Detailed Financial Management Assessment

October 2016

Nepal: Supporting School Sector Development Plan

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DETAILED FINANCIAL MANAGEMENT ASSESSMENT

A. Executive Summary

1. The program will use country systems for financial management, procurement, and anticorruption systems. The public financial management assessment was undertaken at country-level, and at Ministry of Education (MOE) and/or Department of Education (DOE) and District Education Office (DEO) levels. The country Public Expenditure and Financial Accountability assessment report of 2015 had shown improvement in 16 public financial management performance areas out of 28, compared to the assessment in 2008. The implementation of Government Finance Statistics (GFS) and Treasury Single Account (TSA), and payment of salaries to teachers through the banking system has increased the transparency of the budget execution. However, there are weaknesses in internal controls and oversight as well as capacity shortfalls, at district and school levels, where a major share of program expenditures is executed. Problems with reconciliation of accounts between the funds released by Financial Controller General Office (FCGO) and expenditure recorded by the DEOs and lack of timely action on audit observations also prevent smooth functioning of the system. Improvements in planning and budgeting are also required. Overall fiduciary risk is assessed to be *substantial*. This is primarily due to (i) observed weaknesses in internal controls, (ii) lack of an internal audit service segregated from processing of payments, (iii) capacity challenges at DEO levels implementing a major share of program expenditures and with a role to monitor and supervise school level financial management. Risks will be mitigated through a continuous program of system improvement and filling of vacant accounting and engineering positions at DEOs. A major initiative will be the country-wide roll out of the Computerized Government Accounting System (CGAS) that will provide timely and accurate financial management reporting. An Audit Committee will be set up to report to the School Sector Development Plan (SSDP) steering committee for timely action on audit matters, the resolution of which will be tied to disbursements under disbursement-linked indicator (DLI) thereby providing a strong incentive to clear audit issues and backlogs.

2. The implementation of an agreed Financial Management Action Plan will provide for continuous system improvements and joint monitoring by the government and joint financing partners. An agreed Financial Management Action Plan is a DLI indicator for year 1. The DLI is set to be achieved in the first fiscal year of SSDP. Some of the key actions to strengthen fiduciary systems are in Table 1.

Table 1: Key Actions to Strengthen Financial Management under the School Sector Development Plan[a]

Action	Responsible Agency	Timeline
A. Implementation arrangements		
1. Creation of a steering committee and program coordination secretariat at the national level and a district grant management committee that will include requisite finance and accounting staff.	MOE	Loan effectiveness
2. Creation of a task team in MOE for follow-up on audit matters. An audit committee will be set up to report to the SSDP steering committee for timely action on audit matters.	MOE	Loan effectiveness
B. Actions monitored through disbursement-linked indicators		
1. Approval of fiduciary management action plan	MOE and development partners	March 2017
2. Implementation of the computerized government accounting system	MOE/FCGO	2018
3. Reduction of recurring audit observations as a proportion of total	MOE	Ongoing

Action		Responsible Agency	Timeline
	expenditures		
4.	Implementation of an improved school grant system that responds to contextual needs and is performance oriented	MOE	Gradual implementation from 2018
C.	**Actions monitored through Program Action Plan**		
1.	Improving preparation of the annual strategic implementation plan and the annual work plan and budget based on prioritized key initiatives from the results framework to enable results-based financing	MOE	From 2017 onward
2.	Implementation of approved joint FMAP initiated, reviewed, and updated annually to ensure gradual reduction of recurring SSDP audit observations. Identify districts that have recurring and substantial audit observations.	MOE	March 2017and annually thereafter
3.	Simplified school-based accounting and financial reports included during the amendment of Education Regulation.	MOE	November 2016
4.	Independent annual fiduciary review (including procurement review on a sample basis)	JFPs	Annually
D.	**Actions covenanted as part of the JFA**		
1.	Allocation of annual MOE budget is consistent with the 5-year SSDP budget, with MTEF projections for the education sector designed to achieve results included in the results framework.	MOE/MOF	2017 onward
2.	Allocation of annual MOE budget takes into account the recurrent cost impact of capital investments and required funding each year.	MOF	Ongoing
3.	Introduce program-based budgeting and use of program budget heads compliant with COFOG for SSDP	MOE	2016 onward
4.	Annual fiduciary review	ADB/JFPs	Ongoing
5.	Annual audited program financial statements are submitted in accordance with detailed statement of audit needs.	MOE	Annual

ADB = Asian Development Bank, COFOG = classification of the functions of government, FGCO = Financial Comptroller General Office, FMAP = Fiduciary Management Action Plan, JFA = Joint Financing Arrangement, JFP = joint financing partner, MOE = Ministry of Education, MOF = Ministry of Finance, MTEF = medium-term expenditure framework, SSDP = School Sector Development Plan.

[a] To be finalized jointly by MOE and the JFPs by March 2017 as a DLI for year 1.

Source: Asian Development Bank.

B. Introduction

3. The SSDP is a follow-on program to the current School Sector Reform Program (SSRP) implemented by the MOE of the Government of Nepal. The SSRP has been supported by multiple development partners through a Joint Financing Arrangement (JFA). SSRP will be completed by the current fiscal year (2015/2016).

4. Development partners' contributions to the SSRP were allocated to a broad set of MOE budget heads constituting 82% of MOE's total budget. The remaining 18% were for financing of higher education institutions, operational expenditure for MOE and its DOE as well as various project interventions at central level supported by development partners outside the scope of SSRP.

5. The SSRP budget heads financed activities in pre-primary, primary and secondary subsectors at central and district levels to deliver on annual physical targets with progress reported on through Implementation Progress Reports. Disbursements from the development partners were contingent on progress in expenditures under these budget heads.

6. The SSDP is a sector-wide program that aims to consolidate SSRP achievements and strengthen reforms to make school education more inclusive and equitable, and to enhance quality. Like SSRP, SSDP will be supported by multiple development partners through a new

JFA. The development partners' financial contributions will serve to increase the resource envelope of the MOE budget to fully implement the SSDP. Unlike SSRP which was a policy loan, SSDP disbursements will be contingent on delivery of results defined by a set of DLIs; a subset of priority results defined by the Program Result Framework, within the overall expenditure framework of SSDP.

7. All financing for the SSDP, including the contributions of the development partners, will be managed through the regular budget, budget execution, accounting and auditing procedures of the Government of Nepal i.e. the contributions from the development partners will be recorded as revenue for the government consolidated fund and released through the regular budget execution process. It means all funds for program implementation including development partner contributions will be subject to the government's public financial management (PFM) system and procurement procedures. Asian Development Bank's (ADB) financial contribution will be extended by the results-based lending (RBL) modality.

8. The disbursement arrangement means that all PFM-related risks associated with the program are those related to the government's PFM systems and procedures in general, and as they relate to the education sector including MOE, subordinated institutions and schools in particular. In areas identified with specific fiduciary risks by this Fiduciary Risk Assessment, the development partners will jointly, with the government, implement risk mitigating measures.

9. The assessment was conducted in accordance with ADB's policy and guidance, including ADB's Technical Guidance Note: Financial Management Assessment (2015) and ADBs Staff Guidance for Piloting Results-Based Lending for Programs (2013) and is intended to determine the degree to which the systems, procedures and regulations for PFM, procurement management, and anticorruption measures will be able to manage fiduciary risks.[1] The assessment focuses on planning and budgeting, fund flows, internal controls, internal and external audit, management information systems, accounting, financial reporting, staffing and capacity. The assessment with proposed mitigating measures are intended to provide assurance that the development partners' contributions to the program including ADB RBL program funds will be used for the intended purposes, with due consideration for economy and efficiency.

C. Approach and Methodology

10. This fiduciary assessment was undertaken from October 2015 to May 2016. The assessment included a review of the government's PFM system and capacity in management of public funds within the MOF and the FCGO with its subsidiary payment and internal control entities; District Treasury Controllers Offices (DTCO). It included a financial management assessment of the MOE, DOE and DEOs as well as school-level management of grants and other resources for school level expenditures.

11. The assessment was implemented by collecting data and information through consultations with counterparts and consultants, and discussing key issues with stakeholders. It included a review and testing of the government's financial management system by analyzing itemized data from the TSA system. The assessment was also supported by a review of a significant number PFM previous diagnostic studies conducted by various agencies and

[1] ADB. 2013. *Piloting Results-Based Lending for Programs*. Manila; ADB. 2013. *Staff Guidance for Piloting Results-Based Lending for Programs.* Manila.

consultants on behalf of the government and development partners, both general PFM diagnostic studies as well as sector specific studies.

12. The ADB Financial Management Assessment Questionnaire is also used for further guidance to the assessment for issues of relevance to assessing the government's PFM system and how it will apply to the implementation of SSDP. The responses to the relevant Financial Management Assessment Questionnaire issues are available upon request.

13. Among the main diagnostic studies reviewed as input for this fiduciary assessment was the ADB Public Finance Management Assessment (2005), a review of Public Sector Accounting and Auditing in Nepal (2007)[2], the World Bank Public Expenditure Review (2010)[3], Public Expenditure and Financial Accountability Assessments in 2008 and 2015[4] ,an operational risk assessment of public financial management reform in Nepal (2013)[5] and Nepal's Public Financial Management Reform Strategy/Program Phase II (2016/2017−2025/2026)[6]. Various reports from the Nepal Public Expenditure and Financial Accountability (PEFA) secretariat provided information on progress in implementation of reforms to strengthen PFM in Nepal.[7]

14. Two consecutive tracking studies for the education sector, a fund flow tracking study for the SSRP conducted by ADB in 2013[8] and a Public Expenditure Tracking Study for the education sector in 2014[9] provided, among others, insights on management practices at service delivery levels of the education system. They provided insights into how government funding translates into service delivery at school level confirming observations from field visits conducted as part of this assessment.

