

Financial Management Assessment of Small Farmers Development Bank and Small Farmers Agriculture Cooperatives

Currency Equivalents
(as of 20 September 2019)

Currency unit	–	Nepalese rupees (NPR)
NRs1.00	=	\$0.0087
\$1.00	=	NRs114.12

ABBREVIATIONS

ADB	–	Asian Development Bank
AGM	–	annual general meeting
BFIA	–	Bank and Financial Institution Act
BoD	–	board of director
CBS	–	core banking software
CEO	–	chief executive officer
CPIA	–	Country Policy and Institutional Assessment
DOC	–	Department of Cooperatives
FY	–	fiscal year
FMA	–	financial management assessment
GoN	–	Government of Nepal
IT	–	information technology
KYC	–	know your customer
MFI	–	microfinance institution
MIS	–	management information system
MoA	–	memorandum of association
MOF	–	Ministry of Finance
NEPSE	–	Nepal Stock Exchange Limited
NFRS	–	Nepal Financial Reporting Standards
NRB	–	Nepal Rastra Bank
OCR	–	Office of Company Register
PAR	–	portfolio at risk
RMC	–	risk management committee
RoA	–	return on assets
SEBON	–	Securities Board of Nepal
SFAC	–	Small Farmers Agriculture Cooperative
SFDB	–	Small Farmers Development Bank
VDC	–	Village Development Committee

NOTES

- (i) The fiscal year (FY) of the Government of Nepal ends on 15 July. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2019 ends on 15 July 2019.
- (ii) In this report, “\$” refers to United States dollars.

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EXECUTIVE SUMMARY

Objectives. The assessment was conducted to (i) assess the capacity, procedural and organizational constraints that can hinder project implementation; (ii) identify financial management risks and establish appropriate monitoring and supervision processes to mitigate these risks; (iii) assess Small Farmers Development Bank (SFDB) and selected small farmers agriculture cooperatives (SFACs) financial performance, risk management structure, capacity, etc. in view of implementing the Asian Development Bank (ADB)'s financial intermediary loan; and (iv) assess SFDB and selected SFACs' governance.¹

The overall financial management risk for the project is assessed as **Moderate**. The executing agency, Ministry of Finance (MOF), has prior experience administering donor-funded programs including ADB projects. The implementing agency, SFDB, has experience in development assistance including ADB projects. It also has reasonable governance, monitoring and reporting frameworks and standards in place. SFACs also have reasonable governance structure in place but monitoring and reporting frameworks and standards needs to be improved.

Key risks identified include (i) weak governance; (ii) prolonged political transition, continued weak portfolio performance and poor sustainability of assets; (iii) financial management practices in SFDB and SFACs; (iv) staffing, internal control and management information system (MIS) practices in SFDB and SFACs; and (v) credit default risks from SFACs and end-borrowers. Appropriate risk mitigation measures are proposed in Table 8.

¹ Sana Kisan Bikas Laghubitta Bittiyasanstha Ltd or commonly called SFDB.

I. INTRODUCTION

1. This financial management assessment (FMA) assesses the capacity of MOF as executing agency, SFDB as implementing agency and 20 selected partner SFACs. These sample SFACs were selected by SFDB based on their experience, existing portfolio size, financial indicators and willingness to participate in the program. The assessments were conducted between April 2019–May 2019.

II. COUNTRY AND SECTOR FINANCIAL MANAGEMENT

2. **Country policy and institutional assessment.** Nepal ranks sixth in South Asian economies, the second lowest of the developing member countries in South Asia from 2013 to 2016 for the World Bank's Country Policy and Institutional Assessment (CPIA)'s public sector management and institutions cluster.²

Table 1: Public Sector Management and Institutions Average, 2013–2016

Countries	2013	2014	2015	2016
Bangladesh	2.9	2.9	2.9	2.8
Bhutan	3.9	3.9	3.8	3.9
India	3.6	N.A.	N.A.	N.A.
Maldives	3.2	3.2	3.1	3.1
Nepal	3.1	3.1	3.1	3.1
Sri Lanka	3.3	3.3	3.4	N.A.

N.A. = not applicable.

Note: One is the minimum and six is the maximum.

Source: World Bank Group, Country Policy and Institution Assessment database.

3. **Improving portfolio performance.** Nepal's Country Partnership Strategy places particular emphasis on improving portfolio performance. The specific measures to do this include (i) ensuring higher project readiness filters; (ii) using project preparation facilities; and (iii) strengthening project management expertise, including planning, monitoring, and troubleshooting. This will build on the existing quarterly and annual review process and Nepal portfolio performance review. More resources will be provided to increase the capacity of Nepal's institutions and to improve asset management. ADB will also work on sector-related fiduciary oversight measures.³

4. **Microfinance sector in Nepal.** Microfinance institutions (MFIs) in Nepal are regulated by Nepal Rastra Bank (NRB). Banks & Financial Institutions Licensing Policy-2006 and Bank & Financial Institution Act-2017 are the governing regulations for MFIs. In addition, NRB issues directives to MFIs to ensure smooth operation of MFIs.

5. MFIs are broadly categorized into national- and regional-level based on the paid-up capital. Further, depending on operation, wholesale and retail MFIs are required to have minimum paid up capital of NRs10 million–NRs600 million.

² The World Bank's CPIA quantifies the qualitative aspect of a country's policies and institutions. This cluster measures property rights and rule-based governance, quality of budgetary and financial management, and transparency, accountability, and corruption in the public sector in a country

³ ADB. *Country Partnership Strategy. Nepal: 2013–2017*. Manila.

Table 2: Capital Requirement of MFIs

Particulars	National Level	Regional Level	4-10 Districts	1-3 Districts
Retail MFIs minimum paid up capital	NRs100M million	NRs60 million	NRs20 million	NRs10 million
Wholesale MFIs	NRs600 million	N.A.	N.A.	N.A.

MFI = microfinance institutions, N.A. = not applicable.

Source: NRB bank & financial institutions licensing policy -2006.

6. Currently, there are 82 MFIs licensed and supervised by the NRB. These MFIs have approximately 3 million saving members and 2 million borrowing members. In fiscal year (FY) 2017–2018, MFIs mobilized NRs157.98 billion in loan, NRs96.93 billion in borrowings and NRs53.51 billion in deposits.⁴ MFIs are a major source of rural enterprises finance. Average micro-, small-, and medium-sized enterprise financing by MFIs was 11% of total outstanding loan as of October 2018.⁵ However, it is difficult for MFIs to provide enterprise financing due to (i) asset-liability duration mismatch (liability i.e., funding is normally for a year and micro-, small- and medium-sized enterprise loan duration is typically 18–36 months); (ii) MFIs' limited sources of funding; and (iii) MFIs' limited knowledge and capacity in rural enterprise financing.

7. MFIs in Nepal must comply with the Nepal Financial Reporting Standards (NFRS) from FY 2018–2019 as adopted by the Institute of Chartered Accountants of Nepal. MFIs also require engaging NRB-approved external auditor to conduct audit of statements within 6 months of the closure of financial year. Furthermore, NRB makes annual onsite and offsite inspection of MFIs to ensure compliances of directives issued. In addition, MFIs are required to send monthly and quarterly report to NRB on the prescribed format.

III. PROJECT FINANCIAL MANAGEMENT SYSTEM

A. Executing Agency's Institutional Capacity

8. The Financial Sector Management and Corporation Coordination Division, MOF will be the executing agency. It has prior experience in administering similar donor-funded programs including those of ADB. It has the oversight capabilities needed to oversee the financial soundness and governance of the SFDB and the SFACs.

9. **Project steering committee.** A project steering committee as detailed below has been proposed at the executing agency which is expected to meet at least once annually:

- (i) Secretary of Ministry of Finance (MOF) – Chair,
- (ii) Joint Secretary, Financial Sector Management and Corporation Coordination Division (FSMCCD),
- (iii) Executive Director, Microfinance Promotion and Supervision Department, Nepal Rastra Bank (NRB),
- (iv) SFDB Chief Executive Officer (CEO), and
- (v) SFDB representative as the secretariat.

10. Further, a project implementation unit will be established at SFDB. It will be headed by a project coordinator. The project implementation unit will implement and monitor the project implementation, coordinate with technical assistant consultants, and report project progress to MOF and ADB.

⁴ NRB publication: progress report on MFI as of October 2018.

⁵ NRB publication: progress report on MFI as of October 2018.

