

Financial Management Assessment

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India: Maharashtra Rural Connectivity Improvement Project—Additional Financing

Prepared by the Maharashtra Rural Road Development Association, State Government of Maharashtra, for the Asian Development Bank.

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**MAHARASHTRA RURAL CONNECTIVITY IMPROVEMENT PROJECT – ADDITIONAL
FINANCING**

Funded by:

Asian Development Bank

Executing Agency:

Rural Development Department of Government of Maharashtra

Implementing Agency:

Maharashtra Rural Road Development Association (MRRDA)

Financial Management Assessment

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List of Abbreviations

ADB	Asian Development Bank
APFS	Audited Project Financial Statements
CAAA	Controller of Aid, Accounts and Audit
CAG	Comptroller and Auditor General
CPD	Client Portal for Disbursement
CPS	Country Partnership Strategy
DEA	Department of Economic Affairs
EA	Executing Agency
EAP	Externally Aided Project
FMA	Financial Management Assessment
GDP	Gross Domestic Product
GOI	Government of India
GOM	Government of Maharashtra
GSDP	Gross State Domestic Product
IA	Implementing Agency
IPAI	Institute of Public Auditors of India
MOF	Ministry of Finance
MMGSY	Mukhya Mantri Gram Sadak Yojana
MRRDA	Maharashtra Rural Development Association
PMGSY	Pradhan Mantri Gram Sadak Yojana
PIU	Project Implementing Unit
PMC	Project Management Consultancy
PMU	Project Monitoring Unit
PWD	Public Works Department
RDD	Rural Development Department
SDG	Sustainable Development Goals
SOE	Statement of Expenditure
TOR	Terms of Reference
WA	Withdrawal Application

1. EXECUTIVE SUMMARY

1. The Financial Management Assessment (FMA) was conducted as part of the ongoing project in February 2019 and updated in March 2020 for the additional financing, in accordance with ADB's Guidelines for the Financial Management and Analysis of Projects¹ and Financial Due Diligence: a Methodology Note, and Technical Guidance Notes.² The FMA has reviewed the capacity of MRRDA, who will implement the project, including fund flow arrangements, governance, staffing, budgeting, accounting and financial reporting systems, internal control procedures, financial information systems, and internal and external audit arrangements.

2. The FM assessment found that MRRDA has adequate financial management capacity to: (i) record the required financial transactions, (ii) provide reliable annual financial statements and audit reports in a timely manner, (iii) safeguard the financial assets and (iv) use the SOE procedure under ADB's disbursement procedures up to a threshold of USD 200 000 for each expenditure item. However, the assessment also identified the following risks: (i) limited experience in ADB procedures and reporting requirements, and (ii) decentralized flow of funds to the regions. As a result, the overall financial management risk is assessed as moderate.

3. The identified risks will be mitigated by: (i) hire an FM expert to support the PMU, (ii) ensuring continuous training in ADB's systems and procedures, (iii) ensuring quarterly financial reporting and quarterly internal audits as well as iv) adopting ADB specific supplementary FM procedures. Moreover, MRRDA will maintain separate books of accounts for the additional financing project and the project financial statements will be audited annually by an auditor acceptable to ADB, following auditing standards acceptable to ADB.

2. INTRODUCTION

4. Maharashtra is the second largest state of India in terms of population (estimated at 116 million in 2018) and third largest inland mass (308,000 square kilometers [km]). Maharashtra is also the most industrialized state, contributing 14.8% of India's total gross domestic product (GDP) in 2016-2017. The agriculture sector remains central to Maharashtra's economic and political landscape. The sector contributes 11% of the Maharashtra's GDP and accounts for 79% of rural employment. The majority of the state's population (54.8%) live in rural areas and are primarily dependent on the agriculture sector for employment and income generation. Rural connectivity underpins rural development in Maharashtra. Maharashtra has a road network of 303,000 km of which 67% are rural roads. Roads are the dominant mode of transportation, utilized by over 80% of passengers and 60% of freight traffic. However long-term underinvestment has affected all levels of the road network, and the rural road network is in the worst condition.

5. A financial management assessment (FMA) has been carried out as a part of the due diligence of the project.³ The fiduciary assessment of MRRDA is carried out to determine the

¹ ADB. 2005. *Financial Management and Analysis of Projects*. Manila. Available: <http://www.adb.org/documents/financial-management-and-analysis-projects>

² ADB. 2015. *Financial Due Diligence: A Methodology Note*. Manila. Available: <http://www.adb.org/documents/financial-due-diligence-methodology-note>

³ The assessment was carried out by ADB financial management consultant (Mr. P.R. Devaraj)

degree to which the financial management arrangements are adequate to manage fiduciary risks and provide reasonable assurance that ADB funds will be used for their intended purpose.

3. COUNTRY AND SECTOR FINANCIAL MANAGEMENT ISSUES

6. **Inherent risk.** Overall, India has in place robust Public Financial Management (PFM) systems. However, the implementation of the PFM systems varies from state to state. The overall FM inherent risk of India is moderate.

7. **PFM Assessments.** To date three PEFA assessments have been carried out in India of which two have been made public: one at the national level in 2010 and the other at subnational level (Himachal Pradesh state) in 2009. According to the national level assessment areas such as: i) credibility of the budget, ii) budget comprehensiveness and transparency, and iii) policy based budgeting as well as subareas including a) predictability in the availability of funds for commitment of expenditures, b) timeliness and regularity of accounts reconciliation and c) quality and timeliness of annual financial statements, appear to be performing relatively well. However, other important subareas such as i) effectiveness of internal audit, ii) Transparency, competition and complaints mechanisms in procurement and iii) Scope, nature and follow-up of external audit require further strengthening.

Table 1: 2010 Government-level PEFA-based PFM Performance Assessment⁴

PFM Performance Dimension	Calculated Ratings		Risk Rating
	Numerical Scores ^a	Equivalent PEFA Ratings	
Credibility of the budget	2.67	B	Medium
Comprehensiveness and transparency	3.58	A	Low
Policy-based budgeting	1.75	C	High
Predictability and control in budget execution	2.44	C+	High
Accounting, recording, and reporting	3.00	B	Medium
External scrutiny and audit	2.33	C	High
Calculated Overall Score	2.75	B	Medium

^a The calculations were based on A=4, B+=3.5, B=3, C+=2.5 C=2, D+=1.5 and D=1, which is the generally applied approach for quantifying PEFA scores.

8. As the available PEFA assessments are by now partly outdated, it is important to also draw lessons from other assessments and the past performance of the ADB portfolio. In accordance with the ADB working paper Funds Flow, Accounting, and Audit in India (2013), ADB projects make extensive use of the country's public financial management systems, including the following:

- **Accounting standards.** Government entities and State Owned Enterprises (SOEs) follow national accounting standards. Government entities follow the Indian

⁴ The scores of the individual performance indicators of the 2010 PEFA assessment were computed to provide the averages for the six high-level PFM dimensions as well as the overall score. A corresponding risk rating was also added.

Government Accounting Standards (IGAS) - cash basis, formulated by the Govt. Accounting Standards Advisory Board (GASAB).