15. Diagnostic work like the World Bank assessment on Strengthening Budgeting Process for Results (2014)[10] and a proposed new Financial Management Framework for the Education Sector (2015) provided updates on the status of the main risks and challenges related to public financial management.[11] They present specific recommendations on how to strengthen current PFM practices in the education sector of relevance to this assessment in the design of risk mitigating actions to reduce fiduciary risks in the implementation of SSDP.

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[2] World Bank. 2007. *Nepal Public Sector Accounting and Auditing: A Comparison to International Standards Country Report.* Washington, D.C.
[3] World Bank. 2010. *Nepal - Public Expenditure Review Report No. 55388-NP*. Washington, D.C.
[4] Government of Nepal. Ministry of Finance, Office of the Auditor General and Financial Comptroller General Office. 2008. *Public Expenditure and Financial Accountability: An Assessment of the Public Financial Management Performance Measurement Framework as of FY2005/2006.* Kathmandu; Government of Nepal. Ministry of Finance Nepal and PEFA Secretariat. 2015. *Public Expenditure and Financial Accountability Assessment: Nepal PFM Performance Assessment II as of FY2013/2014.* Kathmandu.
[5] Overseas Development Institute, Centre for Aid and Public Expenditure. 2013. *Operational Risk Assessment of Public Financial Management Reform in Nepal: A Review of Challenges and Opportunities.* https://www.odi.org/publications/7832-operational-risk-assessment-public-financial-management-nepal-review-challenges-opportunities
[6] Government of Nepal. Ministry of Finance. 2016. *Nepal's Public Financial Management Reform Strategy/ Program Phase II.* Kathmandu. http://www.pefa.gov.np/wp-content/uploads/Second-Phase-PFM-Reform-Actionplan.pdf
[7] Nepal Public Financial Management Multi-Donor Trust Fund, six monthly progress reports various years.
[8] ADB. 2013. *School Sector Program – Public Expenditure Tracking Survey (PETS) - Fund Flow Tracking Survey for 2011/2012.* Manila.
[9] World Bank. 2014. *Report No. ACS8283; Public Expenditure Tracking and Quantitative Service Delivery Surveys in Nepal's Education Sector.* Washington, D.C.
[10] World Bank. 2014. *Nepal: Strengthening Budgeting Process for Results.* Washington, D.C.
[11] N. K. Sharma. 2015. *Financial Management Framework for the Education Sector (2015).*

16. As part of the assessment a review of the annual reports for 3 fiscal years of the Auditor General of Nepal was conducted. The purpose was to identify types of observations of relevance to PFM in the education sector with particular emphasis on recurring observations indicating areas of particular risks.[12] The assessment also included a review of the portfolio of cases reported to the Commission for the Investigation of Abuse of Authority (CIAA), the government's anticorruption agency. The CIAA portfolio review was done to assess trend in reported cases and types of cases to assess areas of particular risk as concerns mismanagement of public funds and abuse of authority in the education sector.

17. In addition, the government has envisaged a number of PFM Reform Actions under its PFM Reform Strategy 2015–2016 to 2025–2026, which will address some of the risks in the Program. Specifically, processes are underway to revise the legal framework for an internal audit service as well as capacity building interventions by the PEFA secretariat to support Public Accounts Committee (PAC) to improve on process and procedures for follow up to Auditor General findings.

D. Planning and Budgeting

18. The government budget is guided by a Medium-Term Expenditure Framework (MTEF). The MTEF is intended to translate policy targets into priority spending to meet policy objectives. The MTEF serves as a tool to maintain fiscal prudence at the aggregate level, allocation efficiency by ministries based on sector strategies and promote "value for money" by linking spending to results. The earthquake of April 2015 had an impact on the completion of MTEF for which there has been no MTEF the last 2 fiscal years. However, the preparation of a sectoral MTEF has started again and is guiding the budget process for the next fiscal year 2016/2017. The MTEF is the main instrument for the government in aligning budget allocations to medium term policy targets and ensuring that current level of investments do not exceed future recurrent cost requirements to maintain the investments.

19. The budget is prepared through a clearly defined budget calendar but remains split between the National Planning Commission, which manages the MTEF and capital (development) expenditure budget process, and MOF, which manages annual recurrent expenditure and overall budgeting. The lack of full integration between the MTEF and annual budget preparation process results in parallel and disjoint activities. Accordingly, the annual budget continues to be prepared on an incremental basis without sufficient consideration for sector strategies and results reflected in the MTEF, and ensuring future recurrent cost requirements from current level of investment are considered in the budget process. These issues will be addressed in the annual budget preparation of MOE with revised estimates prepared annually during the SSDP implementation. Among others, a provision will be made in the JFA to ensure that allocations for MOE budget is in compliance with the budget projections for SSDP for which recurrent cost impact of capital investments and required funding to achieve program results have already been considered. In the ongoing MTEF preparation process within MOE, they have been allocated budget ceilings broadly in compliance with SSDP.

20. More than 80% of expenditures in annual budgets are classified as priority expenditure. This indicates low level of real prioritization and continued funding of non-core activities even during times of reduced funding levels. Prioritization will be an important element in the annual

[12] Annual Report of the Office of the Comptroller and Auditor General for the fiscal years 2011/2012, 2012/2013 and 2013/2014 including management letters to MOE.

budget process reflecting key results as presented under the SSDP result framework. As such the Result Framework and associated costing of strategies to deliver them has been developed to ensure that key sector targets can be achieved with sufficient amount of funding allocated.

21. A particular challenge for the education sector has been the absence of a sector planning tool to make forecasts on resource requirements to meet education sector targets. During the design of SSRP, technical assistance was provided in making budget forecasts for the cost of SSRP interventions in addition to basic cost projections using demographic forecasts of the school age population with enrollment targets and student-teacher ratios determining required classrooms, teachers, textbooks and other inputs. However, the budget forecasting model was never internalized in MOE and thus not updated to make updated forecasts for consecutive years. Under SSDP, it is intended to develop a more consistent and conventional revised model to be internalized in MOE to support the annual budget process linking budget allocations to sector targets with updated projections for each consecutive budget year.

22. School Development Committee is involved in planning, management and raising resources from community for school development.

E. Budget Execution

23. The key challenges related to budget execution are weaknesses in expenditure prioritization, cash management, and late approval of annual plans which impact on development spending and delivery of sector program results. Analysis of implementation shows that late approval of annual work plans results in low level of budget execution for key development spending consisting on program interventions to deliver MTEF results. This is also an issue having impact on budget execution in the education sector.

24. The government's budget outturns compared to originally approved budget are broadly within initial budget ceilings indicating an acceptable level of budget credibility and fiscal discipline. Monitoring of budget execution, especially arrears, has improved over the years and in particular after the introduction of TSA system, which has improved cash management significantly among others through more timely processing of payments and improved monitoring of available cash to accommodate expenditures as they occur. However, for some ministries, expenditure overruns as well as changes in composition of expenditure remains a challenge. This has among others been observed in the education sector with expenditure in excess of budget allocation at district level signifying challenges in budget discipline.

25. Even though formal systems have been developed for more effective budget execution and accounting, actual implementation indicate several deviations from financial regulations. Central systems continue to be upgraded (e.g. information systems), however progress in line ministries in the areas of budget execution, monitoring and budget discipline remains a challenge as well as lack of qualified staff at district levels to effectively manage budget execution within budget allocations. Lack of qualified staff for the positions as Chief Finance and Administrative Officer (CFO) at the level of DEOs is one of the main challenges for the education sector.[13]

[13] FCGO is in charge of seconding accounting staff to DEOs DoE indicate that 15 out of 75 DEOs have the positions vacant and hence use staff in other positions without the required qualifications to maintain accounts. Seconded staff by FCGO to other DEOs are also often externally recruited staff without required experience in public sector accounting.

26. Weaknesses in budget discipline and cash management are evidenced by budget overruns, outstanding aid reimbursement which in some fiscal years has constituted more than 2% of gross domestic product, extensive use of the overdraft facility and turning to domestic borrowing towards the end of the fiscal year.

27. The legal framework provides line ministries with considerable virement powers. Significant budget reallocations take place across spending categories during the year. While this does provide flexibility to line ministries to adjust according to changing circumstances, combined with weaknesses in internal controls it results in weak accountability of resource use. Reallocation of unspent within capital spending has increased to an average of 30% of the total capital budget. The implementation of program-based budgeting[14] is expected to improve alignment of spending to sector targets, help monitor budget implementation, and reduce expenditure variances. Among others, the introduction of Program Budget Heads (PBHs) more in compliance with Classification of the Functions of Government standard and use of activity codes has, helped in budgeting and monitoring expenditure linked to subsector targets. During the SSDP appraisal, further restructuring of classifications codes for MOE was introduced and reflected in the definition of PBHs in the JFA i.e. by including separate program heads for training and capacity interventions under respective sub-sector budget head rather than as separate PBHs.

28. For some years, the Government of Nepal budget has not been approved before several months into the fiscal year and authorization to execute spending under the budget delayed with major shares of the budget only executed during the last months of the fiscal year. This has had impact on delivery of program results. The challenge is not execution of budget in total but execution of capital expenditures.

29. MOF monitors ministries budget execution through regular budget meetings and compare budget outturns as reported on by TSA with the information contained in the Budget Information System and the subsidiary Line Ministry Budget Information System. The review includes analysis of deviations from originally approved budget.