B. Implementing Agency's Financial Management Capacity

11. SFDB was established in July 2001 and licensed by the NRB as a microfinance (class D) institution. It is a wholesale microfinance owned by SFACs, commercial banks and general public. Its main objective is to improve the lives of the rural poor and promote access to finance to small farmers especially those in the hills and mountain areas.⁶

12. **Corporate governance.** The annual general meeting (AGM) is the apex body of SFDB. AGM nominates or elects the Board of Directors (BoD) for a term (generally a 4-year term), approves the financial statements and management report. In addition, AGM appoints and fix remuneration of external auditor.⁷

13. The BoD is primarily responsible for policy formulation and approval of annual budget as well as strategic guidance. In addition to the BoD, the following sub-committees headed by a non-executive board member are actively engaged and governed by respective terms of reference, as mandated by NRB's directives: (i) Audit Committee; (ii) Staff Management and Service-Facilities Committee; (iii) Risk Management Committee; and (iv) Anti-Money Laundering Monitoring Committee. Furthermore, the following sub-committees headed by the Chief Executive Officer (CEO) and the Deputy CEO respectively, are functioning to expedite the day-to-day operation of SFDB: (i) Loan Sub-committee and (ii) Hiring Sub-committee.

14. **Composition of Board of Directors, qualification and experiences.** The BoD comprises of seven representatives; four from promoter group, two from general public and one independent professional director appointed by the BoD. The BoD elects and nominates the chairman among themselves. Each member of the BoD is either nominated or elected by the AGM from their respective shareholder group for a 4-year term. Section 14(3) of Bank and Financial Institution (BFIA) 2017 requires one independent professional director in the BoD of licensed MFIs.

15. **Human resources.** Human resources-related activities are governed by the Human Resource Policy-2005. SFDB follows a stringent recruitment and development process. Vacant and newly created positions are published in newspapers or other platforms and competitive recruitment process is adhered to select suitable candidates. The Hiring Sub-committee headed by the deputy CEO is responsible for the new hire.

Table 3: Number and Composition of Human Resources

SN	Service Type	Number of Staffs			Vacancies for 2017–2018
		Female	Male	Total	
1	Permanent staff	15	53	68	90
2	Contract staff	0	26	26	11
3	Brought in transferring from other institution	0	1	1	-
4	Daily wage-based staff	3	1	4	4
5	Staff from projects	-	-	-	-
TOTAL		18	81	99	101

Source: Small Farmers Development Bank Annual Report 2017/18.

16. In FY2017–2018, SFDB heavily relied on the contract staff and hired 26 contract staffs against the budgeted 11. The permanent staff were 68 against the budgeted 90. Contract and

⁶ www.skbbbl.com.np.

⁷ Company Act 2073 Section 67-86.

daily wage staff constituted 30.30% of total workforce in the FY2017–2018 which may result high staff turnover rate.

17. **Experience on donor funded program.** In the past, SFDB implemented various donor funded programs including Rural Finance Sector Development Cluster Program (I & II). Details of donor-funded program are summarized below.

Table 4: Details of Donor-Funded Programs

Project	Budget (USD)	Expected Outcome
Disaster Risk Reduction and Livelihood Restoration for Earthquake Affected Communities, Project funded by ADB Duration: 2015–March 2019	Credit: 5.5 million Training: 1.5 million	Livelihood restoration credit to earthquake affected 15,700 families. Earthquake resilience training to about 1600 people. Disaster risk management training - 730 people
Kisankalagi Unnat Biubijan Karyakram—Improved Seeds Project Duration: 2012 to 2019	Grant: 1.7 million Loan: 8 million	Establish 75 SFACs and access to finance to 32,000 members
Sakchyam Project funded by DFID Duration: 2018- 2020	Grant: 1.3 million	Establish 40 New SFACs in Karnali Province to enhance access to finance
Clean Start project of UNCDF Duration: 2014–2019	Loan: 0.16 million	Loan to install 45,000 solar home system and Improved cooking stove
Rural Finance Sector Development Cluster Program-II funded by ADB Duration: 2011–2016	Loan and Grant: 3.1 million	Restructuring of SFDB and Strengthening of SFACs to expand financial services to additional 360,000 clients. Expansion of financial services in the hills and mountain
Rural Finance Sector Development Cluster Program-I funded by ADB Duration:2009–2010	Loan and Grant: 0.5 million	Restructuring poor performing SFACs Strengthening of SFDB

ADB = Asian Development Bank, DFID = Department for International Development of the United Kingdom, SFAC = small farmers agriculture cooperative, SFDB = Small Farmers Development Bank, UNCDF = UN Capital Development Fund.

Source: Small Farmers Development Bank.

18. **Selection of SFACs and lending process.** SFDB practices disciplined criteria to select the SFACs. Selection is based on general and financial indicators as detailed in following table.

Table 5: Small Farmers Agriculture Cooperative General Selection Criteria

Registered as a cooperative
At least two years of experience in providing savings and credit services after registration
No cumulative loss in the balance sheet and earned profit during the fiscal year when assessment was conducted
Potentiality to increase outreach and business
Develop three years business plan
Proper record keeping, in a double entry bookkeeping system
Regularity in general assembly and board meetings
No delinquent loans with board of directors, staff and their family members in the cooperative and other financial institutions

Table 6: Small Farmers Agriculture Cooperative Eligibility Criteria

SN	Indicators	Year of SFDB Membership		
		Year 1	Year 2	Year 3
1	Number of members	250	300	400
2	Percentage of female members	>40%	>50%	>60%
3	Internally generated fund	NRs2 million	NRs3 million	NRs4 million
4	Internally generated funds / Outstanding loan	>30%	>35%	>40%
5	Capital adequacy			
6	Primary capital	2	4	5
7	Total capital	5	8	10
8	Operational self-sufficiency	>100%	>105%	>110%
9	Repayment rate	>80%	>90%	>90%
10	Return on equity	>1%	>2%	>3%
11	Operating expenses ratio	<5%	<4%	<4%
12	Net worth	Positive	Positive	Positive

Source: Small Farmers Development Bank.

19. **Credit services.** SFDB provides wholesale credit to SFACs and other MFIs of similar nature to relend to their members. Lending practices and procedures of SFDB is governed by the lending policy of SFDB, NRB directives to MFIs and good practices and premises of microfinance. The prevailing credit facilities of SFDB have predefined target communities for disbursement. SAFCs or MFIs should utilize credit facilities from SFDB to provide loans to the following groups:

- (i) family with land area, up to 0.76 hectare (ha) (15 Ropanis) in hill and up to 0.67 ha (1 Bigah) in Terai;
- (ii) individual or family with no regular income and having difficulties for livelihood;
- (iii) individual or the family with no due loan to be paid to other banks and financial institution and government; and
- (iv) deprived communities such as-Dalits, Janajatis, Madhesis, marginalized people, women and SMEs.

20. The borrowers have to comply with specific requirements outlined above to get credit facilities (normally term loan) from SFDB. The credit facilities from SFDB does not require any collateral but personal and institutional guarantee of board members and respective borrowers (SFAC and MFIs) are required. In addition, borrowers have to maintain at least 5% of outstanding loan in Client Security Fund account maintained with SFDB. Interest is paid on Client Security Fund as determined by SFDB (at present 7% if contribution is up to 8.5% and 8% if contribution is beyond 8%). Normally, duration of credit facilities is 3 years.

21. Credit sanction limit is guided by the lending policy of SFDB. At present, branch managers are allowed up to NRs110 Million whereas CEO can sanction up-to NRs150 Million. Prior approval from the Board is required beyond the prescribed limited. However, an individual borrower exposure limit is set at 25% of the core capital of SFDB.

Table 7: Loan Demand Frequency and Approval Limit of Area and Central Office (NRs)

Loan Approval Limit	Branch Office	Head Office
1st Phase	2.5 million– 5 million	10 million
2nd Phase	5 million -10 million	15 million
3rd Phase	90 million -110 million	150 million

Source: Lending Policy - 2009 of SFDB.

22. As of 14 January 2019, the largest outstanding loan was NRs215.28 million and cumulative loan of top 20 borrowers stood NRs3,420.09 million which represented 19.68% of outstanding loan.

23. Credit sanction process is relatively simple and straight forward. SFACs send duly filled credit demand forms to SFDB during March–April. SFDB collects the demand forms from all SFACs during its annual budgeting. Based on the availability and proposed program of SFACs, SFDB sanctions the credit limit to each SFACs and informs them during June-July. Once the credit limit is sanctioned, SFACs can withdraw according to their disbursement schedule to small farmers.