- **Flow of funds.** All external assistance including ADB's project are included in the Central budget and in the state budget. All funds disbursed by ADB are first received in the Consolidated Fund of India by CAAA. Central sector entities withdraw the funds through their respective budget appropriations while for state sector entities, the Plan Finance Division in the DOE authorizes a transfer to the state treasury account maintained with the Reserve bank of India.
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- **Audit arrangements.** All ADB projects are audited by the CAG or a private firm empaneled by the CAG. The CAG maintains a list of empaneled audit firms, and rotates auditors from time to time. Moreover, ADB has agreed with CAG and DEA on an Audit ToRs, which are being used for all projects.

9. **Country program partnership 2018-2022.** Despite of the mostly robust country PFM systems and practices, the ADB's India country partnership strategy 2018-2022 identified the EA/IAs capacity to handle multidisciplinary tasks on interdepartmental coordination (such as for statutory requirements) and governance in terms of compliance and enforcement in project operations as matters of potential concern.

10. **ADB portfolio.** Furthermore, the following risks have been noted as part of some ongoing ADB projects in the India portfolio:

- i. Moderate turnover of project FM staff and continuous need of training in ADB systems and procedures;
- ii. State treasury releases ADB funds to the EA/IA with a delay or in tranches when funds are disbursed using advance fund method, which may lead to delays in project implementation.
- iii. The financial information included in the QPRs and the project financial statements does not include all information as required by ADB;
- iv. Audited project financial statements are submitted with a delay;
- v. No management letter provided as part of the audit report;
- vi. The approval and consequently the submission of the audited entity financial statements are considerably delayed;

11. These risks will need to be continuously monitored during project preparation and throughout implementation.

12. **State level PFM assessment.** There is no PEFA or ROSC report publicly available for the Maharashtra state. However, as part of a recent project design⁵, the World Bank identified the following challenges in implementing its portfolio in the state of Maharashtra: i) low disbursement

⁵ World Bank Project Appraisal document: Maharashtra Project on Climate Resilient Agriculture (February 2018),

in initial years caused by implementation challenges, ii) capacity strengthening required in various internal controls such as reconciliations, control over payments, physical verification of assets and adequacy of FM supervision, iii) occasional delays in provision of funds to implementing agencies. These challenges are being addressed by i) following the applicable State and Country systems (including budgetary and treasury systems) and ii) by adding additional requirements where needed such as interim financial reporting and an internal audit function. These findings are also in line with the conclusions and recommendations of this assessment.

4. PROJECT DESCRIPTION

13. The Maharashtra Rural Road Development Association (MRRDA) is the nodal agency for the implementation of the Mukhya Mantri Gram Sadak Yojana (MMGSY), was established as a registered society in accordance with the Society Registration Act 1860 on 23 June 2003. The MMGSY has been started by the GOM as a flagship scheme in October 2015 under Rural Development Department (RDD). The MMGSY scheme is designed on the lines of Pradhan Mantri Gram Sadak Yojana (PMGSY) of GOI. A Project Management Unit (PMU) established within MRRDA will support the proposed project implementation.

14. The project is aligned with the government's Vision 2030 and the country partnership strategy for India 2018–2022 of the Asian Development Bank (ADB).⁶ The project will improve about 2,965 km of rural roads to all-weather standard including some 236 bridges. The project will also support the government's agricultural strategy for increasing agricultural productivity by (i) encouraging commercial agriculture and agribusiness development, (ii) increasing employment opportunities for rural poor people, and (iii) reducing the state's poverty incidence.

15. At the time of the FMA, the Project cost is estimated at around \$430 million and will be financed by ADB (\$300), and GOM (\$130million). The project will mainly incur expenditures as part of civil works contracts (estimated at 97% of base cost), and salaries and operation costs. The project is expected to be implemented over a five-year period although the bulk of the expenditures under civil works are expected to be incurred during project year 2 and 3 (2022 and 2023). By that time the ongoing project has already completed most of its activities and as a result the FM related workload is expected to remain relatively constant.

16. The project implementation support consultants hired under the ongoing project will also support the PMU in implementing the additional financing.

5. DETAILED FINANCIAL MANAGEMENT ASSESSMENT

vii. Overview of the executing agency/implementing agency

17. Rural Development Department, Government of Maharashtra will be the executing agency, and MRRDA will be the implementing agency. MRRDA was created as a special purpose vehicle under Rural Development Department to implement PMGSY and then MMGSY. It was established as a registered society in accordance with the Society Registration Act 1860 on 23 June 2003. MRRDA's activities include: i) Upgrading, rehabilitating existing and constructing roads and ii) maintaining the roads for a period of 10 years after construction. After the initial 10

⁶ ADB. 2017. *Country Partnership Strategy: India, 2018–2022*. Manila.

years, the responsibility for maintaining the improved/constructed roads is handed over to the Panchayati.

18. MRRDA does not prepare entity financial statements. Instead both programmes, PMGSY and MMGSY are audited separately. The fixed assets by way of infrastructure like building, furniture, equipment etc., is owned by RDD. i.e. Rural Development Department, Government of Maharashtra. In addition, MRRDA maintains a fixed asset register in the form of a road list. All the permanent staff of MRRDA is that of State Government. The entire payroll of MRRDA Staff is paid by Rural Development Department, Government of Maharashtra

19. The MMGSY (and PMGSY) is operated through 2 funds and 2 corresponding bank accounts. Under each of the schemes two separate balance sheets are prepared for 2 funds and audited separately:

- i. Mukhya Nidhi (MN) which is used for the investment cost. MN receives funding from: i) state government grants, ii) District Planning Committee Grants and iv) NABARD RIDF grants.
- ii. Prashaskiya Nidhi (PN) which is used for administrative expenses (electricity, honorarium to staff, computer maintenance). PN receives 2% of the received State fund as per government resolution dated 28 October 2015.

20. In its CoA, MRRDA has set up sperate sub-sets of accounts for Mukhya Nidhi and Prashaskiya Nidhi.

21. Looking at the MMGSY audits (Mukhya Nidhi) for FYs 2017-18 and 2018-19 it is observed that:

- iii. the auditor issued an unqualified opinions in both years.
- iv. In the FY 2017-18 MRDDA received INR 2 459.59 crores (USD 354,48 million) as grants from the government and spent around INR 2 818.63 crores (USD 406.23 million). In the FY 2018-19 MRDDA received INR 2 801.62 crores (about USD 400 million⁷) as grants from the government and spent around INR 2 625.98 crores (about USD 375 million).

22. Based on the above, it is concluded that MRRDA has adequate absorption capacity to utilize ADB loan funds within the project implementation period.

- i. Implementation arrangements.

23. MRRDA is governed by the "Governing Body," which is headed by the Chief Secretary as chairperson, Secretary RDD, Secretary (Roads) PWD, Secretary Planning Department, Secretary (Expenditure) Finance Department, Chief Engineer and Deputy Secretary (MMGSY) RDD as members. There is an executive committee headed by the Secretary (MMGSY), RDD is the immediate supervisory agency of the MRRDA. The organizational structures of MRRDA is attached as Appendix-1.