F. Accounting and Internal Controls

30. MOE reporting requirements follow the Government of Nepal's financial regulations, which among others require each entity to reconcile their accounts with DTCOs and submit monthly expenditure returns to MOF and FCGO before subsequent budget releases are made. All payments are recorded in the government's TSA System. Separate systems with partial consolidation of information like CGAS, TSA, Line Ministry Budget Information System, etc. are together labelled "Integrated Financial Management Information System". The target however is to have one Integrated Financial Management Information System but this will requires new design if to function effectively. Accounts are maintained manually by MOE and subordinated institutions.[15] Other central level agencies and DEOs mostly use Excel versions of cashbook

[14] Program-based budgeting links budget allocation and expenditure to results. In practice, it means adding a new dimension to the budgeting process with program and activity codes i.e. in addition to the conventional functional and economic codes. The aim is to improve the efficiency and effectiveness of public spending by systematically linking budget allocations to results and making use of performance information to monitor efficacy and effectiveness of spending.

[15] Some three government ministries and agencies are using the FCGO CGAS system on a stand-alone basis, but this does not include MOE, and only includes one of the DEOs.

and ledger. The accounting includes recording of revenues and expenditures by institutional, functional and economic categories of expenditures as well as segregation of expenditures by projects and sources of funds at transaction level.[16]

31. Budget and accounting information has become more transparent after the implementation of GFS classification and the TSA. Progress has been made in piloting the Nepal Public Sector Accounting Standards (NPSAS), which are compliant with international financial reporting standard (cash-based International Public Sector Accounting Standards [IPSAS]) at the ministry level, although further work is required and will be supported under SSDP for MOE.[17]

32. The rollouts of the TSA system for payment processing to all 75 districts have provided reliable and up-to-date information on budget execution. Fiscal reports are publicly available, however, the fiscal reports are not comprehensive and many autonomous government agencies and donor projects operate outside the government budget and accounting framework. This is also the case for the education sector were approximately 18% of donor funding for government projects are not captured by the government budget and disbursed outside the government treasury system i.e. disbursements made directly to project accounts operated by the government agencies directly without passing through the TSA revenue accounts.

33. Transaction level analysis conducted as part of this assessment suggest that payments are executed in a timely fashion and usually within one day of receiving the requests from the budget holders (MOE/DEOs) with only few exceptions. The payments are recorded in the FCGO web-based integrated accounting system (TSA) and reconciliation of DTCO accounts are done end of day with the bank by uploading bank statements to the system. Reconciliation with cost centers (MOE and DEOs) are to be done within 7 days of the end of each month. The account reconciliation process provides a reasonable assurance as concerns financial reporting, however, year-end reconciliation suggests that there The accounting units within MOE at central and district levels totals 177 entities and approximately 34,000 schools at primary and secondary levels. Accounts are maintained by each entity through a variety of accounting systems with the choice of system at the discretion of each entity. Most DEOs maintain manual cashbooks and ledgers and prepare financial statements by use of Excel spreadsheets to produce financial statements in the prescribed format as per financial regulations. At school level most school accounts are prepared manually with a simple consolidated income and expenditure statement produced end of year for submission to DEOs. The DEOs also maintain accounts by program component and activity codes (program specific) but the manual process leads to significant deviation in overall balances when consolidating the more than 100+ cost centers. The above system creates significant challenges for compilation of end year financial

[16] The chart of accounts consists of a 21-digit code. The classification system enables segregation of allocations and expenditures by administrative units with budget and sub-budget heads (Ministries, Departments and agencies), functional and sub-functional areas and type of expenditures i.e. recurrent and capital (economic classification codes). Functional codes are also used to identify Project and program expenditure which creates a challenge when to estimate total cost by sub-sector, in particular for programs with expenditures cutting across subsectors. This will be addressed by defining sub-functional codes to segregate expenditures across sub-sectors by the introduction of program-based budgeting.

[17] The NPSAS, based on IPSAS, was developed by the Accounting Standards Board, Nepal, for FY2009/2010 and was approved by the Cabinet in September 2009. The Government piloted the NPSAS in two ministries in FY2013/2014 and for FY2014/2015 all ministries, DTCO, and entities are required to prepare consolidated financial statements compliant with IPSAS by using Auditor General form no. 13 (Statements of Expenditure), no.14 (Statements of Advances), no. 15 (Statements of Bank Accounts), no. 9 (Statements of Revenue), and no. 17 (Annual Financial Statements).

statements for MOE and in reconciling these with the TSA end year statements.[18] During SSDP this challenge will be addressed by MOE in cooperation with FCGO rolling out the web based computerized accounting system CGAS to DOE and all DEOs. This will enable online financial accounts for all MOE as all entries are made to one central database of journal entries hosted by FCGO. In addition, SSDP will also consider measures to consolidate and compile accounts the country in a speedy and accurate fashion.

34. There is a comprehensive set of financial regulations guiding budget execution. However, weaknesses in enforcement of these rules, in particular in the absence of an effective internal audit function at central, sector and lower levels as well as inadequate qualifications of staff in positions as CFOs, among others at DEOs, has created several challenges in maintaining fiscal discipline and compliance with these regulations. Auditor General observations in consecutive audits point to a number of recurring issues and challenges:

(i) DEOs have made salary payment to teachers in excess of budget—for teachers that have already retired and double release of salaries to the same teachers. Excess budget releases for teacher salaries have been increasing every year.
(ii) Completion of contracts for construction and repairs/maintenance of classrooms and schools are not certified in time by technical staff, headmaster and chairperson of School Management Committee (SMC), with capital expenditures spilling over beyond the specified year, thereby signaling lack of compliance with contract specifications.
(iii) Distribution of and monitoring of scholarships has not followed agreed procedures. Monitoring of scholarships and the extent to which they have reached the intended beneficiary remains a challenge.
(iv) Expenses incurred without adequate supporting documentation often related to travel, organization of workshops and training as well as expenses for stationery and other inputs at school level.
(v) Expenditure incurred from contingency budget in a blanket fashion without attribution to specific head and expenses of the previous year paid from the current year's budget without approvals.
(vi) Excess budget releases for schools with cases of "ghost schools" receiving grants; conditional or earmarked grants to schools not used for the stated purpose but for some other educational purpose.

35. The above are samples of recurring observations that relate to weaknesses in capacity for financial management in particular at District Levels including weaknesses in DEO monitoring of school level financial management. Records of payments through DTCOs are recorded real time online in the web based TSA system. However, most DEOs use different and often standalone excel spreadsheets to emulate cashbooks and ledgers. This creates a challenge in timely consolidation of accounts under all accounting entities of MOE.

36. FCGO through its DTCOs serve as the paymaster general. A separate unit within each DTCO serves as the internal auditor. The budget release is authorized by the MOE, while actual

[18] The end year reconciliation process is to be completed within 3 months of the fiscal year. However, with the numerous cost centers in MOE this is a time consuming effort. DOE finalized the 2014/2015 reconciliation process in February 2016; initially with an unreconciled balance of $84 million (approximately 16% of total expenditure) by the end of the fiscal year reduced to $13 million (approximately 2% of total expenditure) 4 months later after significant efforts to identify the transaction level imbalances.

processing of payments are made by DTCOs on presentation of payment requests signed by the unit or entity under MOE and the FCGO at respective unit (i.e. MOE, DOE and DEOs).

37. The same applies at school level for all requests for payment (salaries, other expenses) with the signatory of the head teachers. DTCO executes the payment to the school bank account on receipt of the request from the DEO. DEO maintains the payroll of teachers while schools submit monthly request to DEOs for payment to their bank account for the total amount to be distributed to the teachers. The total amount for salaries is paid by the DTCO on request of DEO to the School Bank account. The head teacher then makes transfers from the school bank account to teachers' bank account or withdraws cash for direct payments to teachers who do not have bank accounts.[19]

38. Teacher salaries as well as most other payments to schools are executed as earmarked grants.[20] However, as observed by Auditor General audits, schools frequently do not follow the rules or purpose for which they received the grant. Unspent balances of a grant from 1 year to another appear to be treated as unconditional for purposes of expenditure. To address the above, DEOs need to be provided adequate human resources for monitoring and supervision, an issue which is addressed in SSDP by recruitment and deployment of accounting and procurement staff at DEO levels to monitor and supervise school level spending in compliance with the purpose of the grants transferred to schools.

G. Internal Audit

39. The DTCO internal audit function is an ex-post sample testing of the existence of supporting documentation (e.g. invoices, etc.) available at cost centers in support of the payment requests processed by DTCO. This "inspection" takes place sometimes bi-monthly, sometimes less frequent pending the level of capacity of the DTCO. The main challenges concerning internal controls and audit are on the one hand related to capacity, frequency and type of internal controls and on the other integrity of controls due to institutional arrangement with limited segregation of duties.

40. There is no internal audit service in the respective ministry like MOE or subordinated levels like DEOs. The internal audit function is maintained by DTCOs but, as mentioned, this is limited to verification of documentation at infrequent intervals. As the DTCO is also the same entity executing the payments, questions can be raised as to the integrity of the internal controls by non-segregation of duties between different entities. Combined with challenges in meeting staffing requirements for financial management at DEOs, the lack of an effective internal audit function may serve to explain many of the above recurring observations of Auditor General with limited effective capacity in enforcing rules and maintaining fiscal discipline in the system.

41. Under government's PFM Reform strategy, processes are underway to revise the legal framework for an internal audit service as well as capacity building interventions by the PEFA

[19] During the time of this assessment it was estimated that more than 80% of teachers have bank accounts and the target is to have all teachers receiving their salaries through bank transfers.

