

FINANCIAL MANAGEMENT ASSESSMENT

I. INTRODUCTION

1. The financial management assessment (FMA) was carried out in January – March 2021 for the Guangxi Li River Comprehensive Ecological Management and Demonstration Project (the Project) in accordance with Asian Development Bank's (ADB's) *Financial Management Technical Guidance Note*.¹ This assessment is carried out on the executing agency (EA), namely, Guilin Municipal Government (GMG) as represented by its Project Management Office (PMO), and two implementing agencies (IAs), namely Guilin Lijiang Tourism Investment and Operation Co., Ltd. (GLTICO) who is responsible for implementing subprojects located within Guilin municipal city, and Longsheng County Xingsheng Urban and Rural Construction Investment Co. (LXICO) who is responsible for implementing subprojects located within Longsheng Autonomous County. The assessment includes the review of project funds flow, staffing, accounting policies and procedures, budget management, internal and external auditing arrangements, reporting and monitoring, and financial information systems.

II. BRIEF PROJECT DESCRIPTION

2. The Project will help GMG implement its strategies and action plans to develop the local tourism and improve the environment management of Li River and Longsheng Autonomous County in a sustainable and inclusive manner. The investment project covers the development of 14 subprojects, 13 of which are located in Li River area and the rest 1 located in Longsheng, and implementation of technical and institutional support to the PMO. It is expected to achieve three major outputs: (i) institutional capacity and knowledge in river management and sustainable tourism strengthened; (ii) river ecological protection infrastructure enhanced; and (iii) sustainable village preservation and low-carbon facilities implemented.

3. Under the Project, most of subprojects are non-revenue generating project or they can only generate a very limited amount of revenues which are appraised as insufficient to support the service of debt finance or even the recurrent operation and maintenance costs during the operation period. Since Longsheng is a county located within the geographic territory of Guilin but directly administered by provincial government GGZAR, repayment of the ADB loan mostly will be separately made by GMG or Longsheng County Government (LCG) for subjects located in their respective territory by buying back the related subproject assets through scheduled installment payments that will be made to the related IAs to cover the IA operation cost, subproject O&M costs, full service of ADB loan and other debt finance plus a cushion to bear the related foreign exchange risk and interest risk of ADB loan. If the GMG or LCG are not capable of making the scheduled installments, its GGZAR's responsibility to bear the O&M cost and repay the ADB loan principles and interests in full.

¹ ADB. 2015. *Financial Management Technical Guidance Note*. Manila.