⁷ Using the exchange rate as at March 2019 (USD=70INR)

24. A project management unit (PMU) established at the headquarters of MRRDA will oversee the project implementation. The PMU will be headed by a project director and two deputy project directors. The PMU will also be assisted by consultants. In addition to the PMU, there will be six regional offices and 34 Project Implementation Units (PIUs) at 34 districts.

25. The MRRDA through its PMU will have the overall responsibility for project's financial arrangements including budgeting, flow of funds, internal controls, accounting, financial reporting and audit arrangements. In this regard the PMU will coordinate and oversee the project's financial management activities undertaken by the six regional office and the 34 PIUs. The PMU will: i) prepare consolidated periodic financial reports for the project, ii) prepare and follow-up on withdrawal applications submitted to ADB and iii) ensure that the project is regularly audited by internal and external auditors and that their audit observations are resolved in a timely manner.

26. The six regional offices headed by superintending engineer and supported by an accountant will supervise the 34 PIUs. Each PIU will be headed by executive engineer, supported by 3 deputy engineers, and an accountant and will be responsible for the day-to-day implementation and supervision of project activities under the guidance of PMU.

i. Ongoing ADB financed RCIP project.

27. MRRDA has started implementing the ongoing RCIP project, which became effective in late 2019. As at end of July 2020, the PMU has made good progress with regards to the agreed actions outlined in the PAM of the ongoing project, although some areas have been delayed due to the COVID-19 lock down. The main achievements and delays are summarized below:

- a. **Funds flow.** Counterpart funds have been released in a timely fashion by GoM under a separate budget code and 12 Withdrawal applications amounting to \$30.1million (15% of the total loan) under the reimbursement procedure has been processed by ADB. Around 140 million (70% of the total loan) has been committed;
- b. **Staffing.** The PMU and the PIUs are fully staffed with the exception of one accountant position in the PMU which is still vacant. MRRDA has made the request for the position and is following-up on it regularly. It is expected that the vacant accountant position is filled by October 2020. Moreover, the hiring of the FM expert under the Project Implementation Support Consultancies (PISC) package has been delayed due to delay in the procurement process of the PISC and the COVID-19 lockdown. It is expected that the PISC including the FM expert will be in place by October 2020. In order to mitigate the risk, technical experts including a senior FM expert⁸ financed by an ADB TA have been fielded in to support the PMU/ MRRDA until the PISC is in place;
- c. **Accounting.** The MRRDA has implemented SBI Cash Management Product (CMP) systems to book real time expenditure through Tally software from 1st July 2019;
- d. **Supplementary FM procedures.** The supplementary ADB specific FM procedures manual attached to the PAM of the ongoing RCIP project has been approved and is being followed under the guidance of the senior FM

⁸ The senior FM expert was hired in June 2020.

expert hired under the TA. The manual is to be further improved based on experience gained as part of the ongoing project and recommendations made by ADB;

- e. **Chart of Accounts (CoA).** The chart of account has been modified to track receipts and payments separately for the project. Authorizations and payments are effected separately for ADB project;
- f. **Filing of records.** The central filing of all project reports and supporting documentation has been done for ADB payments. The physical project records and supporting documents will be centrally made available at the time of audit and ADB inspection;
- g. **Internal audit:** The latest Internal Audit covered the period 1.7.2019 to 31.12.2019. The latest internal audit report focused on the newly introduced cash management product (CPM) portal. The audit found that the final payments are in order and accounted for but some data filing errors were identified and as a result an additional training session in the use of CMP and uploading the necessary information has been recommended by the auditors. The recommended training will be organized as soon as the COVID-19 situation improves. The appointment of the state level and divisional level internal auditors have been completed but the audit work could not be completed due to the COVID-19 lockdown;
- h. **External audit.** Due to the COVID-19 lockdown the first external audit has been delayed. Currently, the audit is expected to start in August 2020 and consequently the submission of the APFS to ADB may not take place before the end of October or early November 2020. The audit ToR agreed between ADB, CAG and DEA will be used for F. Y. 2019-20 onwards;
- i. **Quarterly progress reports.** The PMU has submitted one QPR covering the first three months of project implementation from effectiveness to March 2020. The QPR included the following information: i) Basic project information; Summary of Contracts awarded, expenditures incurred, and claims submitted and completed length of road; ii) detailed in information on financial and physical progress by contract package, iii) Status of staffing, iv) Status of Input(s) (Procurement and Consultant Recruitment, v) Progress on Project Output(s), vi) Status of Last Action Plan, vii) Previous ADB Review Mission/TPRM / last Progress Report); viii) Status of Major Loan Covenants; and, ix) Key Implementation Challenges and Proposed Action. However, there is scope for improving the analysis of the figures and deviations. In particular, in the future the status of the FM action plan, reconciliation with AB disbursement records and status of audit observations need to be discussed more in detail. The FM expert to be hired under the PISC will be focusing to support the PMU to address these issues and ADB will also need to review the next QPRs in particular for Q3 and 4 in detail to ensure these comply with ADB's standards.
- j. **ADB systems (CPD and LFIS).** The PMU has received training in ADB's disbursement systems and procedures.

ii. Strengths and weaknesses

28. The main strength of the MRRDA is that it has extensive experience in implementing large projects, including PMGSY projects of the GOI and MMGSY projects of the GOM. However, MRRDA still has limited experience in implementing ADB financed projects as the ongoing RCIP project only became effective in late 2019. As a result, the FM arrangements of the MRRDA and its PMU will need to be supported as described in the sections below.

iii. Organization and staffing

29. The finance team currently consists of the following positions: an financial controller (FC), and two accounts officers in the PMU, six regional accountants (one in each regional office) and 34 district accountants (one in each district PIU).

30. The officers and senior staff in finance and accounts section are either on contract basis or on deputation from another department. They are supported by the outsourced professionals as and when required. Dedicated finance and accounting staff are now at MRRDA. Their selection in MRRDA is based on their qualifications, experience and performance record. The staff are qualified and have the capacity to handle project accounting. Adequate staff are employed to manage the current finance and accounting function of the Entity with the exception of one account officer in the PMU which is currently vacant. However, as the ongoing project and the AF project will partially overlap an additional FM staff may be needed for the time period of April 2021 to September 2022 when the workload is expected to be the highest. The situation needs to be carefully monitored by the PMU and by ADB to ensure additional staff is assigned to the project based on the actual needs.

31. Considering ADB' requirements with regards to financial management and the additional work load as part of the project, it is recommended to strengthen the capacity of the MRRDA and its PMU by the following: i) filling the vacant position of the account officer by October 2020, ii) ensure the FM expert is engaged through the proposed Project Implementation Support Consultancy (PISC) to focus exclusively on the two ADB projects and iii) to hire an additional accountant for the period the ongoing project and the additional project overlap. A sample TOR for the engagement of National Financial Expert is given in Annexure 3. In addition, it is important that the project staff and especially the newly hired accounts staff are given continuous training in ADB policies and procedures.

iv. Accounting Policies and Procedures

32. MRRDA is managing its own accounts and is using double entry cash basis accounting system that allows for the proper recording of project financial transactions. MRRDA is having a robust accounting system which is able of collecting, storing and processing financial and accounting data that are used by decision-makers. Day-to-day activities are governed by governmental rules and regulations including the Public Works Department Code, Public Works Account Code, General Financial Rules and Treasury Code and PMGSY guidelines. A computer-based method for recording of accounting activity in conjunction with information technology resources is carried out.