[20] Most of the revenue for a school is in the form of conditional grants. Schools have very limited discretionary authority over their funding which is typically only 5% to 10% of the total grants received. However, some schools receive community and other donations for which they may implement school improvement and the grant received for construction and rehabilitation is often based on submission of a School Improvement Plan endorsed by the SMC for approval by DEO.

secretariat to support PAC to improve on process and procedures for follow up to Auditor General findings.

42. To address the above, and to strengthen capacity in financial management, among others for effective follow up of recurring Auditor General findings, SSDP have made a provision to strengthen MOE internal financial monitoring team, in cooperation with FCGO, to ensure recruitment and deployment of adequate staff at DEO levels for improved monitoring and supervision of schools (in SSDP included as a DLI) and support financial monitoring and supervision though an Annual Fiduciary Review process (a provision included in the JFA).

H. External Audit

43. Auditor General starts the preparation of the annual audit plan in May of the current fiscal year.[21] Auditor General is organized by departments headed by an Assistant Auditor General responsible for audit of a cluster of institutions/ministries and conduct institution wide audits (functional budget heads). There are 14 Assistant Auditor Generals and/or departments covering the 26 ministries of the Government of Nepal.

44. The department auditing MOE has 20 audit staff. Value for Money/ Performance audits are conducted by a separate department specialized in conduction evaluations/ performance audits (assessing effectiveness, efficiency and impact of spending linked to quality and quantity of service delivery).

45. The actual audit starts mid-August and continues to mid-February. The audit report is issued mid-April although the constitution do not set any requirement on date. The report is submitted to the President for onward submission to the PAC of the Parliament. Auditor General audit coverage and quality has improved over the years despite prevailing limitations in capacity to conduct performance audits.

46. AG conducts financial and compliance audits on a majority of government revenues and expenditures using International Organization of Supreme Audit Institutions (INTOSAI)-based standards. The audit of MOE includes subordinated institutions like DEOs, but not grant receiving institutions like schools and universities.[22] In total the audit of MOE includes 177 budget entities. The audit is conducted through a risk-based approach based on some indicators of materiality and risk of non-compliance with financial regulations.

47. Through a rating system decisions are made on frequency of audits (annually, biannually or every third year) for which entity to conduct a full scope audit. Some entities, like MOE and selected Districts, are covered with full scope audits each year.

48. MOE always responds to the audit observations raised in Auditor General management letters but the challenge is lack of follow up. PAC has not been effective in enforcing measures recommended by Auditor General to be implemented by respective ministry/agency. PAC calls the auditees, like MOE, to stand before the committee. The secretaries of the ministries meet with PAC where they are asked to prepare action plans to address the challenges. A challenge

[21] The fiscal year for the Government of Nepal runs from July to June.

[22] Grants to Primary and Secondary schools are included in the audit of AO: to assess level of compliance with the conditions for the grants, however school block grants are not included as they are to be managed at the discretion of the schools and audited by auditors appointed by the SMCs. The Universities receives their funding from the MOE budget through the University grants commission and are autonomous entities with their own appointed auditor.

is that the action plans do not contain any timeline on when they will be implemented and there is limited evidence of actual resolve as confirmed by recurring observations by the Auditor General. Several mitigating actions have been proposed under SSDP to address the above, which in turn is expected to reduce the number of recurring audit observations and reduction in recurring audit observations has been included as a DLI.

49. At the school level, each school account is subject to financial and social audits managed by SMC. At the DEO and SMC levels, however, there are challenges related to effectiveness of their financial monitoring and oversight which will be addressed through specific mitigating actions proposed for the program. These include implementation of simplified procedures for financial reporting which will raise the level of assurance to the financial statements presented.

I. Anticorruption

50. The Constitution of Nepal gives provisions for an independent judiciary with courts consisting of the Supreme Court, Appellate Court and District courts. In addition, it gives provisions for a number of constitutional bodies such as the Commission for the Investigation of Abuse of Authority, Auditor General, Public Service Commission and Attorney General as key institutions to combat and oversee that constitutional rights are adhered to and to address any misuse of public office by any government employee.

51. The Anticorruption Act of 1952, the new and revised act of 1960 with the establishment of an Anticorruption Department in the form of Special Police Department to control corruption and the formation of a Commission on Controlling Abuse of Authority in 1977 were the preface to the establishment of the CIAA in 1990. The Interim Constitution of Nepal 2007 put renewed emphasis on CIAA to investigate and probe cases against persons holding public office who are considered to have abused their authority by way of corruption or other forms of misconduct.

52. There is limited data available to measure level of corruption in Nepal and what is available is either scant or outdated. However, data on perception of corruption are available from various survey data. As per the Corruption Perception Index 2014 published by Transparency International, Nepal scored 2.9 and with one exception always below 3 since 2004 i.e. as per Transparency International classification as “corruption rampant countries”. The Control of Corruption Index 2014 published by World Bank, gives Nepal a score of 36.1 (out of 100) where lower values indicate weak governance ratings.

53. In the latest Global Corruption Barometer Bi-annual Survey of Transparency International from 2013, 72% of respondents in Nepal stated that corruption has increased over the years. The Global Corruption Barometer survey for Nepal also revealed political parties (90%) as highly corrupt institutions in Nepal, followed by public officials and civil servants (85%), police (80%), parliament (79%), judiciary (77%). As many as 45% of respondents stated that education system in Nepal is corrupt and/or extremely corrupt although only 3% of respondents reported paying bribe for Education Services (as compared to police and judiciary with 37% and 30% respectively).

54. Of the 22,600 complaints received by CIAA for the fiscal year 2013/2014, approximately 10% were related to the education sector of which the majority was related to tertiary education with bribery to be paid for licensing of a private academic institution and award of student certificates as the most prominent ones. For primary and secondary education (SSDP) the main

areas are related to leakages in the use of grants and award of free textbooks and scholarships to non-eligible students.

55. As reported by the Public Expenditure Tracking Study[23], 20% of schools do not have a functional Parent-Teacher Association tasked with monitoring responsibilities that includes conducting the annual social audits. There are large regional differences in both the formation of Parent-Teacher Associations and frequency of social audits as well as financial audits conducted by auditors appointed by the SMCs.

56. Evidence from reviews of SSRP suggest that a large and an increasing share of public investments in education through increased teachers, universal access to textbooks and significant coverage of scholarships to the target population is a clear indication of improvements in spending linked to service delivery. However, there are a number of constraints that can be observed which will result in continued leakages of funds i.e. not used for the intended purpose.

57. Among them are the challenges with timely distribution of textbooks, financial management at the district and school level characterized by poor quality of record-keeping and auditing. Furthermore, the self-reported education management information system is not subject to independent validation which, as confirmed by the PETS, results in overstating student attendance and number of eligible students for scholarships to attract more transfers which are then used for a different purpose or limited reporting of its actual use.

58. One of the key elements to combat corruption under SSDP will be strengthening of financial management capacity and oversight at the DOE level. This is linked to interventions within SSDP to improve capacity in financial management at DOE level by filling CFO positions with qualified staff. This will in turn serve to strengthen DOE school financial monitoring and supervision, to improve the functioning of SMCs and to ensure that social audits are performed at regular intervals. By linking budget releases to schools with school level social audits undertaken, and capacity development in financial management, monitoring and supervision by DEOs, there will be strong incentives to counteract opportunities for corrupt practices at school levels.

J. Program Fund Flow Arrangements

59. All money from ADB will be credited central treasury adding to the overall resource envelope of the Government of Nepal's annual budget. All sector program funds will be released through the regular budget execution process of the government. All proceeds will be made in accordance with government's procedures for transfers and cash management under each budget head (Ministry/Program). An account will be maintained at Nepal Rastra Bank as a sub-treasury revenue account credited the Central Treasury Account of the Government of Nepal. As funds will be disbursed to the government based on achievement of results rather than as cost sharing with the government particular expenditure items as the case was under SSRP, there is no longer a need for specific foreign currency account to track the prorate share of each development partner disbursement to the program.

[23] World Bank. 2014. *Report No. ACS8283; Public Expenditure Tracking and Quantitative Service Delivery Surveys in Nepal's Education Sector.* Washington, D.C.

K. Financial Reporting and Auditing Arrangements

60. A detailed Statement of Audit Needs has been agreed with the MOE, duly harmonizing the requirements of all the development partners (Appendix 3).[24] The MOE will prepare consolidated program financial statements based on financial information generated by the CGAS system including program-wise statement of receipts and payments on a cash basis, prepared in accordance with GFS codes and NPSAS compliant. The consolidated financial statements will cover all vertical programs implemented by the MOE, including primary and secondary education, as well as expenditure across all 177 Accounting Units and 34,000 schools.

61. The audit of the project financial statements shall be carried out by the Office of the Auditor General (OAG) of Nepal in accordance with the Government of Nepal's Auditing Standards[25] as supplemented by this Statement of Audit Needs. The audit would cover the entire Program, i.e. covering all sources and application of funds, including the ADB, cofinanciers and the Government of Nepal as well as direct payments and grants in kind, if any. The MOE shall provide all pertinent information to the Auditors including preservation and use of resources procured and its reflection in the program accounts, so as to facilitate comprehensive audit coverage. The audits should be carried out annually from commencement of the program.

62. A complete set of audited program financial statements includes: (i) audit opinion/report on the Project Financial Statements in accordance with the INTOSAI Fundamental Auditing Principles and Guidelines more commonly referred to as the International Standards of Supreme Audit Institutions (ISSAI) or national equivalent additional; (ii) audit assurances as to whether loan proceeds have been applied to the program; (iii) Project Financial Statements and Statement of Budget vs. Actual along with complete Notes to the Financial Statements including necessary break downs and details, summary of accounting policies and descriptive explanatory notes; (iv) management letter; and, (v) management response on previous year audit observations.

