June 2008

Good Practice Example–Financial Management Report

Asian Development Bank
A. Summary [for RRP Appendix]

1. ADB conducted a Financial Management Assessment (FMA) of the proposed Program financial management arrangements in accordance with ADB’s Guidelines for the Financial Management and Analysis of Projects. The FMA considered the Department of Works (DOW), in its role as the proposed project executing agency (EA), and also the National Road Authority (NRA), which has been established to finance road maintenance.

Country-level Issues

2. Country issues that potentially impact program and project financial management include a weak public financial management (PFM) environment, management and skills capacity issues, and ADB country portfolio issues.

3. Country PFM arrangements were assessed in 2006 using the Public Expenditure Financial Accountability (PEFA) PFM Performance Measurement Framework. The assessment identified overall PFM improvements between 2002 and 2006. However, shortcomings were found in elements of the predictability and control of budget execution, in particular the effectiveness of payroll controls. Accounting, recording and reporting were also weaker elements, which undermines accountability, particularly for the large sums held in trust accounts. There is little evidence that PFM arrangements have improved since 2006; indeed in April 2008, the Auditor General advised the Public Accounts Committee that accounting and reporting systems in all departments [had] collapsed.

4. In common with many ADB developing member countries (DMCs), PNG has a shortage of skills in general management, financial management, financial analysis and management accounting. In particular, few accounts personnel possess practical skills beyond basic bookkeeping. The impact of these skill shortages on Government operations is amplified by high demand for financial skills from the private sector, particularly in the petroleum and mining sector, and from parastatal entities, which pay higher remuneration and, in most cases, provide better conditions.

5. The 2007 Country Portfolio Review Mission (CPRM) concluded that ADB projects in PNG in recent years have performed poorly, relative to other ADB DMCs in terms of both implementation and development outcomes. Historically, the major portfolio implementation issues have included (i) delays in endorsement of contracts by the National Executive Council (NEC), (ii) counterpart funds not being provided in a timely manner, and (iii) delays in the submission of audited annual project accounts (APAs). Particular issues involved the submission of supporting documentation to substantiate the liquidation of imprest funds and difficulties in auditing APAs in part due to poor project record-keeping, unreconciled bank accounts and ledger accounts, and lengthy delays in receiving responses to audit queries.

Risk Analysis

6. The risk-assessment approach is based largely on International Standard on Auditing 400 Risk Assessment and Internal Control. Inherent risk was assessed as substantial in large

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part due to country-level risks and past ADB experiences.\textsuperscript{4} Control risk was rated as high mainly because of experience with past projects in the sector.\textsuperscript{5} Particular weaknesses concerned record-keeping, internal controls, project accounting and reporting, and understanding of and adherence to financial management policies and procedures.

**Risk Mitigation**

7. The Program design reflects lessons from ADB experience both at the country level and in the road sector. Particular attention was paid to the financial management arrangements for Loan 1709-PNG and Supplementary Loans 2243 and 2244.

8. Financial management arrangements for the proposed Program will be significantly stronger. Disbursement arrangements were considered carefully. Given previous issues involving imprest accounts and payment procedures, direct payment procedures will predominate, imprest accounts will not be established, and the reimbursement procedure for eligible expenditures will apply with full supporting documentation.

9. In the case of NRA, ADB will provide technical assistance to establish robust financial management arrangements, including for record-keeping, internal controls, payables, receivables, budgeting, accounting, project management, and bank and trust account management.\textsuperscript{6}

10. Specific measures will include capacity-building support and the engagement by NRA and HRMG of independent accounting support to ensure, among other things, timely and rigorous reconciliations, orderly record keeping, and strict adherence to financial management policies and internal controls, and to ensure an orderly and timely year-end process for the preparation and audit of annual project accounts. Capacity needs of DoW and NRA will be assessed by the Program consultants and resources have been carried out in the program to carry out the needed capacity development.

\textsuperscript{4} Inherent risk is the susceptibility of the financial management system to factors arising from the environment in which it operates, such as country rules and regulations and entity working environment (assuming absence of any counter checks or internal controls).

\textsuperscript{5} Control Risk is the risk that the accounting and internal control framework is inadequate to ensure funds are used economically and efficiently and for the purpose intended, and that the use of funds is properly reported.

\textsuperscript{6} TA 3716-PNG: Road Authority Development Project.
B. Introduction

11. This Financial Management Assessment (FMA) has been prepared in accordance with ADB’s Guidelines for the Financial Management and Analysis of Projects. The FMA considered the Department of Works (DOW), in its role as the proposed project executing agency (EA), and also the National Road Authority (NRA), which has been established to finance road maintenance.

12. This assessment was prepared by Mr. Barry Reid (Senior Financial Management Specialist, PARD, ADB) and Ms. Elvira Rustamova (Operations and Administration Officer, PLCO, ADB) during fact-finding on 16–27 June 2008, and may be amended to reflect subsequent developments and agreements. Preparation activities included reviewing documents, interviewing counterparts and consultants, and discussing issues with stakeholders. Mitigating actions were identified together with counterparts.

C. Program and Project Description

13. The objective of the proposed Highlands Region Road Improvement Program is to increase economic development and reduce poverty in Papua New Guinea (PNG) by improving and ensuring the ongoing maintenance of the core road network of the Highlands Region. The Highlands Region, which comprises five provinces, is home to 40% of PNG’s population and generates a disproportionate share of the country’s GDP.