33. Moreover, controls are in place concerning the preparation and approval of transactions, ensuring that all transactions are correctly made and adequately explained. Approvals on the transactions are done as per the delegation of powers given by the Authority. It is mandatory to get Administrative approvals from competent authority for each transaction based on the

delegation of powers. Government of Maharashtra rules & regulations are adequate to guide activities and ensure accountability of staff. Bank reconciliation is done on monthly basis. At present there are controls in place concerning the preparation and approval of transactions, ensuring that all transactions are correctly made and adequately explained.

34. Furthermore, there is physical inventory of fixed assets taken during annual audit. While government procedures are followed to safeguard and protect assets from fraud, waste and abuse. The allocation for expenditures is adequate to report on project activities and disbursement categories. Additional sub account head can be added as and when required.

35. In order to ensure full compliance with ADB's requirements at all levels, it is recommended to supplement the PMGSY guidelines with additional project specific FM procedures including reporting templates, audit ToR's, etc.. In addition, the chart of accounts will need to be updated to capture the receipts from ADB loan and project specific categories in line with project cost categories.

36. GOM policy has been followed for record retention of minimum of 8 years. For creation of assets, the records are to be maintained till the value of assets depreciated. Till now no records are destroyed in MRRDA. A systematic record keeping is being maintained for easy access for scrutiny by authorized users. Data retrieval is also user friendly, being maintained online.

37. As the PMU will prepare WAs centrally, it is recommended that all supporting documentation as required by the ADB loan disbursement handbook will need to be collected and centrally stored by the PMU. The PMU will also need to ensure that financial records related to the project are filed orderly in physically safe location and electronically backed up at least on a weekly basis. All records will be made available to the auditors and ADB staff and retained at least 2 years after the loan closing date.

v. Internal Audit

38. MRRDA appoints an internal audit firm to conduct semiannual internal audit at the regional office level and issues reports to an audit review committee. The internal audit is conducted in accordance with the PMGSY guidelines. These reports are considered by the statutory auditor while conducting the state level entity audit. However, there occasional delays in completing Internal Audit.

39. In order to strengthen the internal audit function in MRRDA, it important that the engaged internal audit firm conducts internal audits on a quarterly basis and reports to the audit review committee within 45 day after the end of the reporting period. The Internal audit should follow a risk-based approach and focus in particular on the financial activities carried out the regional offices and PIUs. The audit committee will consider key issues pointed out by the auditors and ensure timely resolution of observations by project management. The appointment of the state level and divisional level internal auditors have been completed for the fiscal year, but the audit work could not be completed due to the COVID-19 lockdown.

vi. External Audit

40. The statutory audit of the programs implemented by MRRDA are carried out by the independent statutory auditor appointed from the panel approved by the CAG of India. Normally there has been no delay in the program audits. The Audit of MMGSY for the FY 2017-18 was completed by December 2018 and for the FY 2018-19 it was completed in September 2019. The

statutory auditors will also audit ADB project-level statements for the ADB-funded project expenditures. Template financial statements provided in the standard terms of reference for the audit of ADB-assisted projects, agreed with the CAG of India, DEA, and ADB, can be referred to as a guide. In addition, transaction audits are also carried out periodically during the year by the state accountant general to ensure relevant codes and standards are conformed with. The statutory auditors must prepare separate certification work for the ADB project related expenditures. The audits are conducted as per Indian Auditing Standards. A review of the audits from FY2015 to FY2019 indicates no major adverse audit comments. There are some minor audit observations that are being addressed by the MRRDA. The Audit Report received from the Statutory Auditor is placed before the MRRDA Managing Body and Governing Body for review every year. The Audit Report is also to be placed before the Legislature as per government requirements.

41. As per the loan and project agreements, the audited project financial statements (APFS) are to be submitted in English to ADB within 6 months of the end of each fiscal year. The annual audit report should include a separate auditor's opinion on the use of statement of expenditures, compliance with loan covenants and use of loan proceeds in accordance with the loan agreement for intended purposes. MRRDA must be reminded of ADB's approach to delayed submissions, and the requirements for satisfactory and acceptable quality of the audited APFS.⁹

42. MRRDA and will (i) maintain separate accounting records for the Project; (ii) have such accounts audited annually, in accordance with appropriate auditing standards consistently applied by independent auditors whose qualifications, experience, and terms of reference are acceptable to ADB; (iii) furnish to ADB as soon as available but in any event not later than 6 months after the end of each related fiscal year, certified copies of such audited project accounts and the report of the auditors relating thereto (including the auditors' separate opinions on the use of the loan proceeds and compliance with the financial covenants of the loan agreement) as well as a management letter; and (iv) furnish to ADB such other information concerning such accounts and the audit thereof as ADB shall from time to time reasonably request.

43. The audit of the ADB project account will to be carried out by the firm of Chartered Accountant taken from the panel approved by the CAG. The TOR agreed between DEA, CAG and ADB will be used for this purpose.

vii. Financial Reporting Systems

44. Financial Reporting should demonstrate the accountability of MRRDA, and the resources entrusted to them and provide information useful for decision making by indicating whether resources were obtained and used in accordance with the legally adopted budget, and legal and

⁹ ADB's approach and procedures regarding delayed submission of audited project financial statements:

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

contractual requirements, including financial limits established by appropriate legislative authorities. It must provide information about the sources, allocation and uses of financial resources and how MRRDA financed its activities and met its cash requirements. It must also provide additional information that is useful in evaluating MRRDA's ability to finance its activities and to meet its liabilities and commitments. Effective reporting is one that provides information about the financial condition of the Implementing Agency and aggregate information useful in evaluating performance in terms of service costs, efficiency and accomplishments.

45. The MRRDA reports comply with the reporting requirements of the GOM. These reports are prepared monthly, quarterly and annually for audit. It is recommended to prepare quarterly progress reports to ADB. The quarterly financial progress reports are expected to include at least the following financial information: i) cash recipient and payments by financing source, ii) Cash payments by component output, iii) financial vs physical progress report (cumulative since the start of the project and for the fiscal year), iv) expenditure forecast for the next six months, v) list of signed contracts and vi) status of Financial Management Action plan, compliance with financial loan covenants, as well as implementation status of external and internal audit observations. The project financial statements will be based on the template agreed between ADB and the CAG.