63. The audited program financial statements of MOE along with their Audit Reports and Management Letters shall be submitted to ADB within 9 months of the end of the fiscal year, i.e., by 15 April of each year.

64. To ensure the timely submission of audited project financial statements, MOE will formally request the OAG to include SSDP Program financial statements audits in their yearly work plan. To support timely submission, unaudited project financial statements should be submitted to the OAG for audit within 3 months of the end of the fiscal year.

65. The MOE is responsible for the preparation and fair presentation of the project financial statements and for maintaining sufficient internal control, as determined necessary, to ensure that the financial statements are free from material misstatement, whether due to fraud or error. To this end, MOE must provide the auditor with a 'Management Representation Letter' with a copy to ADB.

66. The Audited Project Financial Statements will cater to the requirements of all Development Partners, and the SOAN is developed to ensure harmonized requirements and

[24] The Statement of Audit Needs does not intend in any way to limit the scope of the statutory audit.
[25] OAG has adopted Auditing Standards issued by the INTOSAI.

only one reporting.[26] Common PFSs types/formats will be developed with other development partners so that MOE can prepare the agreed PFSs without much difficulty for the SSDP as a whole. These templates are for guidance purpose only, and intended to be working drafts, subject to flexibility and change, as needed by MOE. In line with NPSAS, the annual financial statements should have a statement for budget vs actuals for the entire year with percentage variance.

67. The auditor will provide reasonable assurance as to whether the program financial statements present a true and fair view of the receipts and expenditures, or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. The auditor will also provide assurance as to whether (i) financial covenants of the loan agreement have been complied with, if any, and (ii) whether loan proceeds have been used for the purposes intended.

68. **Management Letter.** Serious issues affecting the auditor's opinion as to whether the financial statements give a true and fair view, should be referred to in the audit opinion itself. Matters that are not material and do not affect the true and fair representation of the project financial statements should not be referred to in the audit opinion and included therein. A separate management letter may be issued for this purpose. The auditor may wish to reiterate serious issues already identified in the audit report, in his management letter clearly indicating that the weaknesses identified during this course of examination though not material but are included in this management letter are relevant for further improvement in overall operations of the entity. Auditors are encouraged to clearly segregate the management letter, and mark the management letter as 'confidential', to enable its easy separation from the audit opinion and project financial statements, and prevent inadvertent disclosure of the management letter along with the Audited Project Financial Statements.

69. ADB would need a review of actions taken on the recommendations presented in the previous audit report on the progress made.

70. Review missions and normal program supervision will monitor compliance with financial reporting and auditing requirements and will follow up with concerned parties, including the external auditor.

71. ADB has made MOE and the government aware of ADB's approach on delayed submission, and the requirements for satisfactory and acceptable quality of the audited financial statements. ADB reserves the right to require a change in the auditor in a manner consistent with the constitution of the borrower, or for additional support to be provided to the auditor, if the audits required are not conducted in a manner satisfactory to ADB, or if the audits are substantially delayed.

72. ADB retains the right to verify or have audited (i) the program, (ii) the validity of MOE's certification for each withdrawal application, and (iii) that ADB's financing is used in accordance with ADB's policies and procedures.

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[26] Since all development partner contributions are sourced directly into government treasury, it is expected that receipts will be recorded reflecting each development partner disbursements and the balancing amount attributed to the government share. Expenditure details will be extracted directly from CGAS duly reconciled with MOE records.

73. Public disclosure of the program financial statements, including the audit report on the program financial statements, will be guided by ADB's Public Communications Policy (2011). After review, ADB will disclose the program financial statements for the program and the opinion of the auditors on the financial statements within 14 days of their endorsement by posting them on ADB's website. The Audit Management Letters contain proprietary information intended solely for the needs of the management and will not be disclosed.

74. In addition to the above, the MOE shall also submit to ADB annually a Certificate of Compliance, attested by the OAG , confirming that eligible expenditure incurred during the fiscal year, and cumulative from commencement of the program to date exceed total disbursements from ADB. Eligible expenditure refers to all non-procurable items (salaries, utilities, etc.) and procurements from ADB-member countries less (i) high value contracts and (ii) expenditure on civil works with potential safeguard (Indigenous People and Involuntary Resettlement) implication as identified through the two-stage safeguard screening process, if any. Such certificate shall be accompanied by a consolidated breakdown of such eligible expenditure by cost category.

L. Summary of Risks and Mitigating Measures

75. The latest PEFA from 2015 confirmed many of the same challenges as the 2008 (PEFA) i.e. challenges related to compliance with financial management rules and regulations despite progress in several areas by the implementation of interventions by the national PEFA secretariat supported by a Multi-Donor Trust Fund.

76. As part of the Government PFM Reform Strategy Phase 2, 2016–2025, the government's detailed roadmap addresses various areas of weaknesses, some of which will also contribute to addressing the risk under the SSDP.[27] These include:

Table 2: Summary of Government of Nepal PFM Reform Strategy Actions FY2017–2025

	Government of Nepal PFM Reform Strategy Actions FY2016–2025	**Responsible**	**Supported under Program for MOE**
1	Redesign the BMIS to record information on quarterly estimates of both the government and donor fund	MOF	
2	Systems (BMIS, LMBIS, FMIS, RMIS and TSA) harmonized and interconnected by building interfaces	MOF	
3	Allocate a separate budget code to identify the budgetary support flow donor-wise	MOF	
4	Prepare internal control manual/ guideline by all line ministries and implement for enhancing degree of compliance with rules for processing and recording financial transactions	MOFALD	
5	Develop capacity for producing NPSAS based consolidated financial statements on annual basis by all the line ministries and government central agencies	MOFALD	Yes
6	Prepare and provide a simplified handbook on financial management to schools:	MOE	Yes
7	Improve current initiation for interfacing, interconnecting and harmonizing BMIS, LMBIS, FMIS, RMIS and TSA	FCGO	
8	Implement NPSAS in all economic entities and enhance skill of PFM staffs for preparing NPSAS report through advanced training	FCGO	

[27] Government of Nepal, Ministry of Finance. 2016. *Nepal's Public Financial Management Reform Strategy/Program Phase II (2016/2017–2025/2026)*. Kathmandu. http://www.pefa.gov.np/wp-content/uploads/Second-Phase-PFM-Reform-Actionplan.pdf

	Government of Nepal PFM Reform Strategy Actions FY2016–2025	Responsible	Supported under Program for MOE
9	Upgrade and implement of CGAS in all spending units of the Government of Nepal	FCGO	Yes
10	Prepare and implement a comprehensive plan of action for reform of internal control system of the Government of Nepal	FCGO	
11	Prepare and implement a comprehensive plan of action for Internal Auditing System reform	FCGO	
12	Enhance the monitoring system of bank reconciliation of expenditures and revenue in FCGO through TSA and RMIS	FCGO	
13	Establish a unit (Audit Committee) in all line ministries with assigned duties to settle the audit irregularities within stipulated time frame as per the existing legal provision	OAG	Yes
14	Establish Regional/Provincial Offices of OAG to facilitate the auditing and clearance of audit irregularities	OAG	
15	Review and update the existing Risk based and Performance Audit Guidelines/Manual	OAG	
16	Make legal provision that the Secretary (as a chief accounting officer) has authority to make clearance of irregularities with due investigation and recommendation	OAG	
17	Trainings to auditors to develop capacity for risk-based and performance-based audit approach	OAG	
18	Use ICT for audit documentation and follow up of audit report	OAG	

BMIS = budget management information system, CGAS = Computerized Government Accounting System, FCGO = Financial Controller General's Office, FMIS = Financial Management Information System, ICT = information and communication technology, LMBIS = Line Ministry Budget Information System, MOE = Ministry of Education, MOF = Ministry of Finance, MOFALD = Ministry of Federal Affairs and Local Development, OAG = Office of Auditor General, PFM = public financial management, RMIS = revenue management information system, TSA = treasury single account.

Source: Government of Nepal, Ministry of Finance. 2016. *Nepal's Public Financial Management Reform Strategy/Program Phase II (2016/2017–2025/2026)*. Kathmandu. http://www.pefa.gov.np/wp-content/uploads /Second-Phase-PFM-Reform-Actionplan.pdf

77. While these are over a longer time frame, and require centralized support from MOF and FCGO, government's focus on resolving PFM issues will contribute to risk reduction for the program. Additionally, some of the above interventions will be supported and encouraged through the SSDP.

