

FINANCIAL MANAGEMENT ASSESSMENT

EXECUTIVE SUMMARY

1. The financial management assessment (FMA) identified the main financial management risks as: (i) implementation risk - lack of familiarity with ADB disbursement procedures and requirements which could delay project implementation, (ii) compliance risk - lack of familiarity with ADB financial management requirements, particularly on accounting, reporting and auditing, which may delay project reporting (iii) foreign exchange risk - inadequate experience in managing foreign exchange that might increase the burden on Ministry of Road and Transport Development (MRTD) for the repayment of the ADB loan. The overall financial management risk-rating of the project before considering mitigating measures is moderate.

2. The identified financial management risks will be closely monitored during project implementation. The financial management action plan is as follows:

Table 1: Proposed Action Plan for Financial Management

Action	Responsibility	Timing
1. Training MRTD/PIU on ADB disbursement procedures and requirements	ADB, MRTD, PIU	1 month before first disbursement
2. Training MRTD on ADB requirements, including procurement, accounting, reporting, auditing, and foreign exchange risk management	ADB, MRTD, PIU	4 months after effectiveness
3. Recruitment of experienced consultants and skilled accountants to enhance the operational capacities	MRTD	3 months after effectiveness
4. Development of financial management manuals	MRTD/PIU	Before loan effectiveness

ADB = Asian Development Bank, MRTD= Ministry of Road and Transport Development, PIU= Project Implementation Unit.

Source: Asian Development Bank.

I. INTRODUCTION

3. The FMA was conducted in March 2017 in accordance with ADB's Guidelines.¹ The FMA considered the financial management capacity of the MRTD. The assessment covered funds-flow arrangements, staffing, accounting and financial reporting systems, internal and external auditing arrangements, and financial information systems.

4. This assessment was carried out with the support of PPTA consultants. The assessment considered ADB's Country Partnership Strategy 2016-2020 (CPS) and the completed FMA Questionnaire (FMAQ) presented in Appendix 1. In addition to the FMAQ, the assessment includes reviewing relevant financial management regulations, interviewing, and discussions with financial staff from MRTD and the Project Implementation Units (PIUs). The results of the assessment indicate that MRTD has financial management capabilities although training should be provided for new staff and throughout the course of the project.

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

5. The MRTD had experience with ADB requirements during the implementation of previous ADB-funded projects and performed satisfactorily on these. The disbursements for this project will be made by ADB through the imprest account. ADB will undertake periodic review of the project to discuss financial management issues and ensure there is a suitable financial control structure.

II. BRIEF PROJECT DESCRIPTION

6. The project will include three major outputs: (i) road conditions and safety improved, (ii) road asset management capacity and implementation improved, and (iii) project preparation, supervision and implementation improved

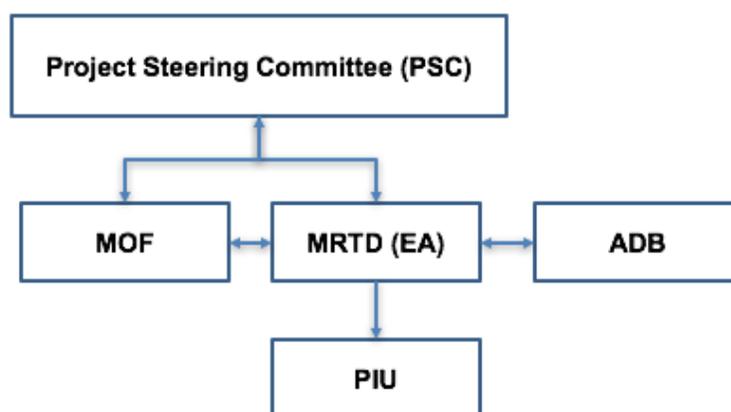
III. PROJECT FINANCIAL MANAGEMENT SYSTEM

A. Project Institutional Arrangements

7. The MRTD will be the EA and the IA for the project. Responsibility for implementation will be delegated to a Project Implementation Unit (PIU) that will be engaged under MRTD to undertake the duties of the IA. Consultants and contractors will be procured separately. The IA, through the PIU, will engage, direct, and coordinate the work of all consultants; be responsible for procurement; and be the employer on all civil works contracts. The PIU (as the IA) will be delegated all necessary legal authority to undertake the above tasks. The MRTD has experience with ADB requirements during the implementation of ADB-funded projects and has performed satisfactorily on previous projects.

8. A Project Steering Committee (PSC) will be formed to be the governing body for the project, comprising officials of the Ministry of Finance (MOF), MRTD and other agencies as needed. The PIU will run day-to-day project operations. The proposed organization chart for project implementation is shown in Figure 1.

Figure 1: Project Organization Structure



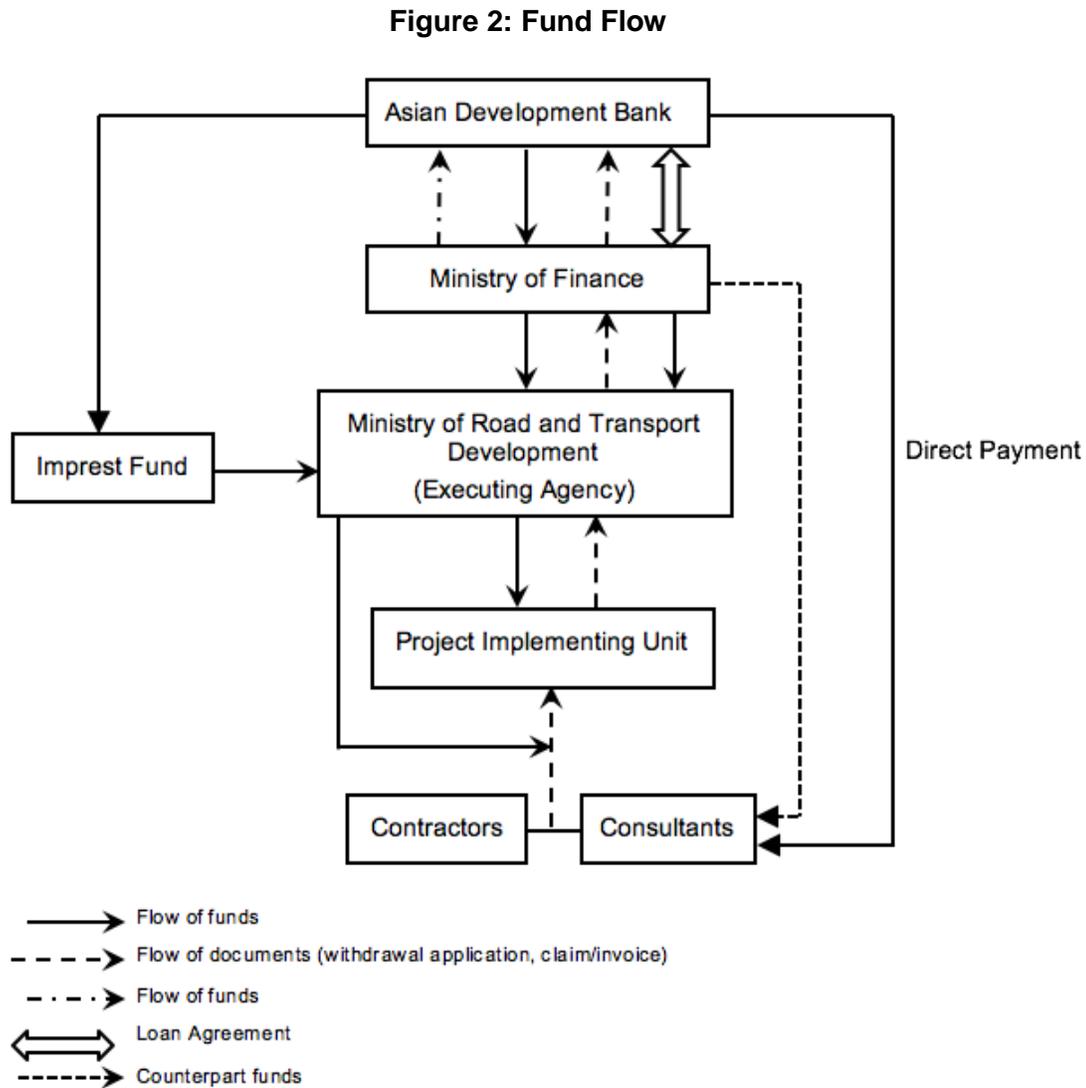
9. The MRTD has recent experience in implementing externally-financed projects namely the construction of 214km road under the Mongolian Western Regional Road Development Project - Phase I, funded by the ADB and the Government of Mongolia.² A senior official of the

² ADB. 2008. Report and Recommendations of the President to the Board of Directors. Proposed Grant Mongolia:

MRTD is usually appointed as the project director to head the PIU. The project director is assisted by a full-time project coordinator and a team of qualified technical, financial, procurement and administrative staff. Under Resolution 196 of the Ministry of Finance, it is assumed that the same procedure will also be adopted for this project.