24. **Core banking software (CBS), information technology (IT) and management information system (MIS).** SFDB, at present, uses Mangus, a customized standalone CBS for banking transaction in branches. Departments and Head Office use spreadsheets for the banking as well as operating transaction and record keeping. As the CBS is standalone, MIS is not real time. Branches send the report to the head office in spreadsheets. The head office subsequently consolidates the report to generate statutory reports as well as required MIS for decision making.

25. Inherent deficiency of standalone software like Mangus poses serious operational risk to SFDB as the CBS is not integrated to handle ever growing balance sheet size and number of clients. In addition, SFDB doesn't have a business continuity plan and disaster recovery plan. Furthermore, prevailing back up practices of SFDB is not prudent which increases serious operational as well as reputational risks in case of natural calamities.

26. SFDB is currently testing "Pumori" a proven CBS widely used by financial institutions in Nepal. However, transition from Magnus to Pumori has yet not been finalized. So, it is imperative to enhance current data back and protection mechanism to protect SFDB from serious operational as well as reputational risk in case of man-made or natural calamities.

27. **Financial reporting.** SFDB needs to implement NFRS from FY2019–FY2020. In addition, SFDB has financial management bylaws, accounting policy and duly approved chart of accounts. SFDB also ensures stringent demarcation between authorization, execution and recording of the transactions. General ledgers, subsidiary ledgers and bank accounts are reconciled monthly and outstanding non-reconciled items are treated as "priority". Variations on the actual and budgeted expenditures are tracked on quarterly basis. Variations require prior approval from competent authority (if the variation is beyond 20%, approval from the BoD is required).⁸

⁸ As briefed by SFDB official during due diligence interview.

28. Accrual based accounting system is followed (interest income on the loan is accounted on cash basis as per the regulatory requirement). Payments are made through cheque except petty cash. Petty cash management is guided by the financial management by-laws. Dual signatures with respective predefined authorities are required to operate bank accounts. The cheque books and passwords are handled by the designated staffs only. Automated payroll management system is in place to manage the payroll. SFDB also maintains contract-wise accounting records to indicate gross value of contract, and any amendments, variations and escalations, payments made, and undisbursed balances are recorded accordingly and regular reconciliation is carried on the undisbursed items.

29. In addition, for any new projects, SFDB maintains separate books of accounts and registers, and prepares annual financial statements comprising of (i) comprehensive income statement, (ii) statements of cash flow, (iii) statement of financial position, and (iv) notes to the account. It also prepares and submits quarterly financial reports on the project expenditures to the donors.

30. **Internal audit.** SFDB has an independent internal audit department which reports directly to the audit committee. The audit committee approves internal audit plans and programs. The head office, all the branches and major clients, on sampling basis are audited at least once in a year. The audit committee reviews the audit reports on quarterly basis and directs the management for corrective actions if required. Separate audit plan and programs are developed for donor funded program or projects undertaken by SFDB.

31. The internal audit is conducted as per the internal control bylaws of SFDB, NRB directives for MFIs and Nepal Standards on Auditing.

32. Currently, internal audit department is staffed with 2 audit professionals. Department is headed by an audit professional who has 30 years of experience in audit and inspection and supported by a chartered accountant who has reasonable experience. In addition to the regular audit, internal audit department is responsible for donor funded programs and projects. As the business or programs grow, current strength of internal audit department may not be sufficient to undertake additional responsibilities. Furthermore, internal auditors may not have sufficient knowledge and understanding of ADB's guidelines and procedures, including the disbursement guidelines and procedures. Internal auditors also do not have IT background or IS audit qualifications, which may limit their skills and expertise to conduct IS audit.

33. **External audit.** An external auditor, appointed by the AGM conducts external audit and reports to shareholders in the AGM. The remuneration and terms of reference of the external auditor is also fixed by the AGM. External auditor's responsibility is to express an opinion on the financial statements prepared by the management. External auditor conducts its audit in accordance with Nepal Standards on Auditing. Those standards require that external auditor comply with ethical requirements, and plan and perform audit to obtain reasonable assurance whether the financial statements are free from misstatements.

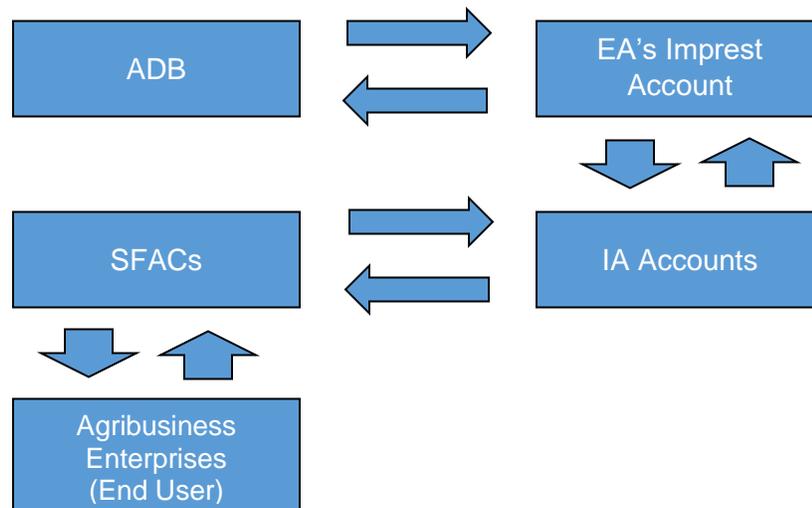
34. The external auditor is responsible for program or projects audit, but external auditor may not have sufficient knowledge and understanding of ADB's guidelines and procedures, including the disbursement guidelines and procedures. SFDB should inform and update external auditor about ADB's guidelines and procedures, including the disbursement guidelines and procedures.

C. SFACs Financial Management Capacity

35. 20 selected SFACs are assessed for preparatory phase. All the SFACs are duly registered with the Department of Cooperatives (DOC) and regularly filing regulatory requirements to DOC. Financial statements are prepared in accordance with local generally accepted accounting principles. All the SFACs have independent audit committee but the effectiveness most of the audit committee could not be confirmed. External auditor is appointed by AGM (most of these SFACs use class B register auditor as an external auditor than class A chartered accountant).

36. In some of SFACs, there is no segregation of duties as total number of staffs are limited to 2–3. SFACs obtain personal guarantee, collateral and other documents for loan disbursal. Though all these SFACs operate in computerized working environment and uses “saraal bitta” software, data management and backup system are not adequate (financial management of practices of SFACs are detailed in Appendix 3).

Figure 1: Fund Flow Arrangements



IV. RISK DESCRIPTION AND RATING

37. Financial management, internal control and risk management assessment was conducted. The executing and implementing agencies have experiences on ADB's program management and implementation. The overall risk is rated **Moderate (M)**.

Table 8: Risk Assessment and Rating

Risk	Risk Assessment	Risk Rating	Risk Mitigating Measures
Inherent Risk			
1. Country-specific risks (Nepal)	Weak governance	Moderate	The government has initiated PFM and public procurement reforms at the national and local levels. ADB will assist with these in conjunction with other development partners but will do this at the project level. Projects will include measures to mitigate fiduciary risks while ensuring accountability and transparency. ADB will collaborate with other partners to

Risk	Risk Assessment	Risk Rating	Risk Mitigating Measures
			strengthen the capacity of integrity institutions such as the Commission for the Investigation of Abuse of Authority and National Vigilance Centre.
	Continued weak portfolio performance	Moderate	ADB will step up efforts to increase project performance by (i) establishing a project preparatory facility, (ii) applying new project readiness filters, (iii) extending project preparatory facility to core sectors, and (iv) building implementation capacity in key agencies. ADB will also (i) strengthen the monitoring and trouble-shooting system for project implementation; and (ii) improve the quarterly and annual country portfolio performance reviews.
	Poor sustainability of assets	Moderate	Sustainability of the project will be ensured through proper allocation of funding, effective project planning and design. The capacity enhancement of project will be done for sustainability.
	Newly adopted federal system of government could impeditment project implementation	Moderate	Nepal newly adopted federal system of government could impeditment project implementation as there are still confusion among central, state and local governments on authorities and responsibilities about different public works. The risk will be managed by maintaining flexibility in project implementation.
2. Entity-specific risks	Financial management practices in SFDB and SFACs. CBS and MIS	Moderate High	TA will support on capacity building for SFDB and participating SFACs. Audited statement of utilization of fund will regularly be obtained from SFDB and SFACs. CBS and MIS will be automated. Business continuity plan and disaster recovery plan will be prepared and implemented.
3. Project-specific risks	Limited institutional experience of SFDB and SFACs on project/enterprise financing. Limited exposures of credit staffs on project/enterprise financing. Ability of SFDB and SFACs to disburse the fund and monitor	Substantial	Institutional capacity of SFDB and SFACs on project/enterprise financing will be enhanced through TA. SFDB will select SFACs based on their experience, financial and management capabilities and proper fund utilization plan. Development of a comprehensive credit manual for enterprise financing and training of credit staff.