III. SUMMARY OF FINANCIAL MANAGEMENT ASSESSMENT

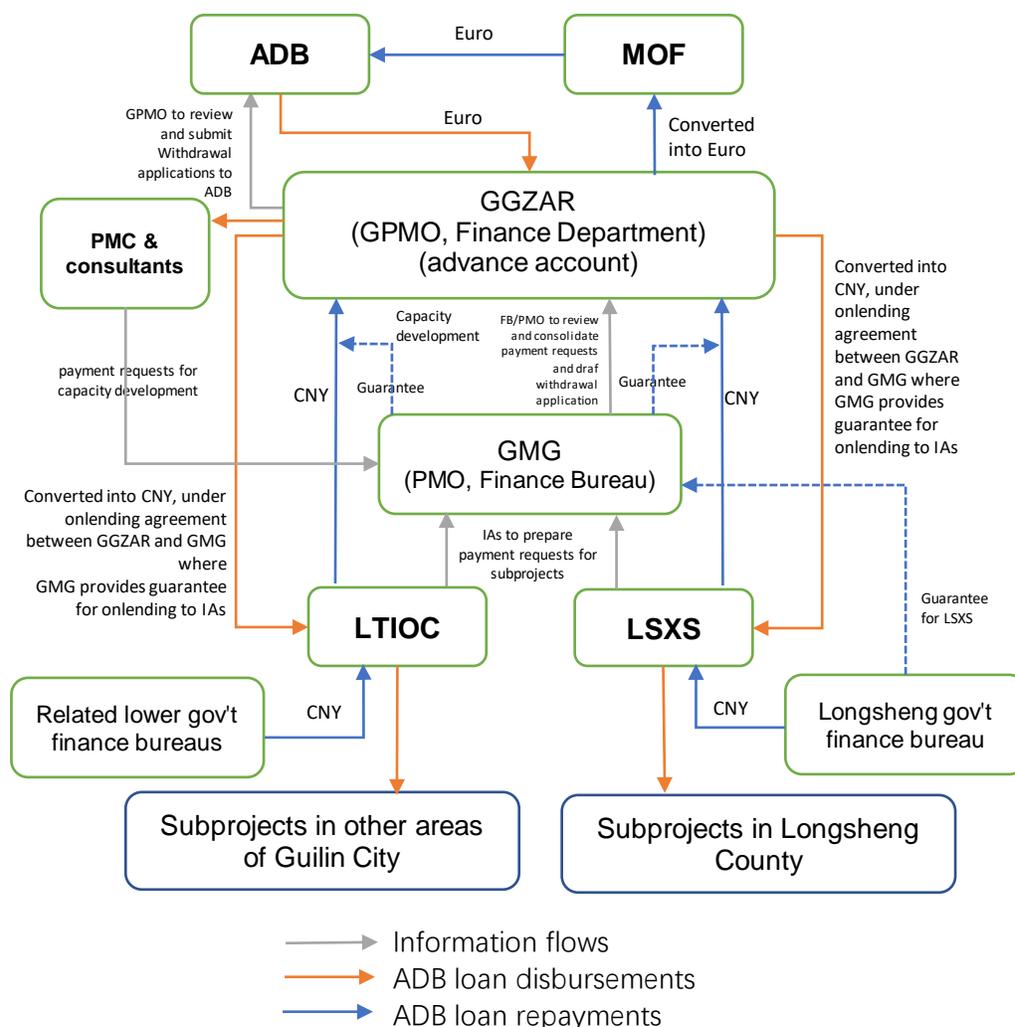
4. The overall assessment of the project financial management risk is moderate. The EA has set up a PMO for administering the loan project. Two IAs have been identified to implement 14 subprojects located within Li River Area and Longsheng respectively. The fund flow arrangement is assessed as practicable. The EA and its PMO follow cash-based accounting and public financial management system on budget preparation, publishing, and implementation, while the IAs as a corporation follow their own accrual based financial management systems. The financial staff of IAs are sufficient while that of the PMO is not in place at the time of assessment. The PMO is subject to project audit organized by the EA and the EA is subject to external audit by the GGZAR. The EA and PMO are required to regularly publish their annual fiscal budget and financial statements online. The IAs usually are subject to external financial audit but such audit only covers their corporate financial statements but not project accounts. As an integrated capacity enhancement solution, it is recommended that the PMO shall recruit qualified financial staff and hire one financial management consultant in time to help it and IAs improve internal control, project financial management system and financial reporting. Both the PMO and the two IAs are recommended to install computerized financial software with project accounting function and project consolidation function. To ensure the usage of funds for designated purposes, the direct payment method is recommended to be adopted by the IAs for subproject financing. In addition, it is necessary for the IAs to expand the scope of external audit to cover the related project accounts under the ADB loan project. In addition, trainings on ADB loan disbursement, financial management, procurement, safeguards, monitoring, and reporting are recommended to be provided to the PMO and two IAs. If the recommended mitigation measures are to be adopted by the related parties, the project financial management risk can be reduced to low.

IV. FUND FLOW

5. A comprehensive fund flow chart is illustrated in Figure 1 below. The PRC (the Borrower) will onlend the proceeds of ADB loan to Guangxi Zhuang Autonomous Region Provincial Government which will onlend the proceeds to GMG with the same lending terms and GMG will bear the foreign exchange and interest rate risk. The GMG will onlend relevant portions of the proceeds of the Loan to GLTICO and, through LCG, to LXICO. GZAR Finance Department will sign an on-lending agreement with the EA under which GZAR Finance Department is authorized by the EA with provision of repayment guarantee to directly transfer the ADB loan proceeds, after GZAR has converted the foreign currency of ADB loan into Chinese Yuan, to the two IAs for identified subprojects. For the loan proceeds to flow to the IAs, first, the IAs will prepare payment requests each quarter in accordance with subproject procurement plan using procurement approaches in line with the PAM and submit them to the PMO. Similarly, the project management consulting firm and individual consultants hired by the PMO to carry out the designated capacity development activities will prepare payment requests and timesheets in line with their TORs and periodically submit them to the PMO. The PMO then will review in cooperation with Guilin Finance Bureau and consolidate the received payment requests as per the PAM and draft withdrawal application and submit the withdrawal application as well as the supporting documents to the provincial finance department. The provincial finance department will then review and submit the withdrawal application based on the PAM and submit it to ADB quarterly. After verifying the withdrawal applications with the loan agreement, project agreement and the PAM, ADB will disburse the requested amount of loan proceeds in foreign currency to an advance account of Finance Department of Guangxi Zhuang Autonomous Region. The portion of ADB loan proceeds for capacity development may be transferred in foreign currency or in converted CNY as per the related consulting subcontracts from the advance account to the project management consulting firm or individual consultants and the loan proceeds for subproject construction will be converted

