

Financial Management Assessment

March 2020

Bangladesh: Rural Connectivity Improvement
Project – Additional Financing

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List of Abbreviations

ADB	Asian Development Bank
AF	Additional Financing
AG	Auditor General
APFS	Annual Project Financial Statements
BAS	Bangladesh Accounting Standards
BFRS	Bangladesh Financial Reporting Standards
BSA	Bangladesh Standard on Auditing
CAG	Controller and Auditor General
CGA	Controller General of Accounts
CPS	Country Partnership Strategy
EA	Executing Agency
FAPAD	Foreign Aided Project Audit Department
FMA	Financial Management Assessment
FY	Financial Year
IA	Implementing Agency
IAS	International Accounting Standard
IBAS	Integrated Budgeting and Accounting System
ISA	International Standards for Auditing
IPC	Interim Payment Certificate
IT	Information Technology
LGD	Local Government Division
LGED	Local Government Engineering Department
MLGRD&C	Ministry of Local Government Rural Development & Cooperatives
MOF	Ministry of Finance
MOP	Memorandum of Payment
PD	Project Director
PDA	Project Design Advance
PMU	Project Management Unit
PMS	Project Management System
RCIP	Road Connectivity Investment Project
SOE	Statement of Expenditure
WA	Withdrawal Application

EXECUTIVE SUMMARY

1. The Financial Management Assessment (FMA) was conducted in February 2018 as part of the due diligence of the Rural Connectivity Improvement Project (current project) in accordance with the Asian Development Bank (ADB) Guidelines for the Financial Management and Analysis of Projects¹ and Financial Due Diligence: a Methodology Note, and Technical Guidance Notes.² The FMA was updated for the additional financing in November 2019 and February 2020. The update focused on reconfirming the FMA arrangements in place and assessing the performance as part of the ongoing project including the achieved progress against the agreed FM action plan.
2. The Local Government Engineering Department (LGED) is the executing and implementing agency of the project. The FMA considered the capacity of the LGED and the project management unit (PMU), including funds-flow arrangements, governance, staffing, budgeting, accounting and financial reporting systems, internal control procedures, financial information systems, and internal and external auditing arrangements.
3. LGED has considerable experiences in implementing donor-funded projects including the ADB-funded current project. A PMU has been established as part of the current project and is currently fully staffed. The PMU will be responsible for all day-to-day management of the additional financing, which include (i) preparing an overall project implementation plan and detailed work program; (ii) providing monitoring and guidance on implementation of project works; (iii) carrying out all tendering process and execution of contracts; (iv) preparing the project progress report and project completion report; and (v) ensuring full compliance with the ADB's safeguard policies. The additional financing will follow the same FM arrangements already established as part of the ongoing project, including the staffing arrangements in the PMU and district offices.
4. The overall FM risk is assessed as Substantial. The main FM risks identified by the FMA include: (i) decentralized flow of funds to district offices, (ii) lack of knowledge of ADB FM and disbursement procedures and systems among project FM staff, and (iii) a partly manual accounting system. These risks will be mitigated through the following: (i) providing training FM and in ADB 's FM disbursement procedures and systems; (ii) developing supplementary accounting instructions; (iii) including the additional financing in the audit plan of LGED's internal audit function; (iv) including comprehensive financial information in the quarterly progress reports; and (v) further computerizing the accounts and intensifying the use of ADB disbursement systems.
5. As per established practice, the additional financing will maintain separate books of account in accordance with accounting standards acceptable to ADB and the detailed project financial statement will be audited annually by an independent auditor acceptable to ADB in accordance with International Standards on Auditing (ISA). Furthermore, a full-time financial expert to be hired as part of the ongoing project will support financial management and audits during the implementation of the additional financing project.

¹ ADB. 2005. [Financial Management and Analysis of Projects](#). Manila.

² ADB. 2015. [Financial Due Diligence: A Methodology Note](#). Manila.

I. INTRODUCTION

1. The Asian Development Bank (ADB) approved the Rural Connectivity Improvement Project (current project) for a regular loan of \$100 million (Loan 3731) and a concessional loan of \$100 million (Loan 3732) on 5 November 2018. The loan agreements were signed on 13 January 2019 and declared effective on 13 February 2019. The project is to be implemented over 5 years. Both loans will close on 31 May 2024.

2. During the Inception Mission (11–18 March 2019) and Review Mission (30 September – 6 October 2019), The Local Government Engineering Department (LGED) and the Ministry of Local Government Rural Development & Cooperatives requested ADB to consider additional financing of \$100 million for the balance of 930 kilometers (km) of rural roads.³

3. A Financial Management Assessment (FMA) was conducted in February 2018 as part of the due diligence of the current project in accordance with ADB's Guidelines for the Financial Management and Analysis of Projects⁴ and Financial Due Diligence: a Methodology Note, and Technical Guidance Notes.⁵ The FMA was further updated for the additional financing in November 2019 and February 2020. The update focused on reconfirming the FMA arrangements in place and assessing the performance part of the ongoing project including the achieved progress against the agreed FM action plan.