Risk	Risk Assessment	Risk Rating	Risk Mitigating Measures
	effective utilization of fund.		
Overall Inherent Risk		Moderate	
Control Risk			
Internal controls	SFDB's internal control is adequate. However, internal audit department is not adequately staffed due to which the internal audit and compliance may not be able to adequately cover the enhanced portfolio after ADB project.	High	Currently, internal audit and compliance department has 2 staffs. Capacity of internal audit department needs to be enhanced.
Funds flow	Fund flow arrangement is transparent	Low	Fund flow arrangement between ADB, EA, IA and SFACs and vice versa is transparent.
Human resource in internal audit, account & finance and credit department	Internal audit, account & finance department staffs do not have adequate experience on ADB's guideline and procedures. Credit department staffs possess limited exposure and experience on project/enterprise financing and risk management practices.	Moderate	Adequate staffs with exposures on ADB's guideline and procedures should be ensured in internal audit, account & finance department. Furthermore, capacity enhancement of internal audit, account & finance and credit department will be done through trainings on ADB's process and procedures and project/enterprise financing and risk management practices.
External audit	Independent external auditor appointed by AGM conducts external audit. External audit practices of SFDB are adequate. However, external auditor may not have adequate experience on ADB's guidelines and procedures.	Low	SFDB should ensure that external auditor adheres ADB's guidelines and procedures.
Overall Control Risk		Moderate	
Overall Risk		Moderate	

ADB = Asian Development Bank, CBS = core banking system, EA = executing agency, IA = implementing agency, MIS = management information system, PFM = public finance management, SFAC = small farmers agriculture cooperative, SFDB = Small Farmers Development Bank, TA = technical assistance.

V. PROPOSED TIME BOUND ACTION PLAN

Table 9: Proposed Action Plan

Weakness	Agreed Action	Responsible Party	Agreed Completion Date
1. Outdated core banking, IT and MIS at SFDB and SFACs	Core banking system and MIS will be upgraded and integrated with real time MIS. Business continuity plan and disaster recovery plan will be established.	SFDB	12 months after the loan effectiveness
2. SFDB's heavy dependency on short-term borrowings from financial institutions results in unpredictable and volatile interest rate structure	Long-term borrowing from external sources should be prioritized to establish a more stable interest rate structure. External borrowing sources will be explored.	SFDB	Throughout the implementation period
3. Weak capacity in financial management of SFDB and SFACs could undermine project implementation	The attached TA will support SFDB and SFACs in building capacity in all aspects of financial management including credit appraisal and risk management. Required project reporting will provide early warning of deteriorating credit quality. Audited statements of utilization of funds and audited financial statements of SFDB and SFACs will be collected.	ADB, SFDB, SFACs	Throughout the implementation period
4. Inadequate human resources in SFDB's internal audit department may increase risks in financial management	SFDB's internal audit department will be strengthened and its capacity will be developed as per the ADB project administration requirement under the attached TA.	SFDB	Throughout the implementation period.
5. SFDB's and SFACs' limited institutional experience on enterprise financing may result in inability to disburse the fund or monitor effective utilization of funds	The attached TA will enhance institutional capacity of SFDB and SFACs on enterprise financing including product design, pricing and risk management. SFACs will be selected based on their past experience, financial and management capacity and proper fund utilization plan.	ADB, SFDB	Throughout the implementation period

Weakness	Agreed Action	Responsible Party	Agreed Completion Date
6. Internal control mechanism at SFDB and SFACs may not be adequate.	Capacity of Internal Audit and Compliance Department will be enhanced. A dedicated internal audit professional in the internal audit department will be appointed. Proper real time reporting and monitoring framework for SFACs will developed at PIU.	SFDB	Within 3 months after the loan effectiveness
7. Key policies and procedures like KYC, Risk Management are yet to be approved and implemented in SFDB. In addition, SFDB does not have IT policy.	KYC and risk management policies and procedures will be approved. IT policy will be developed.	SFDB	Within 3 months after the loan effectiveness Within 12 months after the loan effectiveness

ADB = Asian Development Bank, IT = information technology, KYC = know your customer, MIS = management information system, SFAC = Small Farmers Agriculture Cooperative, SFDB = Small Farmers Development Bank, TA = technical assistance

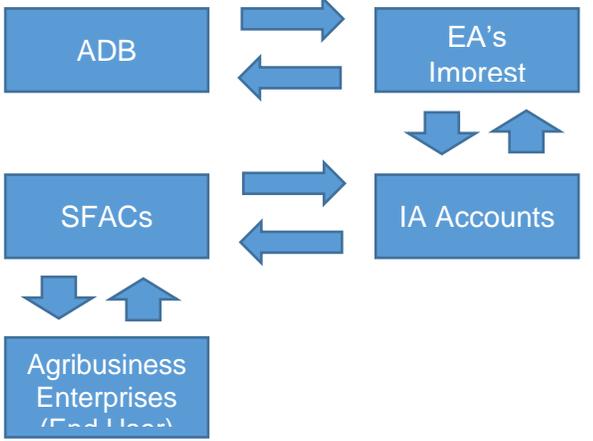
VI. CONCLUSION AND RECOMMENDATION

38. The financial management capacities of the executing and implementing agencies are adequate, however, the implementing agency needs capacity enhancement on certain areas as identified in Table 8 and Appendix 1. SFAC's existing financial management capacity is inadequate. Capacity enhancement of the implementing agency and SFACs is recommended.

FINANCIAL MANAGEMENT ASSESSMENT QUESTIONNAIRE

Topic	Response	Potential Risk Event
1. Executing / Implementing Agency		
1.1 What is the entity's legal status / registration?	Public Limited Company registered with Office of Company Registrar and licensed from NRB (Central Bank of Nepal) to conduct class "D" banking activities	Low
1.2 How much equity (shareholding) is owned by the Government?	Government doesn't own any equity directly but government-controlled banks jointly owns 22.07% equity in the entity	Low
1.3 Obtain the list of beneficial owners of major blocks of shares (non-governmental portion), if any. ⁹	Agricultural Development Bank, Nepal-22.07% NABIL Bank Limited, Nepal-3.04% Nepal Bank Limited, Nepal-1.21%	Low
1.4 Has the entity implemented an externally-financed project in the past? If yes, please provide details.	Yes. ADB (Restructuring of SFDB, Project for Earthquake Affected Communities). Credit USD5.5 million UNCDF (Clean Energy Financing. Loan USD0.16 million IFAD (Enhancing Microfinance Services in Mid and Western Hills of Nepal). Loan USD8 million and Grant USD1.7 million Sakchyam Project funded by DFID. Grant USD1.3 million	Low
1.5 Briefly describe the statutory reporting requirements for the entity.	Monthly/ Quarterly/ Annually statutory reporting to Central Bank. Quarterly statutory reporting to SEBON. Auditors' and AGM report annually.	Low
1.6 Describe the regulatory or supervisory agency of the entity.	NRB (Central Bank of Nepal)	Low
1.7 What is the governing body for the project? Is the governing body for the project independent?	Steering Committee will be the government body for the project. It will be chaired by Joint Secretary - Finance Ministry	Low
1.8 Obtain current organizational structure and describe key management personnel. Is the organizational structure and governance appropriate for the needs of the project?	Entity has appropriate structure and governance framework including independent audit committee and risk management committee headed by non-executive board member.	Low
1.9 Does the entity have a Code of Ethics in place?	Code of Ethics is in place	Low
1.10 Describe (if any) any historical issues reports of ethics violations involving the entity and management. How were they addressed?	Such events have not occurred yet.	Low

⁹ In such cases, consult OAI on the need for integrity due diligence on non-governmental beneficial owners.