Table 1: Financial Reporting Arrangements

Aspects	Arrangements
Reporting entities	MRRDA prepares its annual financial statements programwise (e.g. separately for PMGSY and MMGSY) which are audited by an independent auditor. Annual Audited Financial Statements & Annual Report are submitted to the Governing council of MRRDA, Rural Development Department and to Finance Department of Government of Maharashtra.
Legislative and regulatory basis for financial reporting	As per the Society Registration Act 1860 MRRDA is registered as an Association with Memorandum and Rules and Regulations. MRRDA must prepare annual financial statements of its accounts which are to be audited by an independent auditor. The audited financial statements are submitted before the government including Rural Development Department and Finance Department before end of 30 September every year. These statements are to be approved by the Members of the Governing council of the MRRDA before submitting to RDD and finance department.
Financial reporting standards	The Financial Statements are prepared and presented under double entry system on cash basis and in accordance with the government's accounting laws and regulations
Financial year	The standard annual reporting period is from 01 April to 31 March of the succeeding year.
Currency	The currency of presentation is Indian Rupee.
Language	The annual financial statements will be presented in the English language.
Composition and preparation	<p>The audited project financial statements will comprise:</p> <p>For MRRDA programme specific (separate for PMGSY and MMGSY):</p> <ul style="list-style-type: none"> • Balance sheet • Statement of uses of Funds by the Program • Note forming part of financial statements <p>For MRRDA Project Level – (will follow CAG TOR)</p> <ul style="list-style-type: none"> • Statement of Receipts and Payments • Uses of Fund by Project Activity • Statement of Disbursement with detailed information by withdrawal applications on amounts claimed from ADB and amounts disbursed by ADB

	<ul style="list-style-type: none"> Notes to the Financial Statements
Arrangements for interim financial reporting	The project must prepare quarterly progress report for the physical and financial progress not later than 45 days from the end of each quarter. The financial information will be integrated in the periodic progress reports submitted to ADB. The following financial reports may be annexed to the periodic progress reports: Statement of Cash Receipts and Payments by Category, Physical vs Financial progress report by output, Statement of Withdrawal Applications, List of signed contracts, Status of Financial Management Action Plan, Status Compliance with loan covenants and Status of external audit observations
Country specific circumstances (if applicable)	MRRDA is a Government Society and follows all Government Rules and Regulations applicable in Government of Maharashtra.

viii. Information Systems

46. Commercially available accounting software “Tally” is used for accounting and reporting system. MRRDA presently uses customized Tally ERP software for accounting and financial reporting and is in the process of improving the customization to generate more reports for more effective project monitoring. In June 2019, MRRDA implemented SBI CMP systems to book real time expenditure through Tally software. In addition to the Tally software, MRRDA also has in place a Works Online Management Information System (WOMIS) which allows tracking of roads and physical progress. It is recommended the PMU uses ADB’s disbursement systems, to track WAs and monitor disbursement data and conduct periodic reconciliations between its own records and ADB records

ix. Budgeting

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

48. The budget of MRRDA mentions the budgeted expenditure for next Financial Year and Revised Expenditure for current Financial year for all the projects undertaken by the MRRDA. Budgets are prepared considering all the significant activities of MRRDA which can be compared with Actual expenditure incurred on projects. ADB portion of the expenditure is getting reimbursed from the GOM through state budget and MRRDA will ensure necessary provision in the state budget for the same.

49. Budget is prepared every February of the year. Information regarding Budget for upcoming year and revised budget is collected from concerned divisions and compiled. Review meeting is taken with department heads and the Rural Development Department (RDD) of the GOM. The revisions are made as decided in the meeting. Final Draft of Budget is prepared, approved by the Planning and Finance Department of GOM, and the Final Budget document is prepared for taking the approval from the Legislature. The scheme MMGSY is a Flag Ship Scheme planned and budgeted for 5 years duration, commencing from 2015-16 to 2019-20. The 5-year target fixed as 30000 km and INR 171 billion. In the past there may not be any problem in getting the budget release for the project. Furthermore, under the project all the contracts will be agreed in advance with MRRDA and ADB and as a result the PMU will be able to exercise adequate budget controls when approving during implementation and issue regular variance reports in a timely manner.

50. As of August 2020 the AF project has been approved by the State of Maharashtra. However, as the activities will only start in Q4 2020/21 or in Q1 2021/22, no funds have been earmarked for the AF project in the 2020/21 state budget. The project funds (under a separate budget code) will be made available as part of the 2020/21 budget revision or 2021/22 budget.

x. Disbursement Arrangements

51. The loan proceeds will be disbursed in accordance with ADB's *Loan Disbursement Handbook* (2017, as amended from time to time)¹⁰, and detailed arrangements agreed upon between the government and ADB. Online training for project staff on disbursement policies and procedures is available.¹¹ Project staff are encouraged to avail of this training to help ensure efficient disbursement and fiduciary control.

52. The statement of expenditure (SOE) procedure will be used for reimbursement of eligible expenditures. Supporting documents and records for the expenditures claimed under the SOE should be maintained by the PMU and made readily available for review by ADB's disbursement and review missions, upon ADB's request for submission of supporting documents on a sampling basis, and for independent audit. MRRDA should ensure sufficient category and contract balances before requesting disbursements. Use of ADB's Client Portal for Disbursements (CPD)¹² system is encouraged for submission of withdrawal applications to ADB.

53. Neither ADB's advance fund nor direct payment procedures is expected to be used for the project.

54. The PMU in MRRDA will be responsible for (i) preparing disbursement projections, (ii) requesting budgetary allocations for counterpart funds, (iii) collecting supporting documents as required by the ADB loan disbursement handbook, and (iv) preparing and sending withdrawal applications to ADB.

55. Before the submission of the first withdrawal application, MRRDA, through GOM, should submit to ADB sufficient evidence of the authority of the person(s) who will sign the withdrawal applications on behalf of the borrower, together with the authenticated specimen signatures of each authorized person. The minimum value per withdrawal application is set in accordance with ADB's Loan Disbursement Handbook. Individual payments below this amount should generally be paid by the PMU and subsequently claimed to ADB through reimbursement. ADB reserves the right not to accept withdrawal applications below the minimum amount.

56. Withdrawal applications and supporting documents will demonstrate, among other things, that the goods and/or services were produced in or from ADB members and are eligible for ADB financing.

57. All disbursements under government financing will be carried out in accordance with the regulations of the Government of India and the Government of Maharashtra and accounting principles acceptable to ADB.

¹⁰ The handbook is available electronically from the ADB website: <https://www.adb.org/documents/loan-disbursement-handbook>

¹¹ Disbursement eLearning: http://wqr4.adb.org/disbursement_elearning

¹² The CPD facilitates online submission of WA to ADB, resulting in faster disbursement. The forms to be completed by the Borrower are available online at <https://www.adb.org/documents/client-portal-disbursements-guide>.

xi. Fund Flow Mechanism

58. The MRRDA, on behalf of GOM, will be responsible for implementing the project according to the loan agreement and project agreement. Disbursement methods as outlined in ADB's *Loan Disbursement Handbook* (2017, as amended from time to time). The MRRDA will adopt the reimbursement method for payments as main disbursement method. The total cost of the project is partly funded by Grant from Government of Maharashtra (non-eligible portion) and ADB Loan (eligible portion). However, state government should provide the full amount for both non-eligible and eligible portion initially, following the reimbursement procedure of ADB, every year in the budget. Total budget requirement including the ADB portion shown as capital outlay and ADB reimbursable portion shown as Capital Inlay for the year in the budget. MRRDA will provide the ADB loan and counterpart funds to the PMU for project implementation, ensuring sufficient budget for payments to the contractors based on the submitted invoices. The PMU will then submit claims to the MRRDA, who will in turn submit them to ADB through the office of AAAD. ADB will reimburse the borrower (GOI) out of its loan account. The GOM will be responsible for meeting the financial responsibilities and obligations of the MRRDA for the project.