II. COUNTRY AND SECTOR ISSUES

4. The inherent FM risk in Bangladesh is substantial. The corruption perception index published by TI international has improved slightly from 25 in 2015 to 26 in 2018. In 2018, Bangladesh ranked as 149 out of 180 countries. To date, three PEFA assessments have been undertaken for Bangladesh, 2006, 2010 and 2016. The 2016 PEFA assessment notes that overall there has been a renewed focus on PFM activities and a continued emphasis on improving PFM processes and procedures and that Bangladesh has made positive strides in developing its PFM systems since the 2010 PEFA assessment. However, important areas such as internal audit, annual financial reports and external audit continue to score poorly weak. Indeed, significant delays in finalization of annual financial reports hamper the effectiveness of external audits while the timeliness of the legislature's scrutiny is negatively affected by the backlog of audit reports to be submitted to Parliament. However, the report emphasizes that due to the ongoing reforms at the time of the assessment, the weak score may not do justice to the areas such as procurement, internal audit, oversight of public corporations, and external audit.

5. ADB projects being implemented in the country make use of the country's public financial management systems, including the following:

- (i) All loan and grant proceeds are credited to the government's account through the Central Bank of Bangladesh, and all subsequent repayments to ADB are also channeled through the central bank. However, subaccounts are often maintained by the projects in a commercial bank.
- (ii) The government entities use an integrated budget and accounting system (IBAS). However, IBAS is not capable of recording transactions incurred under foreign-aided projects and as a result separate records are usually maintained manually. This could change through the development and roll out of IBAS++, which may eventually be able to account for all project funds.
- (iii) Most entities prepare their financials in accordance with Bangladesh Accounting Standards (BAS) which are broadly based on the cash-basis International Public Sector Accounting Standards. Accordingly, the financial statements include

³ This was originally 972 kilometers but as construction costs increased this was reduced to 930 kilometers. Routine maintenance budget for these roads is tied to the government's Development Project Proposal (DPP), hence they are currently not maintained, and their condition deteriorates further due to the intense monsoon rains of 2019.

⁴ ADB. 2005. [Financial Management and Analysis of Projects](#). Manila.

⁵ ADB. 2015. [Financial Due Diligence: A Methodology Note](#). Manila.

information about the sources of cash receipts during the period, the purposes for which the cash was used, and the cash balances at the reporting date. The fiscal year in Bangladesh is from July to June.

- (iv) All ADB projects are audited by the Foreign Aided Project Audit Directorate (FAPAD), a specialized arm of the CAG dedicated to providing independent assurance to Parliament as well as to development. Each year, FAPAD identifies all projects subject to audit, considering its available resources.

6. Based on the experience gained with ADB's past and ongoing projects in the country, the following risks will need to be considered during project processing and implementation:

- (i) Low capacity among accounts staff specifically at the regional and district level;
- (ii) Project account staff are not adequately trained in ADB's FM requirements and in the use ADB's financial systems (LGFIS and CPD) to reconcile project accounts with ADB's disbursement;
- (iii) Manual books of account maintained by the projects, resulting in cumbersome reporting which is prone to errors;
- (iv) Bridge financing where ADB funds are used to pre-finance expenditures to be financed by the government or other development partner;
- (v) Inadequate financial information included in the quarterly progress reports submitted to ADB;
- (vi) FAPAD may not issue a separate audit opinion on the use of ADB loan/grant proceeds;
- (vii) The entity auditors may not issue a separate audit opinion on the compliance with financial ratios as required by ADB; and,
- (viii) Lack of follow-up on audit observations including recurring audit observations.

7. To mitigate the inherent risk with regards to Public Financial Management, ADB's country partnership strategy for Bangladesh, 2016–2020 highlights the need to: (i) improve the preparation of timely year end accounts; (ii) adhere to international accounting standards; (iii) strengthening of internal audit; and (iv) appoint skilled personnel to conduct performance audits. The country partnership strategy also states that ADB will support the strengthening of country systems and counterpart capacity—through financial management action plans, fiduciary reviews and technical assistance, continue supporting governance reforms through policy-based lending (e.g., the Good Governance Program) as well as engage with policy makers and key stakeholders, in collaboration with other development partners, to progress enforcement of laws and implementation of agreed reforms.

III. PROJECT DESCRIPTION

8. The proposed additional financing will scale up the current output 1 by including additional 930 kilometers of rural roads. The additional financing is estimated to cost \$163.95 million including ADB financing of \$100 million (100% concessional loan). The additional financing will finance numerous civil work contracts as well as one consulting services contract.

9. LGED has considerable experience in implementing donor-funded projects including the ADB-financed current project. The additional financing will follow the same FM arrangements already established part of the ongoing project. A project management unit (PMU) has been established part of the ongoing project and is currently fully staffed. The PMU is responsible for all day-to-day management of the additional financing, including: (i) preparing an overall project implementation plan and detailed work program; (ii) providing monitoring and guidance on implementation of project works; (iii) carrying out all tendering process and execution of contracts; (iv) preparing the project progress report and project completion report; and (v) ensuring full compliance with the ADB's safeguard policies.

10. The project will be implemented in 16 districts and all LGED district offices are fully staffed.

IV. DETAILED FINANCIAL MANAGEMENT ASSESSMENT

A. Executing and Implementing Entity

11. LGED, a government department under the Local Government Division (LGD) of the Ministry of Local Government Rural Development & Cooperation (MLGRD&C), will be the project executing and implementing agency and responsible for overall project coordination, management, and implementation. The PMU, headed by Project Director, with sufficient support staff, is established within LGED at the central level and is the implementing unit for LGED for the current project and the additional financing. The district office headed by Executive Engineer with support staff, will be monitoring the civil works for the PMU at field level. One construction supervision consultant to be engaged under the PMU will act as the engineer for the construction contracts.