by the provincial finance department into Chinese Yuan (CNY) and the converted loan proceeds in CNY in the advance accounts will then be disbursed to related IAs as per the PMO reviewed and consolidated payment request. For the IAs to finance the identified subprojects, direct payment lending method, which has become normal in the People's Republic of China's (PRC) banking sector for project lending, is recommended to be adopted as much as possible. Such a fund flow arrangement is assessed practicable, but it is also noted that both the PMO and IAs do not have similar experience of implementing international financial institution projects and thus the related training on ADB loan withdrawal is necessary.

Figure 1: Fund Flow Chart



GGZAR = Government of Guangxi Zhuang Autonomous Region, GPMO = GZAR Project Management Office; PMC = Project management consulting firm PMO = (Guilin) Project Management Office,

V. PROJECT FINANCIAL MANAGEMENT SYSTEM COUNTRY LEVEL RISKS:

6. The PRC's public financial management (PFM) is aligned with the basic legislative framework, which is well structured to ensure national consistency while enabling provincial governments to adapt to their own economic situations on the condition that basic regulations are

compatible with the national system. The Budget Law of PRC was enacted in March 1994, revised in August 2014, and came into effect after January 2015. Under the budget law, all government revenues and spending must be accounted for under a unified budget. The local People's Congress is also given more power in authorizing and supervising fiscal budget management, the extent of revenue collection and expenditure, and budget adjustments. The law has strengthened oversight by the legislatures at all levels, and further enhanced the financial management of provincial governments.

7. The 1999 revision to the Accounting Law of PRC aimed at standardizing accounting methods, ensuring the propriety and completeness of accounting documents, and strengthening financial and economic management. The update of the Accounting Law in 2006 brought accounting and financial reporting standards in the PRC in substantial compliance with the International Financial Reporting Standards (IFRS). PRC's accounting standards have gradually converged with the IFRS since 1999 as a result of a series of revisions. The Accounting Law (2017), the Standard Rules for Enterprise Accounting (2000), and the Accounting Standards for Business Enterprises (ASBEs, 2006 updates) provides the framework of PRC's accounting system.

8. The updated Accounting Law brought accounting and financial reporting in the PRC into substantial compliance with IFRS. The Ministry of Finance (MOF) issued a policy called "Standards for Internal Controls for All Administrative Organizations" which came into effect in 2014 to promote transparency in the management and financial controls in all government agencies. The standards introduced methods of risk identification and control, and stipulated the methods of evaluation and supervision, budget management, revenue and expenditure management, government procurements, asset management, construction project management, and contract management.

9. Substantial progress has been made since the late 1990s in enhancing transparency and improving efficiency of budget management. Key initiatives have been placed in the Departmental Budget Reform, the Treasury Management Reform, and the Government Procurement Reform. The budget classification structure has been aligned with the International Monetary Fund's Government Financial Statistics, and a system of single treasury account for each international financial institution (IFI) loan has been established to track funds flows. The Budget law was amended in 2017 to further improve the accounting regulations and accounting supervision system, ensure accountability and integrity of the entity's accounting process and financial information, and increase the disciplinary measures in order to avoid fraudulent accounting procedures. The amended Budget Law resulted in improved budget management efficiency, especially at provincial and municipal levels.

10. The Auditing Law of PRC was revised in 2006 to improve the efficiency in public fund usage and advanced the establishment of a transparent government. In May 2010, it was amended to limit the publishing of audit results, define the mandate of auditing authorities, and clarify conditions for special audit and obligations of auditing firms.

11. No major country-level financial management issues have been noted as the country has a well-established public sector.