59. The project will be budgeted through a single line item in the GOM budget for ADB loan component and Capital Grant from GOM. After the budget is approved, an allocation will be made by GOM, through the RDD to MRRDA. The ADB portion will be released by the RDD based on amount received by the GOM as reimbursement from ADB through GOI. Eligible project expenditures will be submitted by MRRDA to CAAA, Ministry of Finance and Department of Economic Affairs through SOE procedure for reimbursement.

60. Appendix 2 show the flow of funds under the project to MRRDA using the reimbursement procedure.

61. No project funds will flow to the PIU level, but only to the accounts maintained at the regional office level. In MRRDA, the work bills/invoices of the contractors, suppliers, and service providers are first scrutinized, verified and certified by the technical and accounts wing of the concerned District office and subsequently submitted after approval to Division office for payment. The arithmetical calculations are also checked at divisional level. The Finance Division also checks the invoices to ensure that a certificate of the relevant inspecting authority is attached, the invoices are properly stamped and signed, and the payments are released by the finance division of the divisional office.

6. RISK DESCRIPTION AND RATING

62. During implementation, MRRDA faces some risks that can generally be divided in two main categories: (i) country level; and (ii) organization/project level. The identified risks, risks ratings and mitigation actions are summarized in the table below. These risk and mitigation actions will need to be monitored and updated throughout the life of the Project.

Table 3: Financial Management, Internal Control And Risk Assessment And Risk Management Plan		
Risk	Risk Assessment and Risk Description	Mitigation Measures or Action Plans
1. Country-specific risks	M	Not applicable.
2. Entity-specific Risks	M -MRDDA has limited experience in implementing ADB financed projects	MRRDA is a legally registered society. It is independent in its function under the governing body. MRRDA has experience in implementing PMGSY of GOI Aided Projects and MMGSY of GOM Projects. MRDDA is also in early stages of implementing ADB financed RCIP.
3. Project-specific Risks	M Large number of contracts in remote locations.	The works are monitored by 34 PIUs which have already been established.
Overall Inherent Risk	M	
Control Risk		
1. Implementing Entity	M - MRRDA has limited experience in implementing the ADB funded project	- MRRDA will implement the project through its PMU and PIUs. The FM arrangements of the PMU will be further strengthened as described below.
2. Fund Flow	S -Decentralized flow of funds. -Delay in release counterpart funds to the project.	- ADB's disbursement will follow reimbursement procedure and no ADB funds will be channeled to the PIUs. -All WAs will be prepared by the PMU and all supporting documentation will be kept centrally. - MRRDA to ensure with the immediate release of the replenishment of funds from the GOM for the funds received from ADB on reimbursement basis.
3. Staffing	S -increased workload due to the project. -Lack of experience ADB procedures and requirements.	-The capacity of the PMU to be strengthened by hiring a national FM expert exclusively to the ADB project to support the PMU throughout the project life. -ADB to provide continuous training in ADB policies, systems and procedures.
4. Accounting Policies and Procedures	M -The accounting policies and procedures require some supplemental guidance.	- PMGSY FM policies are in place and an ADB specific FM manual was developed as part of the ongoing project. The manual may need to be finetuned to take into account the AF project to ensure ADB's requirements are met at all levels. -Chart of accounts to be updated for the additional financing project.
5. Internal Audit	M. -The internal audits are experiencing some delays due to the COVID-19 lockdowns.	- The internal audit firm engaged by the MRRDA to include the Additional financing in its audit plan and conduct audits on quarterly basis on and report to the audit review committee within 45 days after the reporting period. Quarterly audits need to be resumed as soon as the COVID 19-lock down is over. This needs to be monitored by ADB.
6. External Audit	M -Delay in submission of the audit report	-The statutory audit is carried out by the independent statutory auditor appointed from the panel approved by the CAG of India. A separate audit of the AF project financial statements to be conducted according to the ToRs agreed with DEA, CAG and ADB and the audit report to be submitted to ADB within 6 months after the end of the fiscal year.

Table 3: Financial Management, Internal Control And Risk Assessment And Risk Management Plan		
Risk	Risk Assessment and Risk Description	Mitigation Measures or Action Plans
7. Reporting and Monitoring	M -Frequency and timeliness of periodic financial reporting require strengthening.	-MRRDA to issue quarterly financial reports within 45 days after the reporting period in a format agreed with ADB, including physical vs financial progress and disbursement reports. ADB to monitor the quality of FM information and provide training as required.
8. Information Systems	M -Information systems not used optimally.	-Regular use of ADB disbursement systems, including client portal for disbursement (CPD) and Loan Financial Information Services (LFIS).
Overall Control Risk	M	
FM risk	M	

H – High, S-substantial, M – Moderate, L – Low.

7. TIME-BOUND FM ACTION PLAN

63. Based on the identified risks, the below action plan is recommended.

Table 4: FM Action Plan		
Key risks and Agreed action	Responsibility	Timeframe
1. Hire a national FM expert (financed under the ongoing RCIP project) exclusively to the ADB project to support the PMU throughout the project life.	MRRDA	By loan signing
2. Monitor the workload and engage an additional accountant to support the PMU for the period when the ongoing project and the AF project overlap and as required by the workload.		Continuous
3. Training to be provided in ADB policies and procedures especially to the newly hired staff.	ADB	Continuous
4. Finetune the ADB specific FM procedures to take into account the AF project as required to ensure ADB's requirements are met at all levels.	MRRDA	Before Loan effectiveness
5. Modify the chart of accounts to allow the project to track receipts and payments separately for the additional financing project.	MRRDA	Before Loan effectiveness
6. File all project records and supporting documentation filed centrally, and back them up regularly.	PMU/MRRDA	Continuous
7. Issue quarterly financial reports in a format acceptable to ADB.	PMU/MRRDA	within 45 days after the end of the reporting period.
8. Include the additional financing project in the scope of the Audit firm conducting quarterly internal audits and reporting to the audit review committee within 45 days after the end of the reporting period.	MRRDA	Continuous

9. Adopt the CAG audit ToR's for the annual audit of the AF project and agree with the CAG on the audit timeline to ensure timely submission of the audit report and management letter separately for the Additional financing project.	MRRDA	Within three months after loan effectiveness.
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64. For effective implementation of the project, it is recommended that ADB follows up and reviews with MRRDA the status of recommendations on Financial Management. ADB review missions to review the status on a half yearly basis and suggest remedial measures, as necessary.