B. Fund Flow Arrangement

10. Suggested fund flow arrangements for the Project is shown in Figure 2:



C. Disbursement Arrangements

11. The disbursement arrangements for the proposed project will follow the established disbursement process for the ADB Western Regional Road Corridor Project. These processes are detailed in paras. 10–14.

12. ADB loan proceeds will be disbursed in accordance with ADB's Loan Disbursement Handbook (2015, as amended from time to time), and detailed arrangements agreed upon between the Government and ADB. Direct payment by ADB, and imprest fund procedures, liquidation and replenishment, and statement of expenditures, will be used to disburse the loan proceeds.

13. To facilitate disbursements, the MOF may set up and administer an imprest account in US dollars at a commercial bank acceptable to ADB after the loan becomes effective.³ The request for initial advance to the imprest account should be accompanied by an Estimate of Expenditure Sheet⁴ setting out the estimated expenditures for the first 6 months of project implementation, and submission of evidence satisfactory to ADB that the imprest account has been duly opened. For every liquidation and replenishment request of the imprest account, the borrower will furnish to ADB (i) statement of account (bank statement) where the imprest account is maintained, and (ii) the Imprest Account Reconciliation Statement reconciling the above-mentioned bank statement against the IA records.⁵

14. To expedite flow of funds and simplify the project documentation process, the ADB statement-of-expenditures (SOE) procedure may be used in liquidating and replenishing the imprest account and reimbursing eligible expenditures of not more than \$100,000 per individual payment. Payments over the SOE ceiling will be reimbursed, liquidated, or replenished based on full supporting documentation. 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 an independent audit.⁶

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

16. The payment process to be followed for the civil works contract is as follows:

- (i) The contractor shall submit a request for payment certificate;
- (ii) The supervision consultant shall inspect the works and prepare a payment certificate and submit to the PIU for processing;
- (iii) The PIU representative shall inspect the works and confirm that the works have been completed. The project financial officer of the PIU shall submit an application for

³ The bank charges on the imprest account will be financed from the proceeds of the loan.

⁴ Available in Appendix 29 of the ADB Loan Disbursement Handbook.

⁵ Follow the format provided in Appendix 30 of the Loan Disbursement Handbook.

⁶ Checklist for SOE procedures and formats are available at:

http://www.adb.org/documents/handbooks/loan_disbursement/chap-09.pdf

http://www.adb.org/documents/handbooks/loan_disbursement/SOE-Contracts-100-Below.xls

http://www.adb.org/documents/handbooks/loan_disbursement/SOE-Contracts-Over-100.xls

http://www.adb.org/documents/handbooks/loan_disbursement/SOE-Operating-Costs.xls

http://www.adb.org/documents/handbooks/loan_disbursement/SOE-Free-Format.xls.

- payment to ADB via the MRTD and MOF after the PIU representative confirms the work has been completed; and
- (iv) ADB shall make direct payment to the contractor.

D. Accounting

17. ADB provided technical assistance (TA) to Mongolia in 1998, under TA 2993-MON: Capacity Building in Project Accounting, and relevant training has been conducted every year since for accounting staff. This TA has contributed toward making project accounting meet international and ADB standards and uses modern accounting software, thus computerizing all accounting procedures. Additionally, enactment of the Law on Debt Management and the approval of Rules on Internal Auditing as well as Regulations on Foreign loan use, implementation, organization, financing, monitoring and evaluation of projects and programs funded by these loans have given impetus to improving projects' internal auditing. However, there is a need to improve further the internal auditing practices by the MRTD. External financial experts should be involved in the joint professional experts group consisting of the MOF and MRTD to conduct twice yearly inspections/audit and assessment of project activities.

18. The EA/IA will maintain separate project accounts and records by funding source for all expenditures incurred on the project, following accounting principles and practices prescribed by Mongolia's Accounting Law. The law requires financial statements to be prepared following internationally recognized accounting standards.

E. Auditing

19. The financial statements of the project accounts will be audited annually by an external auditor. The audit will be carried out in accordance with appropriate auditing standards consistently applied by independent auditors whose qualifications, experience, and terms of reference are acceptable to ADB. The IA will submit to ADB, within 6 months after the end of each fiscal year, certified copies of such audited project accounts and the project's financial statements and auditor's reports, all in English. The audit of such financial statements will include, as part of the auditor's report, (i) an assessment of the adequacy of accounting and internal control systems with respect to project expenditures and other financial transactions, (ii) an assessment if the proceeds of the loan were used only for the purposes of the project, and (iii) an assessment of compliance with loan covenants and ADB requirements for project management. The government and the EA/IA are aware of ADB's policy on delayed submission, and the requirements for satisfactory and acceptable quality, of the audited accounts. ADB reserves the right to verify the project's financial accounts to confirm that the share of ADB's financing is used in accordance with ADB's policies and procedures.

F. Reporting

20. During project implementation, MRTD will submit quarterly progress reports. To facilitate project post evaluation, MRTD will furnish ADB with a completion report within 3 months of the end of the project. These reports will provide a detailed description of the sources of funds, physical progress, procurement and contractual status, and highlights of any implementation issues.

21. To effectively monitor project implementation, annual projections of contract awards and disbursements with quarterly breakdowns for each contract for the entire project period shall be prepared and submitted prior to the 15 December each year during project implementation.

22. The MRTD will be assisted by a PSC. The PSC will be set up at central level and will be chaired by the MRTD state secretary and comprise representatives of the MOF, MRTD Monitoring, Evaluation and Internal Audit Department as per the Regulations on Foreign loan use, implementation, organization, financing, monitoring and evaluation of projects and programs funded by these loans (approved by the Finance Minister Order No 196 dated July 10, 2015) and other agencies and stakeholders to be decided considering the project specifics at a later stage if any.

G. Capacity to Manage Foreign Exchange Risks

23. In the past six months, the Mongolian togrog (MNT) has depreciated by almost one-third from MNT1,863: \$1 in June 2016 to MNT2,480.65 :\$1 by mid-December 2016⁷. Foreign exchange risk for the project may arise due to the fluctuations of exchange rate between the currency of loan and MNT. It is uncertain at this stage as to how much of the currency of payment of the civil works and consultancy contracts will be in togrog, US dollars or other international currency. Because of this, the fluctuations in exchange rates that occur because of the time lag between loan commitment (loan preparation and signing) and disbursement could be large. The Government of Mongolia bears the foreign exchange risks. The MRTD monitors the foreign exchange differences in their reporting system. The current balance of loan funds should be determined throughout the life of the Project and not left until it is too late to adjust expenditures.

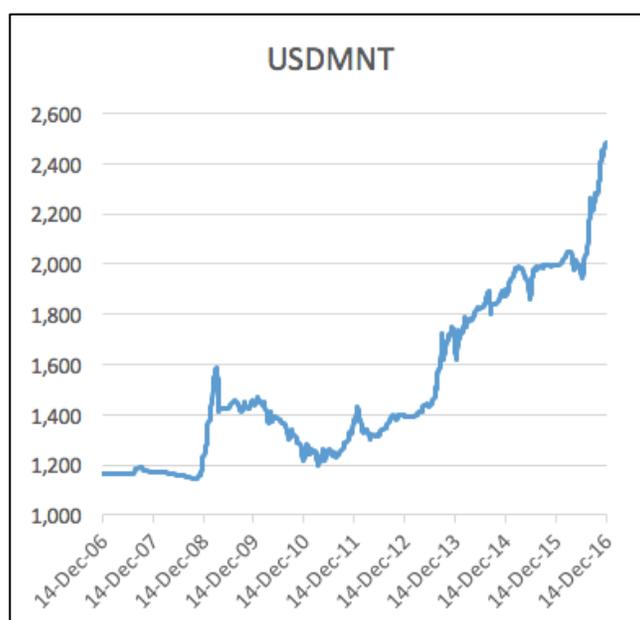


Figure 3: Exchange Rate Depreciation

Source: Bank of Mongolia

H. Staffing

24. The MRTD's Finance and Investment division, as well as Treasury divisions' staff have been vulnerable to the changes in the government, and also the 2016 parliamentary elections.

⁷ <https://mongolbank.mn/dblistofficialdailyrate.aspx>.

25. Table 2 below shows the high rate of the staff turnover: 33% between 2014–2015 and 47% in 2015–2016. Only 6 officers (40%) of staff in the finance related divisions have remained in the period of 3 years from 2014–2016.

Table 2: Staff Turnover in Finance and Investment Division, Ministry of Road and Transport Development (2014–2016)

Items	2014	2015	2016
Number of staff	15	19	15
Number of separated employees		5	9
Number of new recruits		9	5
Turnover		33%	47%
Number of retained staff (3 years)			6
Percent of retained staff (3 years)			40%

Source: MRTD / Consultant estimates.