ENTITY LEVEL ASSESSMENT:

A. Financial Management System at the GZAR

12. GGZAR has so far undertaken several ADB-financed projects, such as Guangxi Baise Vocational Education Development Project, Guangxi Hezhou Mountain Mining Areas Vitalization Project, and Guangxi Regional Cooperation and Integration Promotion Investment Program tranche 1-3 etc., and therefore has practical knowledge and experience in ADB policies and procedures, which may be shared with the IA and IAs. The overarching provincial level financial management system and project management arrangement of GGZAR has been continually assessed by ADB with a sound result.

13. GGZAR has established a PMO to oversee the implementation of all IFI projects within GZAR including this ADB loan project. The PMO of GGZAR (GPMO) has received a lot of technical and financial support from donors and development financial institutions. As such, it has acquired a good level of familiarity and experience with donor requirements and processes. With knowledge transfer from the existing project management offices and consultants, it is expected that the GPMO will continue to gain proficiency in the financial management of donor-funded projects and can transfer the related knowledge and experience to the project PMO and IAs under the ADB loan project if needed.

B. Financial Management System at the EA and IAs

14. The EA, namely GMG, a government entity, is the main beneficiary institutions of the project. At the EA level a PMO has been established within the Development and Reform Commission of Guilin (Guilin DRC). It is supported by two IAs, GLTICO and LXICO, who are engaged to implement the identified 14 subprojects under the Project. The two IAs are both 100% state-owned enterprises (SOE). Particularly, GLTICO will be responsible for 13 identified subprojects in Li River area and LXICO for 1 identified subproject in Longsheng Autonomous County. The FMA was undertaken on the financial management systems of the EA and IAs.

15. **Budgeting.** The budgetary system of GMG, as in other municipal cities or counties, use line-item budget with cash accounting, providing transparent data on current revenues and expenditures. This type of budgeting ensures compliance with appropriations and strict controls on inputs. In line with the new Budget Law, all government revenues and expenditures including government debt will be included in a summary budget plan. Such plan will be prepared by budgetary units and subject to the approval of the standing committee of the local congress in Guilin. An annual financial report issued by the related finance bureau of the local governments is publicly available on the government's website, which includes the information on the approved budget and actual budget allocation at year end. For the proposed ADB loan project, the PMO is supposed to prepare the project budgets with necessary support from the related IAs. Because the financial management function of the PMO is to be newly established, it is assessed that financial management capacity enhancement is needed for the PMO to properly developing the budget plan, and the consolidated loan withdrawal plan etc. for all the subprojects under the Project.

16. **Accounting and Reporting.** The Accounting Law (2017), the Standard Rules for Enterprise Accounting (2000), and the Accounting Standards for Business Enterprises (ASBEs, 2006 updates) provide the framework of accounting system in PRC with which the EA and IAs should comply. The financial management assessment questionnaires replied by the EA indicate

that the EA's PMO adopt a cash-based accounting system whereby revenues and expenses are recorded upon receipt of cash or upon payment by cash respectively. This allows for the proper handling and recording of project financial transactions including (i) the allocation of expenditures in accordance with the respective components and their contract management, (ii) clear policies and procedures of handling the fund, namely payment, cash, and bank account, and (iii) safeguard over assets. GGZAR has implemented a lot of ADB loan projects. Consequently, GGZAR has established a sound financial management system within the GPMO, which includes effective internal controls, adequate financial reporting, and adequate retention policy of financial reports, among others. It is expected that such experiences can be extended to the PMO in Guilin and the related IAs through joint trainings organized by ADB and the GPMO. In addition, the EA, GMG, implemented a World Bank financed Li River Comprehensive Environment Improvement project between 1998-2008. It has accumulated some basic experience on disbursement, accounting, and reporting for IFI project.

17. From the subproject aspect, all two IAs have adopted an accrual-based accounting system in compliance with the Accounting Law, accounting standards for business enterprises and generally accepted accounting principles (GAAPs) of the PRC, which is deemed sufficient for project accounting as required by the ADB loan². The IAs also have established financial management systems accepted by the related government as sole shareholder for management accounting, financial planning, contract management, accounting, and fixed asset management that can supplement or enhance the capacity of EA for smooth implementation of the ADB loan project. In principle, all accounting records of the IAs' 14 subprojects will be kept in compliance with ADB requirement.