8. SUPERVISION AND IMPLEMENTATION SUPPORT PLAN.

65. In order to ensure sufficient knowledge in ADB's FM requirements, including procedures and related systems, the MRRDA will ensure that each PMU financial staff assigned to the project undertake the following actions within the first three months working with the project:

- I. Become aware of the ADB and national anticorruption policy and whistle blowing mechanisms;
- II. Master loan/grant agreement including the loan covenants and the relevant sections of the Project Administration Manual, as well as the ADB loan disbursement handbook
- III. Obtain user/reader rights (as required) to ADBs systems including: the Client Portal for Disbursement and the Loans and Grants information Service (LFIS).
- IV. Complete the ADB Disbursement eLearning course
- V. Complete the Cash Basis IPSAS for ADB Project Financial Reporting -eLearning course

66. In addition, the PMU should on a yearly basis liaise with ADB to ensure participation in FM and disbursement training events organized by ADB in the region, especially in the first two years of project implementation.

67. Moreover, it is recommended that a financial management specialist (ADB staff or consultant) will participate in a mission annually (subject to availability of resources) to supervise and provide implementation support to the project and follow up the fiduciary risk at various levels including the use of the SOE. In light of the risk assessment, the following activities will be undertaken by the end of January 2022:

- i. Follow-up on the status on the staffing arrangements including the vacant accountant position and hiring of the FM expert as part of the PISC – Target Date: by end of October.
- ii. Review and provide feedback on the QPRs for Q2 and Q3 = Target date by end of September 2020 and end of November 2020 respectively; and
- iii. Review and share findings of the first APFS – Target date by End of December 2020

68. Furthermore, during the first two years of implementation the supervision plan of the project will especially focus on the following actions:

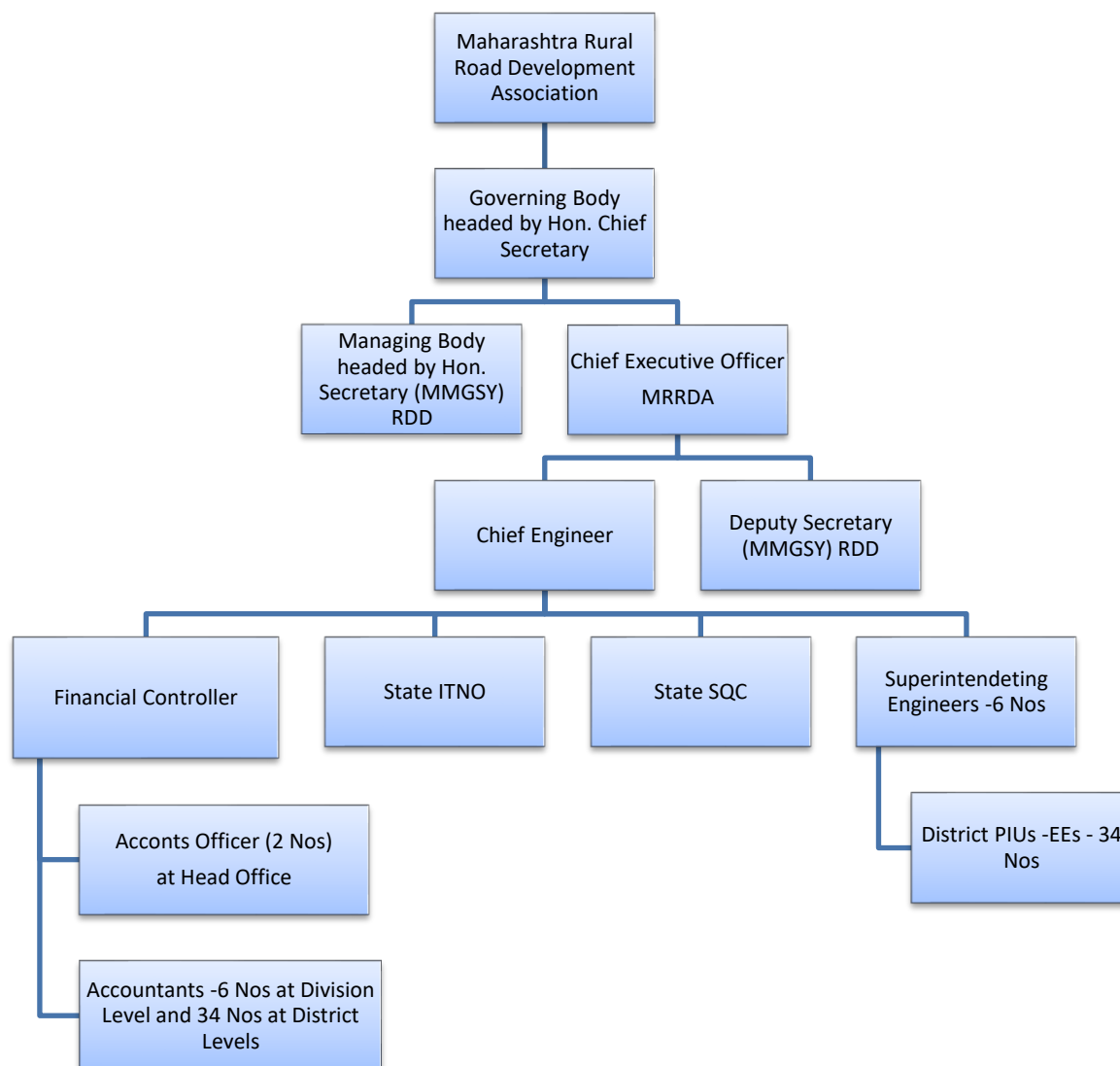
- Detailed review of the status of the FM action plan outlined in the PAM.
- Detailed review of adequacy of the staffing arrangements at the FM unit within the PMU, including the TOR's and performance of the financial staff and training needs identification;

- Detailed review of the project financial management and accounting procedures in use;
- Walkthrough of the accounting software and review of the financial reports produced by the accounting software and the use of budget controls;
- Review of overall flow of funds (and resolving any bottlenecks);
- Detailed review of the use of the Statement of Expenditure (SOE) procedure and the adequacy of supporting documentation;
- Follow-up on the on the timeliness of the internal audit function and status of internal audit recommendations;
- Detailed review of records management, filing and information back up;
- Follow-up on contracting the project (independent) external auditors;
- Follow-up on external audit recommendations; and,
- Follow-up on recommendations from past supervision missions.

The supervision process will be complemented by desk review of financial information included in the QPRs and Audited project Financial statements.