26. The Chief Accountant is responsible for all projects that are fully funded by the government. The IA accounting staff within the existing PIUs on projects similar to the proposed project have suitable qualifications in finance and accounting, and have some working experience in managing ADB and/or World Bank funded projects. The IA staff has been trained in ADB procedures and has a track record of effectively managing the funds in these projects.

27. However, the proposed project is a new project and key staff such as project financial officer and procurement officer will be appointed by the MOF. Based on the recruitment selection and proposals from the IA per the Regulations on Foreign loan use, implementation, organization, financing, monitoring and evaluation of projects and programs funded by these loans (Regulations are approved by the Finance Minister Order No 196 dated July 10, 2015). The regulations do not provide sample job description nor terms of reference for the PIU accountant nor the financial officer so these have been drafted as per ADB requirements.

28. The IA will implement accounting policies and procedures that allow proper recording of project financial transactions, including allocations of expenditures in accordance with the respective components, disbursement categories, and sources of funds. All the accounting and supporting documents will be retained on a permanent basis that will allow authorized users easy access.

29. The financial officer for the project will prepare the recording of the transactions, including the custody of assets involved in the transactions. Project management staff will order and monitor all goods and services. The accounting staff will prepare all payments as well as the bank reconciliations and these will approved by the Chief Accountant and Project Director assigned to the project.

I. Budgeting System and Payments

30. The IA has experience in managing budgeting system and payments in previous projects. The project's budgets, including physical and financial targets, will be prepared in sufficient detail for all significant activities under each project component. The ADB will assist with this process. The actual expenditures will be compared to the budget at least on a quarterly basis, and explanations will be prepared for significant variations from the budgets.

J. Policies and Procedures

31. The IA shall use cash accounting method which follows the Mongolian accounting standards.

K. Information Systems

32. No online storage, offsite storage, offshore storage, fire, earthquake and calamity protection for documentation backups have been identified for the existing PIU. The MRTD and PIU will be advised to secure a back-up in cooperation with the Mongolian National Data Center.

IV. RISK DESCRIPTION AND RATING – INCLUDING FINANCIAL MANAGEMENT AND INTERNAL CONTROL RISK ASSESSMENT

A. Financial Risk Assessment

33. A risk analysis was carried out as part of the requirements of TA 7449-MON: Regional Transport Development Project and of this PPTA. The risk assessment considered the staffing, internal control, accounting and reporting policies and procedures, and auditing standards and arrangements of the EA and the IAs. Based on the assessment, the overall project financial management risk before mitigation is considered to be moderate and the summary of this analysis is shown in Table 3.

34. During implementation of the project, the EA and the PIU may face some risks that can be divided into two main categories: (i) country level, and (ii) organization and project level. Further, all contracts with foreign suppliers and/or consultants financed from loan funds are subject to approval by the EA, and the MOF, which takes considerable time and eventually will undermine project implementation. These, together with project-specific risks and activities to mitigate them, are summarized below. Financial management risks will need to be considered and updated throughout the life of the investment project. Risk mitigation measures will also be updated accordingly.

Table 3: Financial Management and Internal Control Risk Assessment

Risk Type	Risk Assessment	Risk Description	Mitigation Measures
Inherent Risk Assessment			
Country-Specific Risks	M	Government faces political and financial pressures in the adoption of sustainable road maintenance and maintenance funding concepts	Ongoing policy dialogue and long-term engagement of all decision makers in policy reform
Entity-Specific risks	M	Historically, project steering committee (PSC) are not actively involved during implementation. Due to years of inadequate financing, MRTD has shown limited interest in maintenance projects Insufficient government support (financially, ownership)	Capacity development will be provided to manage project implementation. ADB will review the proposed PIU staff prior to engagement. PMC procurement specialist recruited early to assist. Ensure that the counterpart funds are available and included in the state budget.

Risk Type	Risk Assessment	Risk Description	Mitigation Measures
Control Risk Assessment			
Implementing Agency	M	Newly recruited staff of the PIU may perform below required level. Inexperienced staff selected with limited knowledge of ADB requirements which may cause delays during the project implementation.	Ensure to appoint or recruit suitable staff. Training provided by ADB and PMC team support in capacity building and development especially in procurement, disbursement and project monitoring and reporting requirements.
Funds Flow	L	Minimal investment required by Government however they are required to budget funds allocation in state budgets, and cover project financing charges.	As the loan agreement becomes a law after being ratified by the Parliament of Mongolia the counterpart funds, and loan disbursements are to be automatically included in the state budget.
Staffing	M	In anticipation of a new PIU, unskilled or inexperienced PIU and MRTD staff causes delays in implementation. MRTD unable to provide liaison staff or road asset management unit staff. The internal auditor has insufficient knowledge and understanding of ADB's guidelines and procedures including disbursement guidelines and procedures. PIU may lack experience with ADB reporting and monitoring requirements	The PIU and PMC encourage MRTD to provide or recruit suitable staffing. Additional expertise and on-the-job training will be provided by the PMC staff. The trainings of FM staff on ADB procedures to include the disbursement guidelines. Trainings will include all ADB monitoring and reporting requirements
Accounting and Reporting	L	None specific	An accounting policy and procedures manual for the PIU will be drafted, that covers the national accounting standards and the requirements of ADB.
Internal Audit	M	Lack of internal control in both collection process and cash handling roles of the project financial officer	Develop financial management manual MRTD's Internal Auditing, Monitoring and Evaluation Department will provide internal control services. Adopt segregation of duties among finance staff and ensure adequate control mechanism
External Audit	L	None specific	An external auditor acceptable to ADB will audit the project accounts annually in accordance with the international auditing

Risk Type	Risk Assessment	Risk Description	Mitigation Measures
			standards. Audited accounts are required to be submitted to ADB within 6 months after the end of a calendar year.
Reporting and monitoring	L	None specific	MRTD through the PIU, and the PMC will regularly report in accordance with ADB requirements on inherent adequate control mechanisms.
Information Systems	M	Lack of skill in appropriate accounting software and systems for contract management, contractor payments. Historical practice of not ensuring adequate onsite and offsite data storage.	The PIU to use computerized accounting software. It is recommended that MRTD and PIU to back up their project data through National Data Center. The PMC will assist the PIU to strengthen the efficiency of existing information systems and reporting
Overall Risk	M		

H = high, S = substantial, M = moderate, L = low.
 ADB = Asian Development Bank, MOF = Ministry of Finance, MNRM = Mongolian Resident Mission (ADB), MRTD = Ministry of Road and Transport Development, PIU = project implementation unit, PMC = Project Management Consultant, TA-9158 = Strengthening of Public Procurement for Improved Project Implementation
 Source: PPTA consultants.

35. Although the EA has performed acceptably in the past, considering changes in the staff related to 2016 parliamentary elections, there is still room for improvement. Additional training of all project staff should be undertaken to ensure all ADB procedures are well known to staff. It is recommended that training provided by ADB and supported by the supervision consultant should include:

- (i) A series of financial management workshops. The full extent of these workshops and other forms of training required will be defined by ADB. Proper financial management capacity assessment of the project financial officers recruited needs to be conducted after contracting and specialized training and re-training for the project financial officers recruited is recommended;
- (ii) The senior staff visiting ADB headquarters in Manila to receive specialist training;
- (iii) All documents on ADB website relating to financial management be translated to Mongolian; and
- (iv) Regular reviews of the finances carried out during ADB missions.

1. Financial Sustainability Analysis

A. Background

36. The question of Mongolia’s ability to assume more national debt for its infrastructure development, including road construction is evaluated annually in the International Monetary Fund’s (IMFs) Article IV Consultation. The situation over the recent years has changed. The national debt has increased significantly and although it is still judged to be sustainable, there are worrying signs on the horizon. The official statement from the IMF Mission to Mongolia in

November 2016 indicated: “The mission held very productive discussions with the Mongolian authorities on the 2016 Article IV Consultation as well as on policies that could become part of an IMF-supported economic and financial program. Common policy views were developed in many key areas”.⁸

37. The latest debt sustainability exercise for Mongolia conducted by IMF and the World Bank in 2015 states: “Mongolia’s long-term prospects remain bright, but liquidity risks are high in the near term. The country’s resource wealth is estimated at \$1 trillion to \$3 trillion, and this is assumed to continue being realized gradually. Mongolia is thus projected to be solvent given the strong projected revenues from mining over the long term. It does, however, face serious liquidity pressures and risks in the short term, before mining exports ramp up. Until then, financing outsized prospective fiscal and balance of payment (BOP) deficits will be difficult, and thus policies should be focused to avoid building up excessive debt and manage BOP pressure.”⁹

38. The assessment of the overall financial sustainability of Mongolia must be understood by accounting for a series of positive and negative factors. On the one hand, success in securing bilateral and multilateral support would stabilize the government’s liquidity position and the economy’s external position for a period, providing the government with time to address the decline in its fiscal strength until mining output comes on stream and supports growth and the government’s finances. Mongolia’s natural resources wealth is largely untapped and, if effectively harnessed could generate very strong gross domestic product (GDP) growth in the medium to long term. In turn, as the country’s growth potential is realized, government revenues would rise sharply and the government’s debt burden would fall, possibly at a rapid pace. On the other hand, failure to secure financing, particularly in the context of a further deterioration in growth and debt dynamics, would raise the risks of a balance of payments crisis and debt restructuring. Because of its dependence on mineral exports, Mongolia is now considered as vulnerable to external shocks. Moody’s Investors Service (“Moody’s”) has recently downgraded Mongolia’s government long-term issuer and senior unsecured ratings to CAA1 from B3, which is below investment grade.