18. At present, neither the PMO, nor the two IAs have installed a computerized software that can automatically produce and report project-level financial statements although they have the basic entity-based accounting system installed. There is a need for at least the two IAs to install appropriate financial software or expand their existing financial software in line with the project implementation schedule to cover project-based accounting and project consolidation functions. Particularly, the financial management capacity at the PMO and GLTICO is recommended to be enhanced for appropriate consolidation, reporting and accounting reconciliation for the overall loan project through pursuing support from the capacity development component embedded in the base investment costs of the project.

19. **Staffing.** The EA has established a project leading group within the municipal government, under which a PMO was set up within the Guilin DRC. A deputy director of Guilin DRC was appointed as the PMO director, and the chief of foreign capital section of Guilin DRC was assigned as vice director of the PMO. Other office staff will be allocated from the PMO member agencies. Sufficient financial staff and project assistants are planned to be hired after the ADB loan agreement is signed in line with the project implementation schedule. Since the World Bank loan project for Comprehensive Environment Improvement of Li River was closed 12 years ago, most of the staff in the PMO will be new and thus still need to take necessary trainings with regards to ADB's disbursement, financial management, procurement, safeguards, and monitoring and reporting requirements. Such trainings are not difficult to organize since the provincial GPMO has rich related experiences and can help the PMO to build such capacity. TORs of the related

² Under the accrual method of accounting, revenues are recorded when they are earned, while expenses are recorded when these are incurred. In both instances, regardless of whether cash is received or is paid, the revenues and expenses are recorded at the time of earning in the case of revenues or at the time the expense is incurred as in a liability. That being the case, the cash-based report prepared by the IA's PMO can be used as a control to ensure the ADB loan proceeds are used for designated purpose while the PIEs' accrual reports on the receivable and payable accounts can be used as a base to assess the PIE's financial standing.

financial management consultant to be outsourced by the PMO will be provided to ADB for confirmation before the recruitment to ensure that the PMO will hire professionals with notable experience and capacity to undertake the financial management function of the loan project as a whole. At the subproject level, each IA has established an ADB loan implementation unit with enough qualified finance and accounting personnel designated to undertake the subproject financial management function. The IAs' implementation units will provide supplementary support to the IA's PMO for subproject financial management. Since none of the two IAs have prior experience in ADB funded projects, it is essential that all IA financial staff shall take the above-mentioned financial management training as well.

20. **Auditing, Internal Control and Reporting.** In compliance with the PRC regulation on auditing, internal control and reporting, the EA typically conduct internal audits on the performance of financial management responsibilities, budgeting, financial and asset management, and internal controls within functional departments of the government, lower governments and affiliated state-owned enterprises including the PMO and the two IAs. The EA itself is subject to provincial government GGZAR's audit. After years of implementation of the risk-based internal control standards enacted in 2014 and with experience accumulated from implementing IFI loans, internal audit, and control within provincial government authorities at municipal level in Guangxi has been greatly improved. It is found that the PMO do not have a professional in charge of internal audit, and each of the IAs has not set up a dedicated internal audit department either to carry out project specific audit. This is mainly resulted from their business nature and their reliance on the effective superior government's external audit. The major work of IAs is to organize financing and construct qualified environment-protection facilities that are supposed to be transferred to lower governmental entities once the construction is completed. Their own audit usually will not be accepted by the lower governments. And thus, they usually rely on a higher government-organized project acceptance audit as a form of control for each project construction, which is expected to be objective, cover all key aspects, and can be used as evidence for asset transfer to lower governments and in return for receipt of the scheduled investment return. Since both IAs are 100% SOE and their business is simply focused on fundraising and construction organizing, such a project audit arrangement has an effect of cost saving due to human power streamlining and is typically accepted by the share-controlling governments as well because the necessary control is still in place and is working.

21. With regards to external audit, the two IAs are required by law to have their corporate financial statements audited annually by an accounting firm accredited by higher level authorities. Since their establishment, external auditors of the relevant IAs have issued standard unqualified opinion on the audited financial statements. The external audit usually does not include project specific audit, which is to be required for the ADB loan project.

