



Financial Management Assessment

Project Number: 54107-002
Loan Number: XXXX
August 2021

**Nepal: Electricity Grid Modernization Project-
Additional Financing**
Nepal Electricity Authority (NEA)

Financial Management Assessment of Nepal Electricity Authority

A. Background

1. The financial management assessment (FMA) conducted in July 2020 in accordance with the Guidelines¹ of the Asian Development Bank for the original project was updated in May 2021. The FMA considered the capacity of the Nepal Electricity Authority (NEA), including funds-flow arrangements, staffing, accounting and financial reporting systems, financial information systems, and internal and external auditing arrangements. NEA has shown significant improvements in recent years. The FMA considers the NEA, a state-owned entity, in its role as the executing agency (EA) and implementing agency (IA) for the project.

2. Nepal Electricity Authority is an integrated utility fully owned by the Government of Nepal (GoN) and is engaged in the business of generation, transmission, and distribution of electricity in Nepal. It was established as an autonomous body under the virtue of the Nepal Electricity Authority Act, 1984. Operationally, NEA is split into nine directorates-each headed by a Deputy Managing Director.

B. NEA's Financial Management Strengths and Weaknesses

3. Strengths:

- The financial management system of the government is based on a robust legislative framework, the Financial Procedures Act (1999) and the Financial Procedures Rules (2007). As a 100% state owned enterprise, NEA applies the financial rules and regulations of the government and has its own set of board-approved accounting policies and procedures manual.
- NEA has significant experience in the implementation of ADB financed projects and staff are familiar with ADB financial management procedures.
- Implementation of enterprise resource planning (ERP) is an output of this loan (additional financing). It will help NEA improve its financial management, accounting and reporting capacity. This will include planning related modules for fixed assets and stores and spares management.
- Nepal Electricity Regulatory Commission (ERC) issued its first tariff order for NEA in June 2020. In the tariff order, ERC has rationalized electricity tariffs through appropriate price signals. The reduction in tariffs for high-end residential consumption will fuel the electricity demand and likely improve NEA's financial sustainability over a medium to long term period. At the same time, the tariffs have been increased for high tension (HT) industrial consumers, allowing NEA to recover additional revenue. The increase residential demand and consumption will propel or at least maintain the levels of industrial electricity consumption, resulting in accrual of two-dimensional benefits for NEA.

4. Weaknesses:

- Audit reports indicate internal control weaknesses.
- Non-compliance with certain key accounting standards leading to misrepresentation in the financial statements. These accounting exceptions will likely undermine the full-cost tariff

¹ ADB. 2019. [Financial Analysis and Evaluation](#). Manila; and ADB. 2015. [Financial Management Assessment](#). Manila.

recovery for NEA, as the ERC may chose not to allow some of the provisional amounts unless NEA is in full compliance of Nepal Financial Reporting Standards (NFRS).

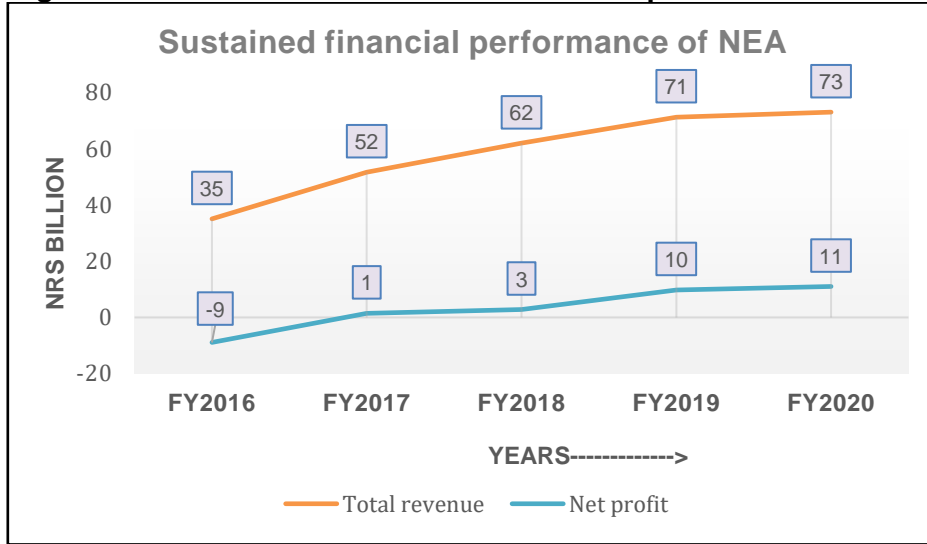
- ERP implementation is scheduled to take place over the next 2 years and till that time manual intervention and partially computerized processes will continue at NEA.

C. Detailed updates on NEA financial management

5. Some of the key and recent financial management and performance enhancement-related initiatives undertaken by NEA are as follows:

6. **Financial performance of NEA.** NEA had reported a net profit of Nepalese Rupees (NRs) 9.8 billion for financial year (FY) 2019. Based on provisional accounts, NEA has posted a net profit of NRs 11 billion for the last FY2020, showing an increase of 12.6% over the previous year, despite COVID-19 related economic slowdown.

Figure 1: Turnaround and sustained financial performance of NEA



7. NEA has sustained its financial performance since the financial turnaround which happened in FY2017. The turnaround of NEA happened on account of revenue improvement and operational efficiencies brought in by continuous supply of electricity and a very disciplined commercial and technical loss reduction program, coupled with government-supported financial restructuring.

