and reporting. The head of the Store Unit is responsible for custody of assets.</p>
7. Budgeting System	
<p>The Project Director, in coordination with the Accounts Section of the CPMO, is responsible for preparing budgets. The government allocate necessary budget for project activities. Budgets are prepared in detail for all significant activities and provide benchmark for budget variance analysis. Actual expenditures are compared with budget before each transaction. Variation approvals are required in advance if required.</p>	<p>The Project Coordinator, in coordination with the CPMO and the Accounts Section of DAE, is responsible for preparing budgets. The government allocate necessary budget for project activities. Budgets are prepared in detail for all significant activities and provide benchmark for budget variance analysis. Actual expenditures are compared with budget before each transaction. Variation approvals are required in advance if required.</p>
8. Policies/Procedures	
<p>The accounting system is cash based. The accounting standards followed are defined by the FCGO and the Office of the Auditor General of Nepal (OAGN). These are based on Nepalese Accounting Standards. The Financial Procedure Act and Rules, and the Procurement Act and Rules cover all routine financial management and related administrative matters.</p>	<p>The accounting system is cash based. The accounting standards followed are defined by the FCGO and the OAGN. These are based on Nepalese Accounting Standards. The Financial Procedure Act and Rules, and the Procurement Act and Rules cover all routine financial management and related administrative matters.</p>
9. Internal Audit	
<p>Internal audits are performed every month by the relevant District Treasury Controller Offices (DTCOs) and submit report often in quarterly basis.</p>	<p>Internal audits are performed every month by the relevant DTCO for the PIU, and by Regional Directorates and District Development Committees'</p>

However, internal audit staffs appointed by the DTCO are not professionally qualified for auditing, these are not risk based, often delayed, and internal audit recommendations are not followed up on.	(DDCs) internal auditor for DADOs and submit report often in quarterly basis. However, internal audit staffs appointed by the DTCO are not professionally qualified for auditing, and the audits are not risk based, are often delayed, and internal audit recommendations are not followed up on.
10. External Audit	
<p>Statutory external audit of DOI is conducted after the end of each fiscal year by staff appointed by OAGN. Delays in sub projects implementation and significant expenditures in last month of the fiscal year were the major issue brought out in the audit report.</p> <p>The CPMO submitted audited project financial statements (APFS) of FY 2011/12 on 13 March 2013 to the ADB, which is within the time limit agreed with the GON (9 months after completion of the FY). The financial statement includes expenditure made under the DOI and DOA. Major highlights of the management letter submitted by the AOGN with the APFS of CMIASP of FY 2011/12 were: (i) non recording of expenditure through direct payment amount by the FCGO, (ii) non reimbursement of about 50% of the GON expenditure by the project, (iii) use of project vehicles in non project related agencies, (iv) contribution of WUAs have not been properly recorded in books of account and project account. However, monitoring and compliance of audit qualifications are weak.</p>	Statutory external audit of DOA is conducted after the end of each fiscal year by staff appointed by OAGN. Delays in spending authority to DADO and inadequate and unbalance staffing at DADO were the key issues raised in the audit reports.
11. Reporting and Monitoring	
Financial statements are prepared on a monthly, trimester and annual basis. Financial statements and supporting schedules are prepared according to Nepalese Accounting Standards.	Financial statements are prepared on a monthly, trimester and annual basis. Financial statements and supporting schedules are prepared according to Nepalese Accounting Standards.
12. Information System	
There is no computerized financial management system in the CPMO.	The DAE accounting system is computerized and uses software developed by private sector contractors.

2. The OAGN will carry out an external audit of project financial statements within nine months of the completion of each fiscal year. Normally ADB would require the audited project financial statements to be submitted to ADB within 6 months of fiscal year close, under this project, there are 64 "Cost Centers"¹ that need to submit their financial statements to center and this takes more time. To-date, the executing agency has submitted audited project financial statements on time. The Government will submit project financial reports in accordance with ADB requirements after completion of the each fiscal year and audited annual project financial report within nine months of the completion of each fiscal year.

¹ 35 DADOs, 21 IDD, 2 RIDs, 2 RADs, 2 Divisions in DOI, CPMU, and the PIU/DAE.

3. The World Bank ranked Nepal a "high" fiduciary risk country due to its failure to comply with its own legal and regulatory framework. Key issues raised included lack of compliance with and poor implementation of regulations, weak monitoring, weak staff capacity in accounting and financial management, low prioritization in terms of allocating resources to institute good financial management systems, and poor accounting for funds. The Government is addressing these weaknesses through the introduction of a Treasury Single Account System (TSAS), preparation of Nepal Public Sector Accounting Standards (NPSAS), development of a computerized government accounting system (CGAS), and capacity development through training, workshops and studies. Since CMIASP-AF will operate under the existing Public Financial Management (PFM) legal environment and government regulatory framework there is limited scope to improve the financial management system at the project level. Therefore, recommendations made for financial management improvement relate largely to fulfilling ADB's financial reporting requirements.

4. Fund Flow and Disbursement Mechanism - Project financing will consist of an ADB loan, government funds, and Water Users Association (WUA) contributions in cash or in-kind. Project funds will be budgeted separately for MOI and MOAD. Each ministry will be responsible for financial management of activities they implement. ADB and government funds will be channeled to implementing units through the government treasury system. Based on actual expenditures made in project implementation, the CPMO will claim reimbursement from ADB in accordance with SOE procedures. WUAs' contributions will be managed by the Sub-project Management Unit (SMU) at the field level. A US dollar imprest account will be opened at NRB (the Central Bank of Nepal) by the CPMO. ADB will transfer funds to the imprest account. The project will withdraw funds from this account for major payments and to reimburse funds provided by the Government.

5. The current mechanism of funds transfer is appropriate for CMIASP-AF implementation. However, the reimbursement of funds by ADB is sometimes delayed by the late submission of required documents by the division/district offices to the CPMO, and poor financial reporting from divisions/districts to DOI and DOA to produce reports according to ADB's reporting requirements. The development of a financial management manual and periodic training of accountants at the regional directorates, division, subdivision, and district offices is essential to address the problem of delays in the reimbursement of funds. This is in progress by the Nepal Resident Mission for dissemination to all ADB funded project PMU staff and is expected by early 2014.

B. Project Description

6. The Department of Irrigation (DOI) of the Ministry of Irrigation (MOI), in cooperation with the Department of Agriculture (DOA) of the Ministry of Agricultural Development, has been implementing the Community-Managed Irrigation Agriculture Sector Project (CMIASP) since 2006 with the financial support of the Asian Development Bank (ADB) and Organization of Petroleum Exporting Countries Fund for International Development (OFID). CMIASP is rehabilitating 111 farmer-managed irrigation systems (FMIS) in 35 districts of the central and eastern development regions through participatory planning, forming and strengthening of water users associations (WUAs), improving irrigation facilities and operation and maintenance (O&M), and supporting agricultural extension and productivity. CMIASP is scheduled for closure by 31 March 2014.

7. DOI experience in implementing CMIASP as well as a similar project in the western development region has been positive and the Government has requested ADB for additional financing for an extension of the project (CMIASP-AF) country-wide. It is expected that CMIASP-AF would finance not only the rehabilitation and expansion of FMIS, but the rehabilitation and partial management transfer of some agency-managed irrigation systems (AMIS). The project is expected to upgrade irrigation infrastructure to (i) enhance supplementary irrigation during the monsoon season and (ii) where possible, provide irrigation for a second and/or third crop in the summer and/or winter season. Physical improvements of the systems will be supplemented by water-user training in effective water use and system maintenance, and the provision of agriculture extension. DOI is currently preparing Subproject Preparation Reports (SPPRs) of 77 FMIS subprojects that have met CMIASP's selection criteria. In addition, rehabilitation and partial management transfer of five AMIS in the hills are also to be included in CMIASP-AF.

C. Country Issues

8. Nepal's legal and regulatory framework for ensuring public sector financial accountability is specified in constitutional provisions of the Office of the Auditor General of Nepal (OAGN), the Commission for Investigation of Abuse of Authority, and the Public Accounts Committee. The Financial Procedures Act and Financial Administration Regulation specify comprehensive provisions for budget preparation and approval, accounting and reporting, internal control mechanisms, and the Local Self Governance Act provides regulations for financial accountability at the local level.² However, the country assessment report, The World Bank ranked Nepal a "High" fiduciary risk country due to the failure to comply with the legal and regulatory framework. Lack of compliance and poor implementation of regulations, weak monitoring, weak accounts staff in accounting and financial management, low priority in terms of allocating resources to institute good financial management systems, poor accounting for funds, etc. were identified as key issues contributing to the high fiduciary risk of the country.

9. The Government carried out a public expenditure and financial accountability (PEFA) assessment with the support of the World Bank in 2008. This indicated that while the system is well designed, it is unevenly implemented and represents a high fiduciary risk environment in Nepal. The PEFA assessment identified four public financial management (PFM) areas and prepared an action plan to strengthen public financial management performance. Table 1 highlights the results of the PEFA indicators and the key issues identified in the assessment report, 2008 that may be relevant to CMIASP-AF.

Table 2: Public Financial Management Indicators and Key National Level Issues

PFM Indicators	Key Issues
<p>A. PFM OUT-TURNS</p> <p>PI-1: Aggregate expenditure out-turn compared to original approved budget.</p> <p>PI-4: Stock and monitoring of expenditure payment arrears.</p>	<ul style="list-style-type: none"> • Deviation of actual expenditure from budgeted expenditure • The system of arrears recording is weak and partial • Since the accounting system is cash based, there is no system to account the liabilities

² World Bank, 2003. *Financial Accountability in Nepal, A Country Assessment 2003*, Washington.

PFM Indicators	Key Issues
<p>B. Key cross cutting issues</p> <p>PI.5. Classification of the budget.</p> <p>PI-7. Extent of un-reported government operations.</p> <p>PI.10. Public access to key fiscal information</p>	<ul style="list-style-type: none"> • There is no clarity in the policy on use and implementation of extra-budgetary funds. • Off budget donor-funded activities are not under the purview of statutory financial reporting by FCGO and of audit by OAG. • Making transparent of all contracts with the value above NRs 6 million has not yet been institutionalized
<p>C. Budget Cycle</p> <p>PI.11. Orderliness and participation in the annual budget process.</p> <p>P.12. Multi-year perspective in fiscal planning, expenditure policy and budgeting.</p> <p>PI-19. Competition, value for money and controls in procurement.</p> <p>PI-20. Effectiveness of internal controls for non-salary expenditures</p> <p>PI-21. Effectiveness of internal audit.</p>	<ul style="list-style-type: none"> • Top-down approach of budget formulation process needs to be replaced by bottom-up approach so that fixed budget calendar will be more effective. • Public participation has not been formalized in the formulation of the annual programs and budgeting. • Linkages between sector strategies, investment budget and forward expenditure estimates are, at best, weak and questionable in meeting the policy outcomes. • On procurement tracking, although the use of open competition is mandatory for procurement, there is no system to maintain data. • Often procurement is sliced into small packages to avoid referral to higher authority for approval. • Lack of competition (collusion, muscle-power, external influence) • Inadequate attention on value for money in public expenditures • Although there is a good procedure for expenditure commitment control, enforcement, especially during the last trimester of the fiscal year, is violated often in the name of crisis and emergency. • Other than the MTEF, there is no mechanism for controlling commitment of future liabilities. • Lack of appropriate system of advance treatment has created huge volume of financial irregularities and increased public concern. • Internal audit reports are generally weak and not focused from the risk management perspective. Very little observations are made on the performance of internal control systems. • Internal auditors do not use professional audit methods or follow the risk-based approach. The scope of work under internal audit is also not properly defined. There is no Code of ethics for internal auditors. The concept of internal audit committee has not yet been introduced in the system. • Capacity is even weaker in case of local government, and the internal audit system as required by local Financial

PFM Indicators	Key Issues
<p>PI-22. Timeliness and regularity of account reconciliations.</p> <p>PI-23. Availability of information on resources received by service delivery units.</p> <p>PI-25. Quality and timeliness of annual financial statements.</p> <p>PI-26. Scope, nature and follow-up of external audit.</p>	<p>Administration Regulations has not yet been institutionalized.</p> <ul style="list-style-type: none"> • There are inherent difficulties in receiving bank statements because of the tradition of working with manual system and insufficient staff. • With respect to the external budget, verified information is not provided by the Government on the extent to which reported disbursements are reaching the beneficiaries. • The assets and liabilities are neither accounted nor disclosed in the consolidated financial statements. • There is no National Public Sector Accounting Standard • Advance payments are treated as expenditures in the existing cash basis of accounting. • The audited consolidated financial statements and annual revenue and expenditure statements do not include accounting policies and explanatory notes as required by IPSAS; whereas the consolidated financial statements issued by the Financial Comptroller General Office for government use include basic accounting principles and assumptions. • Follow-up on audit recommendations is generally weak due to non-enforcement of existing legal provision. As a result, issues raised by the Auditor General are repeated in subsequent reports.
<p>D. Donor Budget Cycle</p> <p>D-1. Predictability of Direct Budget Support.</p> <p>D-2. Financial information provided by donors for budgeting and reporting on project and program aid.</p>	<ul style="list-style-type: none"> • Poor predictability of inflows of budget support has affected the predictability of funds. • In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates) is very low and does not meet the criteria mentioned in rating. • All major donors, primarily, bilateral, do not provide budget forecast for disbursement of project aid for coming fiscal year and at least 3 months prior to its start.