22. Although the existing audit and internal arrangement within the PMO and IAs is acceptable to the governments for their business as usual. For the proposed ADB loan project, lack of internal audit function within the PMO and IAs does constitute a control risk especially because ADB has special procurement, environmental and social safeguards requirements for subprojects to be qualified for subsequent loan disbursements. It is recommended that the PMO shall ensure that the financial management consultant to be recruited shall have rich experience in relation to project audit and shall cause him/her to help it organize regular internal control (checks) on all subprojects and annual project audits as required by ADB. The EA shall cause the related IAs to fully cooperate with the PMO's internal control actions including but not limited to engaging a 3rd party auditing firm if necessary, to ensure the subproject implementation is in compliance with the Project Administration Manual. Moreover, it is noted that, as a sovereign loan, the Project will be subjected to provincial audit agency's acceptance audit. As such, the overall audit arrangement

can be deemed acceptable to ensure proper financial management if the recommendation is adopted.

VI. RISK DESCRIPTION AND RATING

23. The risk assessment covered the following areas: the staffing, internal control, accounting and reporting policies and procedures, and auditing standards and arrangements for the loan project implementation. Based on the assessment, the overall financial management pre-mitigation risk is moderate. The risks and mitigation measures are summarized as follows.

1. Control Risk

24. Control risk is the risk that the project's accounting framework proves adequate to ensure project funds are used economically and efficiently for the purpose intended, and that the use of the funds is properly recorded.

25. Risks associated with the Project have been identified. The overall control risk finding is moderate. A summary of risk analysis is shown in Table 1 below.

2. Inherent Risk

26. Inherent risk is the susceptibility of the project financial management system to factors arising from the environment in which it operates, such as country rules and regulations and entity working environment (assuming absence of any counter checks or internal controls). The overall inherent risk at the country and entity levels is low.

Table 1: Financial Management Risk Rating and Proposed Mitigation Measures

Risk Description	Risk Assessment	Mitigation Measures or Risk Management Plan
A. Inherent Risk		
<p>1. Country specific</p> <ul style="list-style-type: none"> -There are sufficient skills, expertise, and experience in the field of public financial management in the country context -National accounting standards as issued by the Ministry of Finance are equivalent to Generally Accepted Accounting Principles (GAAP), International Financial Reporting Standards (IFRS) and acceptable to ADB. -Audit reports of supreme audit institutions are submitted timely in accordance with International Auditing Standards, and ADB requirements. -Experience in projects funded by international financial institutions indicates generally high financial management capacity. 	Low	None
<p>2. Entity specific</p> <ul style="list-style-type: none"> - Financial statements of the EA are prepared in a timely manner and audited and the PMO will follow the same practice. 	Low	Sustainability analysis on the fiscal strength of GMG and LACG from which the two IAs can get funding support has been done by ADB consultant before the loan approval

<p>-GGZAR and the EA have implemented IFI funded loan projects.</p> <p>- financial standing of the two IAs is weak compared to the loan amount to be borrowed by them and meanwhile the related governments (Guilin Municipal Government and Longsheng Autonomous County Government) are held responsible for provision of counterpart fund and repayment of the loan, which helps significantly mitigate the risk</p>		<p>and indicates that the fiscal budgets of GMG and LACG have no problem for counterpart fund and loan repayment. Loan assurance shall be made to ensure that the government will provide the required counterpart fund in time.</p>
Overall Inherent Risk	Low	
B. Control Risk		
<p>1. Implementing Entity</p>	Low	<p>All IAs are 100% SOE that are closely watched by the related government agencies and can be directed by the PMO as per the guidelines set out in the related ADB accepted Project Administration Manual.</p>
<p>2. Fund Flow</p> <ul style="list-style-type: none"> - Clearly defined fund flow arrangement which is currently being applied for many other ADB projects in GZAR - the PMO is responsible for spending the capacity development budget - Complicated composition of subprojects may mix the usage of funds 	Moderate	<ul style="list-style-type: none"> - The loan proceeds, including oversight of the advance account, will be managed by Finance Department of GZAR, which is experienced in fund flow oversight. Like previous ADB-financed operations in GZAR, the newly established PMO will be responsible for project management and coordination with support from Finance Department of GZAR. - the PAM will stipulate detailed selection procedure, budgets, and TORs the PMO shall abide by when choosing eligible consulting expert team/firm for the capacity development package. - approval of payment requests of the IAs will be subject to prior examination on the supporting documents by the PMO and Guilin Finance Bureau. - the IAs will establish or designate a bank account specially used for the loan project - the PMO shall ensure that all subprojects will pass the necessary assessments of ADB in advance before enlisted in the loan project