12. LGED has been implementing various projects funded by multilateral and bilateral donors such as the World Bank, ADB, IFAD, DANIDA, DFID, GTZ, KfW and JICA in rural infrastructure development.

13. LGED is currently implementing the current project, which became effective in February 2019. As of February 2020, the PMU has made some progress with regards to the agreed actions outlined in the project administration manual of the ongoing project, including the following:

- (i) The FM staff has been appointed to the PMU and the 34 District Offices;
- (ii) The ongoing project has been included in the audit plan of LGED's internal audit function; however, the first audit report has not yet been shared with the PMU;
- (iii) Counterpart funds have been released in a timely fashion;
- (iv) ADB share of funds are being released to the District Office based on the agreed Funds Requisition Form and the contractor's invoice; and
- (v) The practice to park a portion of ADB funds in another account for future payment of retention money has been abolished.

14. However, the following critical actions are still in progress and will need to be followed up closely:

- (i) The development of a supplementary manual outlining the check and review system for manually prepared information to prevent misstatements. In late December 2019, ADB provided the PMU with a draft outline and inputs for the manual which are currently being finalized by the PMU; and
- (ii) The recruitment of an FM consultant responsible to provide support to the PMU and the District Offices. The tendering for the project implementation support consultant (PISC) package is ongoing and the FM consultant is expected to be recruited by May 2020.
- (iii) The PMU has submitted QPRs as required for the ongoing project but the financial information is not adequate, partly because the FM consultant under the Project Implementation Support Consultant (PISC) is not yet in place in the PMU (mobilization expected in May/June 2020).

15. Furthermore, during the initial FM assessment the following weaknesses were identified as fiduciary risk in the initial FM assessments of systems and processes, which still remain relevant:

- (i) The FM staff needs training on ADB's policies and procedures;
- (ii) 34 District Offices are going to monitor and implement the civil works for the current project, out of which 16 will monitor and implement the works under the additional financing;
- (iii) Comprehensive FM information, including analysis of physical and financial progress needs to be added to the quarterly progress reports;
- (iv) Partly insufficient use of existing accounting and monitoring software in the projects;

- (v) Bridge financing issues noticed in the other ADB projects handled by LGED; and
- (vi) The practice to park a portion of ADB funds in another account for future payment of retention money abolished on the ongoing project and will also be forbidden under the additional financing project. Any other method such as accepting bank guarantee in lieu of retention at the end of the contract is to be considered.

16. The first audit of the current project was undertaken by FAPAD in accordance with International Standards on Auditing and the audited project financial statement (APFS) covering the FY2018–2019 was submitted to ADB on time.⁶ The auditor issued an unqualified opinion on the financial statements, the use of the statement of expenditure (SOE), and the advance/imprest account reconciliation statement. As per usual practice, FAPAD did not issue a specific opinion on the use of loan proceeds as required by ADB. However, this assurance is implied from the overall audit opinion and the audit opinion on the imprest account. ADB is currently supporting an initiative to revise the FAPAD audit manual which will include ADB's requirement to issue a separate audit opinion on the use of funds.

17. ADB's audit review of the APFS identified a number of immediate actions including the submission of a reconciliation statement of reported amount against actual ADB's disbursements as well as an advance/imprest account statement. The audit review also identified a number of actions to be implemented to improve the quality of the APFS in the future. These actions will need to be followed up as part of review missions.

B. Personnel, Accounting Policies and Procedures, Internal and External Audit

18. **Personnel.** LGED, the executing and implementing agency, will post sufficient dedicated finance and accounting staff in the PMU at the central level to manage the implementation for LGED. All the staff has to be in place before the start of the project. The organizational structure of PMU is depicted in Appendix C.

19. **Accounting Policies and Procedures:** Project finances were managed based on the existing Bangladesh Accounting Standard (BAS), IFRS and IAS on modified cash basis. The existing regulations are having adequate control in place concerning the preparation and approval of transactions. Detailed chart of accounts is in place. Cost allocations are done based on chart of account. The books of accounts are maintained in spreadsheet and updated manually. Accountant of the District Office is updating the details in the Integrated Budgeting Accounting System (IBAS) software for the government payments. The government is planning to implement the online data entry into the software by the field unit so the subsequent data entry can be avoided. The development of IBAS++ is part of the government process for accounting external aided projects.

20. The major component of the additional financing project comprises civil works. The IPCs/bills of the contractor are verified regarding the bill of quantities (BOQ) agreed rates per the contract agreement at various stages. In respect of goods and services, well established procedures are in place. The payments to the staff and officers are made per the government rules and regulations. The controls for preparation of payroll and changes thereto are considered adequate.

21. The counterpart funds are managed through Treasury Account in Controller General Accounts. The payments on these vouchers are made by the Executive Engineers of the District Office per the delegation of powers. Bank statements are reconciled on a monthly basis. Accounting software IBAS is used to record the transactions. The supporting documents are kept in the District Office for audit as well as for future reference. LEGD has developed a computerized

⁶ The APFS was received by ADB on 31 December 2019. LGED resubmitted the APFS on 22 January 2020 clarifying that both loans 3731 and 3732 were covered in the APFS.

accounting system, called Uniform Financial Management System (UFMS) which helps the preparation of the SOE.

22. The government procedures are followed to safeguard and protect assets from fraud, waste and abuse. A physical inventory of fixed assets is undertaken during annual audit.