FCGO = Financial Comptroller General's Office, IPSAS = International Public Sector Accounting Standards, MTEF = Mid-Term Expenditure Framework, OAG = Office of the Auditor General
Source: Government of Nepal. 2008. *An Assessment of the Public Financial Management Performance Measurement Framework*. Kathmandu.

10. In 2008, the PEFA Secretariat under the Ministry of Finance prepared a Public Financial Management Strategy for 2010 – 2012 for Nepal's Public Financial Management Reform Program Phase 1, which defined a number of reforms to be carried out over the period. These included the introduction of a Treasury Single Account System (TSAS), preparation of Public Sector Accounting Standards (PSAS), development of a computerized government accounting system (CGAS), and capacity development through training, workshops and studies. This is supported by a Multi Donor Trust Fund managed by the World Bank

11. The Asian Development Bank (ADB) Nepal Country Partnership Strategy (CPS) 2010-2012 identified risks relating to PFM, public procurement, and corruption. The PFM assessment

shows that the (i) overall risk related to public expenditure management in Nepal is high; (ii) the overall risk of corruption affecting PFM systems is high; and (iii) the overall fiduciary risk is, therefore, also high. Some broad mitigation measures recommended to be in place during the CPS period included: (i) engaging the political leadership to recommit to the Mid-Term Expenditure Framework (MTEF) at central and subnational levels; (ii) incentivizing, and strengthening the capability of government departments to adhere to PFM standards, including strengthening treasury systems at central and subnational and district levels; (iii) reconfiguring (taking into account the new federal structure) minimum conditions and performance measures to reward the generation of own-source revenues in local bodies and to delegate greater responsibility for the accountability of funds; (iv) enhancing the transparency of the budget and of expenditures; and (v) establishing stringent and agreed upon fiduciary provisions, before engaging with the Government and other development partners to develop a sector-wide approach in the urban development and rural infrastructure sectors.

12. In addition, the Public Sector Accounting and Auditing report prepared jointly by the World Bank and the Government in 2007 highlighted key areas for improvement to meet international standards of accounting and auditing. Key actions recommended in relation to public sector accounting and auditing are:

- A more comprehensive plan for Nepal to adopt cash-based International Public Sector Accounting Standards (IPSAS) as part of a longer-term program to adopt accrual-based reporting of expenditures for each government entity,
- Nepal accounting laws and regulations should specify adoption of IPSAS, Nepal Accounting Standards, and applicable International Accounting Standards and International Financial Reporting Standards.
- More effective training requires curricula more attuned to international standards.
- A code of conduct for accountants is needed.
- A chief financial officer should be designated and made accountable for specific functions and duties.
- The Government should empower the Accounting Standards Board to set IPSAS-based public sector accounting standards.
- There is a need for the OAGN to adopt the Nepal standards on auditing for government audit, in addition to the International Organization of Supreme Audit Institutions auditing standards.
- The Audit Act should be revised to make provision for conducting any type of audit and to provide more effective independence.
- A strengthened Public Accounts Committee and other departmental administrative processes are needed for following up on issues raised in audit reports.
- Audit appointments should include requirements for a degree with accounting or auditing content.
- Auditing methods need to be updated.
- An audit opinion needs to be provided on consolidated government financial statements.
- There is a need for forensic audit training and improved reporting.
- Progressive implementation of the international standards is needed to improve public financial management by providing a more ambitious and comprehensive reform program.

13. Since CMIASP-AF will operate under the existing PFM legal environment and regulatory framework there is limited scope to improve the financial management system for the project.

Therefore, recommendations made for financial management improvement are limited largely to managing project specific risks, rather than risks at the level of the DOI.

D. Risk Analysis for CMIASP-AF

Table 3: Financial Management Internal Control and Risk Assessment

Risk	Risk Assessment	Risk Mitigation Measures
Inherent Risk		
1. Country-specific Risks	High	<ul style="list-style-type: none"> Fully adopt fiduciary risk mitigation measures initiated by the Government in public financial management system improvement. Consider flexibility in project design to adopt new project implementation arrangements in case of state restructuring after adoption of a federal government system.
2. Entity-specific Risks	Moderate	<ul style="list-style-type: none"> Make CPMO responsible for timely approval of the project's annual program, and timely notification of spending authority to spending units. Anticorruption and procurement procedures should follow ADB requirements as outlined in the Project Administration Memorandum (PAM).
3. Project-specific Risks	Moderate	<ul style="list-style-type: none"> Agriculture Development Plans are prepared by DADOs but the budgets may not be harmonized with the DOA's annual budget Strengthen project supervision and monitoring by defining milestones for procurement of works and construction management. Provide a consultant to support CPMO in procurement of Project Implementation and Management Support consulting services, and provision for a procurement consultant in the Project Implementation and Management Support (PIMS) consultant team to support IDD's for works procurement. Provide for mandatory insurance of irrigation project infrastructure constructed under the project in agreement with WUAs.
Overall Inherent Risk	Moderate	
Control Risk		
1. Implementing Entity	Low	<ul style="list-style-type: none"> Government to ensure required human resources in CPMO and PIU in time, and to discourage the frequent transfer of key staff such as Project Director, Project Coordinator and heads of Accounts Sections.
2. Funds Flow	Low	<ul style="list-style-type: none"> Outline contents of financial management manual in the PAM, and prepare the manual at the start of project implementation. Provide funding for periodic training on financial management to accounts staff of CPMO, PIU, Regional Directorates, IDD's and DADOs, specifically in respect of programming budgeting and reporting requirements for SOE procedures. Provide a financial management consultant in the Project Implementation and Management Support (PIMS) consultant team to support project entities in project financial reporting and funds flow.

3. Staffing	Low	<ul style="list-style-type: none"> • Current practice is satisfactory. • Current practice is satisfactory.
4. Accounting Policies and Procedures	Low	
5. Internal Audit	Moderate	<ul style="list-style-type: none"> • The government is planning to introduce audit committees to sector ministries in the future through its PFM reform program to deal with any identified issues. Till then, project review missions will be fielded and annually implementation status of internal audit recommendations will be monitored • Statement of Audit Needs will be provided to DOI and OAG for project financial statements audit. • Define in the PAM a project implementation monitoring system and responsibilities, and an incentive/sanction system. • Establish a computerized project accounting software³ at the CPMO. • Provide support to IDD's and DADO's to establish a computer-based financial information system with necessary hardware and internet access.
6. External Audit	Low	
7. Reporting and Monitoring	Moderate	
8. Information Systems	Moderate	
Overall Control Risk	Low	

Substantial, High, Moderate, Low

E. Project Financial Management: Strengths and Weaknesses

14. The Project will be implemented by DOI and DOA. Project financial management is aligned with the government financial management system. It comprises planning, budgeting, disbursement, account keeping, reporting, asset management, internal controls, internal audit, and external audit. Project funds will be channeled through the government budget system and the Project budget will, therefore, be included in national budget (Red Book). The Ministry of Finance (MOF) will delegate spending authority to MOI and MOAD, which will delegate spending authority to their implementing agencies. The National Planning Commission will be responsible for approving the project's annual program in accordance with the established system. Spending units will receive project funds through the concerned District Treasury Controller Office (DTCO) under the Financial Comptroller General's Office (FCGO).

15. The Government has introduced TSAS, so that DTCOs are responsible for the payment and bank reconciliation of project funds according to the payment order provided by implementing agencies. DTCO is responsible for internal audit of the project funds and OAGN is responsible for external audit. Unless otherwise agreed with ADB, the project will follow procedures stated in the Financial Procedure Act and Rules and the Procurement Act and Rules for all routine financial management activities. The current accounting system is adequate to reflect government transactions, resources and expenditure and to ensure that the system is capable of producing timely, relevant and reliable financial information required for planning and implementation purposes.

16. The Central Project Management Office (CPMO) of DOI and the Project Implementation Unit (PIU) of DOA will prepare annual programs and budgets based on the medium-term expenditure framework in which programs and budgets are submitted by regional, division and district level offices. Project budgets will be prepared by including all significant activities with

³ It is recommended to establish a customized project accounting software from the local market especially for project financial reporting as per the ADB requirements.

details of physical and financial targets, which will provide a benchmark for performance monitoring. Approved Sub-Project Preparation Reports (SPPRs) are the basis for programming and budgeting for the project. For agricultural activities, which are defined in the SPPR Agricultural Development Plans (ADPs), in addition to government programming and budgeting procedures, the project is required to follow the local governance planning and budgeting system described in the Local Self Governance Act (LSGR) and Regulations. However, the bottom up planning process to include programs identified at sub-project level is yet to be fully adopted in annual budgeting process by the DOA.

17. The Accounts Section⁴ established under the CPMO is responsible for accounting and financial management of the project. It is responsible for project budgeting, disbursement, accounting, reporting and auditing of project activities implemented by DOI. Similarly, the Accounts Section⁵ under the DAE is responsible for project budgeting, disbursement, accounting, reporting and auditing of project activities under DOA. For aggregated project financial reporting and statement of expenditure (SOE) procedures, the Accounts Section under the CPMO is responsible. DOA is required to submit reports and necessary documents for aggregated project reporting and SOEs to the Accounts Section of CPMO. Accounts Sections of the regional offices, divisional offices and district level offices are responsible for submitting required project related financial reports and documents to the Accounts Section of their concerned departments. The accounting systems in DOI and DOA are not fully computerized.⁶ In the absence of a fully computerized accounting system, spreadsheets are being used for financial reporting.

18. Reliable and timely financial reporting are significant issues faced by the project. This is mainly due to the lack of financial reporting training of accounts staff of district level offices. As such, the project needs to include a program for strengthening the accounting and financial management system for effective implementation of the project.

⁴ In the Accounts Section, one accounts officer, who is a permanent government employee, is assigned by FCGO. In addition, an accountant is hired on contract by the project.

⁵ There is one accountant in the Accounts Section of DAE, who is a permanent government employee, responsible for financial management of project activities implemented under DOA.

⁶ A computerized accounting system is used by the Accounts Section of DAE, some District Agricultural Development Offices (DADOs), and more than 50% of Irrigation Development Division/Irrigation Development Sub Division (IDD/IDSD).

Table 4: Project Financial Management: Weaknesses and Solutions

Weakness	Solution
Annual programs deviate from SPPRs and ADPs, especially in respect of agricultural activities.	<ul style="list-style-type: none"> • Mandatory inclusion of identified programs at subproject level in the project's annual program and budget. • Strengthened monitoring of project activities.
Delays in submission of SOEs due to an absence of reliable and timely reporting from division/district level offices.	<ul style="list-style-type: none"> • Preparation of a project financial administration manual. • Training of the accountants of IDD and DADOs every two years on financial management and SOE procedures. • Establish a computerized accounting software in the CPMO. • Introduction of on-the-job support mechanisms especially for annual programming and budgeting and financial reporting

ADP = Agriculture Development Plan, CPMO = Central Project Management Office, DAE = Directorate of Agriculture Extension, DADO = District Agriculture Development Office, IDD = Irrigation Development Division/Irrigation Development Sub-Division SOE = Statement of Expenditure, SPPR = Subproject Preparation Report

F. Implementing Entity

19. DOI will be the executing agency of the project and DOA will be an implementing agency. DOI and DOA will implement the project through their central, regional, division/subdivision and district level offices.