B. Macroeconomic and Fiscal Position of The Government

39. The government in 2012–2014 had a loose monetary policy in place to sustain growth, but this has since been rolled back. This reduced economic growth from 12.3% in 2012 to 2.3% in 2015 and to 1% in 2016, as well as negative growth expected in 2017 (Table 4).¹⁰ The foreign direct investment decline reduced foreign currency exchange and led to a significant fall in the value of the Mongolian togrog (MNT), which in combination with an expansionary fiscal policy resulted in inflationary pressures. Inflation decreased during 2015-2016 to below the 7% target; 6.6% in 2015 and 1.1% in 2016, forecasted to be 6.6 in 2017. The current account deficit narrowed considerably to 3.0% in 2016 and expected to be around 4.9% in 2017. The balance of payments is stable as well.

40. The government’s fiscal deficit is significant due to revenues that are below the target, and pre-election increase in investment spending in 2016 an on-budget structural deficit of 4.5% of GDP) in 2014 (exceeding the 2% limit in the Fiscal Stability Law), and significant off-budget

⁸ International Monetary Fund. 2016. Press Release: Statement at the Conclusion of the IMF Mission to Mongolia. 4 November 2016. Washington DC.

⁹ International Monetary Fund. 2016 Staff Report For The 2015 Article Iv Consultation—Debt Sustainability Analysis. 19 March 2015. Washington DC.

¹⁰ International Monetary Fund. 2015. Mongolia – 2015 Article IV Consultation Report. Country Report No. 15/109. Washington, D.C.

spending by the Development Bank of Mongolia. These factors resulted in a total deficit equivalent to 11.4% of GDP in 2014 and 15.4% of GDP in 2016.

41. In 2017 the supplementary budget brought most spending on-budget, but the overall deficit was still projected to reach about 10.6% of GDP (Table). Public debt has risen sharply and, with 77.4% in 2014, exceeded the 40% Fiscal Stability Law limit. The IMF in April 2015 assessed Mongolia to be at high risk of debt distress. It will thus be a major policy challenge to implement prudent macroeconomic management that allows sufficient scope for productive investment and social protection, especially given that elections took place in mid-2016.

Table 4: Selected Macroeconomic Indicators: 2012-2017

Item	2012	2013	2014	2015	2016	2017 (est.)
GDP growth (%)	12.3	11.6	7.9	2.4	1	-0.2
Inflation (%)	14.3	10.5	12.8	6.6	1.1	6.1
Current account balance (% of GDP)	-27.4	-25.4	-11.5	-4.7	-3	-4.9
GDP (MNT billion)	16,68	19,17	22,22	23,16	23,88	
Total central government expenditure (MNT billion)	8	4	7	7	6	26,052
Total central government expenditure to GDP (%)	4,379	4,683	5,229	4,998.	7,749.	6,999.5
Government and Development Bank of Mongolia fiscal deficit to GDP (%) ^a	26.2	24.4	23.5	21.6	32.4	26.9
	-9.8	-8.9	-11.4	-7.9	-15.2	-10.6

GDP = gross domestic product, MNT = Mongolian togrog.

^a Fiscal deficit is the government's on-budget deficit plus the Development Bank of Mongolia balance. Source: Asian Development Bank Mongolia Resident Mission, Ministry of Finance, International Monetary Fund.

42. **Unreported off balance budget activities.** A number of unreported off balance budget activities appeared in 2012, jeopardizing the budget discipline. The percentage of such activities in the total consolidated budget expenditures were double digits between 2013 and 2015 (Table 5) and had been gradually decreasing since then. Although consolidated budget deficit was reported as 1.3–5.0% of GDP in 2013–2015, off balance budget and budget related expenditures reached 3.1–12.7% of GDP, so budget deficit in terms of the percentage to GDP has reached double digits. This total budget expenditures has increased loan service spending in the recent years.

Table 5: Consolidated Budget and Off-budget Spending (billion MNT)

Item	2012	2013	2014	2015	2016	2017 ^a
1. Total Revenues	4,881.2	5,940.1	6,276.6	5,981.1	5,852.1	6,160.2
2. Total expenditures	6,017.8	6,164.7	7,144.5	7,138.0	9,519.9	8,569.1
3. Consolidated budget deficit	-1,136.6	-224.6	-867.9	-1,156.9	-3,667.8	-2,408.7
4. Budget deficit as percent to GDP, %	-8.2	-1.3	-4.0	-5.0	-15.2	-9.1
5. Budget Related Spending, of which:	255.7	2,236.5	1,474.0	1,156.6	1,407.7	355.3
Not included in the budget	255.7	2,236.5	1,378.7	722.9	524.9	111
Included in the budget / amendments	-	-	95.2	433.7	882.8	244.3
Percent non-reported items in total Expenditures	4.2%	36.3%	19.3%	10.1%	5.5%	1.3%

^a This included proposed amendments for 2017 budget.

Source: Ministry of Finance, Development Bank of Mongolia, Bank of Mongolia.

43. Dependence on the mining income, negative external and internal economic environment, deficiencies in the fiscal discipline and integrity led to a considerable increase of the budget deficit. Financing of this deficit by issuing high interest rate bonds led to an accumulation of foreign debt as well as interest payments threatening fiscal sustainability.

44. Thus, the Government has reached working agreement with the IMF on an \$440 million Extended Financing Facility to achieve a gradual decrease in budget deficit by; (a) ensuring integrity of the budget; (b) increased fiscal discipline; (c) ensuring sustainable revenue sources by introducing new taxes, increasing tax rates as well as expansion of the tax base and postponing the retirement age; and (d) increasing efficiency of budget spending.

45. Real economic growth as a result is expected to recover to 1.8% in 2018 and 8.1% in 2019 from projected -0.2% in 2017. The last column of the Table 4 of the estimates for the 2017 are incorporating the Government's pre-agreement with the IMF on a working level and are the details contained in the draft law on budget amendments for the 2017 submitted to the parliament for an approval during the 2017 Spring Session.

46. The amendments to the budget were approved by the parliament in April; hence the IMF Extended Financing Facility program is expected to be approved by the Fund Board in May. This will provide a green light to all the donors as well as private investors, easing the short run pressure on the government finances.

C. Financial Sustainability

47. To establish the fiscal impact of the project on the government budget and the financial sustainability of the project, an analysis has been undertaken on MRTD historical expenditures. It examines budget size (Table 6), recurrent and capital expenditure budget shares (Table 7) and by budget plan, amendments and executed budgets (Table 8).

48. MRTD expenditures were volatile in both absolute and relative terms with huge increase in 2016, to MNT981.2 billion from MNT224.4 billion in 2015 and reducing to MNT476.1 billion in 2017 budget amendments.

Table 6: Ministry of Road and Transport Development Actual Expenditures: 2012–2017

Item	2012	2013	2014	2015	2016	2017
MRTD expenditures (in billion MNT)	446.5	509.3	344.6	224.4	981.2	476.1
Total central government expenditure (in billion MNT)	6,017.8	6,164.7	7,144.5	7,138.0	9,519.9	8,569.1
GDP (in billion MNT)	16,688.0	19,174.0	22,227.0	23,167.0	23,886.0	26,052.0
Total MRTD expenditure to total central government expenditure (%)	7.4	8.3	4.8	3.1	10.3	5.6
Total MRTD expenditure to GDP (%)	2.7	2.7	1.6	1.0	4.1	1.8

Source: Ministry of Finance

49. A breakdown of MRTD 2012–2017 expenditures for recurrent and capital costs shown in

50. Table reveals the reason for this volatility is connected largely to capital expenditures. As for the recurrent expenditures, they have a clear decreasing trend in absolute terms from MNT 20.4 billion in 2012 to MNT 8.8 billion in 2017 as well as in relative terms from 4.6% in total expenditures in 2012 to 1.9% in 2017. The capital expenditures had a volatile performance in

absolute terms but had a clear rising trend in relative terms from 95.4% in total expenditures in 2012 to 98.1% in 2017.