Table 3: Financial Management Risks Financial Management Risks

Risk Type	Risk Description	Risk Rating	Management Plan/Mitigation Measures
Inherent Risk[a]			
1. Country-level risks	Budgets in recent years have been prepared without an MTEF, i.e., on an incremental basis without consideration for future recurrent costs or impact of investments, and with weak links between policy targets and budget allocations. Risks related to lack of segregation of duties in budget release and control of expenditures and challenges related to follow-up on audit findings.	Before mitigation: substantial After mitigation: moderate	An MTEF is expected to be finalized to guide the budget process for fiscal year 2017. The presentation of the annual SSDP budget consistent with the initial SSDP budget and MTEF projections for the education sector will be included as a provision in the JFA. Processes are under way to revise the legal framework for an internal audit service and for capacity building interventions by the PEFA secretariat to support PAC in improving follow-ups on the auditor general's findings.
2. Agency-specific	Lack of qualified accounts and finance staff in DEOs; many	Before mitigation:	Approved positions will be filled by 2017. The establishment of the SSDP steering

Risk Type	Risk Description	Risk Rating	Management Plan/Mitigation Measures
risks	positions are not filled, greatly affecting financial management supervision and monitoring of schools' expenditures. The school grant system is mostly norms-based rather than based on needs, making it difficult for schools to effectively improve performance. Compliance with complex rules for multiple school grants leads to frequent audit observations.	substantial After mitigation: moderate to substantial	committee and program coordination secretariat at the national level and a district grant management committee that will include requisite finance and accounting staff is envisaged. Increase in capacity and supervision will lead to fewer recurring audit observations. The SSDP includes the provision to revise the school grant system with needs- and performance-based criteria for fund allocation, improved school capacity, and improved monitoring for results.
Overall inherent risk		Substantial	
Control Risk[b]			
1. Planning and budgeting	Government of Nepal has a well-defined budget calendar with budget allocations linked to annual strategic implementation plans and work plans. However, budget allocations are not based explicitly on meeting the goals and targets and on achieving results.	Before mitigation: moderate After mitigation: low	A process to introduce PBB is under way and program budget heads compliant with COFOG will be introduced for SSDP as well as activity codes to segregate spending by SSDP results-based interventions. This will better link budget allocations to policy targets and will improve monitoring of cost efficiency and effectiveness by introducing program and activity codes in the budget and accounts. An improved process of annual work plan and budget preparation linked to achievement of yearly results will also be introduced.
2. Funds flow	Cash management and budget releases are managed though a new TSA management system with daily reconciliation with bank statements. Payments for salaries are processed without delays. Budget releases for capital expenditures are often delayed by slow approval of programs and stage-wise completion, which prevents further installments.	Before mitigation: moderate After mitigation: low	RBL serves as an incentive for delivery of results and thus will trigger timely approval of work plans and execution of program-related expenditures. Bottlenecks in budget utilization by schools will also be mitigated through streamlined financial procedures and capacity support for the schools.
3. Accounting and internal control	While accounts are to be reconciled between budget holders (MOE and subordinated institutions) 7 days after close of each month, actual reconciliations and controls are made by DTCOs retrospectively and infrequently. DEOs have no standardized accounting system, which is a challenge for the upward consolidation process for effective monitoring of budget execution.	Before mitigation: substantial After mitigation: moderate	SSDP will include a rolling annual fiduciary review process to compensate for weaknesses in internal controls, and limited capacity internally in MOE and in subordinated institutions to effectively exercise internal controls. The rollout of CGAS, the web-based standardized accounting software, to all DEOs and consolidation of subordinate institutions' reports at DOE using simple Excel-based software will enable effective financial monitoring of MOE budget execution and timely reconciliations of balances between TSA and MOE accounts.
4. Financial reporting	Interim financial reports on payments made (cash basis)	Before mitigation:	Implementation of CGAS at all MOE spending levels will improve timely

Risk Type	Risk Description	Risk Rating	Management Plan/Mitigation Measures
	are produced in timely fashion from the TSA system, which registers online in real time each transaction made by functional, institutional (budget holder at central and district levels), and economic codes. Challenges relate to issues of congruence between MOE annual budget and work plan preparation and FCGO system of recording expenditures, and significant delays in submitting FMRs and audit reports.	moderate After mitigation: low	presentation of expenditure by institutional, functional, and program/activity categories and FMRs. During SSDP appraisal it has been agreed to revise the MOE program budget heads to better comply with COFOG standards, as reflected in the JFA. Annual audited program financial statements shall be submitted in accordance with a detailed statement of audit needs. MOE will be supported to prepare progressively more NPSAS-compliant PFS.
5. Concurrent (internal) audit	Weak internal controls and oversight of expenditures, particularly in the schools, The function is undertaken by DTCOs and is limited to inspection of vouchers and supporting documentation for payment requests. The inspection is not done regularly. There are delays in reconciliation of accounts and financial management reports.	Before mitigation: substantial After mitigation: moderate to substantial	A rolling annual fiduciary review will strengthen internal capacity for financial management and audit compliance. Nationwide implementation of CGAS will increase the efficiency and accuracy of accounting and reporting. An agreed FMAP will be implemented, with specific focus on increased monitoring of units assessed as "high risk" with repetitive audit observations.
6. Statutory (external) audit	OAG reports are generally submitted in timely fashion and with a scope and comprehensiveness as per INTOSAI standards. However, evidence of effective follow-up on audit findings is limited.	Before mitigation: moderate After mitigation: low	A financial management task team in MOE will facilitate timely follow-up on audit findings. An audit committee will be set up to report to the SSDP steering committee for timely action on audit matters. JFPs and MOE will monitor the implementation of the FMAP, which will include stated actions with a timeline to resolve audit findings.
Overall control risk		Moderate to substantial	
Overall Risk		**Substantial**	

CGAS = computerized government accounting system, COFOG = classification of the functions of government, DEO = District Education Office, DOE = Department of Education, DTCO = District Treasury Controller Office, FGCO = Financial Comptroller General Office, FMAP = Fiduciary Management Action Plan, FMR = financial monitoring report, INTOSAI = International Organization of Supreme Audit Institutions, JFA = Joint Financing Arrangement, JFP = joint financing partner, MOE = Ministry of Education, MTEF = medium-term expenditure framework, NPSAS = Nepal Public Sector Accounting Standards, OAG = Office of the Auditor General, PAC = Public Accounts Committee, PBB = program-based budgeting, PEFA = Public Expenditure and Financial Accountability, PFS = project financial statement, RBL = results-based lending, SSDP = School Sector Development Plan, TSA = treasury single account.

[a] Inherent risk is the susceptibility of the program financial management system to factors arising from the environment in which it operates, such as country rules and regulations and the agency's working environment (assuming the absence of any counterchecks or internal controls).

[b] Control risk is the risk that the program's accounting and internal control framework is inadequate to ensure that funds are used economically and efficiently and for the purposes intended, and that fund use is properly reported.

Source: Asian Development Bank.

78. The table above presents a summary of key risks for the Program and proposed mitigating actions. The overall risk is considered *substantial***.** This is primarily due to (i) observed weaknesses in internal controls, (ii) lack of an internal audit service segregated from processing

of payments, (iii) capacity challenges at DEO levels implementing a major share of program expenditures and with a role to monitor and supervise school level financial management.

79. In response to the identified risks, risk-mitigating measures will be implemented to ensure adequate staffing of accountants and procurement staff at DEO level combined with a rolling fiduciary review process to support MOE and subordinated institutions in strengthening their compliance with the government's financial regulations. Furthermore, implementation of Result-Based Budgeting, roll out of the CGAS web-based accounting software to DEOs combined with additional training, among others in account reconciliation, and added interventions by the national PEFA secretariat will serve to strengthen budgeting, financial monitoring and reporting to assess effectiveness and efficiency by presenting spending linked to service delivery targets and planned program results.

ANNUAL FIDUCIARY REVIEW PROCESS

1. The Joint Financing Arrangement (JFA) between the Government of Nepal and development partners supporting the SSDP includes a provision for strengthening fiduciary oversight and support to Ministry of Education (MOE) in implementation of actions to strengthen financial monitoring and supervision at all levels.

2. In particular it will serve to support the role of MOE in how to address weaknesses observed through recurring audit observations and as identified in the School Sector Development Plan (SSDP) Program Fiduciary Systems Assessment. Some issues are addressed in the JFA as actions the government needs to implement as preconditions for development partner disbursements, some are addressed through disbursement-linked indicators (DLIs) on governance and financial management and some captured through specific review procedures. Among them are a JFA covenant related to implementation of a web-based accounting system (Computerized Government Accounting System [CGAS]) already successfully implemented by other ministries at central and district levels. Others are the formation of a unit/team in MOE of financial management professionals and recruitment and deployment of qualified staff at District Education Office (DEO) for financial and procurement monitoring and supervision of schools, the latter as a DLI in the initial year followed by reduced Auditor General observations.

3. The development partners supporting the School Sector Reform Program has already established a Public Financial Management and Governance Thematic Working Group (PFMGTWG) lead by MOE counterpart staff. The PFMGTWG regularly discuss challenges identified and seek to resolve them by among others, using a Financial Management Action Plan (FMAP) as a tool for decision making and monitoring implementation of agreed actions to meet the challenges identified.[28]

4. For SSDP a Financial Management Working Group (FMWG) will be established led by MOE with participation of Development Partners to focus specifically on fiduciary risks related to the implementation of SSDP. They will use the FMAP as the tool for monitoring implementation of proposed actions. As part of this, process the World Bank has been specifically tasked to review periodic Financial Monitoring Reports to assess level of compliance with JFA and level of assurance provided.

5. To help the process of identifying key challenges through a risk based approach, design remedial actions and monitor their execution, the Development Partners will commission an Annual Fiduciary Review (AFR). The AFR will be implemented by externally contracted professionals with the specific task of addressing recurring Auditor General observations, propose remedial actions and annually review the outcome of implementation. Recommendations from the AFR will be included in the FMIAP for follow up by the FMWG. A description of the AFR process is provided in the table below with a template for the Terms of Reference for an AFR is provided in Appendix 2.

6. Additional reviews and surveys will be implemented during the course of SSDP implementation, among them a new Public Expenditure Tracking Study (PETS) to assist in mapping school level challenges and recommend actions related to school level financial management (FM).

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[28] The FMAP will also have procurement actions based on the fiduciary system assessment of the SSDP.

7. Finally, development partners will provide technical assistance, either through the AFR process or specific assistance to help MOE in strengthening its capacity to monitor budget execution and implement recommendations.

8. The following table gives an overview of the annual fiduciary review process to assess and support the MOE in improving financial management and procurement at all levels.