20. DOI is one of two departments under the Ministry of Irrigation.⁷ It has five Regional Directorates, one in each of the five development regions, 26 Division Offices and 20 Subdivision Offices to implement programs at the distinct level. In addition, there is an Irrigation Management Division responsible for agency-managed large irrigation projects, and mechanical divisions in key centers of the country.

21. DOA is one of the three departments⁸ under MOAD. The DOA will implement the project through DAE which is one of 12 central level directorates under DOA. DOA has five Regional Directorates, one in each of the five development regions, and several other regional or special offices throughout the country responsible training, laboratory, horticulture, vegetable, fisheries etc. There are 75 District Agriculture Development Offices (DADOs) under DOA covering all districts of Nepal.

22. Both DOI and DOA have experience in implementing externally-financed projects. DOI is implementing CMIASP and the Irrigation and Water Resources Management Project (IWRMP) supported by World Bank. DOA is implementing three ADB-financed projects (the Commercial Agriculture Development Project, Raising Incomes of Small and Medium Farmers Project, and CMIASP), and the World Bank-financed IWRMP.

⁷ The other is the Department of Water Induced Disaster Prevention.

⁸ The other two are the Department of Livestock and the Department of Food Technology and Quality Control. In addition there are several other autonomous institutions under the MOAD

23. The central level institutional set up, the CPMO under DOI and PIU under DOA, will implement CMIASP–AF. IDD of DOI and DADOs under DOA will be involved in sub-projects implementation in field level. In addition, Regional Directorates of DOI and DOA will provide support to division/subdivision and district offices. The Project Director of CMIASP-AF will be responsible for project implementation.

G. Funds-Flow Mechanisms

24. There are no significant changes in fund-flow mechanisms for CMIASP-AF compared with the current practice of CMIASP. Two imprest accounts were proposed for CMIASP in project design but they opened only one. As this has worked well, only one imprest account is also proposed for CMIASP-AF.

25. Project financing will consist of an ADB loan, government funds, and WUA contributions in cash or in-kind. ADB and government funds will be channeled to implementing units through the government treasury system. WUA contributions will be managed by the SMU at the subproject level. After the loan agreement is signed between the Government and ADB, project funds will be included the Red Book for project implementation. MOF will delegate spending authority to MOI and MOAD, which will delegate to DOI and DOA. DOI and DOA will delegate spending authority to the implementing units (CPMO, PIU, Regional Directorates, IDDs and DADOs) in accordance with the approved program by the National Planning Commission (NPC).

26. Spending units will receive project funds on a trimester basis through DTCOs as approved by NPC and MOF for Priority 1 projects, such as CMIASP-AF and all donor projects. The Government will transfer one third of project funds to the implementing unit's account from the Treasury at the start of each fiscal year. The remaining funds will be transferred based on implementation progress and the receipt of funds from ADB. Based on actual expenditures made in project implementation, the CPMO will claim reimbursement from ADB in accordance with SOE procedures to reimburse GON expenditure to FCGO in MOF.

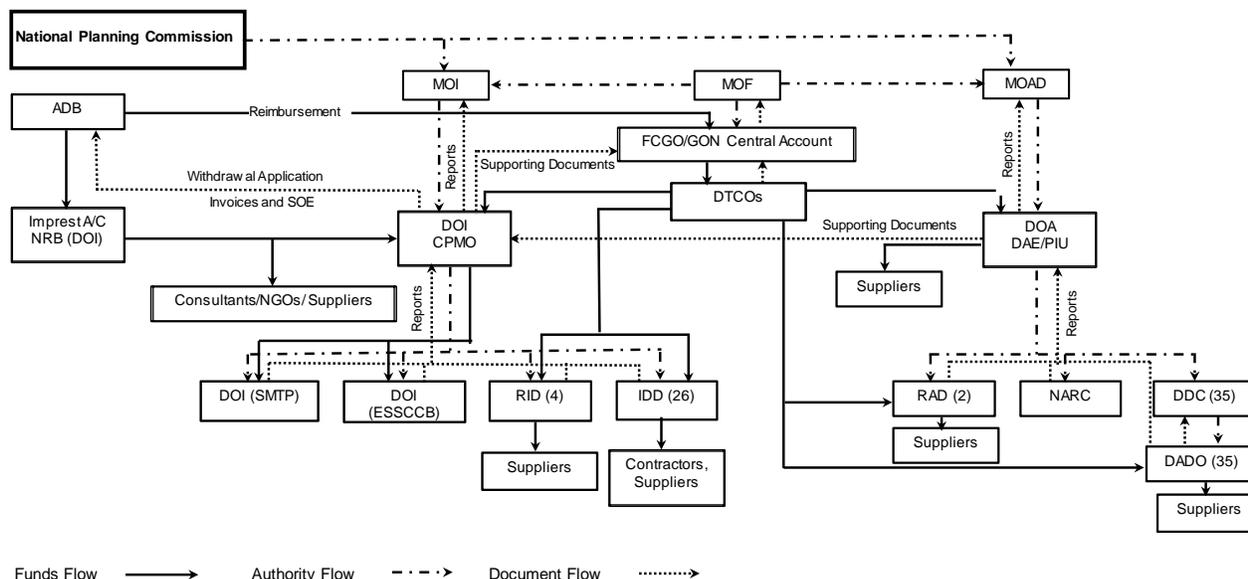
27. In order to facilitate funds flow, a US dollar imprest account will be opened at Nepal Rastra Bank (NRB, the Central Bank of Nepal) by the CPMO. The ADB will transfer necessary fund to the imprest account. The project director and accounts officer will operate the imprest account. The project will withdraw funds from this account for major payments (payment in USD to the contractor if any and consultancy fee) and to reimburse funds provided by the Government.

28. Since DOI and DOA/DAE are implementing CMIASP, they have experience managing ADB funds and SOE procedures. The current mechanism of funds transfer is appropriate for CMIASP-AF implementation. However, the reimbursement of funds by ADB is delayed by the late submission of required documents by the division/district offices to the CPMO, and poor financial reporting system from divisions/districts to DOI and DOA to produce reports according to ADB's reporting requirement. The development of a financial management manual and periodic training of accountants at the regional directorates, division, subdivision, and district offices is essential to address the problem of delays in the reimbursement of funds.

29. Project funds will be budgeted separately for MOI and MOAD. Each ministry will be responsible for financial management relating to activities they implement. The CPMO will be responsible for coordinated planning, programming, implementation and reporting at the central level. Regional Project Support Units and Subproject Management Units will be responsible at

the regional and subproject levels respectively. The funds flow chat of the project is presented in Figure 1.

Figure 1: Funds Flow under CMIASP



ADB = Asian Development Bank, CPMO = Central Project Management Office, DADO = District Agriculture Development Office, DAE = Directorate of Agriculture Extension, DDC = District Development Committee, DOA = Department of Agriculture, DOI = Department of Irrigation, DTCO = District Treasury Controller Office, ESSCCB = Environment, Social Safeguard and Climate Change Branch, FCGO = Financial Comptroller General's Office, MOAD = Ministry of Agricultural Development, MOF = Ministry of Finance, MOI = Ministry of Irrigation, NARC = Nepal Agriculture Research Council, RAD = Regional Agriculture Directorate, RID = Regional Irrigation Directorate.

H. Personnel

30. FCGO deutes accounting staff to government offices and government projects. FCGO accounting staff are permanent government employees recruited under the Nepal Civil Service Act 1993. They are trained under the training plan of Ministry of Finance, which is general training for all accounts staff, and are adequately qualified to undertake the job. The Nepal Civil Service Act stipulates that staff may not be transferred from one ministry/department to another before the completion of two years of service in that particular ministry/department. As such, accounting staff involved in CMIASP-AF will generally serve for a period of at least two years.

31. The CPMO Accounts Section is responsible for project accounting and financial management. The Accounts Section has two staff, one accounts officer and one accountant. The accounts officer is deputed by FCGO. The one accountant is hired by the project on contract. Both accounts staff are experienced in accounting and financial reporting.

32. In case of the DOA/DAE PIU, regional offices of DOI and DOA, IDD and DADOs, entities' accounts staff are also responsible for project accounting and reporting. In general, in the Regional Directorates of DOI and DOA and in IDDs, two accounts staff work in the accounts section, which is adequate. However, continuous training to increase skill levels should be planned to improve the quality of work and to ensure timely reporting. In DAE and DADOs, only one accountant is assigned to the accounts section. Vacant accountant positions and frequent

transfer of accountants in DADOs are major issues facing the PIU/DAE in fulfilling the accounting and reporting responsibilities of the project. Therefore, one additional accountant at PIU/DAE is required to facilitate timely project financial reporting requirements.

I. Accounting Policies and Procedures

33. The project will follow the standard government cash-based accounting system established by FCGO. Based on previous experience with CMIASP, the Project Director at the CPMO, the Director of DAE, regional directors, divisions chiefs of IDD, and DADO heads will be responsible for authorizing transactions for CMIASP-AF. The Accounts Section of each office will be responsible for accounting and reporting, and the Store Unit of concerned offices will be responsible for the custody of assets. It is mandatory in the government accounting system to keep all accounting and supporting documents in a secure location on a permanent basis. No unauthorized persons are allowed to handle accounting documents. Expenditure is automatically controlled by the budget sheet. Explanations are required for significant variations from the implementing agency heads. Regional Director, Director General of DOI, Secretary of MOI and MOF are authorized based on the nature and percentage of variation.

J. Internal Audit

34. DTCO is responsible for internal audit of all government offices⁹, which it does on a monthly basis. DTCO submits internal audit reports to the head of the audited office in trimester basis in general and the Project Director, if applicable. The accounts staff of DTCO have experience in accounting but they are not, in general, professionally qualified auditors. In addition, conflict of interest may arise if they are assigned to audit an entity from which they transferred. In the case of DADOs, the internal auditor is appointed by the District Development Committee is responsible for internal audit. The internal audit report is submitted to the final auditor appointed by OAGN.

35. Following an audit, the head of the concerned office has to take immediate action to address the findings of the internal audit report. However, in practice, internal audit recommendations are usually ignored.

K. External Audit

36. OAGN is a constitutional independent body responsible for carrying out external audit of government transactions. The external audit of project accounts is conducted following the end of each fiscal year in accordance with OAGN's work plan and by staff appointed by OAGN. The audit is performed in accordance with the Government Auditing Standards Part 3: Segment Audit Guidelines – Project Financial Statements issued by the OAG in October 2005. These guidelines were prepared specifically keeping in mind donor requirements, mostly ADB and World Bank. The CPMO will submit consolidated Audited Project Financial Statements of the DOI and DOA to the ADB.

37. OAGN submits the external audit report of government funds to the President to take corrective action as necessary. The main issues raised by audit reports on DOI/DOA transactions are delays in delegation of spending authority, delays in subproject implementation,

⁹ Local Bodies are authorized to appoint internal auditor by their own. The DDC internal auditor is authorized to internal audit of the fund channelled through the DDC.

and large expenditures in the last month of the fiscal year, under staffing or inappropriate staff at DADOs etc. The Public Accounts Committee (PAC), which is a parliamentary body, is responsible for providing direction to government entities to address issues raised by audit reports. However, follow-up on audit recommendations is generally poor due to a weak monitoring system. As a result, issues raised by the Auditor General are repeated in subsequent reports.

38. External audits of the CMIASP are conducted according to Nepalese Auditing Standards in accordance with International Organization of Supreme Audit Institutions (INTOSAI) Auditing Standards. However, there is no practice of collecting entity-level (RDs, IDDs, DADO) final audit reports with management's response by the CPMO. The CPMO submits audited project financial statements to the ADB as certified by the OAGN at centre. The CPMO submitted audited project financial statements of FY 2011/12 in March 13, 2013 to the ADB. The financial statement includes expenditure made under the DOI and DOA. Major highlights of the management letter were: (i) non recording of expenditure through direct payment amount by the FCGO, (ii) non reimbursement of about 50% of the GON expenditure by the project, (iii) use of project vehicles in non project related agencies, (iv) contribution of WUAs have not been properly recorded in books of account and project account.