C. Budgeting

23. **Budgeting.** The financial management cycle of budgeting, execution, accounting, and financial reporting mirrors and provides basic support to the project cycle of planning, implementation, recording results, and reporting. The financial management supports the project management and helps to assure that resources go towards the successful completion of the project and are not wasted.

24. Budgeting in LGED is done on annual basis. The Project Director prepares the budget requirement for the year and submits it to the Chief Engineer, LGED. The Chief Engineer submits the consolidated budget of his department to the Secretary Planning Ministry. The consolidated budget of the country is prepared by the Ministry of Finance and the budget is approved in the State's Legislature system. There is a system to compare the actual expenditure with the budgeted expenditure. Before incurring any expenditure, the budget provision is considered.

25. The capital costs related to new investment will form a part of the LGED capital expenditure budget. To ensure the implementation of the new project within its allocated timeframe, it is vital that the Treasury extends a firm commitment to prioritize the new project investment and fully allocate the necessary funding requirement to LGED during the annual budgetary process.

26. The current process of fund disbursement seems satisfactory based on the experience of past and ongoing foreign and nationally funded projects executed by LGED except in few cases. The Treasury releases the budgetary allocation normally in quarterly installments. These budgetary releases used for the counterpart payments for civil works by the District Office. In case of any shortfall in the budget release, the payment will be affected and may lead to delays in the execution of the project. To avoid this, proper budgeting at the beginning and commitment from the Ministry of Finance (MOF) for the proper release of counterpart fund in time is required.

D. Internal Audit

27. LGED has established an internal audit unit headed by a superintending engineer reporting to the LGED chief engineer. The internal audit unit is further divided into an internal audit section (15 positions) and an external audit monitoring section (9 positions).

28. LGED internal audit unit has a comprehensive internal audit manual since July 2017 which was developed as a collaboration between LGED, USAID, and UNOPS. The manual covers the whole audit cycle from the development of an audit plan to the follow-up on implementation of audit observations. In addition, it contains specific sections on procurement audit, audit of internal controls, project audit, works audit and IT audit. The manual also includes practical checklists and templates for reporting audit observations.

29. Due to shortage of staff the internal audit is carried out yearly. Semiannual internal audits would reduce the documentation risk since no pre-audit of vouchers is done prior to making payment due to shortage of staff. The ongoing project has been included in the annual internal audit program of the LGED internal audit unit and the PMU will request them to also cover the additional financing project.

E. External Audit

30. FAPAD under CAG of Bangladesh conducts audit of accounts of all foreign-aided projects. FAPAD conducts the audit based on the International Standard for Auditing. Usually APFS for ADB-financed projects are received on time or with minor delays. However, in the past FAPAD has not issued a separate opinion on the use of loan proceeds as required by ADB. ADB is currently supporting an initiative to revise the FAPAD audit manual which will include ADB's requirement to issue a separate audit opinion on the use of funds.

31. As per the established practice, the PMU will maintain separate accounts for the ongoing and additional financing projects and have such accounts and related financial statements audited annually by independent auditors acceptable to ADB and in accordance with the provisions of the Loan Agreements and as specified in the ADB's guidelines. Due to the differences in the respective scope of the ongoing RCIP and the AF project, two separate APFS will be submitted to ADB: one for the ongoing project and another one for the AF project.

32. Part of the additional financing project, the PMU/LGED will also need to inform FAPAD about the requirements of the timely audit of the additional financing project by loan effectiveness. The government and LGED have been made aware of ADB's approach to delayed submissions and the requirements for satisfactory and acceptable quality of the audited APFS.⁷

F. Financial Reporting Systems, including use of Information Technology

33. Financial reporting should demonstrate the accountability of the LGED/PMU and the resources entrusted to them and information useful for decision making by indicating whether resources were obtained and used in accordance with the legally adopted budget, the legal and contractual requirements, including financial limits established by appropriate legislative authorities. Financial reporting must provide information about the sources, allocation and uses of financial resources and how the LGED/PMU financed its activities and met its cash requirements. It must also provide information useful to evaluate the LGED/PMU's ability to finance its activities and meet its liabilities and commitments. Effective reporting is providing information about the financial condition of the LGED/PMU with aggregate information useful in evaluating the department's performance in terms of service costs, efficiency and accomplishments.

34. The LGED/PMU reports comply with the reporting requirements of the government. These reports are prepared monthly, quarterly and annually for audit. It is recommended that the PMU prepares and submit to ADB quarterly progress reports. In addition, it is suggested to include supplementary financial and disbursement reports in the quarterly progress report.

35. **Financial Reporting.** Timely reporting and quality of information are essential for the timely monitoring of the project. The LGED/PMU will submit to ADB its financial reports of the project within 15 days after completion of each quarter in both electronic and hard copy formats.