8. **Tariff determination.** The ERC issued its first tariff order on 15 June 2020 based on prudent cost recovery principles notified in its tariff-setting regulations. In its maiden tariff order, the Commission rationalized tariffs for some of the consumer categories which resulted in marginal reduction of average tariffs for NEA.

9. In the tariff order, ERC allowed NEA, a return-on-equity of 8.52% on 30% cost of its fixed assets. However, around 15% of the interest claims were disallowed and the ERC directed NEA to capitalize these interest expenses as they were incurred during the construction period of various schemes.

10. The subsequent tariff-setting exercise was delayed because of onset of COVID-19 crisis. However, the tariff determined by the ERC is applicable until the issuance of subsequent tariff

order. NEA's economic analysis wing is responsible for submission of tariff petition; the department with inputs from other functional department, is preparing a new tariff proposal for submission to the ERC. NEA has also appointed Ernst & Young LLP, India for assistance in submitting tariff petitions.

11. **NFRS implementation and accounting manuals.** Nepal Financial Reporting Standards (NFRS), prepared in line with International Financial Reporting Standards (IFRS), were notified on September 13, 2013. However, NEA could not fully adopt NFRS on account of resource and operational constraints, and it continued to follow a mix of Nepal Accounting Standards and Generally Accepted Accounting Principles (GAAP) for few years. The issue was repeatedly highlighted by its auditors and the financial statements were qualified.

12. NEA, with the help from the external advisors, prepared its financial statements for FY2019 and FY2020 based on NFRS. Previous years' financial statements were also remeasured and reclassified wherever necessary in accordance with NFRS.

13. As noted in the previous FMA, the company cannot be in full compliance with NFRS unless the asset verification and revaluation (and impairment) exercise is completed. NEA expects its financial statements to fully comply with NFRS during FY2022 in the wake of operational difficulties arisen out of COVID-19 crisis.²

14. However, NEA has strengthened its accounting policies and expects its financial statements for FY2020 and FY2021 to exhibit perceivable improvement in reporting areas over previous years.

15. NEA's Board has recently approved its accounting manuals prepared by its consultants-Deloitte. However, these manuals were prepared long time back and are required to be updated in line with current organizational structure of NEA.

16. The activity of accounting manual update will be funded through Norwegian grant administered by ADB through technical assistance (TA) attached to the SASEC Power Transmission and Distribution Systems Strengthening (PTDSSP) loan.

17. **NEA Corporate Development Plan (FY2020–FY2024).** NEA released its inaugural Corporate Development Plan (CDP) in early 2020.³ The release of this document, which was approved by NEA's board in late 2019, is a milestone in NEA's recovery, bringing together for the first time a cogent and comprehensive plan for NEA's (and the broader electricity sector's) short-term development. It sets forth operational goal, identifies investment and financing needs and outlines restructuring plans. The \$3.6 billion capital plan covers NEA's investments in hydropower development, transmission and distribution as well as electric vehicle charging infrastructure, assigns responsibilities for implementation of each of the plan's component and articulates a monitoring framework.

18. NEA has forwarded its CDP to Ministry of Energy. The managing director (MD) of NEA is the process-owner of CDP. Implementation of the CDP across NEA, is one of the key performance indicators (KPIs) of the MD. It is expected that there CDP will facilitate and streamline planning and coordination across the organization.

² Nepal Financial Reporting Standards (NFRS) compliance will require revaluation and impairment of its fixed assets. The consultants appointed for the physical verification of assets, cannot perform their duties because of travel restrictions and other operational difficulties arisen on account of COVID-19 crisis. The project which started in April 2020, was supposed to be implemented over 18 months under the normal circumstances.

³ In earlier years, the Nepal Electricity Authority (NEA) periodically released a corporate plan. However, these documents were not widely disseminated and had a limited in scope.

19. **Financial restructuring plans of NEA.** The first financial restructuring of NEA was undertaken by GoN during FY2011–FY2012 when NEA’s accumulated loss of over NRs.27 billion (closing balance at the end of FY2010–FY2011) were written-off.

20. Pursuant to covenants included in the loan agreement signed with ADB for Power Transmission and Distribution Efficiency Enhancement Project (PTDEEP) in September 2017, NEA sent two financial restructuring plan (FRP) proposals (FRP II and FRP III) to GoN. FRP II proposal was approved and executed for FY2016–FY2017. However, FRP-III proposal was not considered further by GoN due to:

- ❖ NEA had already been profitable after FRP II;
- ❖ Reduction of interest rates on various state loans to NEA, was one of the primary reliefs sought in the FRP-III. However, most of the NEA’s recent loans were on-lent by GoN on back-to-back basis, in the loan currency itself; these loans were already offered at concessional rates and hence further interest rate reduction was not plausible.

21. **Strengthening of internal audit department.** Recently, NEA’s management has taken various initiatives to strengthen NEA’s internal audit department. The Board has approved risk-based internal audit manuals in December 2019. Though these manuals were available for many years, however they could not be adopted earlier for several procedural reasons. These risk-based internal audit manuals will strengthen the internal audit process at NEA.

22. Similar to the accounting manuals, the internal audit manuals were prepared long time back and are required to be updated now. Again, ADB has agreed to fund the activity of internal audit manuals update, from the TA attached to the EGMP loan.