		- direct payment method shall be adopted by the IA to finance the subprojects to eligible service/equipment suppliers
<p>3. Staffing</p> <ul style="list-style-type: none"> - Accounting departments are well staffed with qualified and experience staff in the two IAs but currently the PMO has not hired financial staff; Moreover, although the provincial GPMO has rich experience with ADB procedures, the Guilin PMO and the 2 IAs have no such experience - neither the PMO nor the two IAs have internal audit department -financial management capacity of the PMO is critical and needs to be enhanced 	substantial	<ul style="list-style-type: none"> -GPMO will help ADB provide necessary guidance and training to the PMO and two IAs on ADB procedures -The PMO shall allocate enough financial staff within 3 months after the loan agreement is signed - each of the IAs shall hire a qualified staff with financial/audit background to take charge of internal control before the loan effectiveness -A financial management consultant will be recruited by the PMO for the loan project to assist in improving and standardizing the internal control system and project accounting and reporting systems in the PMO and IAs
<p>4. Budgeting</p> <ul style="list-style-type: none"> - Line-item budgeting practiced by IA 	Moderate	<ul style="list-style-type: none"> - the PMO will be trained by ADB and guided by the to-be-hired financial consultant on consolidating payment requests from various subprojects submitted by the two IAs and on preparation of annual project budget and updating it periodically. - the IAs shall support the financial management consultant hired by the PMO in improving its subproject budgeting and procurement planning practice - the IAs' project budgeting system after being improved by financial management consultant shall ensure the preparation of quarter, semiannual and annual budgets on a rolling basis, timed with government budgeting schedule to obtain ADB loan disbursements in time
<p>5. Accounting policies and financial management</p> <ul style="list-style-type: none"> -The PMO as a government agency practices a cash-based accounting system, while the two 	Substantial	-the PMO will also adopt accrual accounting for the ADB loan

<p>IAs practice accrual accounting in accordance with the PRC's GAAP, which are adequate for project accounting needed for the proposed ADB loan.</p> <ul style="list-style-type: none"> - The PMO and two IAs do not have a computerized financial software that can automatically generate project financial statements (LXICO even does not have accounting software) -The IA and PMO are subject to government fiscal budget management regulations and the two IAs have established a comprehensive system for planning and budgeting, financial reporting, fixed asset management with timely registry and periodic inventory check, and auditing. 		<p>project with help from the financial consultant to be hired</p> <ul style="list-style-type: none"> -Project accounting will be segregated from IA accounting and will be done by PMO with necessary support from the two IAs - LXICO shall install financial software - the IAs shall add project accounting and project consolidation function in its financial software
<p>5. Internal Audit</p> <ul style="list-style-type: none"> - Continuous routine internal audits are carried out for the IA as well as for all new investment projects. -GPMO has vast experience in ADB loan project auditing. - Both IAs do not have internal audit department and rely on government organized audit for internal control due to their business nature 	Substantial	<ul style="list-style-type: none"> - The GPMO will lend its ADB loan project auditing experience to the PMO and IAs - The financial management consultant shall help the PMO for organizing regular internal control (checks) and annual project audit on all subprojects with reference to the PAM. - as mentioned in the staffing section, each IA shall hire one qualified financial staff in charge of internal control- The two IAs shall provide all necessary support for the PMO organized regular internal inspections and project audits including engaging a 3rd party audit firm if necessary
<p>6. External Audit</p> <ul style="list-style-type: none"> -IAs are subject to both government project audit and annual external audit by auditing firms on their corporate financial statements. The loan project will undergo provincial government-organized audits after project completion, which arrangement is currently acceptable - External audit reports of EA's previous IFI projects have been submitted on time with standard unqualified audit opinions and the PMO will be subject to the same external project audit by provincial audit department. 	Low	<ul style="list-style-type: none"> -The loan assurances will ensure that the audited financial statements of the loan project will be submitted to ADB on time. - external inspection and audit by the government are strict. The related government agencies closely oversee the IAs' operation and conduct regular audit on investment projects implemented by the IAs for project acceptance, and disbursement of government payments is conditioned with prior approval by the related government authority.