Table 7: Ministry of Road and Transport Development Recurrent and Capital Expenditures (2012–2017)

Item	2012	2013	2014	2015	2016	2017
MRTD expenditures (in billion MNT)	446.5	509.3	344.6	224.4	981.2	476.1
Recurrent expenditures	20.4	17.3	16.3	9.4	9.1	8.8
Capital expenditures	426.1	492.0	328.3	215.0	972.0	467.3
Recurrent expenditures in total expenditures (%)	4.6	3.4	4.7	4.2	0.9	1.9
Capital expenditures in total expenditures (%)	95.4	96.6	95.3	95.8	99.1	98.1

Source: Ministry of Finance.

51. Table shows significant discrepancies between the MRTD budget plan, amendments and execution, especially related to the capital expenditure planning, amendments and execution.

Table 8: Ministry of Road and Transport Development Total and Capital Expenditures, by Budget Plan, Amendments and Executed Budgets: 2014–2017

Year	Budget Type	MRTD portfolio (MNT millions)		Difference between budget plan, amendments and execution			
		Total Expenditures	Capital Expenditures	Total Expenditures MNT million	%	Capital Expenditures MNT million	%
2014	Plan	295,343	280,729				
	Amendments	303,824	289,649	8,481	2.9	8,920	3.2
	Execution	344,587	328,302	40,763	13.4	38,653	13.3
2015	Amendments1	203,237	189,803				
	Amendments2	158,495	149,251	-44,742	-22.0	-40,552	-21.4
	Execution	224,417	214,979	65,922	41.6	65,728	44.
2016	Plan	242,620	234,416				
	Amendments	936,430	927,015	693,810	286.	692,599	295.5
	Execution	981,155	972,015	44,725	4.8	45,000	4.9%
2017	Plan	315,694	306,941				
	Amendments	476,134	467,292	160,440	50.8	160,351	52.2

Source: Ministry of Finance / for 2017 data parliament.

52. The difference between MRTD capital expenditure budget plan and amendments as well as budget execution rose from 3.2% and 13.3% in relative terms in 2014, to drop initially by -21.4% and then increase 44% for 2015. A huge hike in 2016 almost tripled the planned budget by the amendments and the execution almost followed the amendments with only 4.8% discrepancy.

53. The 2017 amendments to the MRTD capital expenditure budget (the one agreed with the IMF program) has also increased by more than half (52.2%) from the planned one. This type of investment increase, packaged with the tax increase, has created heated discussions around the 2017 budget amendments: the civil society (Trade Unions), taxpayers (Chamber of Commerce and Industry) and the opposition had critical views on these proposals.

54. However, the amendments to the 2017 budget have been approved by the parliament as stated earlier; the IMF program is to be approved by the IMF Board in May 2017. The Government has secured its financial position in the short run; it has paid the current international obligations, secured support from major donors, such as USD 440 million Extended Financing Facility,

commitments were made by Government of Japan (up to USD 850 million on concessional terms).

55. Despite the above worrying factors, Mongolia still has the capacity to borrow to strengthen its infrastructure, especially if loans are of a concessional nature and in the light of the upcoming approval of the IMF program and stabilization of the Government of Mongolia sovereign credit rating on the international markets.

Financial Management Assessment Questionnaire¹¹

(Note: This questionnaire should be used as a tool only to gather information relevant for assessing financial management capacity of executing and implementing agencies. It may be used selectively for second subsequent projects, or periodic financing reports. Additional questions may be required as deemed fit).

Topic	Response	Potential Risk Event
1. Executing / Implementing Agency		
1.1 What is the entity's legal status / registration?	Ministry of Road and Transport Development	
1.2 How much equity (shareholding) is owned by the Government?	It is a government ministry	
1.3 Obtain the list of beneficial owners of major blocks of shares (non-governmental portion), if any. ¹²	-	
1.4 Has the entity implemented an externally-financed project in the past? If yes, please provide details.	It has successfully completed the first phase of Project for the construction of paved road running from Nalaikh district, UB to the southern border point Zamiin- Uud under ADB financing. A 215 km long Nalaikh-Choir section of the paved road was constructed 2004-2005. The construction of Choir-Sainshand 225 km road section started in 2006. Also, construction of 214km road under the Mongolian Western Regional Road Development Project - Phase I has been completed successfully.	
1.5 Briefly describe the statutory reporting requirements for the entity.	Mongolian Accounting Law enacted in 2002 requires international accounting reporting practices for the entity.	
1.6 Describe the regulatory or supervisory agency of the entity.	It is a government ministry	
1.7 What is the governing body for the project? Is the governing body for the project independent?	The project will have a Project Steering Committee.	
1.8 Obtain current organizational structure and describe key management personnel. Is the organizational structure and governance appropriate for the needs of the project?	Project implementing Unit (PIU), Project coordinator, Project financial officer, Project procurement officer and consultants are required to be set up for executing the Project.	
1.9 Does the entity have a Code of Ethics in place?	No Code of Ethics for the Ministry, it is covered by general Civil Service Code of Ethics	
1.10 Describe (if any) any historical issues reports of ethics	Not identified.	

¹¹ This questionnaire should be administered by ADB staff or consultant (the Reviewer), and utilized only to obtain information, and to identify and describe potential risk events. Rating of risks should be carried out separately by assessing their likelihood and impact.

¹² In such cases, consult OAI on the need for integrity due diligence on non-governmental beneficial owners.

Topic	Response	Potential Risk Event
violations involving the entity and management. How were they addressed?		
2. Funds Flow Arrangements		
2.1 Describe the (proposed) project funds flow arrangements in detail, including a funds flow diagram and explanation of the flow of funds from ADB, government and other financiers, to the government, EA, IA, suppliers, contractors, ultimate beneficiaries, etc. as applicable.	Project fund flow is documented on a flow chart.	
2.2 Are the (proposed) arrangements to transfer the proceeds of the loan (from the government / Finance Ministry) to the entity and to the end-recipients satisfactory?	Yes	
2.3 Are the disbursement methods appropriate?	Yes	
2.4 What have been the major problems in the past involving the receipt, accounting and/or administration of funds by the entity?	There haven't been major problems in the past in the receipt, accounting and/or administration of funds by the entity in respect to road Projects financed internationally.	
2.5 In which bank will the Imprest Account (if applicable) be established?	In previous cases, Imprest Accounts were opened in Trade and Development Bank and in recent years with the State Bank. Ministry of Finance has got an annual contract with the State Bank.	
2.6 Is the bank in which the imprest account is established capable of – <ul style="list-style-type: none"> • Executing foreign and local currency transactions? • Issuing and administering letters of credit (LC)? • Handling a large volume of transaction? • Issuing detailed monthly bank statements promptly? 	Yes. Trade and Development Bank - Yes. Not detected for the State Bank. Yes. Yes.	
2.7 Is the ceiling for disbursements from the imprest account and SOE appropriate/required?	No.	
2.8 Does the (proposed) project implementing unit (PIU) have	No as it will be a new entity (PIU) to be formed.	

Topic	Response	Potential Risk Event
experience in the management of disbursements from ADB?		
2.9 Does the PIU have adequate administrative and accounting capacity to manage the imprest fund and statement of expenditure (SOE) procedures in accordance with ADB's Loan Disbursement Handbook (LDH)? Identify any concern or uncertainty about the PIU's administrative and accounting capability which would support the establishment of a ceiling on the use of the SOE procedure.	No as it will be a new entity (PIU) to be formed.	
2.10 Is the entity exposed to foreign exchange risk? If yes, describe the entity's policy and arrangements for managing foreign exchange risk.	Yes. The entity is able to regularly monitor foreign exchange situation and in case of risks can manage it in association with Finance Ministry.	
2.11 How are the counterpart funds accessed?	Allocation at the agreed percentage specified in the Loan Agreement through the annual state budget plan of the Government of Mongolia	
2.12 How are payments made from the counterpart funds?	Finance Ministry endorses the payments from counterpart funds within the approved budget.	
2.13 If project funds will flow to communities or NGOs, does the PIU have the necessary reporting and monitoring arrangements and features built into its systems to track the use of project proceeds by such entities?	Major state road projects were implemented with no involvements of any communities and/or NGOs in the past.	
2.14 Are the beneficiaries required to contribute to project costs? If beneficiaries have an option to contribute in kind (in the form of labor or material), are proper guidelines and arrangements formulated to record and value the labor or material contributions at appraisal and during implementation?	The beneficiaries are not required to contribute to Project costs. Beneficiaries do not have an option to contribute in kind (in the form of labor). In Mongolia the road companies that win work will recruit some local non-professional people for construction work.	