23. NEA has indicated that it has strengthened and streamlined the internal audit department and its functioning. The department, headed by a dedicated and full-time director, reports to the Audit Committee on regular basis and their observations are forwarded to the MD for implementation.

24. NEA has also filled senior level positions in the department which were earlier vacant for a long time. The department has also recruited 7 external qualified chartered accountants on contract basis to strengthen its function.

25. Now, the frequency of internal audit department’s briefing to the Board of Directors has been increased from twice-in-a-year to thrice-in-a-year (trimester basis).

26. **Forex risk management policy.** The previous FMA had noted that NEA was in process of preparing and implementing a forex risk management policy. The policy was aimed for identifying and managing forex risk in all activities undertaken by NEA, its subsidiaries. NEA was undertaking internal deliberations on the draft policy at that time and was expected to implement it during the subsequent financial year.

27. During this assessment, however, NEA informed that it could not prioritize the implementation of a forex risk management policy on account of Covid-19 crisis. But the company has recently resumed consultations with its advisors. It is expected that the policy would be approved in this financial year for implementation over the next financial year.

28. **Implementation of an ERP System.** During FY2014, NEA initiated the bidding process for implementation of ERP at NEA under the World Bank funding. However, the bidding process had to be halted because of technical reasons. According to NEA’s staff, the bidding framework did not allow NEA to interact or intervene with the prospective bidders-such interactions were otherwise justified considering the nature of this procurement.

29. Later on, NEA appointed a consultant to prepare a road map for effective roll-out of ERP. NEA invited expression of interests (EoI) for procurement of information system or selection of system integrator (SI). The request for EoI was published in May 2019. During the last FMA, evaluation of the bids was under process and NEA was looking forward to awarding the contract as soon as possible.

30. However, the bid evaluation process resulted in a single qualified bidder and their financial bid was substantially higher than the budgeted cost. NEA requested the World Bank to cancel the current bidding process and invite fresh bids.

31. Failure of 2 successive bidding processes is a major setback for ERP implementation at NEA and it has delayed the process considerably.

32. On the positive side, NEA had a steep learning curve during the last bidding process, and it has already geared up itself for the next one. It is proactively reviewing its cost estimates and technical requirements. To minimize disruptions, NEA has planned to split the implementation process in 2 separate packages and invite 2 separate bids-separately for revenue management system (RMS) and integrated financial management information system (IFMIS). The split would enhance cost-competitiveness and facilitate higher number of qualified bidders.

33. The implementation will now be funded under the current loan (EGMP-additional financing).

34. **Physical verification and revaluation of assets.** During the last FMA, NEA informed that it had selected Deloitte India through a transparent and competitive bidding process, for physical verification and revaluation of its fixed asset-base. Award of contract was pending due to lockdowns and ban on traveling.

35. During this assessment, it was noted that NEA had already awarded the contract to Deloitte India. Though the consulting firm commenced its work immediately. However, the scope of the activities was limited on account of continuing lockdowns and travel restrictions. According to terms of the contract, the consultants are expected to complete the assignment by December 2021/January 2022. However, NEA is expecting an extension of around 2–3 months for the contract period to compensate for the loss of time due to continuing COVID-19 crisis.

36. Meanwhile, the project scope includes conduct of physical verification of NEA's assets segregated into various asset-classes, along with identification of damaged, obsolete and non-existent assets, in accordance with NFRS. Inventory verification will identify slow moving, non-moving, damaged and obsolete inventories. The consultant will also develop a fixed-asset register based on types of assets and inventories which will be subsequently updated to include the valuations carried out based on the identified nature and condition of assets and inventories. The recommendations will also include appropriate adjustments including write-offs and disclosure requirement and adjustments for outstanding inter-unit balances linked to fixed assets and inventories.

37. **Asset insurance.** During the previous assessments, it was noted that NEA is seeking assistance of external agencies in preparing a policy for insurance of its fixed asset-base.

38. However, the travel restrictions have severely hampered NEA's initiatives on this front and no progress was made since the last financial management (FM) assessment. But NEA is hopeful that the project will be on track over next few months.

39. **COVID-19 response plan.** NEA had constituted a 4-membered committee, headed by Deputy Managing Director (Finance) to evaluate the impact of COVID-19 crisis on finances and operations of NEA and prepare a comprehensive response plan to counter the adverse impact.

40. The committee supported by an external consultant has completed its assessment and submitted a detailed report to the senior management of NEA.

41. The assessment has evaluated the impact of the COVID-19 crisis on consumer demand, revenue, distribution losses, capital expenditure, consumer receivables. The key findings of the committee were:

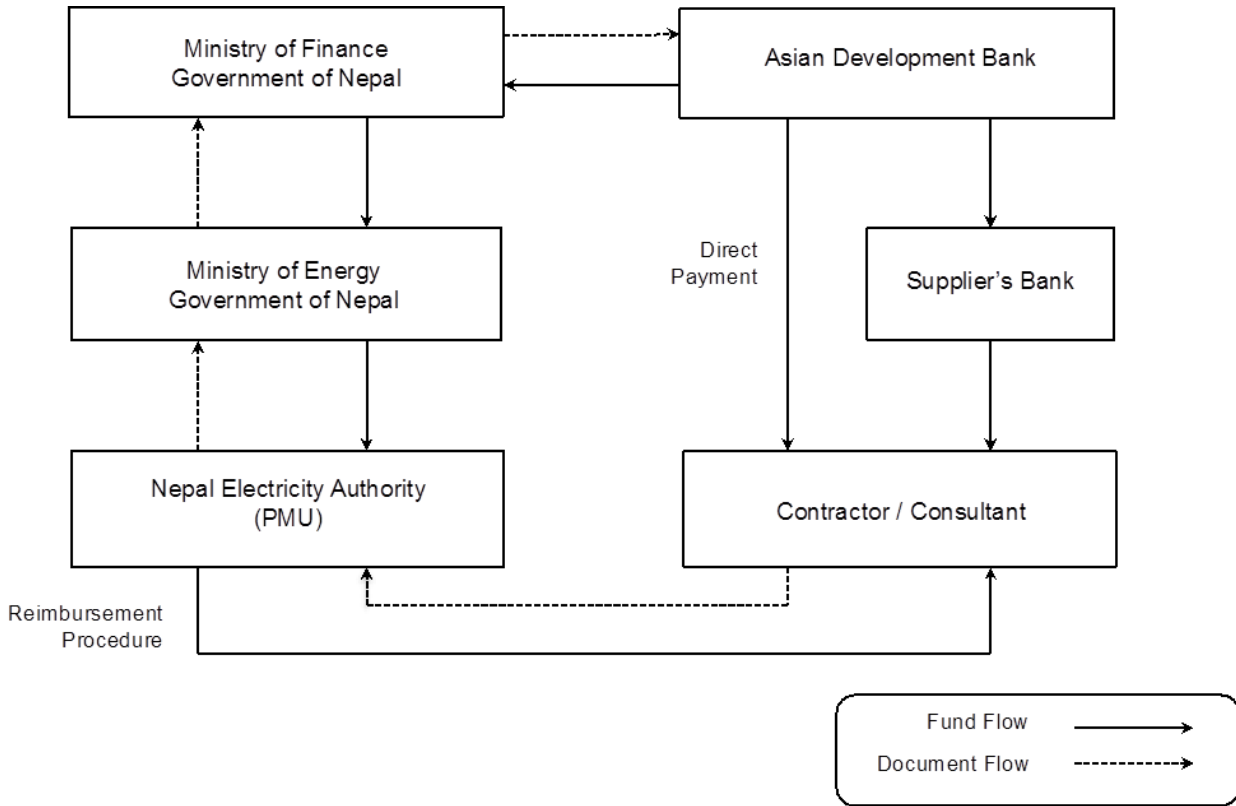
- ❖ There was an increase of 3 percentage points in the distribution losses from the base level of 14–15%.
- ❖ Implementation of capital expenditure schemes was hampered initially due to travel restrictions and transportation constraints. However, the implementation was expedited in the latter part of the crisis and now the cumulative capital expenditure for the year is reasonably in line with previous years.
- ❖ The consumer demand dipped significantly on account of partial shutdown or slowdown of industrial and commercial establishments. However, the expensive power purchase was also avoided on account of lower requirement. Therefore, the adverse impact on revenue was subdued and overall impact was decrease in net profit of NEA for the year.
- ❖ Consumer collection dropped significantly on account of lower customer turnout for bill payment in wake of COVID-19 crisis. This resulted in rise in receivables. It is expected that the average collection dropped to 90% (of billed revenue) from baseline levels of 95%.
- ❖ Government of Nepal provided interim financial relief to electricity consumers by providing direct subsidy based on consumption to select domestic consumers. It is estimated that total of NRs3 billion is payable to NEA from GoN against this financial relief package. NEA has recorded this as other revenue in its provisional FY2020 financial statements.

D. Disbursement Arrangements and Funds Flow Mechanisms

42. Loan proceeds will be disbursed in accordance with ADB's Loan Disbursement Handbook (2012, as amended from time to time), and detailed arrangements agreed upon between the government, NEA and ADB. The direct payment mechanism is preferred. Supplier invoices will be sent to the project management unit (PMU) for initial verification in accordance with ADB's and NEA's procedures. The PMU accountant will prepare documentation for withdrawal of funds and the PMU Director will approve and submit to ADB with supporting documentation. The PMU is assessed to have reasonable capacity to manage statement of expenditure (SOE) procedure. However, keeping in view financial management issues mostly at corporate level, a ceiling of \$100,000 is suggested for reimbursement of eligible expenditures under SOE procedures. Majority of expenditure under the project is expected to be financed through direct payments.

43. The proposed fund flow mechanism is as follows:

Figure 2: Proposed Funds and Document Flow Diagram



Source: Asian Development Bank

I. RISK DESCRIPTION AND RATING

44. **Risk Assessment.** Table 1 summarizes the financial management risk assessment at the time of EGMP loan processing for NEA and provides updates to the risk assessment and reports on the risk mitigation and management measures proposed at the time. The pre-mitigation risk assessment of NEA remains **substantial** overall.

Table 1: Financial Management Internal Control and Risk Assessment (FMICRA)

Risk Type/area	Risk rating		Risk description	Mitigation measures	
	EGMP processing (original project)	EGMP- additional financing (Current FM assessment)	EGMP- additional financing (now)	EGMP processing (Original Project)	EGMP- additional financing (Current FM assessment)
1. Country specific risks	Substantial	Substantial	Weak governance	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 strengthen the capacity of integrity institutions such as the Commission for the Investigation of Abuse of Authority and National Vigilance Centre.	No change.
	Moderate	Moderate	Continued weak portfolio performance	On an overall country level, 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	No change.