Fiduciary Review Process

Timing	Activity	Role of ADB	Role of Other Development Partners
November	Review of annual Financial Monitoring Reports	As member of PFMWG reviewing compliance and performance. Assess follow up linked to FMAP	World Bank to do a prior review of compliance for presentation to the PFMWG
April	Review of OAG reports including management letter. Prepare TORs for AFR.	Part of PFMWG reviewing OAG and develop TORs for AFR to assess specific risk areas identified by OAG	Joint PFMWG review and TOR for AFR in the PFMWG
May to June	AFR including post procurement review completed each year by end fiscal year.	Review AFR outcome and propose remedial actions to be included in FMAP and, if required, TA to strengthen FM and procurement and DEO levels.	Co-financing AFR and through PFMWG review AFR outcome and propose remedial actions to be included in FMAP and, if required, TA to strengthen FM and procurement and DEO levels.
March, September	DLI reviews	Review implementation of DLI on FM including recruitment and deployment of FM and procurement staff including training at DEO levels.	Review implementation of DLI on FM including recruitment and deployment of FM and procurement staff including training at DEO levels.
After 2 fiscal years; April - June	Public Expenditure Tracking Study for a stratified sample of Districts and Schools (5% districts = 4, 5% schools of different grades =240 schools).	Prepare TORs and contract firm to undertake PETS. Through PFMWG review outcome and propose remedial actions to be included in FMIA and, if required, Propose TA to strengthen FM and procurement at DEO levels.	Cofinancing PETS and through PFMWG review outcome and propose remedial actions to be included in FMIA and, if required, Propose TA to strengthen FM and procurement at DEO levels.

AFR = Annual Fiduciary Review, DEO = District Education Office, DLI = disbursement-linked indicator, FM = financial management, FMAP = Fiduciary Management Action Plan, OAG = Office of Auditor General, PETS = Public Expenditure Tracking Study, PFMWG = Public Financial Management Working Group, TA = technical assistance, TOR = terms of reference.
Source: Asian Development Bank.

TERMS OF REFERENCE FOR ANNUAL FIDUCIARY REVIEW

A. Background

1. The Government of Nepal and multiple development partners are supporting the School Sector Development Program (SSDP) through a Joint Financing Arrangement (JFA). The development partners financial contributions are contingent on delivery of results defined by a set of disbursement-linked indicators (DLIs); a subset of priority results defined by the Program Result Framework and adequate systems and procedures for financial management implemented by the government.

2. SSDP uses the government's public financial management (PFM) system for management of all funding of the program activities. The use of government PFM systems for development partner disbursement to the Central Treasury Account requires that fiduciary risk can be managed within levels acceptable to the government and development partners. In this respect, a fiduciary risk assessment of SSDP, with due consideration of both PFM and procurement issues, has been carried out during SSDP preparation. The level of fiduciary risk was assessed as acceptable provided that specific disbursement-linked indicators to improve the system are implemented and maintained by the Government of Nepal.

3. Government PFM systems operate with reasonable controls in place. Reports are produced which provide the government and development partners with the ability to monitor both budgeted and actual levels of expenditure in accordance with their information needs. The government's Integrated Financial Management Information System (IFMIS) has the capacity to generate reports upon request and to required levels of detail.

B. Purpose of the Annual Fiduciary Review

4. The Annual Fiduciary Review (AFR) will provide additional assurance to the IFMIS generated budget management reports constituting the Statement of Expenditures for financial monitoring purposes. In addition the AFR will focus on reviewing selected risk-areas each year including areas identified by annual reports of the Auditor General of Nepal. The AFR will provide concrete recommendations for improvement and value addition in the proposed risk areas subject for review.

C. Scope of the Annual Fiduciary Review

5. The AFRs each year will be implemented with focus on some selected areas which will be decided during the joint mission for SSDP. The following are areas of focus for the AFRs for the duration of SSDP:

- (i) Review of internal controls and in particular controls over payroll processing and personnel data management.
- (ii) Release procedures for cash transfers and distribution of non-cash inputs to schools and related financial management including school level grants, their application, accounting, financial reporting as well as school level financial and social audits.
- (iii) Review whether District Education Office staffing issues are being progressively addressed.
- (iv) Review of compliance with the Government of Nepal procurement guidelines at central, district level and school levels on a sample basis;

(v) Review relevant reports from Auditor General and in particular, concerns in recurring observations from these audits, which are both general and specific to Ministry of Education and district education offices.

6. The assessments should be based on a sample as specified under the specific tasks described below.

D. Specific tasks for the AFR FY XXXX-XX

7. The AFR FY XXXX-XX will focus on the following areas:

(i) Monitor progress against Financial Management Action Plan.
(ii) Monitor unreconciled balances between Treasury Single Account and Ministry of Education accounts.
(iii) Ensure processes for the preparation of program financial statements are working as intended.
(iv) Other fiduciary issues arising from Auditor General annual audit reports and other financial management reviews relevant to program financial management.

E. Timing and reporting

8. The AFR will commence latest by XX-XXX-XXXX, with an estimated total duration of the assignment of maximum 4 weeks. The work is to be concluded by early XX-XXXX with the submission of a report presenting outcomes from the above tasks including a summary of recommendations, actions for follow-up, timeframe for when they should be completed and indication of the responsible entity/unit.

9. The government and Development Partner will discuss the results of the AFR each year in an Annual Review Meeting. The TORs for the succeeding year's AFR will also be agreed in Annual Review Meeting. Following deliverables are expected:

(i) Inception report (within 1 week);
(ii) Draft AFR report (within 6 weeks); and
(iii) Final AFR report (within 8 weeks).

F. Qualifications of consultants

10. The assignment will be undertaken by a company who will employ adequate staff with appropriate professional qualifications and suitable experience with the International Federation of Accountants standards, in particular international standards on auditing, and International Organization of Supreme Audit Institution standards, and with experience in performing assessments of programs comparable in size and complexity to similar result-based financing education sector programs. The team should consist of:

(i) **Financial Audit Specialist and Team Leader (2 person-months).** The Team Leader nominated by the firm shall: (i) have at least a graduate degree in financial management or be a certified accountant; (ii) be a member of a recognized accountancy professional body; (iii) have experience from or work with a company affiliated to an international audit firm; (iv) have experience with the Government of Nepal financial management system, procedures, and regulations applying to central government and provincial levels; (v) have experience undertaking financial, compliance, and performance audits including design, management, and implementation of surveys; (vi) demonstrate team leadership, organizational, communication, relational, and report writing skills; and (vii) have an excellent command of the English language.

(ii) **Financial Audit Specialists (2 persons of 2 person-months each).** The specialists shall (i) be certified accountants, and (ii) have at least 5 years of relevant working experience, preferably in government-executed donor-funded projects, as accountants in Nepal.

STATEMENT OF AUDIT NEEDS TEMPLATE

A. BACKGROUND

1. Article 14 (xi) of the Agreement establishing the Asian Development Bank (ADB, the Charter) States that 'Proceeds of any loan made, guaranteed, of participated by the Bank are used only for the purposes for which the loan was granted and with due attention to consideration of economy and efficiency'. In addition, Article 14 (xiv) of the Charter requires ADB to be guided by sound banking principles in its operations. To fulfill the requirements of Article 14 (xi) and (xiv) of the Charter, ADB requires borrowers/project executing agencies to submit Audited Project Financial Statements (APFS) and Audited Financial Statements (AFS).

2. To fulfill the requirements of Article 14 (xi) and (xiv) of the Charter, the executing agencies for all loans/grants are subject to audit conducted by an independent auditor in accordance with standards on auditing that are acceptable to ADB.

3. The objective of the audit is to provide assurance to all stakeholders that program resources were used for the intended purposes. An audit of such financial statements includes; (i) an opinion on whether the program financial statements present a true and fair view, in all material respects, the sources and applications of project funds for the period under audit examination in accordance with an acceptable financial reporting framework, (ii) an audit opinion on whether loan/grant proceeds were used for purposes intended and (iii) an opinion on the status of compliance with loan/grant covenants, if any. As part of the audit, the auditor would also (i) perform an assessment of the adequacy of accounting and internal control systems with respect to program expenditures and other financial transactions, and to ensure safe custody of program finance assets, (ii) determine whether the borrower and program implementing entitles have maintained adequate documentation on all relevant transactions, including statements of expenditures (SOEs), Force Account Works and Withdrawals where applicable, (iii) confirm that expenditures submitted to ADB are eligible for financing and identification of any ineligible expenditures, and (iv) provide details of any irregularities noted in a management letter.

B. FINANCIAL REPORTING AND AUDIT REQUIREMENTS

4. Ministry of Education (MOE)/Department of Education (DOE) will prepare School Sector Development Plan (SSDP) financial statements on a cash basis, in accordance with the Nepal Public Sector Accounting Standards (NPSAS), further guided by the *Government Auditing Standards Part 3: Segment Audit Guidelines for Project Financial Statements issued in October 2005,* as relevant. This shall not be construed to refer to the financial statements of Education Sector as a whole.

5. The audit of the program financial statements shall be carried out by the Office of the Auditor General (OAG) of Nepal in accordance with the Government of Nepal Auditing Standards[29] as supplemented by this Statement of Audit needs. The auditor will review that the funds received from all sources and expenditures incurred during the reporting period are as per agreed terms and conditions. This will include all expenditure to the extent that it relates to the activities pertaining to SSDP jointly agreed between the Government of Nepal and Development Partners, including ADB.

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[29] OAG has adopted Auditing Standards issued by the International Organization of Supreme Audit Institutions (INTOSAI).