3. Staffing		
3.1	What is the current and/or proposed organizational structure of the accounting department? Attach an organization chart.	As disbursements are made directly to executing body with respect to Projects financed by ADB, there is no need to establish a separate accounting unit and MOF just nominates a Project financial officer upon selection and recommendations of the MRTD.
3.2	Will existing staff be assigned to the project, or will new staff be recruited?	No decision has yet been made. As per regulations MRTD appoints Project coordinator upon consultations with the MOF and Ministry of Finance will appoint the financial and procurement staff of the PIU upon MRTD selection recommendations.
3.3	Describe the existing or proposed project accounting staff, including job title, responsibilities, educational background and professional experience. Attach job descriptions and CVs of key existing accounting staff.	Job descriptions including job title, responsibilities, educational background and professional experience of proposed project accounting / financial staff should be included in the PAM.
3.4	Is the project finance and accounting function staffed adequately?	The project finance and accounting function will be performed by the project financial officer. MOF will appoint / nominate the staff.
3.5	Are the project finance and accounting staff adequately qualified and experienced?	The finance and accounting staff on the projects being implemented is adequately trained and qualified with many years of work experience. Hopefully the finance officer to be appointed for the proposed project will also be adequately qualified and experienced.
3.6	Are the project finance and accounting staff trained in ADB procedures, including the disbursement guidelines (i.e. LDH)?	ADB resident Mission conducts special training for project finance and accounts staff.
3.7	What is the duration of the contract with the project finance and accounting staff?	EA concludes a labor contract with the finance and accounts staff on yearly basis in compliance with Mongolian Labor Law.
3.8	Identify any key positions of project finance and accounting staff not contracted or filled yet, and the estimated date of appointment.	There are no key positions not contracted yet.
3.9	For new staff, describe the proposed project finance and accounting staff, including job title, responsibilities, educational background and professional experience. Attach job descriptions.	Draft job descriptions are attached

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?	MRTD approves position descriptions that clearly define duties, responsibilities, lines of supervision, and limits of authority for all of the officers, managers, and staff.	
3.11 What is the turnover rate for finance and accounting personnel (including terminations, resignations, transfers, etc.)?	A policy is pursued to keep key positions such as Chairman of PIU, Project Coordinator, and Project financial officer on sustainable basis until the Project is completed.	
3.12 What is training policy for the finance and accounting staff?	Participation in training courses held in Mongolia by the Government. In addition, annual training plan for the finance and accounting staff is agreed with ADB resident Mission.	
3.13 Describe the list of training programs attended by finance and accounting staff in the last 3 years.	ADB resident Mission used to conduct special training for project finance and accounts staff on annual basis, but now holds them once per two years, although the quality of the training and handouts is reported to be improved.	
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 (in particular, the legal agreements with ADB)? Will the project use the entity accounting system? If not, what accounting system will be used for the project?	In 1998, ADB implemented TA-2993 Project in Mongolia on the recording of Project financial transactions, including the allocation of expenditures in accordance with the respective components, disbursement categories, and sources of funds. Disbursements are made directly to the executing body from ADB through Finance Ministry using the imprest account.	
4.2 Are controls in place concerning the preparation and approval of transactions, ensuring that all transactions are correctly made and adequately explained?	Yes, there are controls in place. ADB accounting procedures are adhered to locally which clearly define the preparation and approval of transactions and loan utilization reports as well as duties and limits of authority of PIU and key positions.	
4.3 Is the chart of accounts adequate to properly account for and report on project activities and disbursement categories? Obtain a copy of the chart of accounts.	Yes. As ADB accounting procedures are followed locally, the chart of accounts is adequate to properly account for and report on Project activities and disbursement categories.	
4.4 Are cost allocations to the various funding sources made accurately and in accordance with established agreements?	Yes, cost allocations to the various funding sources are made accurately and in accordance with established agreements. The detailed conditions are in an established agreement of the Mongolian	

	Government with ADB. ADB is directly financing road construction companies using International accounting standard for cost expenditure.	
4.5 Are the General Ledger and subsidiary ledgers reconciled monthly? Are actions taken to resolve reconciliation differences?	IA uses VINITSA accounting software which corresponds with international standards and is approved by the Finance Ministry. Accordingly general ledger and subsidiary ledgers are reconciled.	
4.6 Describe the EA's policy for retention of accounting records including supporting documents (e.g., ADB's policy requires that all documents should be retained for at least 1 year after ADB receives the audited project financial statements for the final accounting period of implementation, or 2 years after the loan closing date, whichever is later). Are all accounting and supporting documents retained in a defined system that allows authorized users easy access?	Accounting and supporting documents are checked and bound every month and deposited on a timely basis in accordance with Mongolian Accounting Law. Authorized users can get access to them with the permission of higher management. If required, under the surveillance of a project financial officer the user can get acquainted with it.	
4.7 Describe any previous audit findings that have not been addressed.	There are no audit findings that have not been addressed.	
Segregation of Duties		
4.8 Are the following functional responsibilities performed by different units or persons: (i) authorization to execute a transaction; (ii) recording of the transaction; (iii) custody of assets involved in the transaction; (iv) reconciliation of bank accounts and subsidiary ledgers?	<p>The staff have following responsibilities: (i) Project financial officer executes a transaction but the recording of transactions and reports are made by an accountant nominated by EA. (ii) Custody of assets involved in the transaction is done by the storekeeper/treasurer.</p> <p>Bank reconciliations are prepared by the project unit that prepare the following documents: (i) Order to establish the project unit; (ii) Signature Form (approved by notary office) of persons who will sign accounting documents of the project; (iii) Form of stamp; (iv) Official letter (to order bank accounts)</p>	
4.9 Are the functions of ordering, receiving, accounting for, and paying for goods and services appropriately segregated?	<p>Yes. These functions are segregated in the following way:</p> <p>(i) Ordering of goods and services is done by a qualified engineer or staff, and higher management monitors the whole process;</p> <p>(ii) Accounting and paying for goods and services are executed by accountant and the manager exerts control over the execution and signing (first and second signature) the relevant documents;</p> <p>(iii) Receiving is performed by the storekeeper under control of those ordered.</p>	

Budgeting System		
4.10	Do budgets include physical and financial targets?	Yes, budgets include physical and financial targets.
4.11	Are budgets prepared for all significant activities in sufficient detail to allow meaningful monitoring of subsequent performance?	Yes. Budgets are prepared for all significant activities in sufficient detail to monitor subsequent performance. Based on budget reports, the cost performance is strictly controlled.
4.12	Are actual expenditures compared to the budget with reasonable frequency? Are explanations required for significant variations against the budget?	Yes. Actual expenditures are monitored and compared to the budget regularly.
4.13	Are approvals for variations from the budget required (i) in advance, or (ii) after the fact?	Approvals for variations from the budget are required in advance.
4.14	Is there a ceiling, up to which variations from the budget may be incurred without obtaining prior approval?	
4.15	Who is responsible for preparation, approval and oversight/monitoring of budgets?	MRTD (EA) is responsible for preparation of the budget and the Finance Ministry submits the integrated Government budget proposal to the Parliament for approval and is responsible for oversight/monitoring of the budget.
4.16	Describe the budget process. Are procedures in place to plan project activities, collect information from the units in charge of the different components, and prepare the budgets?	Yes. A mechanism is in place to plan Project activities, collect information from the units in charge of the different components, and prepare, reconcile and approve the budgets.
4.17	<p>Are the project plans and budgets of project activities realistic, based on valid assumptions, and developed by knowledgeable individuals?</p> <p>Is there evidence of significant mid-year revisions, inadequate fund releases against allocations, or inability of the EA to absorb/spend released funds?</p> <p>Is there evidence that government counterpart funding is not made available adequately or on a timely basis in prior projects?</p> <p>What is the extent of over- or under-budgeting of major heads over the last 3 years? Is there a consistent trend either way?</p>	<p>Project plan and budgets are prepared according to approved norms and standards by Project accounting staff trained on special courses conducted by the ADB. These are checked by relevant IA staff and approved by the MOF.</p> <p>No. Not the ones related to the international loan funds.</p> <p>No. The Government honors its obligations under the international treaties, including the loan agreements.</p>

Payments		
4.18 Do invoice-processing procedures require: (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 received? (iii) Comparison of invoice quantities with those indicated on the receiving reports? (iv) Checking the accuracy of calculations? (v) Checking authenticity of invoices and supporting documents?	Invoice-processing procedures involve: (i) Comparison of copies of purchase orders and receiving reports; (ii) comparison of invoice quantities, prices and terms, with those indicated on the purchase order and with records of goods received; and (iii) Checking of the accuracy of calculations and obtaining manager's approval/first signature.	
4.19 Are all invoices stamped PAID, dated, reviewed and approved, recorded/entered into the system correctly, and clearly marked for account code assignment?	When payments are made, all invoices are stamped PAID and dated. The approval process is given under No.4.19	
4.20 Do controls exist for the preparation of the payroll? Are changes (additions/deductions/modifications) to the payroll properly authorized?	Controls exist for the preparation of the payroll to Project staff according to the MOF approved limit. No changes are made to the payroll until the completion of the project.	
Policies And Procedures		
4.21 What is the basis of accounting (e.g., cash, accrual) followed (i) by the entity? (ii) By the project?	The basis of accounting is cash according to Mongolian Accounting Law	
4.22 What accounting standards are followed (International Financial Reporting Standards, International Public Sector Accounting Standards – cash or accrual, or National Accounting Standards (specify) or other?	According to Mongolian Accounting Law, International accounting standards shall be followed.	
4.23 Does the project have adequate policies and procedures manual(s) to guide activities and ensure staff accountability?	Project staff that requires special qualifications such as engineers and accountants are trained and provided with a procedures manual. Staff accountability is regulated by position descriptions, duties and responsibilities and approved by the project manager.	
4.24 Is the accounting policy and procedure manual updated regularly and for the project activities?	The accounting policy shall be approved and enforced by an entity's management in accordance with Accounting Law of Mongolia. Because of TA-2993 implemented by ADB in association with EA in 1998, accounting policy has been formulated and accounting staff have been provided with procedure manuals.	