39. The external audit of CMIASP-AF will be carried out by OAGN within 9 months of the completion of each fiscal year, i.e. by April 15 each year. Audited financial reports of the project will be submitted to ADB. Tentative time bound action plan for submission of audited financial statements is given below.

Table 5: Tentative Time Bound Action Plan for Submission of Audited Financial Statements

S.N	Activities	Responsible agency	Minimum days required	Time frame	Remarks
1	Account closing date (FY)	EA/IAs	-	16 July	
2	Annual financial statement preparation by the account section	EA/IAs	14	30 July	
3	Submission of financial statements to concerned authorities (CPMO/PIU)	EA/IAs	1	31 July	Uncertified financial statements are submitted
4	Conduct Internal audit and certify financial statements of the cost centers	Concerned IAs	35	5 Sep	
5	Cost centers submit certified financial statements to CPMO and PIU	IAs	15	20 Sep	It takes time to reach the documents to CPMO and PIU from the districts from remote areas
6	Consolidation of financial statements by the CPMO and PIU- capital and recurrent costs	CPMO/PIU	7	27 Sep	Including follow up from the districts
7	Submission of consolidated financial statements to Ministries / FCGO for final verification of the accuracy of the financial statements	CPMO/PIU	3	30 Sep	

8	Submission of unaudited project account to the CPMO	PIU	5	5 Oct	
9	Preparation of unaudited project account	CPMO	15	20 Oct	All the accounting records are to be verified
10	Final audit of all IAs of the regions, divisions and districts-including DOI, PIU and CPMO	OAG	90	20 Jan	
11	Preliminary audit report to be sent to the concerned offices	OAG	10	30 Jan	
12	Clarification of audit observation to be sent to OAG	EA/IAs	35	5 Mar	There is 35 days as per the rule
13	Submission and audited financial statements to the PIU/CPMO	IAs	15	20 Mar	It takes time to reach the documents to CPMO and PIU from the districts from remote areas
14	Finalization of project accounts after verification with FCGO and OAG	PIU/CPMO	7	27 Mar	
15	Certification by the concerned officials	Departments/ Ministries	4	31 Mar	
16	Submission of audited financial statement to CPMO	PIU	3	3 Apr	
17	Certification by FCGO	FCGO	3	6 Apr	
18	Certification by OAG	OAG	5	11 Apr	Preparation of audit observation report, including status of SOE, Imprest account, financial covenants and comment on previous years audit report
19	Submission of AFS to ADB	CPMO	4	15 Apr	
	Total time required for audited financial statement preparation and submission		9 months		

EA = executing agency, CPMO = central project management unit, FCGO = Financial Comptroller General Office, IA = implementing agency, FY = fiscal year, OAG = Office of the Auditor General, SOE = statement of expenditures, PIU = project implementation unit

L. Financial Reporting and Monitoring

40. The financial management of the project will be governed by various Acts, Regulations and Directives of the Government. It includes a budgeting system, a system of approval of transaction, an accounting system, a reporting system, and internal audit and external audit. The following are the major government provisions, with which the Project will have to comply:

- Public Procurement Act, 2063 (2007)
- Public Procurement Rules, 2064 (2007)
- Financial Procedure Act, 2055 (1999)
- Financial Procedure Rules, 2064 (2008)
- Travel and Days Allowance Rules 2064 (2008)

- Budgeting directives

41. Project implementing entities will prepare financial statements and supporting schedules based on the government accounting and reporting system. The chart of accounts of the government accounting system is adequate for recording project financial transactions. Reporting requirements comprise progress reports every trimester, and financial statements on a monthly, trimester and annual basis. The financial reporting system compares actual with budgeted expenditures and statements of advances. Although the Store Unit prepares reports of inventories and assets, it is not included financial reports. There is no system of accounting of assets and liabilities, balance sheet, and presenting them in consolidated financial statements.

42. The charts of accounts currently followed by government offices are not structured to produce financial monitoring reports required by the project, such as Sources and Uses of Funds, Statement of Budget versus Actual, Category-wise Expenditure, Government Replacement and Reimbursable, Project Output-wise Cost, etc. Therefore, the project has to prepare two sets of financial statements: one for the Government and another for ADB. Since the CPMO will be responsible for preparing the project accounts in accordance with SOE procedures, the CPMO will require spending units to adopt the same system. Draft formats for the Project Financial Report are in Annex C.

M. Information Systems

43. Although a computerized accounting system has been established in DOI and DAE, it does not operate as a full information system. Although more than 50% of division/subdivision offices are using computerized accounting software there is no link to department systems. The CPMO does not have a computerized accounting system. To prepare financial monitoring reports for ADB the CPMO needs to pool accounting and financial data from various sources. This is both time consuming and results in delays in presentation of reports. For reliable and timely financial reporting, the accounts sections of the department entities need to be equipped with a computer-based financial information system with necessary hardware and internet access.

44. Since the CPMO is now doing project budgeting using spreadsheets, it is recommend to establish a locally developed computerized project accounting system only in CPMO – which is available in the market, and the CPMO Accounts Officer requested that this activity be included in the project budget. The government is planning to introduce computerized CGAS for all GON offices and this will be established by the government – no intervention needed from the project. This is presented in more details below.

45. FCGO and DTCOs are fully computerized on CGAS and produce project financial reports required by donors on behalf of DOI and DOA. The CGAS has been developed by the High Level Commission for Information Technology in coordination with FCGO to computerize the existing government accounting system. CGAS comprises revenue, expenditure, deposit and public works accounting transactions of the Government. This is a comprehensive computer-based financial management system and is planned for implementation in other government offices from the fiscal year 2014. It comprises:

- Summary of Sources and Uses of Funds
- Statement of Transfer of Funds
- Cumulative Statement of Expenditure

- Statement of Expenditure by Budget Sub-head Category
- Donor Source Allocation and Expenditure Statement
- Program Expenditure Statement
- Foreign Exchange Account Reconciliation Statement and
- Cash Projection.

N. Procurement Arrangements

46. The CPMO/DOI will be responsible for procurement of individual and project implementation and management support consultants and goods such as vehicles and equipment. The PIU/DOA will be responsible for procurement of goods such as equipment and vehicles for project activities implemented by DOA. The IDD's will be responsible for procurement of works under the general supervision of Regional Irrigation Departments (RID's). The project will allocate funds for capacity building in procurement.

O. Disbursement Arrangements

47. There are no significant changes in disbursement arrangements for the CMIASP-AF from the current practice of CMIASP. Two imprest accounts were proposed for CMIASP in project design but they opened only one. As this has worked well, only one imprest account is also proposed for CMIASP-AF.

48. Under the ADF loan of \$30 million, one imprest account for the project will be established by the DOI in Nepal Rastra Bank after the loan agreement becomes effective. The currency of the imprest account will be in US dollar. The maximum ceiling of the imprest account is 10% of the loan amount. The Project Director and the project Accounts Officer will operate the account and it will be used to pay ADB's share of expenditures. The statement of expenditure (SOE) procedures will be used to reimburse/replenish expenditures and liquidate advances under the imprest account. The ceiling for the SOE is \$30,000. This means that, if any individual expenditure exceeds \$30,000, the supporting documents for that expenditure need to be provided with the withdrawal application. SOE records should be maintained and made readily available for review by ADB's disbursement and review mission or upon ADB's request for submission of supporting documents on a sampling basis, and for independent audit. Direct payment procedures will be used for payments to the contractors in US\$ from the imprest account. The CPMO will maintain the imprest account and submit statements of account in accordance with ADB requirements. The initial amount of the loan proceeds released to the imprest account will not exceed the estimated expenditure in the first six months of the project or not more than 10% of the total loan amount.

49. The CPMO will work the PIU/DOA, RID's and IDD's to prepare annual programs and budgets for the project. The Government will pre-finance project expenditure according to the government Treasury System through MOI and MOAD. The CPMO will be responsible for reimbursement of ADB's share of project expenditures to the Government. The CPMO will submit SOE records to ADB from time to time for reimbursement of eligible expenditures. The minimum value per withdrawal application is \$100,000, unless otherwise approved by ADB. Individual payments below this amount should generally be paid from the imprest account, or by the EA/IA and subsequently claimed to ADB through reimbursement. ADB reserves the right not to accept withdrawal applications below the minimum amount. The PIU/DOA will submit required documents for SOE to the CPMO on a trimester basis. 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.

P. Agreed Action Plan

50. An action plan for financial management improvement agreed with DOI and DOA/DAE is in Table 5. Required activities and financing will be incorporated in project design.

Table 6: Financial Management Action Plan

Agreed Action	Responsible Person	Agreed Completion Date
1. Establish computerized project accounting system at CPMO.	Head of Accounts - CPMO	End of Year 1
2. Provide financial management training (including project budgeting, reporting, accounting and SOE procedures) to IDD and DADO heads and accountants every two years.	Project Director - CPMO	Years 1, 3 and 5
3. Hire one Financial Management Specialist as part of Project Implementation and Management Support consulting services to provide back-stopping support to IDDs/DADOs.	Project Director - CPMO	Year 1
4. Hire one Procurement Specialist to support CPMO in the recruitment of Project Implementation and Management Support consulting services.	Project Director - CPMO	By 15 December 2013
5. Provide procurement training in NCB and ICB for civil works to the IDDs and CPMO/PIU staff every two years.	Project Director - CPMO	Years 1, 3 and 5
6. Hire one Procurement Specialist as part of Project Implementation and Management Support consulting services.	Project Director - CPMO	By May 2014

Q. Conditions

51. Followings are the key financial management actions needed to be taken by the Government.

- The CPMO/DOI and DOA/DAE should be staffed with an adequate number of qualified accounting personnel.
- The Government should allocate within its budget and make available adequate funds on a timely basis for each fiscal year for the implementation of the project to MOI and MOAD to implement project activities.
- Both ADB and Government funds allocated for subproject implementation should be transferred to IDDs and DADOs in time to implement their tasks on a timely and efficient basis.
- WUAs must collect in advance at least NRs200 per household as a cash contribution before completion of the subproject rehabilitation agreement, and not less than 3% in kind contribution in advance of rehabilitation works.
- The Government should maintain SOE records and submit them to the ADB every four months for review.

- Government funds should cover vehicle operation costs, office accommodation and furnishings, travel, water, power, telephone rental (local), taxes, and remuneration of counterpart staff.
- The Government should prepare project financial statements in accordance with ADB requirements and ensure annual audits of the project financial statements in compliance with international audit standards and the Government's specific audit regulations. The Government should also ensure an annual audit of the imprest account and financial statements, and should submit them to ADB within nine (9) months of the end of each fiscal year.
- The project should prepare a project financial administration manual for the use of SMUs including the project programming and budgeting system, accounting, financial reporting, SOE requirements and financial monitoring.
- The Government should provide adequate operation and maintenance support to WUAs to maintain smooth operation of project systems after completion of the project.
- ADB will have right to verify the financial accounts of the DOI and DOA/DAE to confirm that the share of ADB's financing is used in accordance with ADB's policies and procedures

R. Supervision Plan

52. A Project Steering Committee will be responsible for overall supervision of project financing. The Director General of DOI through the Project Director will regularly monitor the status of financial covenants agreed with ADB. The Project Director/CPMO and Project Coordinator/PIU will be responsible for regular supervision of project financial management by IDD and DADOs. ADB project implementation support missions will supervise financial covenants twice in a year in general and recommend corrective actions if any.

ANNEX A. FINANCIAL MANAGEMENT ASSESSMENT OF DOI

Topic	Response	Remarks
1. Implementing Agency		
1.1 What is the entity's legal status / registration?	The Department of Irrigation (DOI) is a government entity under the Ministry of Irrigation (MOI).	There are two departments (i) Department of Irrigation and (ii) Department of Water Induced Disaster Prevention under MOI
1.2 Has the entity implemented an externally-financed project in the past (if so, please provide details)?	Yes.	Recent projects include the Asian Development Bank (ADB) financed Community-Managed Irrigated Agriculture Sector Project (CMIASP) and the World Bank financed Irrigation and Water Resources Management Project (IWRMP)
1.3 What are the statutory reporting requirements for the entity?	DOI reports to the MOI, Financial Comptroller General Office, District Treasury Controller Office as per the government rules based on guidelines provided by the Financial Procedure Rules, and according to the reporting requirements of individual donor agencies.	
1.4 Is the governing body for the project independent	The Central Project Management Office (CPMO) is under DOI but works independently as per organizational set up to implement the project as per the guidance provided by the project Steering Committee.	
1.5 Is the organizational structure appropriate for the needs of the project?	Yes. The project implementation organizational structure is appropriate.	The DOI has established a Central Project Management Office, (CPMO), which is implementing the CMIASP
2. Funds Flow Arrangements		
2.1 Describe (proposed) project funds flow arrangements, including a chart and explanation of the flow of funds from ADB, government and other financiers.	Project financing will consist of an ADB loan, government funds, and beneficiary contributions. The Government will establish a US dollar imprest account at NRB to receive ADB funds. The CPMO operates the account.	