Topic	Response	Potential Risk Event
2. Funds Flow Arrangements		
2.1 Describe the (proposed) project funds flow arrangements in detail, including a funds flow diagram and explanation of the flow of funds from ADB, government and other financiers, to the government, EA, IA, suppliers, contractors, ultimate beneficiaries, etc. as applicable.	 <p>The diagram illustrates the flow of funds between several entities. At the top left is 'ADB'. Below it is 'SFACs', and at the bottom is 'Agribusiness Enterprises (End Users)'. On the right side, there are two boxes: 'EA's Imprest' at the top and 'IA Accounts' below it. Arrows indicate the following flows: ADB to SFACs (right), SFACs to ADB (left), SFACs to Agribusiness Enterprises (down), Agribusiness Enterprises to SFACs (up), ADB to EA's Imprest (right), EA's Imprest to ADB (left), EA's Imprest to IA Accounts (down), and IA Accounts to EA's Imprest (up).</p>	Low
2.2 Are the (proposed) arrangements to transfer the proceeds of the loan (from the government / Finance Ministry) to the entity and to the end-recipients satisfactory?	Proposed arrangements are satisfactory	Low
2.3 Are the disbursement methods appropriate?	Proposed disbursement methods are appropriate	Low
2.4 What have been the major problems in the past involving the receipt, accounting and/or administration of funds by the entity?	Contradictory procurement procedure of ADB, EA and IA	Moderate
2.5 In which bank will the Imprest Account (if applicable) be established?	IA doesn't maintain imprest account. It is maintained by EA.	Low
2.6 Is the bank in which the Imprest account is established capable of – <ul style="list-style-type: none"> • Executing foreign and local currency transactions? • Issuing and administering letters of credit? • Handling a large volume of transaction? • Issuing detailed monthly bank statements promptly? 	N.A.	Low
2.7 Is the ceiling for disbursements from the Imprest account and SOE appropriate/required?	N.A.	Low
2.8 Does the (proposed) PIU have experience in the management of disbursements from ADB?	Proposed PIU does not have experience in the management of disbursement from ADB	Moderate
2.9 Does the PIU have adequate administrative and accounting capacity to manage the imprest fund and SOE procedures in accordance with ADB's LDH? Identify any concern or	Refer 2.8	Moderate

Topic	Response	Potential Risk Event
uncertainty about the PIU's administrative and accounting capability which would support the establishment of a ceiling on the use of the SOE procedure.		
2.10 Is the entity exposed to foreign exchange risk? If yes, describe the entity's policy and arrangements for managing foreign exchange risk.	Entity does not deal with foreign exchange	Low
2.11 How are the counterpart funds accessed?	Through EA	Low
2.12 How are payments made from the counterpart funds?	Through IA	Low
2.13 If project funds will flow to communities or NGOs, does the PIU have the necessary reporting and monitoring arrangements and features built into its systems to track the use of project proceeds by such entities?	Project funds will ultimately flow to SFACs and agro enterprises promoted by these SFACs. PIU will develop reporting and monitoring arrangements and features in place.	Moderate
2.14 Are the beneficiaries required to contribute to project costs? If beneficiaries have an option to contribute in kind (in the form of labor or material), are proper guidelines and arrangements formulated to record and value the labor or material contributions at appraisal and during implementation?	N.A.	Low
3. Staffing		
3.1 What is the current and/or proposed organizational structure of the accounting department? Attach an organization chart.	Current organizational structure is attached	Low
3.2 Will existing staff be assigned to the project, or will new staff be recruited?	SFDB will recruit new staff/s for the project.	Moderate
3.3 Describe the existing or proposed project accounting staff, including job title, responsibilities, educational background and professional experience. Attach job descriptions and CVs of key existing accounting staff.	Attached CV and job descriptions of existing accounting staff separately	Moderate
3.4 Is the project finance and accounting function staffed adequately?	Yes. However, current staffs do not may not able to undertake additional responsibilities	Moderate
3.5 Are the project finance and accounting staff adequately qualified and experienced?	No	Substantial
3.6 Are the project finance and accounting staff trained in ADB procedures,	No. Staff need additional training to handle the project finance and accounting.	Substantial

Topic	Response	Potential Risk Event
including the disbursement guidelines (i.e., LDH)?		
3.7 What is the duration of the contract with the project finance and accounting staff?	Core accounting function is handled by permanent staffs and project finance needs to have additional staffs	Low
3.8 Identify any key positions of project finance and accounting staff not contracted or filled yet, and the estimated date of appointment.	N.A.	Low
3.9 For new staff, describe the proposed project finance and accounting staff, including job title, responsibilities, educational background and professional experience. Attach job descriptions.	N.A.	Low
3.10 Does the project have written position descriptions that clearly define duties, responsibilities, lines of supervision, and limits of authority for all of the officers, managers, and staff?	Yes	Low
3.11 What is the turnover rate for finance and accounting personnel (including terminations, resignations, transfers, etc.)?	Low	Low
3.12 What is training policy for the finance and accounting staff?	No specific training policy	Substantial
3.13 Describe the list of training programs attended by finance and accounting staff in the last 3 years.	Attached herewith training programs attended by finance and accounting staff in the last 3 years (Refer to CV)	Moderate
4. Accounting Policies and Procedures		
4.1 Does the entity have an accounting system that allows for the proper recording of project financial transactions, including the allocation of expenditures in accordance with the respective components, disbursement categories, and sources of funds (in particular, the legal agreements with ADB)? Will the project use the entity accounting system? If not, what accounting system will be used for the project?	Well defined accounting policy and COAs are in place. In addition, the entity follows Central Bank's Directives, Nepal Accounting Standards Principals to keep the records of financial transactions. Entity Accounting System will be used for project.	Low
4.2 Are controls in place concerning the preparation and approval of transactions, ensuring that all transactions are correctly made and adequately explained?	Financial Management By laws in place to ensure the preparation and approval of transactions are correct an adequate	Low
4.3 Is the chart of accounts adequate to properly account for and report on project activities and disbursement	Yes	Low

Topic	Response	Potential Risk Event
categories? Obtain a copy of the chart of accounts.		
4.4 Are cost allocations to the various funding sources made accurately and in accordance with established agreements?	Yes	Low
4.5 Are the General Ledger and subsidiary ledgers reconciled monthly? Are actions taken to resolve reconciliation differences?	Yes. Unreconciled items are treated seriously and corrective actions are taken instantly.	Low
4.6 Describe the EA's policy for retention of accounting records including supporting documents (e.g, ADB's policy requires that all documents should be retained for at least 1 year after ADB receives the audited project financial statements for the final accounting period of implementation, or 2 years after the loan closing date, whichever is later). Are all accounting and supporting documents retained in a defined system that allows authorized users easy access?	As per Income Tax Act of Nepal it should be retained for 5 years. (Refer Wolfberg Questionnaire). All accounting and supporting documents that are retained will have easy access.	Low
4.7 Describe any previous audit findings that have not been addressed.	Previous audit findings have been addressed	Low
Segregation of Duties		
4.8 Are the following functional responsibilities performed by different units or persons: (i) authorization to execute a transaction; (ii) recording of the transaction; (iii) custody of assets involved in the transaction; (iv) reconciliation of bank accounts and subsidiary ledgers?	Yes. Different policy, procedures and by laws implemented by the Entity ensures the segregation of authorities.	Low
4.9 Are the functions of ordering, receiving, accounting for, and paying for goods and services appropriately segregated?	Yes	Low
Budgeting System		
4.10 Do budgets include physical and financial targets?	Yes	Low
4.11 Are budgets prepared for all significant activities in sufficient detail to allow meaningful monitoring of subsequent performance?	Yes	Low
4.12 Are actual expenditures compared to the budget with reasonable frequency? Are explanations required	Yes, quarterly basis. Explanations as well as approval from competent authority (including board of directors if variation is beyond 20%).	Low

Topic	Response	Potential Risk Event
for significant variations against the budget?		
4.13 Are approvals for variations from the budget required (i) in advance, or (ii) after the fact?	In advance	Low
4.14 Is there a ceiling, up to which variations from the budget may be incurred without obtaining prior approval?	Need to prior approval for variations	Low
4.15 Who is responsible for preparation, approval and oversight/monitoring of budgets?	Planning department is primarily responsible for budget preparation and monitoring. Board of Directors approves the budget	Low
4.16 Describe the budget process. Are procedures in place to plan project activities, collect information from the units in charge of the different components, and prepare the budgets?	Budgeting is bottom up approach. Information/feedback/target are collected from respective branches and departments. Planning department process the information and present the draft budget to management for discussion. Ultimately, budget is presented to Board of Directors for approval	Low
<p>4.17 Are the project plans and budgets of project activities realistic, based on valid assumptions, and developed by knowledgeable individuals?</p> <p>Is there evidence of significant mid-year revisions, inadequate fund releases against allocations, or inability of the EA to absorb/spend released funds?</p> <p>Is there evidence that government counterpart funding is not made available adequately or on a timely basis in prior projects?</p> <p>What is the extent of over- or under-budgeting of major heads over the last 3 years? Is there a consistent trend either way?</p>	<p>Yes</p> <p>No</p> <p>No</p> <p>Entity has not done any trend analysis</p>	Low
Payments		
4.18 Do invoice-processing procedures require: (i) Copies of purchase orders and receiving reports to be obtained directly from issuing departments? (ii) Comparison of invoice quantities, prices and terms, with those indicated on the purchase order and with records of goods actually received?	Yes. Financial Administration Bylaws set the guideline for procurement	Low