		-External auditors acceptable to ADB will be contracted under the project. -External audit will cover the ADB loan project accounts at the IA's subproject level
7. Reporting and Monitoring Both the PMO and two IAs are not familiar with ADB's requirements on reporting and monitoring of loan project implementation progress	moderate	The PAM will include guidance on preparing progress reports and annual reports and trainings on reporting and monitoring will be provided by ADB
Overall Control Risk	Moderate	
Overall (Combined) Risk	Moderate	

ADB = Asian Development Bank, EA = executing agency, GAAP = Generally Accepted Accounting Principles, GGZAR = Government of Guangxi Zhuang Autonomous Region, GPMO = Guangxi Project Management Office, GMG = Guilin Municipal Government, IA = implementing agency, IFI = international financial institution, IFRS = International Financial Reporting Standards, LACG = Longsheng Autonomous County Government, LXICO = Longsheng County Xingsheng Urban and Rural Construction Investment Co., PAM = project administration manual, PMO = project management office, SOE = state-owned enterprise, TOR = terms of reference.
Source: Asian Development Bank.

VII. PROPOSED ACTION PLAN

27. The mitigation action plan below is proposed to be implemented to bring the risk rating of the Project from moderate to low.

Table 2. Proposed Time Bound Action Plan

Weakness	Mitigation Actions	Responsibility	Timeframe
Staffing – Strengthen financial staff and audit capacity	-The PMO shall hire qualified finance staff to fill the positions in the PMO with TORs acceptable to ADB -the PMO shall recruit a qualified financial management consultant with TOR acceptable to ADB to assist in the establishment of improved and standardized internal control system and project financial management system at the PMO and IAs - GPMO will lend its project financial management experience to PMO and IAs in the conduct of	PMO, IAs and ADB	- Qualified financial staff (cashier and accountant) to be hired by the PMO within 3 months of loan signature. - Recruit a financial management consultant within 3 months of loan effectiveness - GPMO and ADB will provide trainings to PMO and IA financial staff on ADB procedures by the 6 th month from loan effectiveness and have regular financial management including project auditing and reporting, disbursement training programs throughout the project implementation

	project financial management.		
Funds flow	Direct payment to suppliers and consultants	IA and ADB	-direct payment will be adopted by the IA to pay ADB's share of project costs to a maximum extent during the entire loan disbursement period.
Accounting system- manual preparation of project financial statements by IAs shall be improved	The financial software of IAs shall expand to cover project accounting function to automatically generate project financial statements	IAs	Within 6 months after loan effectiveness
Auditing – PMO conducts regular project audits	The financial management consultant recruited by the PMO will provide advices on how to conduct proper project audit to the PMO and IAs External auditors will be recruited by the IAs to cover the audit of ADB loan project accounts	PMO, IAs and ADB	-PMO should ensure timely submission of annual audited project financial statements as stipulated in the loan agreement. -IAs to submit timely financial reports, for consolidation and subsequent audit

ADB = Asian Development Bank, EA = executing agency, GPMO = Guangxi Project Management Office, GMG = Guilin Municipal Government, IA = implementing agency, IA = project implementing entity, IFI = IFRS = International Financial Reporting Standards, LACG = Longsheng Autonomous County Government, LXICO = Longsheng County Xingsheng Urban and Rural Construction Investment Co., PAM = project administration manual , PMO = Project Management Office (for the proposed loan project)

VIII. CONCLUSION

28. The overall financial management risk of the project is moderate. While the inherent risk is low, the control risk is moderate. The FMA identified the following major risks: the financial staff of the PMO are not in place at present, the PMO and the two IAs have no knowledge of the ADB's fiduciary requirement and procedures, funds may be misused due to complicated subprojects, the financial software of the two IAs cannot automatically produce project financial statements, and the PMO and IAs do not have internal audit department or function. To mitigate these risks, the following actions will be undertaken: (i) qualified financial staff of the PMO shall be designated in time; (ii) direct payment will be adopted to pay ADB's share of project costs as much as possible; (iii) experienced and qualified financial management consultant will be recruited by the PMO to help the PMO and IAs to establish improved project financial management and reporting system; (iv) external audit of IAs shall include the audit on ADB loan project accounts; (v) all financial staff of PMO and IAs will attend the financial management training organized by GPMO and ADB; and (vi) the IAs shall expand their financial software to include the project accounting and consolidation function. With the implementation of these actions, the project's financial management arrangements will satisfy the ADB's requirements under the Project.