Topic	Response	Remarks
	<p>The Government will pre-finance the ADB share of funds in accordance with Government budgeting (Red Book) and expenditure management system (Treasury System) through MOI. DOI provides spending authority to the CPMO, Regional Directorates and IDs for program implementation. After making project expenditures CPMO/DOI claim reimbursement from ADB or other financiers who will replenish funds in accordance with statements of expenditure (SOEs) to the Comptroller General's Office under the Ministry of Finance (MOF).</p> <p>See the attached funds flow chart.</p>	
2.2 Are the (proposed) arrangements to transfer the proceeds of the loan (from the government / Finance Ministry) to the entity satisfactory?	<p>Yes.</p> <p>The arrangements are considered satisfactory as the system and procedures for such transfers already exist.</p>	
2.3 What have been the major problems in the past in receipt of funds by the entity?	<p>No. Significant problem. But under CMIASP there have been delays in collecting financial statements and documents from district/division offices and SOEs from the OPEC Fund for International Development.</p>	
2.4 In which bank will the imprest Account be opened?	NRB	
2.5 Does the (proposed) project implementing unit (PIU) have experience in the management of disbursements from ADB?	DOI and CPMO staff have experience in the management of disbursements from ADB.	DOI is currently implementing CMIASP.
2.7 Does the entity have/need a capacity to manage foreign exchange risks?	The Government will bear foreign exchange risks. The Government has received many foreign loans and has successfully managed the foreign exchange risk.	
2.8 How are the counterpart funds accessed?	Government counterpart funds are accessed through the central budget. The EAs will be responsible for preparing programs, disbursement projections and requesting budget allocations for counterpart funds. Beneficiaries will make their contributions in-kind (in the form of labor) or in cash.	
2.9 How are payments made from the counterpart funds?	The Government will provide counterpart funds from the Government Treasury to the project. Since donor-supported projects are Priority 1 projects, the MOF will	

Topic	Response	Remarks
	<p>transfer one third of the project budget to the CPMO, Regional Directorates and Irrigation Development Division/Irrigation Development Sub-division (IDD) accounts from the Central Treasury after the beginning of each financial year. After submission of income expenditure statements and progress reports from the implementing entities, concerned District Treasury Controller Offices (DTCO) will disburse remaining two tranches to concerned offices.</p> <p>The beneficiaries' counterpart funds for each subproject will be managed by the IDD.</p>	
2.10 If part of the project is implemented by communities or NGOs, does the PIU have the necessary reporting and monitoring features built into its systems to track the use of project proceeds by such agencies?	Yes.	
2.11 Are the beneficiaries required to contribute to project costs? If beneficiaries have an option to contribute in kind (in the form of labor), are proper guidelines formulated to record and value the labor contribution?	<p>Yes.</p> <p>Beneficiaries contribute NRs 50 per hectare up front in cash and 3% in cash or in-kind of the base cost of subproject rehabilitation. The up-front cash is transferred to the Water Users' Association's (WUA) account for operation and maintenance of the subproject after completion of construction. The 3% in-kind contribution is measured, recorded by the IDD and reported through the project progress report.</p>	
3. Staffing		
3.1 What is the (proposed) organizational structure of the accounting department? Attach an organization chart.	An Accounts Section exists in the CPMO.	
3.2 Identify the (proposed) accounts staff, including job title, responsibilities, educational background and professional experience. Attach job descriptions and CVs of key accounting staff.	The CPMO Accounts Section has two staff (one Accounts Officer and one Accountant) positions. Accounts staff position of the IDD comprise one Accounts Officer and one Assistant Accountant. Accounts staff positions are for the permanent civil employees. They are responsible for financial management at the district level.	The Accountant position is not fulfilled by the permanent GON staff but the Accounts Officer is supported by an Accountant engaged on a contract basis by the project.
3.3 Is the project finance and accounting function staffed	Yes.	

Topic	Response	Remarks
adequately?		
3.4 Is the finance and accounts staff adequately qualified and experienced?	Accounts staff at the CPMO have more than 5 years' experience in project finance.	
3.5 Is the project accounts and finance staff trained in ADB procedures?	Existing CPMO accounts staff are trained in ADB procedures but IDD and IDSD accounts staff are not.	
3.6 What is the duration of the contract with the finance and accounts staff?	The staff members are permanent government employees	
3.7 Indicate key positions not contracted yet, and the estimated date of appointment.	Not applicable.	
3.10 Does the project have written position descriptions that clearly define duties, responsibilities, lines of supervision, and limits of authority for all of the officers, managers, and staff?	Yes. The CPMO has defined job descriptions and lines of accountability and reporting.	
3.11 At what frequency are personnel transferred?	Government staff are generally transferred in every two years but key staff including accounts staff of the CPMO remain in position for longer periods. IDD and IDSD staff are transferred every two years.	
3.12 What is training policy for the finance and accounting staff?	The Revenue Administrative Training Centre and Staff College provides basic training to finance and accounts staff. In addition, various governmental and non-governmental agencies provide training to finance and accounts staff depending on project needs.	
4. Accounting Policies and Procedures		
4.1 Does the entity have 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? Will the project use the entity accounting system?	The project will follow the government's standard directed by the Financial Comptroller General's Office. The financial accounting and reporting system includes project financial transaction, allocation of expenditures in accordance with the respective components, disbursement categories and source of funds. The CPMO prepares two types of reports: one for the Government and another for ADB.	
4.2 Are controls in place concerning the preparation and approval of transactions, ensuring that all transactions are correctly made and adequately explained?	Yes. A control system is in place. Transactions are reviewed/approved by the Project Director, implementation entities' head, internal audit and external audit.	

Topic	Response	Remarks
4.3 Is the chart of accounts adequate to properly account for and report on project activities and disbursement categories?	Yes.	Project accounts and sub-accounts are prepared separately as per the reporting requirement of ADB and other financiers.
4.4 Are cost allocations to the various funding sources made accurately and in accordance with established agreements?	Some subproject cost allocations are changed during project implementation. In such cases, the CPMO requests variations in costs allocations.	
4.5 Are the General Ledger and subsidiary ledgers reconciled and in balance?	Yes. General and subsidiary ledgers, imprest account and subsidiary accounts are balanced.	The Government operates a central treasury system through which the District Treasury Controller Office (DTCO) issues checks as per payment orders issued by the CPMO and IDD. The DTCO reconciles payments regularly.
4.6 Are all accounting and supporting documents retained on a permanent basis in a defined system that allows authorized users easy access?	Yes. An appropriate documentation system is in place and is easily accessible to authorized staff.	
Segregation of Duties		
4.7 Are the following functional responsibilities performed by different units or persons: (i) authorization to execute a transaction; (ii) recording of the transaction; and (iii) custody of assets involved in the transaction?	Yes. The Project Director at the CPMO and the Division Head of IDD at SMU level are responsible for authorization. The Accounts Sections at CPMO and IDD levels are responsible for accounting and reporting. The Store Units of CPMO and IDD are responsible for custody of assets.	
4.8 Are the functions of ordering, receiving, accounting for, and paying for goods and services appropriately segregated?	Yes. The Store Unit is responsible for ordering and receiving of goods. Payment is made by the Accounts Sections.	
4.9 Are bank reconciliations prepared by someone other than those who make or approve payments?	Yes. The Project Director or IDD heads approves the payment and DTCO make the payment. Accounts Sections are responsible for reconciliation of bank statements.	
Budgeting System		

Topic	Response	Remarks
4.10 Do budgets include physical and financial targets?	Yes.	
4.11 Are budgets prepared for all significant activities in sufficient detail to provide a meaningful tool with which to monitor subsequent performance?	Yes. Budgets are prepared in detail for all significant activities, providing a benchmark for monitoring performance.	
4.12 Are actual expenditures compared to the budget with reasonable frequency, and explanations required for significant variations from the budget?	Yes. Actual expenditures are compared to the budget before each transaction. Explanations are required for significant variations from the implementing agency heads. Regional Director, Director General of DOI, Secretary of MOI and MOF are authorized based on the nature and percentage of variation.	
4.13 Are approvals for variations from the budget required in advance or after the fact?	Variation approvals are required in advance.	
4.14 Who is responsible for preparation and approval of budgets?	The Project Director in coordination with the Accounts Section is responsible for preparing budgets. The National Planning Commission, MOI and MOF are responsible for finalizing budgets.	
4.15 Are procedures in place to plan project activities, collect information from the units in charge of the different components, and prepare the budgets?	Yes.	
4.16 Are the project plans and budgets of project activities realistic, based on valid assumptions, and developed by knowledgeable individuals?	Yes.	
Payments		
4.17 Do invoice-processing procedures provide for: (i) Copies of purchase orders and receiving reports to be obtained directly from issuing departments? (ii) Comparison of invoice quantities, prices and terms, with those indicated on the purchase order and with records of goods actually received? (iii) Comparison of invoice quantities with those indicated on the receiving reports? (iv) Checking the accuracy of calculations?	Yes.	
4.18 Are all invoices stamped PAID, dated, reviewed and	Yes.	

Topic	Response	Remarks
approved, and clearly marked for account code assignment?		
4.19 Do controls exist for the preparation of the payroll and are changes to the payroll properly authorized?	Yes. The Accounts Section is responsible for preparing payroll, which has to be approved by the DTCO and office head every year.	
Policies And Procedures		
4.20 What is the basis of accounting (e.g., cash, accrual)?	Cash.	
4.21 What accounting standards are followed?	The accounting standards followed are defined by the FCGO and the Office of the Auditor General of Nepal (OAGN). These are based on International Public Sector Accounting Standards, Nepalese Accounting Standards and International Financial Reporting Standards.	
4.22 Does the project have an adequate policies and procedures manual to guide activities and ensure staff accountability?	Yes. There is a code of conduct of public services and the Financial Procedure Rules has set out the job description of the Accounts Section head. The rules also define procedures for financial transactions.	
4.23 Is the accounting policy and procedure manual updated for the project activities?	No. There is a need to develop an operations manual according to ADB requirements at the project preparation stage.	
4.24 Do procedures exist to ensure that only authorized persons can alter or establish a new accounting principle, policy or procedure to be used by the entity?	Yes. The Financial Comptroller General's Office (FCGO) can make changes based on agreement with ADB for the project.	
4.25 Are there written policies and procedures covering all routine financial management and related administrative activities?	Yes. The Financial Procedure Act and Rules and Procurement Act and Regulation cover all routine financial management and related administrative activities. In addition, manuals prepared by MOF and FCGO provide guidelines on financial management. The CPMO follows ADB guidelines for SOEs.	
4.26 Do policies and procedures clearly define conflict of interest and related party transactions (real and apparent) and provide safeguards to protect the organization from them?	Yes.	
4.27 Are manuals distributed to appropriate personnel?	They are accessible to personnel working on the project.	