36. **Information Systems.** Computerized Integrated Budgeting and Accounting System (IBAS) software is used for recording governmental transactions. Steps are taken by the

⁷ ADB's approach and procedures regarding delayed submission of audited project financial statements:

- (i) When audited project financial statements are not received by the due date, ADB will write to the executing agency advising that (a) the audit documents are overdue; and (b) if they are not received within the next 6 months, requests for new contract awards and disbursement such as new replenishment of advance accounts, processing of new reimbursement, and issuance of new commitment letters will not be processed.
- (ii) When audited project financial statements are not received within 6 months after the due date, ADB will withhold processing of requests for new contract awards and disbursement such as new replenishment of advance accounts, processing of new reimbursement, and issuance of new commitment letters. ADB will (a) inform the executing agency of ADB's actions; and (b) advise that the loan may be suspended if the audit documents are not received within the next 6 months.
- (iii) When audited project financial statements are not received within 12 months after the due date, ADB may suspend the loan.

government to incorporate the expenditure details of the foreign-aided project into IBAS system. LGED has developed a UFMS software which is being introduced on different projects, however, the software can produce only statement of expenditure (SOE). Recognizing the limitations of the UFMS software, LGED started using Financial Management software named 'TOMPRO' for certain projects. To avoid multiple data entries and usage of different software, LGED has to find a solution to effectively use information system in financial management, particularly in accounting, reporting and contract management, either by customizing the existing software or buying/developing a software for LGED entirely. Table 1 summarizes current discussions. It is concluded that existing systems and the manual process are sufficient for the additional financing project, but the government will continue its efforts to find an optimal IT solution, which ideally would be IBAS++. Moreover, to mitigate the risks associated with the manual process, a check and review system will need to be established to prevent errors. It was agreed with the PMU that the manual being prepared under the current project will also be used under the additional financing.

Table 1: Summary of different software solutions

	Description	Risk/ Limitation	Notes
IBAS (MOF)	Record government transactions (counterpart fund).	Foreign-aided project expenditure cannot be recorded.	Government plans to incorporate foreign-aided project expenditures from 2020 under this software.
UFMS (LGED)	Internally developed.	Can only produce SOE.	
TOMPRO	Externally purchased financial management software (developed for foreign-financed projects by IFAD).	Project-based customized software with a very high license fee. Training is needed.	Link to District Office will be an issue since District Office manages several other projects and works other than ADB-funded projects.
Manual	Contract management. Financial reporting.	Manual contract management is difficult to maintain correctly.	Check and review system needs to be established to prevent errors. Manual to be developed by PMU.
Possible solution: Tally		Many not cover SOE, advance account reconciliation?	The cost will be high. A separate study/review is required to find out the suitable software.
Possible solution: IBAS++			When IBAS++ is ready for installation, most of the accounting parts can be managed.

V. DISBURSEMENT ARRANGEMENTS, FUNDS FLOW MECHANISM

37. **Disbursement Arrangements.** The loan proceeds will be disbursed in accordance with ADB's Loan Disbursement Handbook (2017, as amended from time to time).⁸ The project is financed by ADB on Advance Account basis and Direct Payment. The SOE procedure will be used to replenish eligible expenditure for payments under the Advance Account procedure. The SOE records will 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.

38. Pursuant to ADB's Safeguard Policy Statement (2009)⁹, ADB funds may not be applied to the activities described on the ADB Prohibited Investment Activities List set forth at Appendix 5 of Safeguard Policy Statement. LGED/PMU should ensure that the investments are in compliance with applicable national laws and regulations and will apply the prohibited investment activities list to all subprojects financed by ADB.

⁸ ADB. 2017. [Loan Disbursement Handbook](#). Manila.

⁹ ADB. 2009. [Safeguard Policy Statement](#). Manila.

39. LGED/PMU will be responsible for (i) preparing disbursement projections, (ii) requesting budgetary allocations for counterpart funds, (iii) collecting supporting documents, and (iv) preparing and sending withdrawal applications to ADB. Before the submission of the first withdrawal application, the LGED/PMU shall submit to ADB sufficient evidence of the authority of the person(s) who will sign the withdrawal applications on behalf of the Borrower, together with the authenticated specimen signatures of each authorized person. The minimum value per withdrawal application is set by ADB's Loan Disbursement Handbook. Individual payments below this value should be paid (i) by the executing agency and/or implementing agency and subsequently claimed to ADB through replenishment, or (ii) through the direct payment method procedure, unless otherwise accepted by ADB.

40. All disbursements under government financing will be carried out in accordance with regulations of the Government of Bangladesh for the government's component and ADB's procedures for ADB's component.

41. The review of the withdrawal application status of LGED on other projects shows some bridge financing issues. To avoid this to occur, it is recommended to transfer only the ADB's share to the field office sub-advance account for payment of civil works. The civil works payments are made at District Office level by the drawing and disbursing officer. Training on ADB's policies and procedures of the field staff (technical and financial) with the PMU staff at the central level need to be undertaken further during the additional financing project.

42. **Funds flow arrangements.** LGED is the executing and implementing agency and a dedicated PMU established during the ongoing project will also implements the additional financing project. Disbursement methods outlined in ADB's *Loan Disbursement Handbook* (2017) will also be adopted for the additional financing project. LGED/PMU will adopt direct payment method for the foreign component payments. An Advance Account procedure will be followed with replenishment for the local currency payments under civil works contracts, procurement of goods and consulting services under the project. The total cost of the project will be partly funded by the government (non-eligible portion) and the ADB's Loans (eligible portion). With the MLGRD&C support, there may not be any issue in arranging the counterpart funding by LGED for the additional financing project. It is reasonably considered that MOF shall be able to allocate and provide required funds without any delays. Since the counterpart fund is provided quarterly, there can be shortfall of funds in any of the quarters. This can be addressed with the correct budgeting at the initial stage. Any delay in releasing counterpart fund can delay payments to civil works as well as the overall completion of the project. A letter of commitment from the MOF for the timely release of counterpart fund is to be considered for smooth counterpart funds flow to the projects. A funds flow diagram is provided in Appendix A.