Topic	Response	Potential Risk Event
(iii) Comparison of invoice quantities with those indicated on the receiving reports? (iv) Checking the accuracy of calculations? (v) Checking authenticity of invoices and supporting documents?		
4.19 Are all invoices stamped PAID, dated, reviewed and approved, recorded/entered into the system correctly, and clearly marked for account code assignment?	Yes however, PAID is not stamped in the invoices which are paid	Low
4.20 Do controls exist for the preparation of the payroll? Are changes (additions/deductions/modifications) to the payroll properly authorized?	Automated payroll system in place which requires proper authorization for each activity.	Low
Policies and Procedures		
4.21 What is the basis of accounting (e.g., cash, accrual) followed (i) by the entity? (ii) By the project?	Accrual however, interest income is accounted in cash basis due to the regulatory requirement	Low
4.22 What accounting standards are followed (International Financial Reporting Standards, International Public Sector Accounting Standards – cash or accrual, or National Accounting Standards (specify) or other?	National Accounting Standards	Low
4.23 Does the project have adequate policies and procedures manual(s) to guide activities and ensure staff accountability?	Yes	Low
4.24 Is the accounting policy and procedure manual updated regularly and for the project activities?	Yes	Low
4.25 Do procedures exist to ensure that only authorized persons can alter or establish a new accounting policy or procedure to be used by the entity?	Yes. Board of Directors is authorized to alter or establish a new accounting policy or procedures	Low
4.26 Are there written policies and procedures covering all routine financial management and related administrative activities?	Yes	Low
4.27 Do policies and procedures clearly define conflict of interest and related party transactions (real and apparent) and provide safeguards to protect the organization from them?	Yes	Low
4.28 Are manuals distributed to appropriate personnel?	Yes	Low

Topic	Response	Potential Risk Event
4.29 Describe how compliance with policies and procedures are verified and monitored.	Through Internal and External audit and Central Bank's inspection.	Low
Cash and Bank		
4.30 Indicate names and positions of authorized signatories for bank accounts. Include those persons who have custody over bank passwords, USB keys, or equivalent for online transactions.	CEO (Dr. Shivram Prasad Koirala), Deputy CEO (Jhalendra Bhattarai), Chief Manager (Anju Pathak), Senior Managers (Shiva Hari Aryal and Liladhar Dhital, Manager (Mandipa Dahal). Joint signatures are mandatory to operate bank accounts.	Low
4.31 Does the organization maintain an adequate and up-to-date cashbook recording receipts and payments?	Yes. Petty Cash management guideline is in place.	Low
4.32 Describe the collection process and cash handling procedures. Do controls exist for the collection, timely deposit and recording of receipts at each collection location?	SFDB does not collect deposit or perform any cash transactions except petty cash management	Low
4.33 Are bank accounts reconciled on a monthly basis? Or more often? Is cash on hand physically verified, and reconciled with the cash books? With what frequency is this done?	Monthly basis Daily (imprest system)	Low
4.34 Are all reconciling items approved and recorded?	Yes	Low
4.35 Are all unusual items on the bank reconciliation reviewed and approved by a responsible official?	Yes	Low
4.36 Are there any persistent/non-moving reconciling items?	Yes but very immaterial	Moderate
4.37 Are there appropriate controls in safekeeping of unused cheques, USB keys and passwords, official receipts and invoices?	Safekeeping by a designated officer but does not have documented procedures	Moderate
4.38 Are any large cash balances maintained at the head office or field offices? If so, for what purpose?	Refer 4.32	Low
4.39 For online transactions, how many persons possess USB keys (or equivalent), and passwords? Describe the security rules on password and access controls.	SFDB doesn't do online transactions	Low
Safeguard over Assets		
4.40 What policies and procedures are in place to adequately safeguard or protect assets from fraud, waste and abuse?	Coding, numbering and recording of assets are done as per Financial Administration Bylaws	Low
4.41 Does the entity maintain a Fixed Assets Register? Is the register updated monthly? Does the register record ownership of assets, any	Yes Yes Yes	Low

Topic	Response	Potential Risk Event
assets under lien or encumbered, or have been pledged?		
4.42 Are subsidiary records of fixed assets, inventories and stocks kept up to date and reconciled with control accounts?	Yes	Low
4.43 Are there periodic physical inventories of fixed assets, inventories and stocks? Are fixed assets, inventories and stocks appropriately labeled?	Yes	Low
4.44 Are the physical inventory of fixed assets and stocks reconciled with the respective fixed assets and stock registers, and discrepancies analyzed and resolved?	Yes	Low
4.45 Describe the policies and procedures in disposal of assets. Is the disposal of each asset appropriately approved and recorded? Are steps immediately taken to locate lost, or repair broken assets?	Financial Administration By-laws sets parameter for disposal of assets. However, such event not done yet.	Low
4.46 Are assets sufficiently covered by insurance policies?	Only the vehicles are insured. Other fixed assets are not insured	High
4.47 Describe the policies and procedures in identifying and maintaining fully depreciated assets from active assets.	Depreciation is done in WDV basis so all assets are not fully depreciated. Negligible value and useless assets are written off.	Low
<i>Other Offices and Implementing Entities</i>		
4.48 Describe any other regional offices or executing entities participating in implementation.	In addition to Head Office, Regional Offices of entity as well as partner cooperatives (SFACs) will participate in implementation	Low
4.49 Describe the staff, their roles and responsibilities in performing accounting and financial management functions of such offices as they relate to the project.	Attached.	Low
4.50 Has the project established segregation of duties, controls and procedures for flow of funds and financial information, accountability, and reporting and audits in relation to the other offices or entities?	Proper mechanism for flow of funds, financial information, audits and accountability have been established.	Low
4.51 Does information among the different offices/ implementing agencies flow in an accurate and timely fashion? In particular, do the offices other than the head office use the same accounting and reporting system?	Information flow is accurate and real time. Same Accounting and reporting system are used across the entity	Low
4.52 Are periodic reconciliations performed among the different offices/implementing agencies? Describe the project reporting and	Monthly reconciliation performed across agencies	Low

Topic	Response	Potential Risk Event
auditing arrangements between these offices and the main executing/implementing agencies.		
4.53 If any sub-accounts (under the Imprest Account) will be maintained, describe the results of the assessment of the financial management capacity of the administrator of such sub-accounts.	SFDB has not maintained impressed account.	Low
Contract Management and Accounting		
4.54 Does the agency maintain contract-wise accounting records to indicate gross value of contract, and any amendments, variations and escalations, payments made, and undisbursed balances? Are the records consistent with physical outputs/deliverables of the contract?	Contract-wise record are maintained in consistence with physical outputs and deliverables	Low
4.55 If contract records are maintained, does the agency reconcile them regularly with the contractor?	Contract records are reconciled regularly	Low
Other		
4.56 Describe project arrangements for reporting fraud, corruption, waste and misuse of project resources. Has the project advised employees, beneficiaries and other recipients to whom to report if they suspect fraud, waste or misuse of project resources or property?	Project will adhere ADB's guideline on fraud, corruption, waste and misuse of project which will be strictly advise the stakeholders	Low
5. Internal Audit		
5.1 Is there an internal audit department in the entity?	There is an Internal Audit Department which reports directly to Audit Committee	Low
5.2 What are the qualifications and experience of the internal audit staff?	There are two staffs in the Internal Audit Division of Head Office, one being professional Chartered Accountant with 8 years of experience in Auditing and Inspection and other being Registered Auditor with more than 30 years of experience.	Moderate
5.3 To whom does the head of the internal audit report?	It reports directly to Audit Committee.	Low
5.4 Will the internal audit department include the project in its annual work program?	No. Separate audit plan for project is prepared for project	Low
5.5 Are actions taken on the internal audit findings?	The Audit Committee reviews the audit reports on quarterly basis and directs the management for corrective actions as appropriate	Low
5.6 What is the scope of the internal audit program? How was it developed?	Internal Audit program has comprehensive scopes including regulatory compliances, prudence operation, risk assessment and	Low