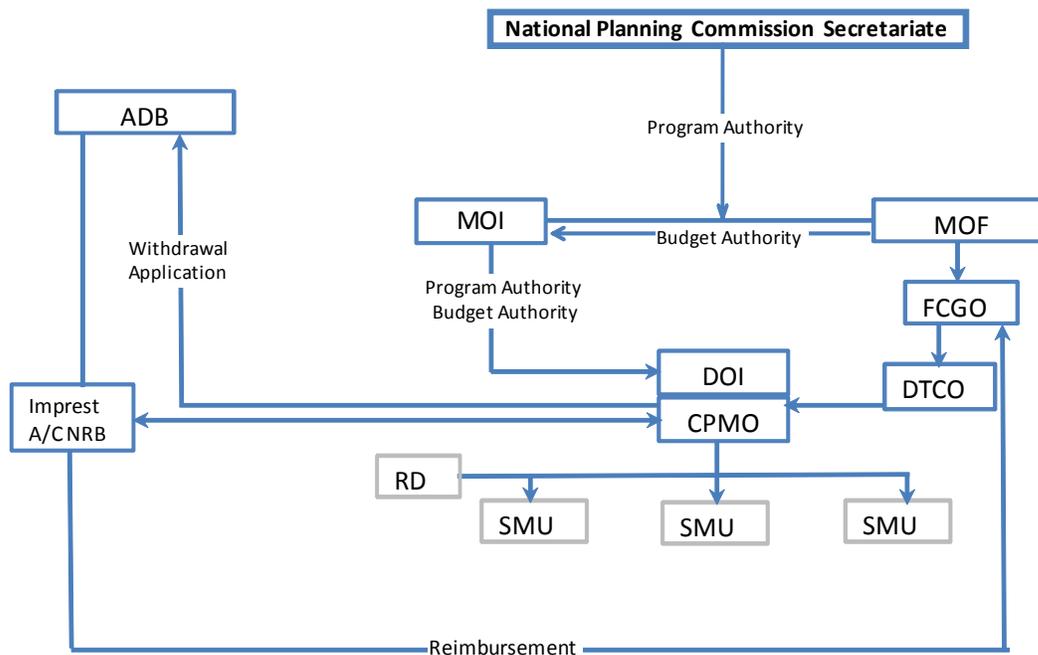
Topic	Response	Remarks
Cash and Bank		
4.28 Indicate names and positions of authorized signatories in the bank accounts.	The Project Director and Accounts Officer at the CPMO and the IDD Head and Accounts Officer at Sub-Project Management Unit (SMU) level provide authorization for payment to the DTCO.	
4.29 Does the organization maintain an adequate, up-to-date cashbook, recording receipts and payments?	Yes.	
4.30 Do controls exist for the collection, timely deposit and recording of receipts at each collection location?	Yes.	
4.31 Are bank and cash reconciled on a monthly basis?	Yes.	By the DTCO
4.32 Are all unusual items on the bank reconciliation reviewed and approved by a responsible official?	Yes.	
4.33 Are all receipts deposited on a timely basis?	Yes.	
Safeguard over Assets		
4.34 Is there a system of adequate safeguards to protect assets from fraud, waste and abuse?	Yes. The Store Unit keeps records of fixed assets and stocks.	
4.35 Are subsidiary records of fixed assets and stocks kept up to date and reconciled with control accounts?	Yes. Subsidiary ledgers are maintained but there is no asset valuation system for providing values in financial statements.	
4.36 Are there periodic physical inventories of fixed assets and stocks?	Yes. A system for verification of physical inventories of fixed assets and stocks exists. As a rule, verification is done on a six-monthly basis as a minimum.	
4.37 Are assets sufficiently covered by insurance policies?	There is a policy for insurance of irrigation projects however it is implemented partially. Other assets, such as vehicles, are covered by insurance.	
Other Offices and Implementing Entities		
4.38 Are there any other regional offices or executing entities participating in implementation?	Yes. Regional, divisional and sub divisional offices under DOI participate in project implementation	
4.39 Has the project established controls and procedures for flow of funds, financial information, accountability, and audits in	Yes. The CPMO maintains procedural and control relations with other offices.	

Topic	Response	Remarks
relation to the other offices or entities?		
4.40 Does information among the different offices/implementing agencies flow in an accurate and timely fashion?	Yes. However the CPMO has experienced delays and inaccuracies in the submission of documents from the IDD and the Department of Agriculture.	
4.41 Are periodic reconciliations performed among the different offices/implementing agencies?	Yes.	
Other		
4.42 Has the project advised employees, beneficiaries and other recipients to whom to report if they suspect fraud, waste or misuse of project resources or property?	Yes. A grievance and complaint system is in place and staff have been made aware of it.	
5. Internal Audit		
5.1 Is there a internal audit department in the entity?	No. There is no internal audit department as such. The internal audit function is performed by the DTCO, every month.	
5.2 What are the qualifications and experience of audit department staff?	DTCO sends experienced staff to perform internal audit but they are not professionally qualified for auditing.	
5.3 To whom does the internal auditor report?	DTCO reports to the concerned Project Director, Regional Director and heads of the IDD.	
5.4 Will the internal audit department include the project in its work program?	Yes.	
5.5 Are actions taken on the internal audit findings?	Yes.	
6. External Audit		
6.1 Is the entity financial statement audited regularly by an independent auditor? Who is the auditor?	Yes. The statutory or external audit is conducted after the end of each fiscal year by staff appointed by OAGN	OAGN is a constitutional, independent body, reporting to the President.
6.2 Are there any delays in audit of the entity? When are the audit reports issued?	No. The audit is generally completed within 9 months after the completion of the fiscal year. The audit report is issued 35 days after the completion of audit.	
6.3 Is the audit of the entity conducted according to the International Standards on Auditing?	Yes. The audit is conducted according to Nepalese Auditing Standards, which comply with International Auditing Standards.	
6.4 Were there any major accountability issues brought out in the audit report of the past	No.	Delays in sub projects implementation and significant

Topic	Response	Remarks
three years?		expenditures in last month of the fiscal year were the major issue brought out in the audit report.
6.5 Will the entity auditor audit the project accounts or will another auditor be appointed to audit the project financial statements?	OAGN prepares the audit plan for the project. Therefore, usually another team of auditor audits the project accounts.	
6.6 Are there any recommendations made by the auditors in prior audit reports or management letters that have not yet been implemented?	No.	
6.7 Is the project subject to any kind of audit from an independent governmental entity (e.g., the supreme audit institution) in addition to the external audit?	No.	
6.8 Has the project prepared acceptable terms of reference for an annual project audit?	Not required.	
7. Reporting and Monitoring		
7.1 Are financial statements prepared for the entity? In accordance with which accounting standards?	Financial statements and supporting schedules are prepared according to Nepal Accounting Standards. These follow International Financial Reporting Standards.	
7.2 Are financial statements prepared for the implementing unit?	Yes.	
7.3 What is the frequency of preparation of financial statements? Are the reports prepared in a timely fashion so as to be useful to management for decision making?	Financial statements are prepared on a monthly, trimester and annual basis. This provides information for management decision making.	
7.4 Does the reporting system need to be adapted to report on the project components?	Yes.	
7.5 Does the reporting system have the capacity to link the financial information with the project's physical progress? If separate systems are used to gather and compile physical data, what controls are in place to reduce the risk that the physical data may not synchronize with the financial data?	Separate financial and physical progress reports are prepared. While preparing the physical progress report, there is a need to synchronize financial data with physical progress.	
7.6 Does the project have established financial management reporting	Yes.	

Topic	Response	Remarks
responsibilities that specify what reports are to be prepared, what they are to contain, and how they are to be used?		
7.7 Are financial management reports used by management?	Yes.	
7.8 Do the financial reports compare actual expenditures with budgeted and programmed allocations?	Yes.	
7.9 Are financial reports prepared directly by the automated accounting system or are they prepared by spreadsheets or some other means?	They are prepared by spreadsheets	
8. Information Systems		
8.1 Is the financial management system computerized?	There is no computerized accounting system at CPMO but more than 50% of IDD's are using computerized accounting system.	The computerized system of IDD is procured from the private developers. The GON is planning to establish Computerized Government Accounting System (CGAS) from coming fiscal year
8.2 Can the system produce the necessary project financial reports?	Partly.	
8.3 Is the staff adequately trained to maintain the system?	Partly.	
8.4 Does the management organization and processing system safeguard the confidentiality, integrity and availability of the data?	Partly.	

Funds Flow under CMIASP



ADB = Asian Development Bank, CPMO = Central Project Management Office, DOI = Department of Irrigation, DTCO = District Treasury Controller Office, FCGO = Financial Comptroller General's Office, MOF = Ministry of Finance, MOI = Ministry of Irrigation, RD = Regional Directorate, SMU = Sub-project Management Unit

**ANNEX B. FINANCIAL MANAGEMENT ASSESSMENT: DEPARTMENT OF
AGRICULTURE/DIRECTORATE OF AGRICULTURE EXTENSION UNDER THE
MINISTRY OF AGRICULTURAL DEVELOPMENT**

Topic	Response	Remarks
1. Implementing Agency		
1.1 What is the entity's legal status / registration?	The Department of Agriculture (DOA) is a government entity under the Ministry of Agricultural Development (MOAD). Under DOA, the Directorate of Agriculture Extension (DAE) is responsible for managing the project under the general supervision of DOA.	
1.2 Has the entity implemented an externally-financed project in the past (if so, please provide details)?	Yes. Externally funded projects under DOA are: <ul style="list-style-type: none"> • Commercial Agriculture Development Project financed by ADB. • Raising Incomes of Small and Medium Farmer's Project financed by ADB. • Community-Managed Irrigated Agriculture Sector Project (CMIASP) financed by ADB. • Irrigation and Water Resource Management Project financed by the World Bank. 	
1.3 What are the statutory reporting requirements for the entity?	DOA reports to MOAD, Financial Comptroller General's Office (FCGO), District Treasury Controller Office (DTCO) and donor agencies according to government rules based on the Financial Procedure Rules and according to the reporting requirements of donor agencies.	
1.4 Is the governing body for the project independent	A Project Implementation Unit (PIU) for CMIASP has been established under DAE of DOA. Agriculture Extension Officer is assigned as project coordinator of the Unit and works under general supervision Director of Directorate of Agriculture Extension.	The PIU coordinates with the Central Project Management Office (CPMO) under the Department of Irrigation (DOI), which implements CMIASP activities.
1.5 Is the organizational structure appropriate for the needs of the project?	The PIU is not appropriately staffed. There is a need for one additional project coordinator (1 st or 2 nd class officer), two agriculture extension officers, and one accountant for effective project implementation.	

Topic	Response	Remarks
2. Funds Flow Arrangements		
2.1 Describe (proposed) project funds flow arrangements, including a chart and explanation of the flow of funds from ADB, government and other financiers.	<p>The Government will pre-finance the ADB share of funds according to the government budgeting (Red Book) and expenditure management system (Treasury System) through the MOAD. DOA delegates spending authority to the PIU, Regional Directorates and District Agricultural Development Offices (DADOs) through District Development Committees DDCs. The PIU and submits statements of actual expenditure made under the project to the CPMO to claim reimbursement from ADB through statement of expenditure (SOE) procedures to the Comptroller General's Office under the Ministry of Finance (MOF).</p> <p>See the attached funds flow chart.</p>	
2.2 Are the (proposed) arrangements to transfer the proceeds of the loan (from the government / Finance Ministry) to the entity satisfactory?	<p>Yes. It is considered satisfactory as the system and procedures for transfers already exist.</p>	
2.3 What have been the major problems in the past in receipt of funds by the entity?	<p>Delays in collecting financial statements and documents from district offices create problems for the timely submission of SOEs.</p>	<p>DADO accounts staff require training in SOE procedures.</p>
2.4 In which bank will the imprest Account be opened?	<p>At NRB by the CPMO/DOI.</p>	<p>DOA will not be involved in the operation of the imprest account.</p>
2.5 Does the (proposed) project implementing unit (PIU) have experience in the management of disbursements from ADB?	<p>The PIU will be responsible for submission of SOEs to the CPMO of DOI, which has experience of managing disbursements from ADB.</p>	<p>The PIU requires one additional accountant to be responsible for project financial management.</p>
2.7 Does the entity have/need a capacity to manage foreign exchange risks?	<p>The Government will bear foreign exchange risks. There is no need to develop the capacity of DOA.</p>	
2.8 How are the counterpart funds accessed?	<p>Government counterpart funds for agriculture component are accessed through the central budget. DOA will be responsible for preparing programs, disbursement projections and requesting budget allocations for counterpart funds. There will be no counterpart fund from beneficiaries under the DOA project component.</p>	
2.9 How are payments made from the counterpart funds?	<p>The Government will provide counterpart funds from the Treasury to the project. Since donor supported projects are Priority 1 projects, the</p>	