4.25 Do procedures exist to ensure that only authorized persons can alter or establish a new accounting policy or procedure to be used by the entity?	Accounting principles and policies can be altered or established under the following circumstances: (i) Changes are made in the Accounting Law; (ii) Accounting software is changed according to Law. Procedure to be used by the entity can be altered by EA upon agreement with ADB.	
4.26 Are there written policies and procedures covering all routine financial management and related administrative activities?	TA-2993 implemented by ADB in association with EA in 1998 has contributed to solving issues connected with policies and procedures covering all routine financial management and related administrative activities.	
4.27 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?	TA-2993 implemented by ADB in association with EA in 1998 defined loan financing principles and duties, responsibilities, lines of supervision for all related officers, managers, and staff which contributed much to the limitation of any rise of conflict of interests. Direct disbursements made from ADB to the executing body provide safeguards to protect the organization from any conflict of interests.	
4.28 Are manuals distributed to appropriate personnel?	During the implementation of the above project, the manuals were distributed to all Project related staff.	
4.29 Describe how compliance with policies and procedures are verified and monitored.	Compliance with policies and procedures is verified and monitored by internal audits performed by the Monitoring, Evaluation and Internal Evaluation department of the IA as well as external audits performed by the Mongolian National Audit Office (NAO), private audit companies contracted by the Ministry of Finance in accordance with laws and regulations.	
Cash and Bank		
4.30 Indicate names and positions of authorized signatories for bank accounts. Include those persons who have custody over bank passwords, USB keys, or equivalent for online transactions.	Authorized signatories for imprest account opened at a bank in Mongolia are authorized signatory from the Finance Ministry and State Secretary for the MRTD (or a Project director upon nomination of the later). As for the sub-accounts project coordinator and project financial officer are the authorized signatories.	
4.31 Does the organization maintain an adequate and up-to-date cashbook recording receipts and payments?	MRTCUD as EA does not do cash transactions.	
4.32 Describe the collection process and cash handling procedures. Do controls exist for the collection, timely deposit and recording of receipts at each collection location?	The Project financial officer is responsible for collection, timely deposit and recording of receipts. The administration exerts controls over this performance.	

4.33	Are bank accounts reconciled on a monthly basis? Or more often? Is cash on hand physically verified, and reconciled with the cash books? With what frequency is this done?	Bank account records are collected on a weekly basis and cash reports are reconciled monthly.	
4.34	Are all reconciling items approved and recorded?	Yes	
4.35	Are all unusual items on the bank reconciliation reviewed and approved by a responsible official?	There are no unusual items on the bank reconciliation. The responsible official does not have the right to review and approve unusual items on the bank reconciliation.	
4.36	Are there any persistent/non-moving reconciling items?	No	
4.37	Are there appropriate controls in safekeeping of unused cheques, USB keys and passwords, official receipts and invoices?	Yes. No online transactions are made from the imprest account. Online banking is used for the sub-accounts.	No regulations on online banking transactions has been identified
4.38	Are any large cash balances maintained at the head office or field offices? If so, for what purpose?	No. The cash are usually used for office stationary and other petty cash transactions only.	
4.39	For online transactions, how many persons possess USB keys (or equivalent), and passwords? Describe the security rules on password and access controls.	The project financial officer possesses the USB key and passwords for the online banking account for the subsidiary accounts. No online banking account has been identified for the Imprest accounts. No security rules on password and access controls were identified.	
Safeguard over Assets			
4.40	What policies and procedures are in place to adequately safeguard or protect assets from fraud, waste and abuse?	Project staff assigned to assets is provided with a signed control card, a copy of which is kept by the accountant. Reconciliation is made each year with the control card.	
4.41	Does the entity maintain a Fixed Assets Register? Is the register updated monthly? Does the register record ownership of assets, any assets under lien or encumbered, or have been pledged?	Project staff assigned to assets is provided with a signed control card, a copy of which is kept by the accountant. Reconciliation is made each year with the control card.	
4.42	Are subsidiary records of fixed assets, inventories and stocks kept up to date and reconciled with control accounts?	Subsidiary records of fixed assets and stocks are kept up to date and reconciled with control accounts by accounting software approved by the Finance Ministry.	
4.43	Are there periodic physical inventories of fixed assets, inventories and stocks? Are fixed assets, inventories and stocks appropriately labeled?	Physical inventories of fixed assets and stocks are done once a year according to Accounting Law. Yes, fixed assets, inventories and stocks in the PIU we visited were appropriately labeled.	
4.44	Are the physical inventory of fixed assets and stocks reconciled with the respective fixed assets and	Yes, proper reconciliations are made periodically and controls are in place.	

	stock registers, and discrepancies analyzed and resolved?		
4.45	Describe the policies and procedures in disposal of assets. Is the disposal of each asset appropriately approved and recorded? Are steps immediately taken to locate lost, or repair broken assets?	According to the regulations issued by the State Property Committee (former name) MRTD appoints a commission in charge of the disposal of assets.	
4.46	Are assets sufficiently covered by insurance policies?	No. Vehicles are covered by insurance policies according to law however other assets are mostly covered by insurance policy against the fire.	
4.47	Describe the policies and procedures in identifying and maintaining fully depreciated assets from active assets.	The fully depreciated assets are to be disposed upon decision of the Disposal Commission nominated by the MRTD State Secretary.	
Other Offices and Implementing Entities			
4.48	Describe any other regional offices or executing entities participating in implementation.	No. There are no other regional offices or executing entities participating in implementation.	
4.49	Describe the staff, their roles and responsibilities in performing accounting and financial management functions of such offices as they relate to the project.	No. There are no other regional offices or executing entities participating in implementation.	
4.50	Has the project established segregation of duties, controls and procedures for flow of funds and financial information, accountability, and reporting and audits in relation to the other offices or entities?	No. As there are no other regional offices or executing entities participating in implementation therefore no controls and procedures are established for flow of funds in relation to other offices.	
4.51	Does information among the different offices/ implementing agencies flow in an accurate and timely fashion? In particular, do the offices other than the head office use the same accounting and reporting system?	As there are no other offices/implementing agencies participating in implementation, there is no information flow.	
4.52	Are periodic reconciliations performed among the different offices/implementing agencies? Describe the project reporting and auditing arrangements between these offices and the main executing/implementing agencies.	As there are no other offices/implementing agencies participating in implementation, there are no reconciliations.	
4.53	If any sub-accounts (under the Imprest Account) will be maintained, describe the results of the assessment of the financial management capacity of the administrator of such sub-accounts.	Sub-accounts (operational account) under the Imprest account will be maintained in FX and local currency. The authorized signatories for the sub-accounts will be the Project coordinator and project financial officer.	
Contract Management and Accounting			

4.54	Does the agency maintain contract-wise accounting records to indicate gross value of contract, and any amendments, variations and escalations, payments made, and undisbursed balances? Are the records consistent with physical outputs/deliverables of the contract?	Yes. The records consistent with physical outputs/deliverables of the contract.	
4.55	If contract records are maintained, does the agency reconcile them regularly with the contractor?	Yes.	
Other			
4.56	Describe project arrangements for reporting fraud, corruption, waste and misuse of project resources. 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?	If fraud, waste or misuse of Project resources or property are detected the employees, beneficiaries and other Project recipients should report to PIU management and the Project Consultant. This is written in their responsibilities and duties.	
5. Internal Audit			
5.1	Is there an internal audit (IA) department in the entity?	Yes. MRDT has got Monitoring, Evaluations and Internal Audit Department (MEIAD)	
5.2	What are the qualifications and experience of the IA staff?	The Director of the Department is a newly appointed one. The auditor conducted the internal audit on the existing PIU (Western Regional Road Corridor Investment Program) has got multiple years of experience, and has got an experience of working with State Specialized Inspection Agency.	
5.3	To whom does the head of the internal audit report?	MEIAD Director reports to the MRDT State Secretary	
5.4	Will the internal audit department include the project in its annual work program?	Yes	
5.5	Are actions taken on the internal audit findings?	Yes	
5.6	What is the scope of the internal audit program? How was it developed?	The scope of an internal audit / financial inspection covers the following: (i) Monitoring over the implementation the laws, rules, regulations and compliance to standards and contracts; (ii) The property preservation, protection, registration, use and consumption; (iii) The activities that have been funded from public resources and spending and its efficiency; (iv) Accuracy and reliability of the finance and budgeting, treasury operations; (v) Efficiency of risk management systems; (vi) Specialized audits by special decision of the MRTD; (vii) Audits of the entity's	