43. **From ADB to the Advance Account.** Loan proceeds will be channeled through an Advance Account in United States dollars and Sub Advance Account in BDT in the Bangladesh Bank. PMU will open a Sub Advance Account in a commercial bank acceptable to the government and ADB. There will be another sub sub-advance account opened by the 16 District Offices where the additional financing project will be implemented for the payment of ADB share for the civil works payments. ADB share of funds will be allocated to the District Office sub advance account by PMU based on the request for funds and the memorandum of payment (MOP) submitted by the District Office for the payment to be made for civil works. The Advance Account will be liquidated and replenished according to the ADB's *Loan Disbursement Handbook* (2017). An example of the request form for funds by District Office for the ADB share from the PMU is in Appendix B.

44. **From ADB to consultants.** Foreign component payments for consultants, contracted by the EA, will be paid directly by ADB after the EA's submission of approved invoices and documentation to ADB in accordance with ADB's *Loan Disbursement Handbook* (2017).

VI. RISK ASSESSMENT AND FM ACTION PLAN

45. During the implementation phase, LGED and the PMU might face risks that can generally be divided in two main categories: (i) country level; and (ii) organization/project level. Financial management risks shall need to be considered and updated throughout the life of the project and risk mitigation measures shall also be updated accordingly. The summary of the overall assessment of the project financial management risks and internal control assessment is presented in Table 2.

Table 2: Financial Management and Internal Control Risk Assessment

Risk	Risk Assessment	Risk Description	Mitigation Measures or Action Plans
<i>Inherent Risk</i>			
1. Country-specific Risks	S	Absorption capacity of the government departments for capital expenditure.	Close monitoring of project activities as well as government's financing management reforms and initiatives is required.
2. Entity-specific Risks	M	LGED, the executing agency has experience in implementing several ADB-financed projects. Bridge financing has been detected in the past part of a few projects.	A separate Project Management Unit (PMU) for the ongoing project is already established within LGED and will implement the additional financing project.
3. Project-specific Risks	S	Decentralized project implementation and flow of funds: the additional financing project will be implemented in 16 districts and each district will manage its own sub advance account.	Establishment of supplementary accounting procedures and training of PMU staff on ADB's policies and procedures as outlined below will reduce the risk.
<i>Overall Inherent Risk</i>	S		
<i>Control Risk</i>			
4. Implementing Entity	L	LGED will implement the additional financing project by using the FM arrangements established under the ongoing project.	The PMU has been established within LGED and the staff is in place.
5. Fund Flow	S	There were cases in the past of delayed release of counterpart fund. Highly centralized flow of funds with 16 sub accounts maintained in each district. Control on over expenditure under ADB share: There were instances in the past of a few projects where the District Office utilized the ADB share in excess of the eligible portion to make payments (bridge financing).	Firm commitment from the MOF for the timely release of counterpart fund will reduce the risk of delays. Direct payment mechanism is to be used for major foreign currency payments for contractors and suppliers for ADB share. Monthly reconciliations of all accounts to be conducted in a timely manner. To avoid bridge financing, it was decided that the PMU will act as a check and balance point, and will release only the ADB share of funds to the District Office to make payments.

Risk	Risk Assessment	Risk Description	Mitigation Measures or Action Plans
6. Staffing	M	Dedicated finance and accounting staff for LGED. Finance staff is already in place in the PMU and District Offices for the ongoing project. However, to date the PISC FM consultant has not been hired yet; as a result, the planned FM capacity building activities are still to be completed.	The FM consultant is to be hired part of the ongoing project before loan effectiveness of the additional financing project. Training to be provided on ADB's FM requirements and systems.
7. Accounting Policies and Procedures	M	Accounts are maintained according to national accounting standards. Existing government policies and procedures are followed. However, ADB funds are partly not covered by government systems.	A check and review system will be established to cover ADB funds advanced to the District Offices and will be outlined in a supplementary manual. The compliance status of loan covenants and status of FM will be reported and assessed through the quarterly progress reports and verified by ADB review missions.
8. Internal Audit	M	The ongoing project is included in the audit plan of LGED's internal audit department. However, no report has yet been issued to the PMU.	The PMU will request the Internal Audit Unit of LGED to include the additional financing project in their annual internal audit program. The PMU must liaise actively with the internal audit unit and implement their recommendations in a timely manner.
9. External Audit	M	The current arrangement of having the audit done by FAPAD of CAG is acceptable to ADB. Annual project audit reports are produced within 6 months after the end of the financial year.	The PMU must liaise with FAPAD to ensure the additional financing project is part of FAPAD's annual audit plan and that ADB's audit requirements are strictly followed.
10. Reporting and Monitoring	M	To provide ADB and PMU with timely financial information, quarterly financial information needs to be compiled and consolidated by the PMU.	Comprehensive financial information is to be included in the quarterly progress reports in a format agreed with ADB within 15 days after the end of each quarter.
11. Information Systems	S	There is a system in place in the government for recording transactions in Integrated Budgeting Accounting System (IBAS). However, subaccounts and expenditures paid from the ADB loan proceeds are not captured in the IBAS software and are therefore maintained manually. The PMU has access to LFIS and CPD under of the ongoing project. There is a manual contract management system in place under the ongoing project.	The ADB systems LFIS and Client Portal for disbursement (CPD) must be used regularly to reconcile project accounts and ADB disbursement records and to keep track of direct payments as well as advances, replenishments and liquidations to the advance account. The PMU must explore and implement suitable IT solutions to fully computerize all accounts and automate financial reporting to the extent possible taking into account the rollout of IBAS++ for donor projects and/or other suitable initiatives.