Appendix – 1

Organization Chart of MRRDA

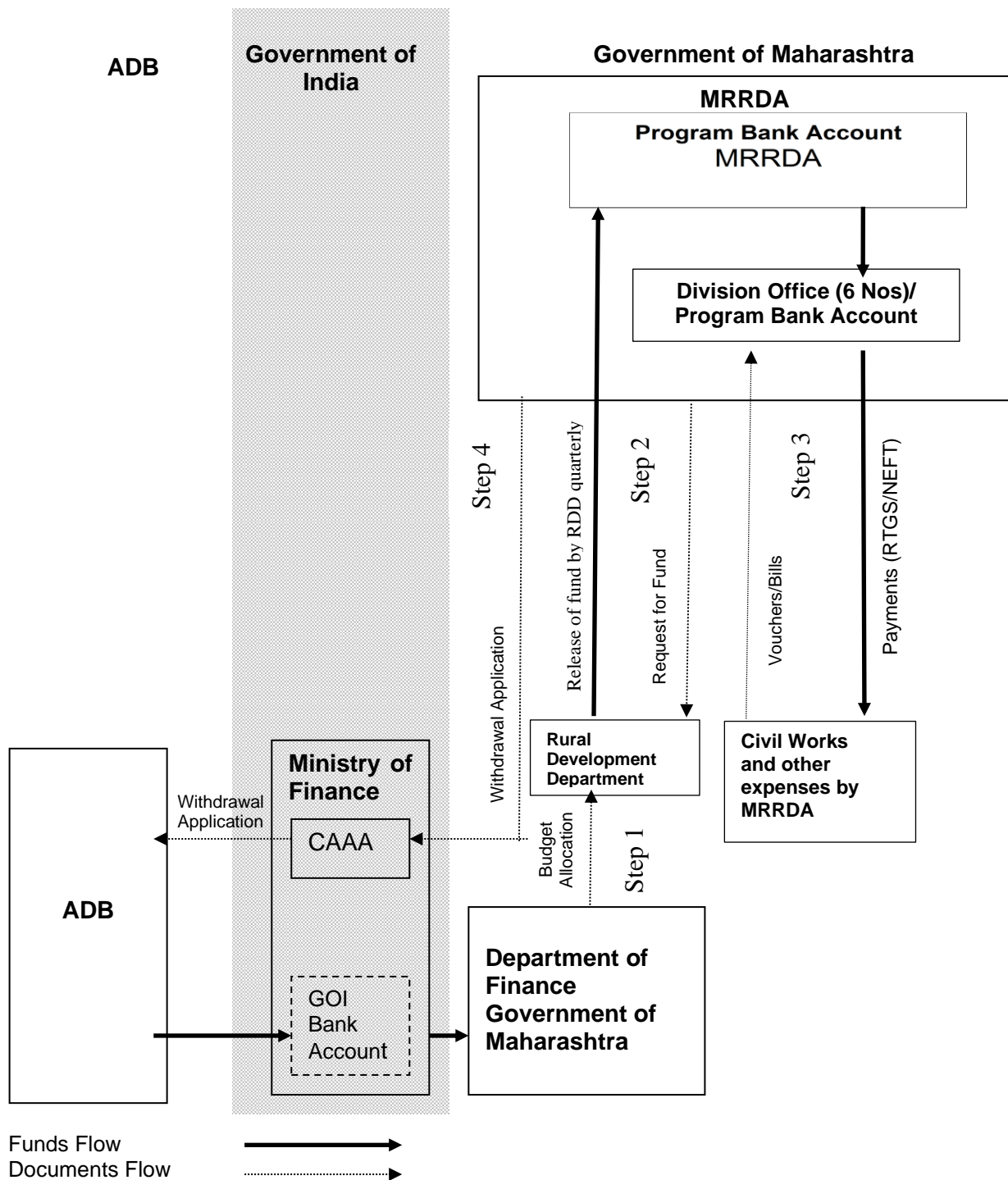


EE=Executive Engineer, ITNO=Information Technology Nodal Officer, MMGSY=Mukhya Mantri Gram Sadak Yojana, MRRDA=Maharashtra Rural Roads Development Association, PIU=Project Implementing Unit, RDD= Rural Development Department, SQC=State Quality Coordinator.

Appendix-2

Maharashtra Rural Connectivity Improvement Project
Fund Flow Diagram for the ADB assisted AF project on reimbursement basis:

The Government of Maharashtra will provide MRRDA with sufficient budget for payments to finance the project expenditures. Subsequently, MRRDA will claim the share of expenditures to be covered by ADB on a reimbursement basis by submitting withdrawal applications through the borrower to ADB. ADB will pay the borrower out of the loan, and the borrower will channel the funds to the Government of Maharashtra.



ADB = Asian Development Bank, MRRDA=Maharashtra Rural Road Development Association, CAAA= Controller of Aid Accounts and Audit, GOI=Government of India.

Appendix-3

TERMS OF REFERENCE FOR FINANCIAL EXPERT (National) –This position is financed under the ongoing RCIP project but the consultant will support the PMU in the implementation of the ongoing and AF project.

A. Objectives

1. The objective of the services is to assist Maharashtra Rural Road Development Association (MRRDA) in providing practical advice in (i) all financial matters referred (ii) to do the function of internal check and (iii) to assist Internal and Statutory Auditor. In conducting the check, special attention should be paid to the following:

- Work under supervision and guidance of PMU and TL, provide support and guidance to the PMU and MRRDA financial and accounting staff, including district accounting staff;
- Assist the PMU in developing a project specific FM manual by reviewing and revising the draft procedures included in the PAM.
- Develop a monitoring format for periodic financial progress monitoring of activities and tasks relevant to financial management of the project;
- Effectively manage the financial aspects of the project in a timely and coordinated manner;
- Be responsible for accurately monitoring and reporting actual and projected expenditures of funds (from government and ADB sources) on a monthly basis and quarterly basis;
- Assist PMU to prepare quarterly, semi-annual, and annual progress reports and completion report;
- Assist PMU to prepare annual project financial statements in the form acceptable to ADB;
- Visit district accounting staff periodically for compliance monitoring of disbursement and accounting requirements and provide technical support;
- Liaise with representatives of the ADB for the project, as necessary and directed by the Project Director;
- Advise on actions to be taken to mitigate gaps in internal controls and effectively follow up on actions to be taken;
- Advise on compliance with loan covenants and ensure that compliance with the covenants is maintained;
- Advise and monitor internal and external audit observations, and effectively follow up and implement audit recommendations for resolving any audit issue;
- Assist PMU to address issues raised by ADB on audited project financial statements and effectively follow up on actions to be taken;

- Assist the Project Director in the preparation of detailed budget for all project activities, and in project financial management control;
- Ensure adherence to ADB requirements and regulations in financial reporting and controls;
- Provide capacity building support to MRRDA (including PMU and district staff of the project);
- Identify training needs of MRRDA staff, prepare tentative training program and coordinate with other relevant projects in preparing training modules, and implement the training program;
- Ensure that relevant staff of MRRDA and other offices understand the differing requirement of the co financiers in budgeting and disbursing funds;
- Advise on the TORs for conducting internal audits;
- Prepare monthly report, quarterly report, annual report in connection to the financial management of the project's, including status of Financial Management Action Plan (in the Project Administration Manual) and MRRDA capacity building support;
- Assist in monitoring of security deposit validity against advances made to the contractors if any; and
- Attend any meeting as instructed by MRRDA.
- Assist with any other duties as may reasonably be assigned by MRRDA and agreed with the ADB;

Required Expertise

The candidate must have more than 5 years' experience in the relevant field preferably with a professional qualification (Certified Public Accountant or chartered accountant) from a recognized institute.