Topic	Response	Remarks
	Government will transfer one third of the project budget to the DOA PIU, Regional Directorates and DADOs account from the Treasury through DTCCO after the beginning of each fiscal year. After receipt of financial statements and progress reports from the implementing entities, the DTCCO will disburse remaining tranches to concerned offices.	
2.10 If part of the project is implemented by communities or NGOs, does the PIU have the necessary reporting and monitoring features built into its systems to track the use of project proceeds by such agencies?	Not applicable. There is no involvement of communities or non-government organizations in project financial management.	
2.11 Are the beneficiaries required to contribute to project costs? If beneficiaries have an option to contribute in kind (in the form of labor), are proper guidelines formulated to record and value the labor contribution?	No. Not for project activities implemented by DOA.	
3. Staffing		
3.1 What is the (proposed) organizational structure of the accounting department? Attach an organization chart.	There is no separate accounts department for the project. The Accounts Section of DAE is responsible for financial management of the project. At the district level, the accounts section of DADO is responsible for accounting and financial management.	There is an accountant in the Accounts Section of DAE, with responsibility for the project account. At district level there is one accountant in the Accounts Section of DADO.
3.2 Identify the (proposed) accounts staff, including job title, responsibilities, educational background and professional experience. Attach job descriptions and CVs of key accounting staff.	Accountants are permanent employees of the Government.	
3.3 Is the project finance and accounting function staffed adequately?	There is a need for one support accounts staff at the PIU for project accounting and the position of the accountant at some of the DADOs needs to be fulfilled by the government.	Where the DADO accountant position is not filled, the accountant of District Treasury Controller's Office (DTCCO) is assigned for accounting functions of the DADO as well.
3.4 Is the finance and accounts staff adequately qualified and experienced?	Experienced government staff are deputed to DAE and have experience in project financial management.	
3.5 Is the project accounts and	Existing DAE accounts staff is trained	

Topic	Response	Remarks
finance staff trained in ADB procedures?	in ADB procedures but DADO accounts staff, in particular recently appointed staff are not. For this reason, DAE faces problems in the timely receipt of SOEs from districts.	
3.6 What is the duration of the contract with the finance and accounts staff?	Staff members are permanent government employees	
3.7 Indicate key positions not contracted yet, and the estimated date of appointment.	Not applicable.	
3.10 Does the project have written position descriptions that clearly define duties, responsibilities, lines of supervision, and limits of authority for all of the officers, managers, and staff?	The Project Coordinator and support staff appointed to the PIU have clear roles and responsibilities.	An Agriculture Extension Officer of DAE is assigned as Project Coordinator in the PIU with three support staff (one computer operator and one office assistant are appointed on a contract basis and one technical assistant of the DAE deputed in the PIU. The Project Coordinator reports to the Director of DAE on project related matters.
3.11 At what frequency are personnel transferred?	Government staff are generally transferred every two years.	
3.12 What is training policy for the finance and accounting staff?	The Revenue Administrative Training Centre and Staff College provides basic training to finance and accounts staff. In addition, various governmental and non-governmental agencies provide training to finance and accounts staff depending on project needs.	The accounts staff of DAE/DADO have not received training on SOE procedures.
4. Accounting Policies and Procedures		
4.1 Does the entity have 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? Will the project use the entity accounting system?	The project will follow the standard government accounting system directed by the Financial Comptroller General's Office. The financial accounting and reporting system includes project financial transactions, allocation of expenditures in accordance with the respective components, disbursement categories and source of funds. The PIU prepares two reports: one for the Government and another for the CPMO for ADB.	

Topic	Response	Remarks
4.2 Are controls in place concerning the preparation and approval of transactions, ensuring that all transactions are correctly made and adequately explained?	Yes. A control system is in place. The system follows approval of transactions by the implementation entities' head as per the budget, internal audit and statutory audit.	
4.3 Is the chart of accounts adequate to properly account for and report on project activities and disbursement categories?	Yes. The chart of accounts in the government accounting system is adequate for recording financial transactions.	There is a need to prepare project accounts and sub-accounts separately as required by ADB and other agencies.
4.4 Are cost allocations to the various funding sources made accurately and in accordance with established agreements?	Yes. Some subproject cost allocations are changed during project implementation. In such cases, the PIU requests variations in costs allocations.	
4.5 Are the General Ledger and subsidiary ledgers reconciled and in balance?	Yes.	
4.6 Are all accounting and supporting documents retained on a permanent basis in a defined system that allows authorized users easy access?	Yes. An appropriate documentation system is in place and is easily accessible to authorized staff.	
Segregation of Duties		
4.7 Are the following functional responsibilities performed by different units or persons: (i) authorization to execute a transaction; (ii) recording of the transaction; and (iii) custody of assets involved in the transaction?	Yes. Lines of authority are defined for various positions in government financial rules and regulations. The Director of DAE at the PIU level, Directors at regional level and DADO heads at district level are responsible for authorization of payments. The Accounts Section at each level is responsible for accounting and reporting. The Store Unit at each level is responsible for the custody of assets.	
4.8 Are the functions of ordering, receiving, accounting for, and paying for goods and services appropriately segregated?	Yes. The Store Unit is responsible for ordering and receiving goods but payment is made by Accounts Section.	
4.9 Are bank reconciliations prepared by someone other than those who make or approve payments?	Yes. The DADO Head approves payments and DTCO makes payments. DTCO is responsible for reconciliation of the bank statements.	
Budgeting System		
4.10 Do budgets include physical and financial targets?	Yes.	
4.11 Are budgets prepared for all significant activities in sufficient	Yes. The budget is prepared in detail for all	

Topic	Response	Remarks
detail to provide a meaningful tool with which to monitor subsequent performance?	significant activities, providing a benchmark for monitoring performance.	
4.12 Are actual expenditures compared to the budget with reasonable frequency, and explanations required for significant variations from the budget?	Yes. Actual expenditures are compared to the budget before each transaction. Explanations are required for significant variations from the implementing agency heads. Regional Director, Director General of DOA, Secretary of MOAD and MOF are authorized based on the nature and percentage of variation.	
4.13 Are approvals for variations from the budget required in advance or after the fact?	Variation approvals are required in advance.	
4.14 Who is responsible for preparation and approval of budgets?	The Project Coordinator in coordination with the CPMO and Accounts Section of DAE is responsible to prepare the program and budget. The National Planning Commission, MOAD and MOF are responsible for finalizing the program and budget.	
4.15 Are procedures in place to plan project activities, collect information from the units in charge of the different components, and prepare the budgets?	Yes. Based on the project document and in coordination with CPMO, the PIU prepares budgets based on the information received from DADOs. At the district, the DADO prepares the budget according to the budget ceiling provided by the PIU in coordination with the Water User's Association (WUA) and DDC.	
4.16 Are the project plans and budgets of project activities realistic, based on valid assumptions, and developed by knowledgeable individuals?	Yes. Due to delays in irrigation subproject implementation, problems may arise in implementation of agriculture related project activities.	
Payments		
4.17 Do invoice-processing procedures provide for: (i) Copies of purchase orders and receiving reports to be obtained directly from issuing departments? (ii) Comparison of invoice quantities, prices and terms, with those indicated on the purchase order and with records of goods actually received? (iii) Comparison of invoice quantities with those indicated on the receiving reports? (iv) Checking the accuracy of calculations?	Yes.	

Topic	Response	Remarks
4.18 Are all invoices stamped PAID, dated, reviewed and approved, and clearly marked for account code assignment?	Invoices are not stamped "PAID". However, an approval procedure is in place.	
4.19 Do controls exist for the preparation of the payroll and are changes to the payroll properly authorized?	The Accounts Section is responsible for preparing payroll, which has to be approved by the DTCO and office head every year.	
Policies And Procedures		
4.20 What is the basis of accounting (e.g., cash, accrual)?	Cash.	
4.21 What accounting standards are followed?	The accounting standards followed are defined by the FCGO and the Office of the Auditor General of Nepal (OAGN). These are based on International Public Sector Accounting Standards, Nepalese Accounting Standards and International Financial Reporting Standards.	
4.22 Does the project have an adequate policies and procedures manual to guide activities and ensure staff accountability?	Yes. There is a code of conduct of public services and the Financial Procedure Rules has set out the job description of the Account Section chief. The rules has also defined procedures for financial transactions.	
4.23 Is the accounting policy and procedure manual updated for the project activities?	No. There is a need to develop an operation manual in accordance with ADB requirements.	
4.24 Do procedures exist to ensure that only authorized persons can alter or establish a new accounting principle, policy or procedure to be used by the entity?	Yes.	The Financial Comptroller General's Office (FCGO) can make changes based on agreement with ADB for the project.
4.25 Are there written policies and procedures covering all routine financial management and related administrative activities?	Yes. Financial Procedure Act and Rules and Procurement Act and Regulation cover all routine financial management and related administrative activities. In addition, manuals prepared by MOF and FCGO provide guidelines on financial management. The PIU follows ADB guidelines for SOEs.	
4.26 Do policies and procedures clearly define conflict of interest and related party transactions (real and apparent) and provide safeguards to protect the organization from them?	Yes.	
4.27 Are manuals distributed to appropriate personnel?	They are accessible to personnel working on the project.	

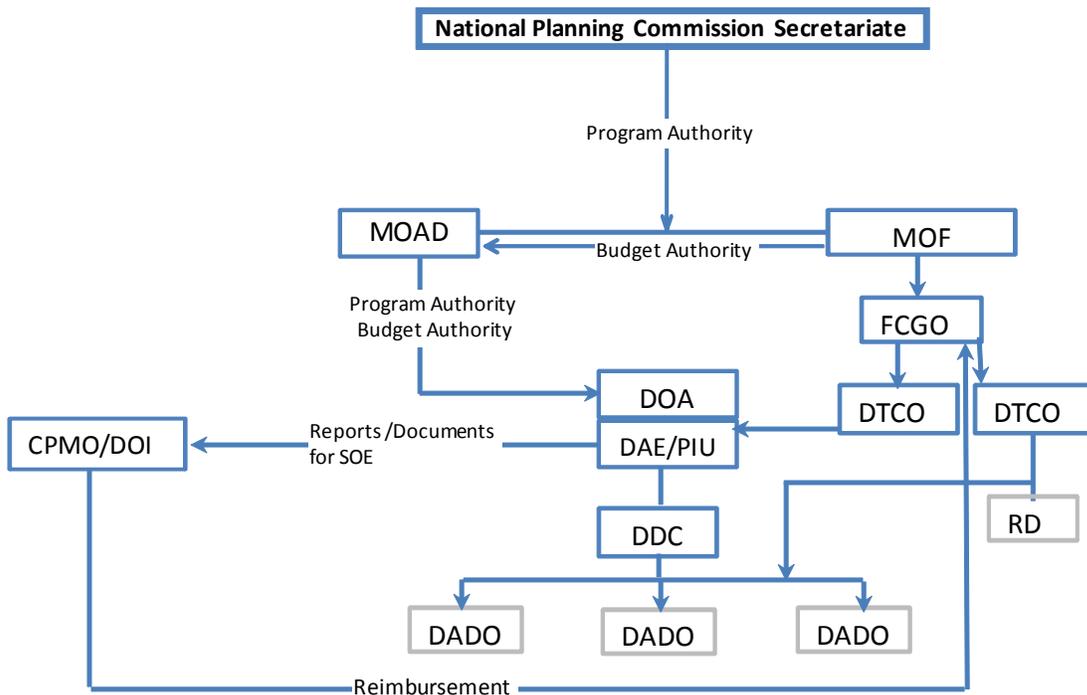
Topic	Response	Remarks
Cash and Bank		
4.28 Indicate names and positions of authorized signatories in the bank accounts.	The Director of DAE and Accounts Officer of the Finance Section at the PIU and DADO Head and Accountant at district level provide authorization for payment to DTCCO.	The DTCCO make payment as per the authorization of the spending unit
4.29 Does the organization maintain an adequate, up-to-date cashbook, recording receipts and payments?	Yes.	
4.30 Do controls exist for the collection, timely deposit and recording of receipts at each collection location?	Yes. The PIU collects reports from DADO for SOEs but there are some delays in timely collection of financial reports	The lack of experience of accountants, frequent transfers and vacant positions are the major causes of delay in submission of SOEs.
4.31 Are bank and cash reconciled on a monthly basis?	Yes.	By DTCCO
4.32 Are all unusual items on the bank reconciliation reviewed and approved by a responsible official?	Yes.	
4.33 Are all receipts deposited on a timely basis?	Yes.	
Safeguard over Assets		
4.34 Is there a system of adequate safeguards to protect assets from fraud, waste and abuse?	Yes. The Store Unit of DAE and DADO keeps records of fixed assets and stocks.	
4.35 Are subsidiary records of fixed assets and stocks kept up to date and reconciled with control accounts?	Yes. Subsidiary ledgers are maintained but there is no asset valuation system for providing values in financial statements.	
4.36 Are there periodic physical inventories of fixed assets and stocks?	Yes. A system for verification of physical inventories of fixed assets and stocks exists. As a rule, these are to be done on six-monthly basis at the minimum.	
4.37 Are assets sufficiently covered by insurance policies?	DOA has no insurance policy covering its assets except for vehicles. For vehicles, insurance cover is third party, not comprehensive.	
Other Offices and Implementing Entities		
4.38 Are there any other regional offices or executing entities participating in implementation?	Yes. Regional offices under DOA and DADO participate in project implementation	
4.39 Has the project established controls and procedures for flow of funds, financial information, accountability, and audits in	Yes. The PIU has maintained procedural and control relationships with other offices.	