Risk	Risk Assessment	Risk Description	Mitigation Measures or Action Plans
Overall Control Risk	S		
Overall FM risk	Substantial		

Note: H – High, S- Substantial, M – Moderate, L – Low.

ADB = Asian Development Bank, CAG = Controller and Auditor General, CPD = Client Portal for disbursement, FAPAD = Foreign Aided Project Audit Department, FM = Financial Management, IBAS = Integrated Budgeting Accounting System, LFIS = Loan Financial Information System, LGED = Local Government Engineering Department, MOF = Ministry of Finance, PISC = Project Implementation Support Consultant, PMU = Project Management Unit.

46. The disbursement and budgeting mechanisms are adequate. The assessment concluded that the overall pre-mitigation financial management risk of LGED is *moderate* and LGED has sufficient capacity to administer advance fund and Statement of Expenditures (SOE) procedures under the proposed fund follow scheme. LGED has agreed to implement the time-bound action plan with key measures to address the deficiencies listed in Table 3.

Table 3: Financial Management Action Plan

Key Risk Area	Risk Mitigating Activity	Timeline	Entity
Bridge financing (use of ADB fund in excess of ADB's share for making payments) noticed under a few existing projects handled by LGED	PMU will release only the ADB share of funds to the District Office based on Funds Requisition Forms along with memorandum of payment from the PMU advance account. PMU will instruct the District Offices to comply with the new process and use the required forms.	Continuous from loan effectiveness throughout project implementation.	LGED/PMU
Staffing	Engage the financial management consultant under PISC of the ongoing project.	By loan effectiveness of the additional financing project.	LGED
Training on ADB's policies and procedures	Conduct trainings to all field staff (accounting and technical) involved in the project.	Continuous from loan effectiveness throughout project implementation.	LGED/PMU
Timely release of counterpart fund	PMU will prepare sufficient counterpart fund budget. Obtain firm commitment from the MOF for the timely release of counterpart fund.	By loan effectiveness and thereafter annually at the time of budget preparation	LGED/MOF
Internal audit	PMU will request the Internal Audit Unit of LGED to include the additional financing project in the annual internal audit program based on the recently introduced Internal Audit Manual. After the statutory audit, internal audit will be carried out over the next 6 months so that mid-year checks are in place. PMU will follow up actively with the Internal Audit Unit and implement the internal audit recommendations within 6 months after the internal audit report has been issued.	By loan effectiveness. Continuous from loan effectiveness throughout implementation.	LGED
External audit	Liaise with FAPAD to ensure the additional financing project is part of FAPAD's annual audit plan and that ADB's audit requirements are followed, including the audit opinion on the use of funds for intended purpose.	By loan effectiveness.	LGED/PMU/ FAPAD

Key Risk Area	Risk Mitigating Activity	Timeline	Entity
	<p>Separate APFS for the AF project to ADB in the format acceptable to ADB.</p> <p>Audit observations and other issues from previous years are to be resolved.</p>	<p>Annually within 6 months after the end of the fiscal year</p> <p>Annually- Within 6 months after the audit report has been issued.</p>	
Timely reporting and monitoring	Include comprehensive FM information (with financial, contract award, payment and disbursement information as well as variance analysis of physical and financial progress) in the quarterly progress reports to be submitted to ADB in a format agreed with ADB.	Within 15 days from the end of each quarter.	LGED/PMU
Preparation of accounts and reporting	Check and review system will be established for manually prepared information to prevent errors. A manual will be developed by PMU.	By loan effectiveness.	LGED/PMU
Retention money	Stop the practice used under previous projects of parking a portion of ADB funds in another account for future payment of retention money. An unconditional bank guarantee of equivalent amount by the contractor is to be considered instead. PMU will instruct District Offices to comply with this new process.	Continuous from loan effectiveness throughout implementation.	LGED/PMU
Information systems	<p>Active use of both ADB systems LFIS and Client Portal for Disbursement (CPD) to reconcile project accounts and ADB disbursement records and keep track of direct payments as well as advances, replenishments and liquidations to the advance account.</p> <p>Explore and implement IT solutions to fully computerize all accounts and automate financial reporting to the extent possible taking into account the rollout of IBAS++ for donor projects and/or other suitable initiatives.</p>	Continuous from loan effectiveness throughout project implementation.	LGED/PMU