Topic	Response	Potential Risk Event
	financial management. The Audit Committee has developed the Internal Audit guideline.	
5.7 Is the internal audit department independent?	Yes, Internal Audit Department reports directly to Audit Committee	Low
5.8 Do they perform pre-audit of transactions?	Pre-audit is normally not performed	Moderate
5.9 Who approves the internal audit program?	The Audit Committee approves Internal Audit Program.	Low
5.10 What standards guide the internal audit program?	Directives from Central Bank to MFIs and Nepal's Standard on Audit guides Internal Audit program. The entity also practices "Risk Based Audit" program	Low
5.11 How are audit deficiencies tracked?	Any deviation on Internal Audit Guideline from Directives of Central Bank to MFIs and Nepal's Standard on Audit guides are reported and addressed immediately. Further, internal audit report is regularly discussed at Audit Committee.	Low
5.12 How long have the internal audit staff members been with the organization?	Head of internal audit is associated with entity for 16 years and other staff is associated for 2 years	Low
5.13 Does any of the internal audit staff have an IT background?	None of the internal audit staffs have IT background	Moderate
5.14 How frequently does the internal auditor meet with the audit committee without the presence of management?	Quarterly or as an when required	Low
5.15 Has the internal auditor identified / reported any issue with reference to availability and completeness of records?	No such issues reported	Low
5.16 Does the internal auditor have sufficient knowledge and understanding of ADB's guidelines and procedures, including the disbursement guidelines and procedures (i.e., LDH)?	Internal Auditors do not have sufficient knowledge and understanding on ADB's guideline and procedures	Moderate
6. External Audit – entity level		
6.1 Is the entity financial statement audited regularly by an independent auditor? Who is the auditor?	Financial statement is regularly audited by an independent auditor appointed by the Annual General Meeting of the entity. Current Auditor is Khagendra Bhattarai & Associates (Chartered Accountants)	Low
6.2 Are there any delays in audit of the entity? When are the audit reports issued?	Previous Fiscal Years' (FY starting from 16 July 2017 to 15 July 2018) audit report was issued on 25 November 2018 and AGM was conducted on 1 February 2019	Low
6.3 Is the audit of the entity conducted in accordance with the International Standards on Auditing or the International Standards for Supreme Audit Institutions, or national auditing standards?	Auditing is conducted in accordance Nepal Standards on auditing which is published by Nepal Auditing Standard Board.	Low

Topic	Response	Potential Risk Event
6.4 Were there any major accountability issues noted in the audit report for the past three years?	External Auditors did not report major accountability issues	Low
6.5 Does the external auditor meet with the audit committee without the presence of management?	Audit Committee is headed by non-executive director and consist of following members: a. Non-Executive Directors-Co-coordinator b. Non-Executive Director- Member c. Chief of Internal Audit Department- Member Secretary. External auditor has direct access to audit committee and meet without the presence of management.	Low
6.6 Has the entity engaged the external audit firm for any non-audit engagements (e.g., consulting)? If yes, what is the total value of non-audit engagements, relative to the value of audit services?	No	Low
6.7 Has the external auditor expressed any issues on the availability of complete records and supporting documents?	No such observations made in the past audit reports	Low
6.8 Does the external auditor have sufficient knowledge and understanding of ADB's guidelines and procedures, including the disbursement guidelines and procedures (i.e., LDH)?	External Auditor may not have sufficient knowledge on ADB's guideline and procedures including LDH	Moderate
6.9 Are there any material issues noted during the review of the audited entity financial statements that were not reported in the external audit report?	No	Low
External Audit – project level		
6.10 Will the entity auditor audit the project accounts or will another auditor be appointed to audit the project financial statements?	External Auditor will audit the project accounts	Low
6.11 Are there any recommendations made by the auditors in prior project audit reports or management letters that have not yet been implemented?	No such issues are reported	Low
6.12 Is the project subject to any kind of audit from an independent governmental entity (e.g. the supreme audit institution) in addition to the external audit?	No	Low
6.13 Has the project prepared acceptable terms of reference for an annual project audit? Have these been agreed and discussed with the EA and the auditor?	Yes. (Attached TOR for Annual Project Audit)	Low

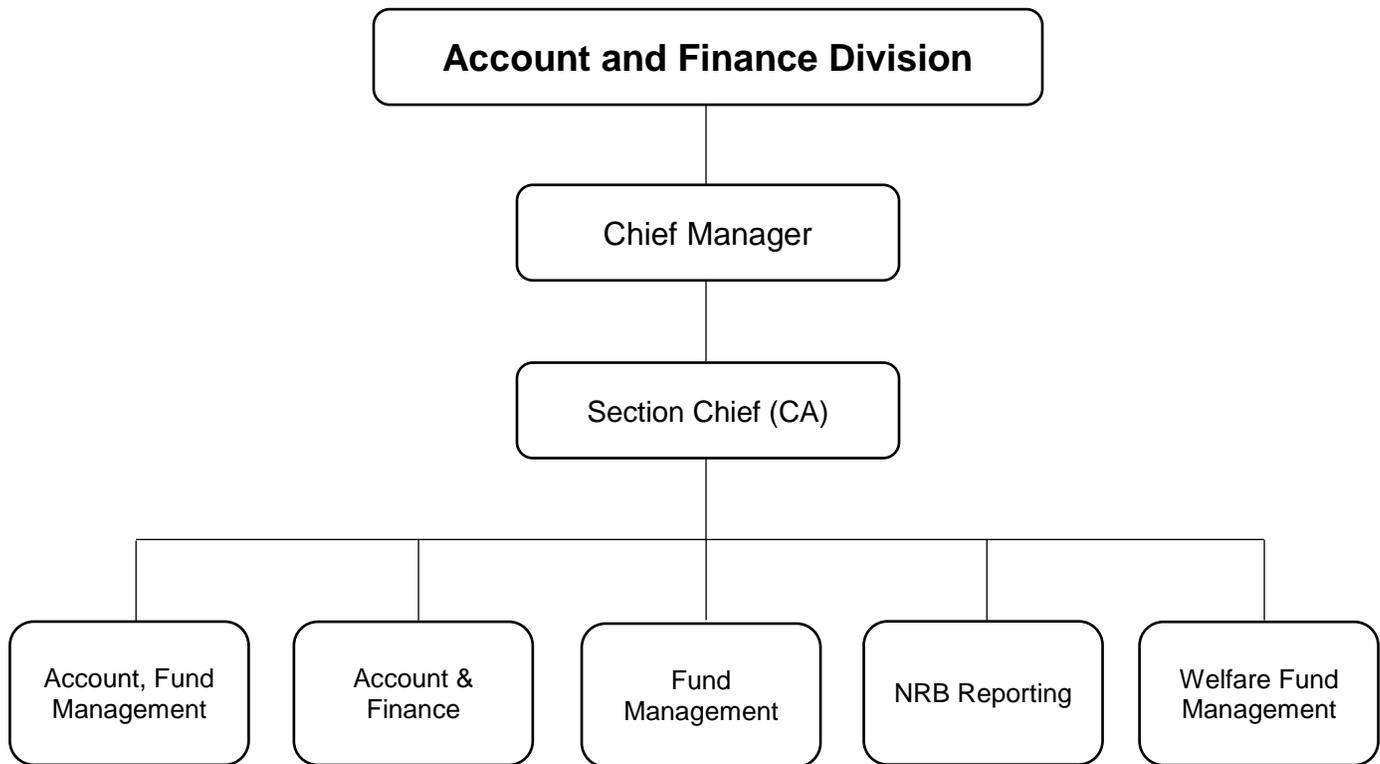
Topic	Response	Potential Risk Event
6.14 Has the project auditor identified any issues with the availability and completeness of records and supporting documents?	No	Low
6.15 Does the external auditor have sufficient knowledge and understanding of ADB's guidelines and procedures, including the disbursement guidelines and procedures (i.e., LDH)?	External auditor may not have sufficient knowledge and understanding of ADB's guideline and procedures. However, entity will update the requirement to the External Auditor. External Auditor should be able to acquire sufficient knowledge and understanding of ADB's guidelines and procedures	Moderate
6.16 Are there any recommendations made by the auditors in prior audit reports or management letters that have not yet been implemented?	Recommendations made by the auditors in prior audit reports or management letters have already been implemented	Low
[For second or subsequent projects] 6.17 Were past audit reports complete, and did they fully address the obligations under the loan agreements? Were there any material issues noted during the review of the audited project financial statements and related audit report that have remained unaddressed?	Yes	Low
7. Reporting and Monitoring		
7.1 Are financial statements and reports prepared for the entity?	Yes	Low
7.2 Are financial statements and reports prepared for the implementing unit(s)?	Yes	Low
7.3 What is the frequency of preparation of financial statements and reports? Are the reports prepared in a timely fashion so as to be useful to management for decision making?	Unaudited financial reports are prepared and published on quarterly basis for management decision making as well as statutory and compliance purpose. Monthly financial statements are prepared for decision making purpose	Low
7.4 Does the entity reporting system need to be adapted for project reporting?	Yes.	Low
7.5 Has the project established financial management reporting responsibilities that specify the types of reports to be prepared, the report content, and purpose of the reports?	Yes	Moderate
7.6 Are financial management reports used by management?	Financial management reports are used by management on regular basis for decision making process.	Low
7.7 Do the financial reports compare actual expenditures with budgeted and programmed allocations?	The financial reports compare budgeted expenditure with actual expenditure on regular basis	Low