Risk Type/area	Risk rating		Risk description	Mitigation measures	
	EGMP processing (original project)	EGMP-additional financing (Current FM assessment)	EGMP-additional financing (now)	EGMP processing (Original Project)	EGMP-additional financing (Current FM assessment)
				implementation; and (ii) improve the quarterly and annual country portfolio performance reviews.	
	Moderate	Moderate	Financing risk: Delays in releasing counterpart funds for the project.	Due to COVID-19 crisis, the financial position of government has further deteriorated. Effective project agreement needs to be established to counter the issue.	The risk has aggravated further because the crisis has deepened further and beyond expectations. However, NEA has not reported any funds release delays for the original project.
2. Entity specific risks	Moderate	Moderate	Financial risk: The approved tariff may be insufficient to recover costs undermining financial sustainability of NEA.	NEA has posted a profit of NPRs 9.8 billion for FY2019. However, the company is facing critical challenges regarding recovery of dues from its consumers on account of COVID-19 crisis. Further, the demand has dropped. ERC is functional and has recently issued tariff order based on cost-recovery principles. Though, tariffs for domestic consumers has been reduced but tariffs for HT industrial consumers have been hiked.	NEA has posted a net profit of NRs 11 billion (provisional) for FY 2020. The economic analysis wing, with inputs from other departments, is preparing a tariff petition. The petition will address the issue of financial impact of Covid-19 crisis on NEA and under-recovery of consumer dues. NEA will ensure that the petition and their tariff proposal are technically sound and in accordance with rules and

Risk Type/area	Risk rating		Risk description	Mitigation measures	
	EGMP processing (original project)	EGMP- additional financing (Current FM assessment)	EGMP- additional financing (now)	EGMP processing (Original Project)	EGMP- additional financing (Current FM assessment)
				<p>The decrease in tariffs for higher slabs under domestic category is likely to fuel electricity demand and is seen as a tariff rationalization step.</p> <p>The financial impact on account of COVID-19 is likely to be mitigated by the ERC in NEA's next tariff petition and is also likely to be reimbursed by the government.</p> <p>Further, NEA has constituted a committee and appointed consultant to prepare an NEA specific response plan.</p> <p>NEA has already appointed consultants who are assisting NEA in preparation of its tariff petition.</p>	<p>regulations of the ERC.</p> <p>NEA will comply with the directives of the ERC in its June 2020 tariff order and submit necessary data and information to ERC in this regard.</p> <p>However, the petition is likely to be submitted after finalization of audit of FY2020 accounts, which has witnessed some delays due to Covid-19 related lockdowns. The audited financial statements of NEA for FY2020 are expected to be finalized by July 2021.</p>
	Moderate	Moderate	Regulatory risk: There has been long standing debate on introduction of new NEA Act and Electricity Act in the country among	Appropriate provisions will be included in the legal agreement to ensure project continuation and uninterrupted progress in the event of any changes in	No change.

Risk Type/area	Risk rating		Risk description	Mitigation measures	
	EGMP processing (original project)	EGMP- additional financing (Current FM assessment)	EGMP- additional financing (now)	EGMP processing (Original Project)	EGMP- additional financing (Current FM assessment)
			the government circles. Among other reforms in the energy sector in the country, one of the key considerations is the unbundling of NEA into generation, transmission, and distribution entities. Since the project involves transmission and distribution enhancement, in the event of unbundling, project implementation may be jeopardized.	NEA's organizational status.	
Overall inherent risk	Moderate	Moderate			
B. Control Risk					
1. Executing agency	Low	Low	Compliance risk: NEA follows structured planning and technical assessment processes. It also has significant experience in implementing externally assisted projects and is	Not required.	No change.

Risk Type/area	Risk rating		Risk description	Mitigation measures	
	EGMP processing (original project)	EGMP- additional financing (Current FM assessment)	EGMP- additional financing (now)	EGMP processing (Original Project)	EGMP- additional financing (Current FM assessment)
			familiar with ADB's financial management and disbursement requirements		
2. Staffing	Moderate	Moderate	Limited capacity of financial management staff, particularly in planning, has the potential to lead to delays and inadequacies in financial management of the project.	<p>NEA has established a dedicated Project Management Directorate (PMD) for ADB projects, headed by a project director. PMD has a finance section which is responsible for financial management and reporting of all ADB funded projects. In addition, a dedicated accountant will also be included in each project unit involved in project implementation. NEA to ensure that accountants assigned to project unit are adequately qualified and possess experience of ADB funded projects.</p> <p>At the entity level, all APFS of ADB funded projects are also reviewed and approved by the finance directorate of NEA. The finance directorate comprises of two departments viz., corporate finance department and accounts department,</p>	No change.