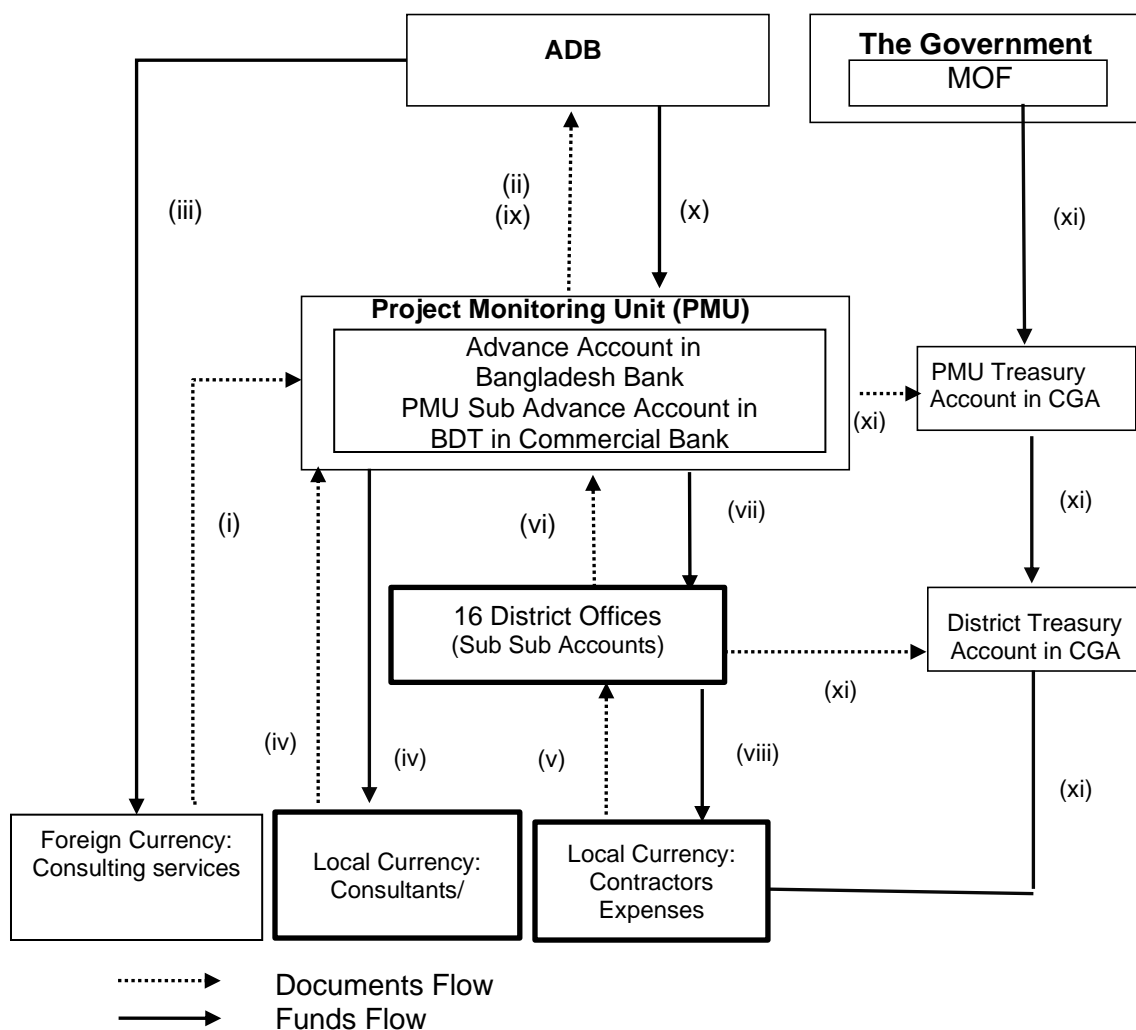
ADB = Asian Development Bank, CPD = Client Portal for disbursement, LFIS = Loan Financial Information System, LGED = Local Government Engineering Department, PISC = Project Implementation Support Consultant, PMU = Project Management Unit.

Source: Asian Development Bank.

47. **Supervision Plan.** ADB will need to supervise the FM through annual supervision/review missions, review of QPRs including the status of the FM action plan and annual review of APFS/AEFS and follow-up on audit observations. The supervision missions should include an FMO/FMS or a qualified FM consultant depending on the needs and available resources.

APPENDIX A: FUNDS FLOW DIAGRAM

The following diagram shows how the funds will flow from ADB and the government to implement project activities.



Notes on funds flow:

For Direct Payment to Consultant for Foreign Currency

- (i) Consultants submits claims to PMU
- (ii) PMU sends request to ADB for direct payments together with consultants' invoices
- (iii) ADB makes direct payment to consultants

For Other Payments and Expenditures under Local Currency & Counterpart Fund payments

- (iv) Consultants submits claims to PMU for payments and PMU make the payment
- (v) Contractors submits claims to District Office for payments.
- (vi) District Office sends Memorandum of Payment (MOP) and Requisition Form to PMU
- (vii) Based on MOP, PMU allot ADB Share of funds to District Office Sub Sub Advance Account for ADB share for making payment.
- (viii) District Office makes payments to Contractors in Local Currency
- (ix) PMU consolidates statement of expenditures and request ADB for liquidation/replenishment.
- (x) ADB makes replenishment to Advance Account
- (xi) Release of counterpart fund quarterly basis based on PMU request to MOF through LGD Planning Section and funds released to District Treasury Account in CGA.

ADB = Asian Development Bank, PMU = Project Management Unit, MOF = Ministry of Finance,

APPENDIX B: FUND REQUISITION FORM FROM PMU BY DISTRICT OFFICE

FUND REQUISITION FORM FOR CIVIL WORK PAYMENT*

EXPENDITURE TO BE FINANCED FROM THE ADVANCE ACCOUNT IN BDT

Name of District Office.....Fund Requisition Number.....

Balance in the District Sub Advance Account in BDT.....as on.....

No.	Contract No.	PCSS No.	Name of Contractor	Total Contract Value	ADB Share**	Government Share**	Amount paid till date		Invoice No. and date	Amount of Invoice	Amount now requested for ADB Share
					XX%	xx%	ADB	Government			
		Total Fund Requisition in BDT									

*To be submitted to PD, PMU along with Memorandum of Payment

** Based on Allocation Table in the Legal Agreement

Signature of the Executive Engineer

Date

APPENDIX C: ORGANIZATION STRUCTURE OF PMU