Topic	Response	Potential Risk Event
7.8 How are financial reports prepared? Are financial reports prepared directly by the automated accounting system or are they prepared by spreadsheets or some other means?	Financial reports are prepared by spreadsheets in head office. Branch offices use automated system, however compilation at head office is done manually through spreadsheets	Substantial
7.9 Does the financial system have the capacity to link the financial information with the project's physical progress? If separate systems are used to gather and compile physical data, what controls are in place to reduce the risk that the physical data may not synchronize with the financial data?	No	Substantial
7.10 Does the entity have experience in implementing projects of any other donors, co-financiers, or development partners?	SFDB has been working with different projects and have experience in implementing such projects	Low
8. Information Systems		
8.1 Is the financial accounting and reporting system computerized?	Not fully computerized	High
8.2 If computerized, is the software off-the-shelf, or customized?	Branches use Mangus software for banking activities. Magnus is customized software	High
8.3 Is the computerized software standalone, or integrated and used by all departments in the headquarters and field units using modules?	Standalone and only used in the branches. Departments and HO uses spreadsheets.	High
8.4 How are the project financial data integrated with the entity financial data? Is it done through a module in the enterprise financial system with automatic data transfer, or does it entail manual entry?	Through spreadsheets. Entity is in the testing phase of Pumori software implementation and expect to integrate the data through automated process.	High
8.5 Is the computerized software used for directly generating periodic financial statements, or does it require manual intervention and use of Excel or similar spreadsheet software?	Refer to point no 8.4	High
8.6 Can the system automatically produce the necessary project financial reports?	Refer to point no 8.4	High
8.7 Is the staff adequately trained to maintain the computerized system?	Yes	Moderate
8.8 Do the management, organization and processes and systems safeguard the confidentiality, integrity and availability of the data?	Yes	Low
8.9 Are there back-up procedures in place?	As entity uses standalone software in branches, local back up is taken which is exposed to significant risk to entity in case of disaster like fire and other natural calamities	High

Topic	Response	Potential Risk Event
8.10 Describe the backup procedures – online storage, offsite storage, offshore storage, fire, earthquake and calamity protection for backups.	Everyday updated. Manual backup for branch level	High

ADB = Asian Development Bank, AGM = annual general meeting, CEO = chief executive officer, COA = chart of account, CV = curriculum vitae, EA = executing agency, HO = head office, IA = implementing agency, MFI = microfinance institution, NA = not applicable, NRB = Nepal Rastra Bank, PIU = project implementing unit, SEBON = Securities Board of Nepal, SFAC = small farmers agriculture cooperative, SFDB = Small Farmers Development Bank, SOE = statement of expenditure, TOR = terms of reference, WDV = written down value.

ORGANIZATION STRUCTURE OF ACCOUNT AND FINANCE DIVISION OF SFDB



NRB = Nepal Rastra Bank.
Source: Small Farmers Development Bank.

FINANCIAL MANAGEMENT ASSESSMENT OF SFACs

Sr. No	Indicators	Rampu	Letang	Semalar	Salang	Dhaibung	Jiling	Kathar	Gadhi	Kumroj	Itahara	Padariya	Rpur	Odraha	Samalbung	Pathariya
1	Regulatory compliance															
1.1	Duly registered with government entity	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
1.2	Regular reporting/filling the required documents to regulator (s)	Yes	Yes.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
1.3	Negative rating/remarks from regulators in the last 3 years	No	No.	No	No	No	No	No	No	No	No	No	No	No	No	No
2	Financial Management Resources and Staffing															
2.1	Total number of staffs	4	11	16	5	3	3	5	3	9	2	4	5	2	3	4
2.1	Finance and accounting functions staffed adequately	Yes	Yes	Yes	Yes	No	No	Yes	No	Yes	No	Yes	Yes	No	No	Yes

Sr. No	Indicators	Rampu	Letang	Semalar	Salang	Dhaibung	Jiling	Kathar	Gadhi	Kumroj	Itahara	Padariya	Rpur	Odraha	Samalbung	Pathariya
5.1	Systematic process for budget preparation and approval	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
5.2	Incorporation of financial targets in budget	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
6	Safeguards over Assets & Data															
6.1	Assets sufficiently covered by insurance policies	No	No	No	No	No	No	No	No	No	No	No	No	No	No	No
6.2	Proper and adequate backup system in place to safeguard data	No	No	No	No	No	No	No	No	No	No	No	No	No	No	No
7	Internal Audit															
7.1	Independent Audit Committee	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
8	External Audit															
8.1	Appointment of external auditor by competent authority	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
8.2	Regular audit of	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Sr. No	Indicators	Rampu	Letang	Semalar	Salang	Dhaibung	Jiling	Kathar	Gadhi	Kumroj	Itahara	Padariya	Rpur	Odraha	Samalbung	Pathariya
10	Accounting Software															
10.1	Computerized working environment	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Sr. No	Indicators	Shriantu	Lokbesi	Latikoili	Tulsibhangyang	Tara Tal
1	Regulatory compliance					
1.1	Duly registered with government entity	Yes	Yes	Yes	Yes	Yes
1.2	Regular reporting/filling the required documents to regulator (s)	Yes	Yes	Yes	Yes	Yes
1.3	Negative rating/remarks from regulators in the last 3 years	No	No	No	No	No
2	Financial Management Resources and Staffing					
2.1	Total number of staffs	3	4	4	6	10
2.1	Finance and accounting functions staffed adequately	No	Yes	Yes	Yes	Yes
2.2	Finance and accounting staff adequately qualified and experienced	No	Yes	Yes	Yes	Yes
3	Accounting Policies and Procedures					
3.1	Preparation of financial statements in accordance with NAS	No	No	No	No	No
3.2	Written policies and procedures to guide financial management and administrative activities	Yes	Yes	Yes	Yes	Yes
4	Segregation of Duties					
4.1	Separation of authorization, and recording of transactions and custodian of assets	No	Yes	Yes	Yes	Yes
5	Budgeting Procedures					
5.1	Systematic process for budget preparation and approval	Yes	Yes	Yes	Yes	Yes

Sr. No	Indicators	Shriantu	Lokbesi	Latikoili	Tulsibhangyang	Tara Tal
5.2	Incorporation of financial targets in budget	Yes	Yes	Yes	Yes	Yes
6	Safeguards over Assets & Data					
6.1	Assets sufficiently covered by insurance policies	No	No	No	No	No
6.2	Proper and adequate backup system in place to safeguard data	No	No	No	No	No
7	Internal Audit					
7.1	Independent Audit Committee	Yes	Yes	Yes	Yes	Yes
8	External Audit					
8.1	Appointment of external auditor by competent authority	Yes	Yes	Yes	Yes	Yes
8.2	Regular audit of financial statements by an independent auditor	Yes	Yes	Yes	Yes	Yes
8.3	Awareness about ADB auditing requirements	No	No	No	No	No
9	Credit Process Management					
9.1	Adequate KYC framework in place	NA	NA	NA	NA	NA
9.2	Proper documentation like collateral, personal guarantee etc	Yes	Yes	Yes	Yes	Yes
9.3	Credit department staffed adequately	Yes	Yes	Yes	Yes	Yes
9.4	Credit department staff adequately qualified and experienced on rural enterprise financing	No	No	No	No	No
10	Accounting Software					
10.1	Computerized working environment	Yes	Yes	Yes	Yes	Yes

KYC = know your customer, NA = not applicable, NAS = Nepal accounting standards.