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	EGMP processing (original project)	EGMP-additional financing (Current FM assessment)	EGMP-additional financing (now)	EGMP processing (Original Project)	EGMP-additional financing (Current FM assessment)
				<p>each headed by a director.</p> <p>The earlier vacant position of the director accounts department, noted in previous FMA, has been filled.</p>	
3. Financial Management Information System	Substantial	Substantial	<p>Limited automation of financial management systems could lead to inconsistencies and errors in financial reporting.</p>	<p>NEA is in advance stage of bid evaluation process for selection of SI for implementation of ERP.</p> <p>As the financial bid is higher than its initial estimates, NEA is likely to negotiate with the sole bidder.</p> <p>Appropriate provisions in the loan agreement/project agreement will be included to mitigate this risk.</p>	<p>The negotiations with the sole qualified bidder failed subsequently. NEA has requested the World Bank to cancel the bidding process for selection of the SI and invite fresh bids.</p> <p>NEA has learnt significantly from the failure of previous bidding processes. It has geared up itself for the next one. It is proactively reviewing its cost estimates and technical requirements. To minimize disruptions, NEA has planned to split the implementation process in 2 separate packages and invite 2 separate bids-separately for revenue</p>

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	EGMP processing (original project)	EGMP-additional financing (Current FM assessment)	EGMP-additional financing (now)	EGMP processing (Original Project)	EGMP-additional financing (Current FM assessment)
					<p>management system (RMS) and integrated financial information system (IFMIS). The split would enhance cost-competitiveness and facilitate higher number of qualified bidders.</p> <p>The implementation will now be funded under the current loan (EGMP-additional financing).</p>
4. Accounting manual	Moderate	Moderate	Out-of-date and inadequate accounting manuals could lead to inconsistencies and errors in financial reporting.	<p>NEA has a comprehensive accounting manual in place, containing accounting policies, in accordance with IFRS, and chart of accounts. The manual was prepared by Deloitte in 2012. However, their approval was pending for a long time.</p> <p>Now, accounting manuals have been approved and NEA is likely to adopt them along with its NFRS compliance process.</p>	<p>NEA's Board has recently approved the accounting manuals prepared by its consultants-Deloitte.</p> <p>However, these manuals were prepared long time back and are required to be updated in line with NFRS.</p> <p>The activity of accounting manual update will be funded through Norwegian grant administered by ADB through</p>

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	EGMP processing (original project)	EGMP-additional financing (Current FM assessment)	EGMP-additional financing (now)	EGMP processing (Original Project)	EGMP-additional financing (Current FM assessment)
					technical assistance (TA) attached to the PTDSSP loan.
5. Fixed Asset Management	Substantial	Substantial	<p>External auditors have issued qualified opinions on fixed asset and inventory system.</p> <p>No fixed asset register with the required information was available. No physical verification of property, plant, and equipment was conducted.</p>	<p>NEA is in the process of hiring consultants for carrying out physical verification of assets and inventories, prepare fixed asset register and carry out valuation of fixed assets and inventories. The process of asset valuation is supported through a component under the World Bank financed Power Sector Reform and Sustainable Hydropower Development Project. Shortlisting of consultants has already been completed through EOIs and five international consulting firms have been shortlisted. RFP was sent to the shortlisted firms on 16 August 2019. Evaluation of bids is in process. As per the terms of RFP, the fixed assets valuation exercise needs to be completed within two years of contract award.</p> <p>Though the process is likely to be delayed</p>	<p>NEA has awarded the contract to Deloitte India.</p> <p>Though the consulting firm commenced its work immediately, however the scope of the activities was limited on account of continuing lockdowns and travel restrictions.</p> <p>According to terms of the contract, the consultants are required to complete their assignment within 18 months of hiring.</p> <p>Though the consultants are confident that the assignment will be completed as scheduled. However, an extension of around 2-3 months may be required to compensate for the loss of time</p>

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	EGMP processing (original project)	EGMP-additional financing (Current FM assessment)	EGMP-additional financing (now)	EGMP processing (Original Project)	EGMP-additional financing (Current FM assessment)
				further on account of COVID-19 crisis in the country.	due to continuing Covid-19 crisis.
6. Risk management	Moderate	Moderate	The government has decided to on-lend all foreign funded loans to NEA with repayments in equivalent foreign currency. Earlier, the foreign exchange risk was borne by the government. NEA has no experience in managing foreign exchange risk.	NEA has already drafted a policy to manage forex risk across NEA. The draft policy is under discussion and NEA is likely to adopt the policy in the next financial year.	Implementation of the forex risk management policy, has been delayed on account of Covid-19 crisis. However, NEA has recently resumed consultations with its advisors. It is expected that the policy would be approved and implemented over the next financial year.
7. Internal Audit and controls	Substantial	Substantial	Currently, NEA has very limited qualified staff in its internal audit function. Further, internal audit manual has not been approved by the Audit Committee and the Board. The internal audit department is functionally reportable to the managing director of NEA, while internal audit reports are submitted to	The internal audit manual has now been adopted by the Board. It is likely to streamline the internal audit function at NEA.	NEA has strengthened and streamlined the internal audit department and its functioning. The department, headed by a dedicated and full-time director, reports to the Audit Committee on regular basis and their observations are forwarded to the Managing Director for implementation.