6. MOE/DOE will submit to Donors' Coordinator audited program financial statements as of mid-July each year, within 9 months of the end of the Nepalese fiscal year in English. A complete set of audited project financial statements includes:

(i) Audit Opinion/Report on the Project Financial Statements in accordance with the International Organization of Supreme Audit Institutions (INTOSAI) Fundamental Auditing Principles and Guidelines[30] more commonly referred to as the International Standards of Supreme Audit Institutions (ISSAI).
(ii) Audit Opinion on Specific Donor Requirements[31] in accordance with ISSAI 4200.[32]
(iii) Project Financial Statements and Statement of Budget vs. Actual along with complete Notes to the financial statements including necessary break downs and details, summary of accounting policies and descriptive explanatory notes (*see Section E below*).
(iv) Management Letter (*see Section F below*).
(v) Status of resolution of previous year audit observations.

7. To ensure the timely submission of audited project financial statements, MOE/DOE will formally request the OAG to include Supporting School Sector Development Plan (SSSDP) program audits in their yearly work plan. To support timely submission, unaudited program financial statements should be submitted to the OAG for audit within 6 months of the end of the fiscal year.

8. In addition, MOE shall also submit to Development Partners a copy of their own Ministry level appropriation account within one month of the date of their submission to the President by the OAG.

9. The MOE/DOE is responsible for the preparation and fair presentation of the program financial statements and for maintaining sufficient internal control, as determined necessary, to ensure that the financial statements are free from material misstatement, whether due to fraud or error. To this end, MOE/DOE must provide the auditor with a 'Management Representation Letter' with a copy to the Development Partners' coordinator. The Letter of Representation (Management Representation Letter) to the auditor will include the following:

(i) Program financial statements are free from material misstatement, including omissions and errors and are fairly presented.
(ii) All documents and other information in relation to the financial statements shall be made available to auditors to ensure that the audit can be commenced at anytime, soon after the date of these financial statements.
(iii) The borrower or executing agency has utilized the proceeds from the loan only for the purposes intended under the legal agreement(s) and maintained adequate supporting documents to substantiate the expenses incurred and charged to the program.
(iv) The MOE/DOE was in compliance with the financial covenants of the financing agreement, if any.
(v) Effective internal control, including over the procurement process, was maintained.

[30] Reference is limited to INTOSAI as the Supreme Audit Institution audits all ADB funded projects in Nepal.
[31] This may be combined with (i) above or given separately.
[32] ISSAI 4200: Compliance Audit Related to the Audit of Financial Statements.

C. AUDIT SCOPE

10. The audit would cover the entire program, i.e. covering all sources and application of funds, including the ADB, cofinanciers and the Government of Nepal. The Director General of DOE shall provide all pertinent information to the Auditors including existence and use of internal controls over resources procured and its reflection in the project financial statements, so as to facilitate comprehensive audit coverage. The audits should be carried out annually from commencement of the SSSDP. The audit for the first year should cover transactions, which occurred from the commencement of the program till the end of the fiscal year.

11. The auditor will provide assurance as to whether the program financial statements present a true and fair view of the receipts and expenditures, and are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.[33]

12. In addition, the joint financing partner, including ADB will require an assessment by the auditors of compliance with provisions of the financing agreement with development partners, including ADB, especially those relating to accounting and financial matters. A reasonable assurance opinion in accordance with ISSAI shall be provided that will inter alia include verification that:

(i) Proceeds from the loan/grants, including counterpart funds were used only for the purpose(s) intended under the legal agreement(s);

13. The auditor should pay particular attention to the following:

(i) The use of external funds in accordance with the relevant legal and financing agreements;
(ii) The provision of counterpart funds in accordance with the relevant agreements and their use only for the purposes intended and maintained adequate supporting documents to substantiate the expenses incurred and charged to the program.;
(iii) The maintenance of proper books and records;
(iv) The existence of project fixed assets and internal controls related thereto;
(v) Any weaknesses in internal controls over the procurement process.

14. Moreover, ADB would need a review of actions taken on the recommendations presented in the previous audit report on the progress made.

D. PROGRAM FINANCIAL STATEMENTS

15. Program Financial statements shall be prepared using Government of Nepal Accounting Standards and apply principles of the proposed Nepal Public Sector Accounting Standards (NPSAS) under the cash basis of accounting in accordance with the Government of Nepal/implementing agency accounting policies.[34] These should include:

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[33] Example of an unqualified opinion "*In our opinion, the financial statements present fairly, in all material respects, the sources and applications of funds of the program for the year ended [date] in accordance with [the financial reporting framework specified in Note xx of the project financial statements/ Nepal Public Sector Accounting Standards and requirements under the loan agreement]*."

[34] State-owned enterprises preparing their own entity level financial statements on an accrual basis in line with International Financial Reporting Standards may choose to also prepare APFS using the accrual basis of accounting.

(i) Sources and Uses of Funds showing the funds received and expended from ADB, Government of Nepal and other financiers for SSDP.
(ii) Statement of Budget vs. Actual showing expenditure for the current year, prior year and cumulative inception to date.
(iii) Detailed notes to the financial statements including explanatory notes, break down of expenditure, reconciliation of reimbursements, Details of expenditure by Currency/Method of Funding/Output Component, and Accounting Policies.
(iv) Annexure to the APFS may include the (a) Statement of Reimbursable Fund and (b) Disbursement Details.

16. Program Financial Statements shall provide sufficient level of detail to identify types of expenditures as identified in the SSSDP program document.

17. The program financial statements may also provide sufficient level of detail to be able to identify expenditure relating to each of the program results and disbursement-linked indicators.

18. The first reporting period of program financial statements will commence on the date of the first financial transaction for SSDP until end of the related fiscal year. First program financial statements are expected to be for the fiscal year ended 15 July 2017.

19. Template financial statements have been annexed to this Statement of Audit Needs for guidance. This template is based on the Annexure given the Government Auditing Standards[35], tailored to incorporate the requirements of the Nepal Public Sector Accounting Standards (NPSAS)[36], which have been approved for adoption by the Government of Nepal in 2009. Although these are not yet effective in Nepal, given the elevated status of the NPSAS on the government's accounting reform agenda, template Project Financial Statements have incorporated some of the key requirements.[37] This is even more relevant since under ADB's revised Public Disclosure Policy 2011, Project Financial Statements shall be disclosed on ADB's website. Please note that any financial statement template is a working draft, which may require adjustment based on the actual activities of the SSDP as well as the Chart of Accounts in use.

E. MANAGEMENT LETTER

20. In addition to the audit report, ADB will require a separate management letter. The management letter should be prepared in accordance with Annexure 12 of the Government Auditing Standards Part 3: Segment Audit Guidelines for Project Financial Statements issued by the Office of the Auditor General, Nepal in October 2005 or prevailing edition at the time of issue date.

21. The management letter should specifically:

(i) Give comments and observations on the notes to the accounts, accounting records, systems, and internal controls that were examined during the course of the audit;

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[35] Government Auditing Standards Part 3: Segment Audit Guidelines – Project Financial Statements issued by the OAG in October 2005 Annexure 1 prepared to cater to donor requirements by the OAG.

[36] Notes to the financial statements should refer to the specific financial reporting framework, for example "Project financial statements have been prepared under the historical cost convention and on a cash basis of accounting in accordance with the Nepal Public Sector Accounting Standards (NPSAS)."

[37] Key modifications to the template are the inclusion of (i) prior year comparative information in all statements and notes (ii) details of expenditure by Output (iii) detailed descriptive explanatory notes.

(ii) Identify specific deficiencies and areas of weakness in the accounting and internal control systems, and any internal control weaknesses related to the procurement process (i.e. bidding, evaluation, and contract management);
(iii) Make recommendations for their improvement;
(iv) Obtain MOE/DOE response to the identified deficiencies along with timeframe for implementation;
(v) include matters that have come to attention during the audit which might have a significant impact on the implementation of the SSDP;
(vi) Follow-up on the status of significant matters and audit recommendations made in preceding years; and
(vii) Provide details of any ineligible expenditure identified during the audit.[38]

22. Serious issues, which affect the auditor's opinion as to whether the financial statements give a true and fair view, should be referred to in the audit opinion. Matters which are not material and do not affect the fair presentation of the project financial statements should not be referred to in the audit opinion, and only addressed in the Management Letter. The auditor may wish to reiterate serious issues already identified in the audit report, in the management letter as well. Auditors are encouraged to clearly segregate the management letter, and mark the management letter as 'confidential', to enable its easy separation from the audit opinion and project financial statements, and prevent inadvertent disclosure of the management letter along with the APFS.

F. GENERAL

23. Review missions, Annual Fiduciary Review and normal program supervision will monitor compliance with financial reporting and auditing requirements and will follow up with concerned parties, including the external auditor.

24. The JFA development partners, including ADB have made MOE/DOE aware of its approach on delayed submission, and the requirements for satisfactory and acceptable quality of the audited financial statements.[39]

25. Development Partners retain the right to verify or have audited (i) the project, (ii) the validity of MOE's certification for each withdrawal application, and (iii) that ADB's financing is used in accordance with their policies and procedures.

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[38] Expenditures are ineligible if (i) incurred for purposes other than the ones intended under the legal agreement(s); (ii) not allowed under the terms of the legal/financing agreements; and (iii) incurred in violation of applicable country/government regulations

[39] ADB's approach on delayed submission of audited project financial statements:

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

G. PUBLIC DISCLOSURE

26. Public disclosure of the project financial statements, including the audit report on the project financial statements, will be guided by ADB's Public Communications Policy (2011).[40] After review, ADB will disclose the project financial statements for the project and the opinion of the auditors on the financial statements within 14 days of date of their acceptance by posting them on ADB's website. The Audit Management Letter contains proprietary information intended solely for the needs of the management and will not be disclosed. Entity level financial statements will also not be disclosed.

Note: This is a statement of audit needs for Joint Financing Partner/ADB and does not in any way intend to limit the scope of the statutory audit.

[40] Available from http://www.adb.org/documents/pcp-2011?ref=site/disclosure/publications