Topic	Response	Remarks
relation to the other offices or entities?		
4.40 Does information among the different offices/implementing agencies flow in an accurate and timely fashion?	Yes. However, the PIU has experienced delays in submission and inaccuracies in documents from DADOs.	
4.41 Are periodic reconciliations performed among the different offices/implementing agencies?	Yes.	
Other		
4.42 Has the project advised employees, beneficiaries and other recipients to whom to report if they suspect fraud, waste or misuse of project resources or property?	Yes. A grievance and complaint system is in place and staff have been made aware of it.	
5. Internal Audit		
5.1 Is there a internal audit department in the entity?	There is no internal audit department as such. The internal audit function is performed by concerned DTCO for PIU and Regional Directorate and DDC's internal auditor for DADOs every month.	
5.2 What are the qualifications and experience of audit department staff?	The DTCO/DDC sends experienced staff to perform the internal audit but they are not professionally qualified for auditing.	
5.3 To whom does the internal auditor report?	The internal auditor reports to the Director of DAE and head of the district offices.	
5.4 Will the internal audit department include the project in its work program?	Yes. DTCO and DDC include the project in their work plans.	
5.5 Are actions taken on the internal audit findings?	Yes.	
6. External Audit		
6.1 Is the entity financial statement audited regularly by an independent auditor? Who is the auditor?	Yes. The statutory or external audit is conducted after the end of each fiscal year by staff appointed by the Office of the Auditor General of Nepal (OAGN).	OAGN is a constitutional independent body, reporting to the President.
6.2 Are there any delays in audit of the entity? When are the audit reports issued?	No. The audit is generally completed within 9 months after the end of the fiscal year. The audit report is issued 35 days after the completion of the audit.	
6.3 Is the audit of the entity conducted according to the International Standards on Auditing?	Yes. The audit is conducted according to Nepalese Auditing Standards, which comply with International Auditing Standards.	
6.4 Were there any major accountability issues brought out in the audit report of the past three	Delays in spending authority to DADO (the spending authority channel is MOF to MOAD to DOA to DDC to	

Topic	Response	Remarks
years?	DADO) and staffing at DADO were the key issues raised in the audit reports. There were no major accountability issues raised in past three years under CMIASP.	
6.5 Will the entity auditor audit the project accounts or will another auditor be appointed to audit the project financial statements?	The entity auditor appointed by the OAGN performs external audit of the project account.	
6.6 Are there any recommendations made by the auditors in prior audit reports or management letters that have not yet been implemented?	No.	
6.7 Is the project subject to any kind of audit from an independent governmental entity (e.g., the supreme audit institution) in addition to the external audit?	No.	
6.8 Has the project prepared acceptable terms of reference for an annual project audit?	No. They are not required.	
7. Reporting and Monitoring		
7.1 Are financial statements prepared for the entity? In accordance with which accounting standards?	Financial statements and supporting schedules are prepared according to Nepal Accounting Standards. These follow International Financial Reporting Standards.	
7.2 Are financial statements prepared for the implementing unit?	Yes.	
7.3 What is the frequency of preparation of financial statements? Are the reports prepared in a timely fashion so as to be useful to management for decision making?	Financial statements are prepared on a monthly, trimester and annual basis. This provides information for management decision making.	
7.4 Does the reporting system need to be adapted to report on the project components?	Yes.	
7.5 Does the reporting system have the capacity to link the financial information with the project's physical progress? If separate systems are used to gather and compile physical data, what controls are in place to reduce the risk that the physical data may not synchronize with the financial data?	Separate financial and physical progress reports are prepared. While preparing the physical progress report, there is a need to synchronize financial data with physical progress.	
7.6 Does the project have established financial management reporting responsibilities that specify what reports are to be	Yes.	

Topic	Response	Remarks
prepared, what they are to contain, and how they are to be used?		
7.7 Are financial management reports used by management?	Yes.	
7.8 Do the financial reports compare actual expenditures with budgeted and programmed allocations?	Yes.	
7.9 Are financial reports prepared directly by the automated accounting system or are they prepared by spreadsheets or some other means?	Yes. DAE prepares financial statements directly through its automated accounting system but DADOs prepares them using spreadsheets.	
8. Information Systems		
8.1 Is the financial management system computerized?	Yes. The DAE accounting system is computerized by using computer software program developed by private developers. but in DADOs it is not	
8.2 Can the system produce the necessary project financial reports?	Partly.	
8.3 Is the staff adequately trained to maintain the system?	Partly.	
8.4 Does the management organization and processing system safeguard the confidentiality, integrity and availability of the data?	Partly.	

Funds Flow under CMIASP



CPMO = Central Project Management Office, DADO = District Agriculture Development Office, DAE = Directorate of Agriculture Extension, DDC = District Development Committee, DOA = Department of Agriculture, DOI = Department of Irrigation, DTCO = District Treasury Controller Office, FCGO = Financial Comptroller General's Office, MOAD = Ministry of Agricultural Development, MOF = Ministry of Finance, RD = Regional Directorate.

ANNEX C. FINANCIAL REPORTING FORMATS (FOR REPORTING TO ADB)

Government of Nepal
Ministry of -----
Department of -----
Community-Managed Irrigated Agriculture Sector Project
Funded by ADB Loan -----

For the period [July 17, 20xx or loan effectiveness date] to July 16, 20xx

Fiscal year 2011/ xx
Sources and Uses of Funds

Sources	Note	Cumulative upto beginning of prior year	During the Prior Year	Cumulative as at [commencement date/beginning of current period]	For the period [commencement date] to July 16, 20XX	As at July 16, 20XX	Applications	Category	Note	Cumulative upto beginning of prior year	During the Prior Year	Cumulative as at [commencement date/beginning of current period]	For the period [commencement date] to July 16,	As at July 16, 2014
		NR								NR				
		[For 1st year, nil]	[For 1st year, nil]	[For 1st year, nil]	For current period	At current year end				[For 1st year, nil]	[For 1st year, nil]	[For 1st year, nil]		
A:	II						Civil Works	1	I					
GON Fund	II						Consulting Services	2	I					
GON Reimbursable Fund							Training Courses	3	I					
ADB Reimbursable							Vehicles	4	I					
							Equipment and Materials	5	I					
Total Remburseable							Staff Development	6	I					
	III						Studies and Reviews	7	I					
ADB Grant:							Project Management,	8	I					
Reimbursement							Others	9	I					
Replenishment														
Transfer to Central Treasury														
Direct Payment														
Charged in the next year														
Subtotal														
B:														
ADB														
Special Imprest	IV						Imprest A/c Balance							
Account/ Initial Deposit							Oustanding							
Exchange Gain							Replenishment							
Subtotal							Exchange Loss							
Grand Total														

Notes I to VI of the financial statements form an integral part of these financial statements

(_____)
Account-In Charge

(_____)
Project Director

(_____)
Secretary Ministry of -----

(_____)
(Financial Comptroller General)

(_____)
Auditor General

Government of Nepal
 Ministry of -----
 Department of -----
Community-Managed Irrigated Agriculture Sector Project
Funded by ADB Loan -----
 July 17, 20xx to July 16, 20xx
 Fiscal Year 20xx/xx

Statement of Budget Vs Actual (or Consolidated Annual Financial Statement)

Current Year

Item No.	Budget Item	Budget Allocation												Amount in NRs			
		Budget Allocation				Budget Released				Expenditure				Balance (Released-Expenditure)			
		GON	ADB Reimbursable Loan	ADB D.P. Loan	Total	GON	ADB Reimbursable Loan	ADB D.P. Loan	Total	GON	ADB Reimbursable Loan	ADB D.P. Loan	Total	GON	ADB Reimbursable Loan	ADB D.P. Loan	Total
Budget Head - Recurrent Expenditure																	
xx																	
xx																	
xx																	
xx																	
Sub Total																	
Budget Head - Capital Expenditure																	
xx																	
xx																	
xx																	
xx																	
Sub Total																	
Grand Total																	

Cumulative to Date

Item No.	Budget Item	Budget Allocation												Amount in NRs			
		Budget Allocation				Budget Released				Expenditure				Balance (Released-Expenditure)			
		GON	ADB Reimbursable Loan	ADB D.P. Loan	Total	GON	ADB Reimbursable Loan	ADB D.P. Loan	Total	GON	ADB Reimbursable Loan	ADB D.P. Loan	Total	GON	ADB Reimbursable Loan	ADB D.P. Loan	Total
Budget Head - Recurrent Expenditure																	
xx																	
xx																	
xx																	
xx																	
Sub Total																	
Budget Head - Capital Expenditure																	
xx																	
xx																	
xx																	
xx																	
Sub Total																	
Grand Total																	

Notes I to VI of the financial statements form an integral part of these financial statements

(_____) Account-In Charge	(_____) Project Manager	(_____) Secretary Ministry of -----	(_____) Financial Comptroller General	(_____) Auditor General
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Government of Nepal
 Ministry of -----
 Department of -----
Community-Managed Irrigated Agriculture Sector Project
Funded by ADB Loan -----
 July 17, 20xx to July 16, 200x

Fiscal year 20xx/xx

Notes to Account - I Category- wise Expenditures

Category	Line Item	Particular	Cumulative upto	During the	Cumulative upto	For the period	As at July 16,	
			beginning of prior		beginning of			[commencement
			year	Prior year	current year/ period	date] to July 16,	Current	
			NR					Year)
1		Civil Works						
	xx	Building Construction						
	xx	Capital Improvement						
			Subtotal					
2		<u>Consulting Services</u>						
	xx							
	xx							
			Subtotal					
3		<u>Training Courses</u>						
	xx							
	xx							
			Subtotal					
4		<u>Vehicles</u>						
	xx							
	xx							
			Subtotal					
5		<u>Equipment and Materials</u>						
	xx							
	xx							
			Subtotal					
6		<u>Staff Development</u>						
	xx							
	xx							
			Subtotal					
7		<u>Studies and Reviews</u>						
	xx							
	xx							
			Subtotal					
8		<u>Project Management, Monitoring and Evaluation</u>						
	xx							
	xx							
	xx							
	xx							
			Subtotal					
9		<u>Others</u>						
	xx							
	xx							
	xx							
			Subtotal					
			Grand Total					

Government of Nepal
 Ministry of -----
 Department of -----
Community-Managed Irrigated Agriculture Sector Project
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 July 17, 20xx to July 16, 200x

Fiscal year 20xx/xx

Notes to Account IV - Statement of Imprest Account

S.N.	Particulars	Equivalent NRs	US\$
A	Balance in Imprest Account as at [beginning of the current year] Exchange Rate 1 UD\$ = NRs xx.xx		
B	Outstanding Replenishments as of [previous year] (i) Remibursement to GON (ii) Direct Payment		
	Total B		
C	Add: Disbursements during the year (i) Remibursement to GON (ii) Direct Payment		
	Total C		
D	Less: Replenishment during the year (i) Remibursement to GON (ii) Direct Payment		
	Total D		
E	Liquidation/ Recovery of Initial Balance (i) Remibursement to GON (ii) Direct Payment		
	Total E		
F	Outstanding Replenishment as of [end of the current year] (i) Remibursement to GON (B+C-D-E) (ii) Direct Payment (B+C-D-E)		
	Total F		
G	Outstanding Amount of Imprest Account (A+F)		
H	Initial Deposit as at (original date)		
I	Exchnage Gain/Loss (G-H)		