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	EGMP processing (original project)	EGMP- additional financing (Current FM assessment)	EGMP- additional financing (now)	EGMP processing (Original Project)	EGMP- additional financing (Current FM assessment)
			audit committee for review and approval.		<p>Similar to the accounting manuals, the internal audit manuals were prepared long time back and are required to be updated now. The activity of internal audit manuals update will be funded by a Norwegian grant, administered by ADB through technical assistance (TA) attached to the PTDSSP loan.</p> <p>NEA has also filled 3-4 senior level positions in the department which were earlier vacant for a long time. The department has also recruited 7 external qualified chartered accountants on contract basis to strengthen its function.</p> <p>The frequency of internal audit department's briefing to the Board of Directors has been increased from twice-in-a-year to thrice-in-</p>

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	EGMP processing (original project)	EGMP- additional financing (Current FM assessment)		EGMP processing (Original Project)	EGMP- additional financing (Current FM assessment)
					a-year (trimester basis).
8. Financial Reporting	Substantial	Substantial	The auditors have issued a qualified audit opinion on the financial statements of NEA for FY2017-2018 due to non-compliance with Nepal Financial Reporting Standards (NFRS).	<p>NEA has already prepared its accounts for FY 2018-19 based on NFRS.</p> <p>However, the compliance is partial as NEA has not completed its asset verification and revaluation process.</p> <p>An expedited compliance will be ensured through appropriate provisions in the loan/project agreement.</p>	<p>NEA has already prepared its accounts for FY 2019 and FY2020 based on NFRS.</p> <p>However, NEA cannot be in full compliance with NFRS unless the asset verification and revaluation (and impairment) exercise is completed.</p> <p>NEA expects its financial statements to fully comply with NFRS during FY2022 in the wake of operational difficulties arisen out of COVID-19 crisis.</p> <p>NEA has strengthened its accounting policies and expects its financial statements for FY2020 and FY2021 to exhibit improvements in reporting areas over previous years.</p>

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	EGMP processing (original project)	EGMP- additional financing (Current FM assessment)	EGMP- additional financing (now)	EGMP processing (Original Project)	EGMP- additional financing (Current FM assessment)
					An expedited compliance will be ensured through appropriate provisions in the loan/project agreement.
9. External Audit	Low	Low	NEA's financial statements are audited annually by the Office of the Auditor General (OAG) of Nepal, the supreme audit institution. Annual reports are normally issued within stipulated timelines.	None required	No change
10. Reporting and Monitoring	Low	Low	Comprehensive monthly and quarterly financial management reporting systems are in place	None required	No change
Overall Control Risk	Substantial				
Overall Combined Risk	Substantial				

45. NEA and ADB have agreed on an action plan to address the following issues that the FMA identified. The financial management action plan is provided in Table 2.

Table 2: Financial Management Action Plan (FMAP)

Risk Description	Mitigation Actions	Responsibility	Timeframe	
			EGMP processing (original project)	EGMP-additional financing (Current FM assessment)
<p><u>Fixed asset and inventory management</u> External auditors have issued qualified opinions on fixed asset and inventory system. No fixed asset register with the required information was available. No physical verification of property, plant, and equipment was conducted.</p>	<p>Hiring of consulting firm for carrying out fixed assets verification, valuation and associated tasks</p> <p>Completion of fixed assets verification, valuation and preparation of NFRS complied fixed assets register</p>	NEA	<p>By December 2020</p> <p>Within two years of hiring of consultant</p>	<p>Completed</p> <p>By July 2022</p>
<p><u>Other qualifications in audit opinion</u> NEA has defined accounting policies and procedures in place. However, during the recent years, external auditors have issued qualified opinions and highlighted persisting issues with regards to non-compliance with NFRS, reconciliations between accounting software and other softwares, various accounting policies, etc.</p>	<p>Audit qualifications related to fixed assets will be resolved through completion of fixed assets valuation exercise. Reconciliations and other system related qualifications are likely to be resolved through installation of ERP. For other audit qualifications, NFRS adoption is being pursued by NEA. Following actions were agreed in this regard:</p> <p>Preparation of NFRS complied financial statements of NEA. Partial compliance to commence from FY2019.</p> <p>NEA has recently appointed consultants to take up the task of physical verification and revaluation of fixed assets. The process is expected to take 18 months,</p>	NEA	FY2022	FY2022

Risk Description	Mitigation Actions	Responsibility	Timeframe	
			EGMP processing (original project)	EGMP-additional financing (Current FM assessment)
	however the timeframe might need to be extended as a fallout of the COVID-19 crisis.			
<p>ERP installation Various software are not integrated and result in reconciliation differences.</p>	NEA to ensure that ERP-based IFMIS and RMS are implemented successfully	NEA	<p>Contract award for ERP SI firm completed by December 2020 and provide regular updates to ADB.</p> <p>Submission of time bound action plan for the implementation of the ERP system by June 2021. Nine modules incorporated in ERP and operationalized (CDP target) by FY2024</p>	<p>The implementation of the ERP is now included as an output under the proposed loan (EGMP-additional financing).</p> <p>Hiring of project management consultants – Q2-2021 Bidding of RMS & ERP packages – Q3-2021 Hiring of RMS & ERP providers – Q1-2022 RMS & ERP providers to submit time bound action plan for implementation of respective packages – Q2-2022 Implementation of ERP & RMS – as per plan (but not later than 2026).</p>
<p>Internal audit function Internal audit function lacks appropriate number of qualified</p>	Consider change in reporting structure of internal audit by directly reporting to the	NEA	By August 2020	Completed