	<p>internal governance, other audit of compliance to relevant standards.</p> <p>In addition to internal auditors a state financial inspector has the following functions:</p> <ul style="list-style-type: none"> • Monitoring the implementation of the budget and finance-related laws and government decisions, rules and regulations, guidelines and standards; • The entity liabilities and receivable; • Revenue estimation, collection and disbursement of funds; • Funding and disbursements of the budget investments and monitoring of its effectiveness; • Primary accounting records and financial statements; • Monitor utilization and spending of the loans issued by international organizations and foreign governments, grants and other similar asset. 	
5.7 Is the IA department independent?	Yes, it is independent from the PIU	
5.8 Do they perform pre-audit of transactions?	No	
5.9 Who approves the internal audit program?	MRTD State Secretary approves the internal audit program	
5.10 What standards guide the internal audit program?	Internal audit program is guided by standards set in the Rules on Internal Auditing approved by the Government Resolution No 483, dated 14 December 2015 replacing the one "On Approving the Rules on Internal Auditing" (Government Resolution No 129 dated 2012)	
5.11 How are audit deficiencies tracked?	Any audit deficiencies are subject to scrutiny by the Minister order; for example the Minister Order "On Implementation of Some Follow up Measures of Audit Recommendations" No 129 dated 2016.05.17 was issued to follow up the recommendations of MNAO audit for the year of 2015.	
5.12 How long have the internal audit staff members been with the organization?	Most of the internal audit staff of the MEIAD of the Ministry are senior officers with multiple years of experience in civil service and in monitoring and evaluations. However, the internal audit function has been assigned to the Department recently, namely in 2015.	
5.13 Does any of the internal audit staff have an IT background?	Yes	

5.14	How frequently does the internal auditor meet with the audit committee without the presence of management?	The Audit committee had two meetings in 2015. The meetings were held in the presence of management.	
5.15	Has the internal auditor identified / reported any issue with reference to availability and completeness of records?	No	
5.16	Does the internal auditor have sufficient knowledge and understanding of ADB's guidelines and procedures, including the disbursement guidelines and procedures (i.e., LDH)?	No	
6. External Audit – entity level			
6.1	Is the entity financial statement audited regularly by an independent auditor? Who is the auditor?	Yes. Mongolian National Audit Office.	
6.2	Are there any delays in audit of the entity? When are the audit reports issued?	There are no delays in audit of the entity. Audit reports are issued within one month after audit is being made (in April).	
6.3	Is the audit of the entity conducted in accordance with the International Standards on Auditing, or the International Standards for Supreme Audit Institutions, or national auditing standards?	The audit of the entity is conducted according to Mongolian Law on Auditing and the International Standards on Auditing.	
6.4	Were there any major accountability issues noted in the audit report for the past three years?	No. There have been no accountability issues during the past three years.	
6.5	Does the external auditor meet with the audit committee without the presence of management?	No	
6.6	Has the entity engaged the external audit firm for any non-audit engagements (e.g., consulting)? If yes, what is the total value of non-audit engagements, relative to the value of audit services?	No	
6.7	Has the external auditor expressed any issues on the availability of complete records and supporting documents?	No	
6.8	Does the external auditor have sufficient knowledge and understanding of ADB's guidelines and procedures, including the disbursement guidelines and procedures (i.e., LDH)?	Yes, the auditors were trained in ADB's guidelines and procedures.	

6.9	Are there any material issues noted during the review of the audited entity financial statements that were not reported in the external audit report?	No	
External Audit – project level			
6.10	Will the entity auditor audit the project accounts or will another auditor be appointed to audit the project financial statements?	An independent auditor from an auditing company, nominated by the Ministry of Finance will audit the Project accounts.	
6.11	Are there any recommendations made by the auditors in prior project audit reports or management letters that have not yet been implemented?	There are no recommendations made by the auditors that have not yet been implemented.	
6.12	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?	Yes. IA is audited by State auditor from Mongolian National Audit Office (e.g. the supreme audit institution) every year.	
6.13	Has the project prepared acceptable terms of reference for an annual project audit? Have these been agreed and discussed with the EA and the auditor?	Auditing time is not predetermined. State auditor sets the time for auditing.	
6.14	Has the project auditor identified any issues with the availability and completeness of records and supporting documents?	No	
6.15	Does the external auditor have sufficient knowledge and understanding of ADB's guidelines and procedures, including the disbursement guidelines and procedures (i.e., LDH)?	Yes	
6.16	Are there any recommendations made by the auditors in prior audit reports or management letters that have not yet been implemented?	No	
6.17	[For second or subsequent projects] Were past audit reports complete, and did they fully address the obligations under the loan agreements? Were there any material issues noted during the review of the audited project financial statements and related audit report that have remained unaddressed?	There were no material issues noted during the review of the audited project financial statements and no issues related audit report that have remained unaddressed	
7. Reporting and Monitoring			
7.1	Are financial statements and reports prepared for the entity?	Financial statements are prepared for the entity in accordance with international accounting standards.	

7.2	Are financial statements and reports prepared for the implementing unit(s)?	Yes. Financial statements are prepared for the implementing unit.	
7.3	What is the frequency of preparation of financial statements and reports? 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 and quarterly basis. The reports are prepared so as to make decisions for the management.	
7.4	Does the entity reporting system need to be adapted for project reporting?	The reporting system is in the same tune with report on the Project components.	
7.5	Has the project established financial management reporting responsibilities that specify the types of reports to be prepared, the report content, and purpose of the reports?	Yes. Within the framework of ADB TA-2993 project financial management reporting responsibilities were established. This management is also spelled out in the Mongolian Auditing Law.as well as in the recently approved Regulations on Foreign loan use, implementation, organization, financing, monitoring and evaluation of projects and programs funded by these loans (approved by the Finance Minister Order No 196 dated July 10, 2015)	
7.6	Are financial management reports used by management?	Yes	
7.7	Do the financial reports compare actual expenditures with budgeted and programmed allocations?	The annexes of financial reports give comparisons of actual expenditures with budgeted and programmed allocations.	
7.8	How are financial reports prepared? Are financial reports prepared directly by the automated accounting system or are they prepared by spreadsheets or some other means?	Financial reports are prepared directly by the automated accounting system approved by the MOF.	
7.9	Does the financial 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?	Yes	
7.10	Does the entity have experience in implementing projects of any other donors, co-financiers, or development partners?	Yes, the entity has an experience of implementing projects financed by other donors like EXIM Bank of P.R. of China, Germany and Economic Development Fund of Kuwait.	

8. Information Systems

8.1	Is the financial accounting and reporting system computerized?	Yes. Fully computerized.	
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8.2	If computerized, is the software off-the-shelf, or customized?	The one used in the PIU we visited is VINITSA, bought and it has been customized a bit for the PIU needs.	
8.3	Is the computerized software standalone, or integrated and used by all departments in the headquarters and field units using modules?	It is a standalone system	
8.4	How are the project financial data integrated with the entity financial data? Is it done through a module in the enterprise financial system with automatic data transfer, or does it entail manual entry?	It requires manual entry	
8.5	Is the computerized software used for directly generating periodic financial statements, or does it require manual intervention and use of Excel or similar spreadsheet software?	The computerized software used for directly generating periodic financial statements	
8.6	Can the system automatically produce the necessary project financial reports?	Yes	
8.7	Is the staff adequately trained to maintain the computerized system?	Yes. The staff of the sample PIU we met was specially retrained more than twice and given certificates to maintain the system.	
8.8	Do the management, organization and processes and systems safeguard the confidentiality, integrity and availability of the data?	Yes. Confidentiality, integrity and availability of the data are safeguarded by the entity's internal rules.	
8.9	Are there back-up procedures in place?	Yes, the back-up copies are held in a hard copy version in safe deposits	
8.10	Describe the backup procedures – online storage, offsite storage, offshore storage, fire, and earthquake and calamity protection for backups.	Onsite storage.	No online storage, offsite storage, offshore storage, fire, earthquake and calamity protection for backups have been identified.

Source: MRTD, MOF

Appendix 2

Organization Chart of the Ministry of Road and Transport Development, Mongolia