Risk Description	Mitigation Actions	Responsibility	Timeframe	
			EGMP processing (original project)	EGMP- additional financing (Current FM assessment)
staff. Risk based internal audit manual has been developed by NEA, however, it has not been approved by the audit committee. Internal audit department is functionally reporting to the MD.	chairman or audit committee on regular basis.	NEA	Completed	Completed
	Approval of internal audit manual by the audit committee and the board of NEA.	NEA & ADB	By December 2020	By December 2021
	Update of internal audit manual. ADB to provide funding under the attached TA (under PTDSSP loan) from the Norwegian grant to assist NEA in update of internal audit manual. Increase level of qualified staff/outsourced consultants in the internal audit department to ensure effective implementation of risk based internal audit.	NEA	By August 2020	Completed
<u>Finance and accounting function</u> NEA has developed an accounting manual and are implementing most of its requirements. However, the same is not approved by the audit committee and the board of NEA. Further, the manual was developed in 2012 and may need to be updated to correspond with current NFRS and operational requirements of NEA.	Approval of accounting manual by the audit committee and the board of NEA	NEA	Completed	Completed
	Update of accounting manual. ADB to provide funding under the attached TA (under PTDSSP loan) from the Norwegian grant to assist NEA in update of accounting manual.	NEA & ADB	By June 2021	By June 2022
<u>Foreign exchange risk</u> NEA does not have a policy in place to address foreign exchange risk. For	Develop risk management policy to address NEA's potential exposure to foreign exchange risk. ADB to assist NEA in arranging and	NEA & ADB	Completed.	Completed.

Risk Description	Mitigation Actions	Responsibility	Timeframe	
			EGMP processing (original project)	EGMP-additional financing (Current FM assessment)
new borrowings, NEA will have to bear foreign exchange risk on all loans to be on-lend by the government.	funding consultants for development of foreign exchange risk policy. Approval of the board for foreign exchange risk policy.	NEA	By August 2020	By July 2021
<u>Financial sustainability of NEA</u> Electricity tariffs that are reflective of efficient costs in the electricity supply would improve NEA's financial health and provide predictability for sustainable investment in the power sector.	NEA to file regular tariff applications to NERC following operationalization of NERC and promulgation of tariff regulations	NERC & NEA	Completed.	In accordance with the tariff regulations of the ERC.
<u>Financial Management Targets under CDP</u> Financial management related activities envisioned in CDP may not be implemented by NEA.	The CDP of NEA for five years from FY2020 to FY2024 has been approved by NEA board. Below are the specific action items (progress against these items should be included in the quarterly progress reports of NEA to be submitted to ADB): 1. Approval of MOF on the NEA CDP 2. Identify and separate Generation, Transmission and Distribution (GTD) assets and liabilities 3. Implementation of Enterprise Resource Planning software capable of generating financial statements of business unit 4. Determine per unit Generation, Transmission	MOF/NEA NEA NEA NEA	By Sept. 2020 FY2023 FY2024 FY2023	By June 2021 FY2023 (No change) FY2024 (No change) FY2023 (No change)

Risk Description	Mitigation Actions	Responsibility	Timeframe	
			EGMP processing (original project)	EGMP-additional financing (Current FM assessment)
	and Distribution cost of service 5. Create individual financial statements for the seven provincial Distribution Companies / Regional Offices	NEA	FY2023	FY2023 (No change)
<u>Submission of APFS & AEFS</u> APFS and AEFS may not be submitted by NEA on timely basis. Quality of APFS submitted may not be appropriate.	NEA to submit audited project financial statements, along with required audit opinions on overall financials and use of loan proceeds and management letter, to ADB on annual basis, within six months of end of each financial year. NEA to ensure compliance with ADB financial management and reporting requirements in preparation of APFS. NEA to submit audited entity financial statements, along with audit opinion on compliance with financial covenants, on annual basis, within one month of approval of audited financial statements by NEA's board.	NEA NEA	Annually from loan effectiveness date till loan closing date. Annually from loan effectiveness date till loan closing date	Annually from loan effectiveness date till loan closing date. Annually from loan effectiveness date till loan closing date (No change)
<u>Submission of periodic progress reports</u> Periodic progress reports may not be submitted on timely basis by NEA to ADB	NEA will provide ADB with quarterly progress reports in a format consistent with ADB's project performance reporting system, no later than 45 days after end of each quarter. The quarterly progress reports should include financial and disbursement report, variance analysis of physical and financial progress, details of utilization of funds and reconciliation with ADB LFIS, status of	NEA	Within 30 days of end of each quarter from loan effectiveness date till loan closing date	Within 30 days of end of each quarter from loan effectiveness date till loan closing date (No change)

Risk Description	Mitigation Actions	Responsibility	Timeframe	
			EGMP processing (original project)	EGMP-additional financing (Current FM assessment)
	implementation of FM action Plan and observations from internal and external audit			

ADB=Asian Development Bank, AEFS= Audited Entity Financial Statement, APFS= Audited Project Financial Statement, CDP=Corporate Development Plan, ERC = Electricity Regulatory, ERP=enterprise resource planning, FM=financial management, Commission, FY=fiscal year, FM=financial management, FMA-financial management assessment, FMAP= Financial Management Action Plan, GTD=Generation, Transmission and Distribution, HT-high technology, IFMIS=Integrated Financial Management Information System, LFIS= loan financial information system, NEA = Nepal Electricity Authority, NERC= Nepal Electricity Regulatory Commission, NFRS= Nepal Financial Reporting Standards, OAG= Office of Auditor General, PMD= Project Management Directorate, PTDSPP=Power Transmission and Distribution Systems Strengthening, TA=technical assistance, RMS= revenue management system, SI=standard instructions, WB = World Bank.