14. The Program will establish a sustainable road system in the Highlands region that will enable maximum use of its natural, mineral and human resources for the people of the Highlands region and the country. This will contribute to PNG's medium-term development strategy (MTDS) objectives of export-driven economic growth, and fostering rural development, poverty reduction, and human resource development. The Program focuses on the Highlands core road network (HCRN) of 2,500 km comprising all national, the main provincial, and some district roads, which together carry the bulk of the region’s traffic and provide accessibility to the population. HCRN represents 65% of the total road network in the Highlands region.

15. The Program is being designed as a multi-tranche financing facility. Overall, the Program investment cost is estimated at $750 million over ten years (2008–2018), of which the Government of PNG and other cofinanciers are expected to finance up to 45%. The first stage of the Program (2008–2012) is estimated to cost $140 million, including ADB financing of $100 million. This first project will focus on upgrading existing national roads. The Program will include technical assistance for preparation of the National Transport Development Plan (NTDP) for 2011–2020.

D. Country-level Issues

16. Country issues that potentially impact program and project financial management include a weak public financial management (PFM) environment, management and skills capacity issues, and ADB country portfolio issues.

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8 The Highlands region comprises five provinces: Chimbu, Enga, Southern, Eastern and Western Highlands.
1. Public Financial Management Arrangements

17. Country PFM arrangements were assessed in 2006 using the Public Expenditure Financial Accountability (PEFA) PFM Performance Measurement Framework. The assessment identified overall PFM improvements between 2002 and 2006. However, shortcomings were found in elements of the predictability and control of budget execution, in particular the effectiveness of payroll controls. Accounting, recording and reporting were also weaker elements, which undermines accountability for the large sums held in trust accounts.

18. In line with the assessment’s findings, in April 2008, the Auditor General advised the Public Accounts Committee that weak budget execution systems had enabled up to one billion kina ($400 million) to be stolen from the Finance Department over a seven-year period. According to the Auditor General, accounting and reporting systems in all departments [had all but] collapsed.

2. Management and Skills Capacity

19. In common with many DMCs, PNG has a shortage of skills in general management, financial management, financial analysis and management accounting. In particular, few accounts staff possess practical skills beyond basic book-keeping. The impact of these skill shortages on Government operations is amplified by high demand for financial skills from the private sector and parastatal entities, which pay higher remuneration and, in most cases, provide better conditions.

3. ADB Country Portfolio

20. The 2007 ADB Country Performance Assessment (CPA) exercise assigned PNG an overall rating of 10.9 – slightly less than the Pacific Developing Member Country (DMC) average of 11.1. The CPA portfolio performance rating for 2007 was 4.0 (out of 6), a decline from the 2006 rating of 4.5. However, the 2007 Country Portfolio Review Mission (CPRM) was less positive. The CPRM showed that ADB projects in PNG in recent years have performed poorly, relative to other ADB DMCs in terms of both implementation and development outcomes. Historically, the major portfolio implementation issues have included (i) delays in endorsement of contracts by the National Executive Council (NEC), (ii) counterpart funds not being provided in a timely manner, and (iii) delays in the submission of audited annual project accounts (APAs).

21. PNG has performed poorly since 2000 in awarding project contracts. The 2007 CPRM noted major problems in obtaining Government approval for contracts awards, particularly where NEC approval was required. PNG likewise has performed poorly in disbursements since 2000, with the exception of 2006 when $10 million from Loan 2079-PNG (Community water transport) was released.

9 Under the PEFA framework, performance is assessed in relation to seven dimensions of public financial management: credibility of the budget; comprehensiveness and transparency; degree to which the budget is prepared with due regard to government policy; predictability and control in budget execution; accounting, recording and reporting; external scrutiny and audit operations; appropriateness of development partner practices in country; and intergovernmental fiscal relationships.


22. The imprest fund turnover ratio declined steadily from 9% in 2000 to 4% in 2006 due to EAs’ inability to submit supporting documentation to substantiate the liquidation of imprest funds. In 2007, there was a gradual tendency to defer the liquidation of imprest account expenditures until Government counterpart funds were fully used.

23. Delays in the timely submission of audited APAs continue. The 2007 CPRM attributed the delays to a lack of staff in the Auditor General’s Office (AGO) and a general shortage of qualified external auditors in PNG (the AGO outsources project audits to the private sector) despite financial accounts being submitted to AGO in a timely manner. However, the AGO contends that although EAs submit APAs in a timely manner, the audit process is unnecessarily time-consuming due to (i) poor project record-keeping, (ii) unreconciled bank accounts and ledger accounts, and (iii) lengthy delays in receiving responses to audit queries.

E. Risk Analysis

24. A Financial Management Internal Control and Risk Management Assessment was conducted. The risk-assessment approach is based largely on International Standard on Auditing 400 Risk Assessment and Internal Control. The following risk assessments are based on existing circumstances, staffing and procedures, and include recommendations for risk mitigation measures.

1. Inherent Risk

25. Inherent Risk is the susceptibility of the project financial management system to factors arising from the environment in which it operates, such as country rules and regulations and entity working environment (assuming absence of any counter checks or internal controls).

<table>
<thead>
<tr>
<th>Risk type</th>
<th>Risk Level</th>
<th>Risk Description</th>
<th>Mitigation Measures</th>
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</thead>
<tbody>
<tr>
<td>1. Country-Specific Risks</td>
<td>H</td>
<td>Poor financial management, including inadequate accountability.</td>
<td>Ongoing efforts are underway to strengthen PFM arrangements, including through the development of the Medium-term Financial Management Strategy, which ADB is supporting. Support provided to consultants on the basis of 1709-PNG experiences will have greater responsibility and accountability. PNRM intends preparing a capacity development plan to improve the capacity of EAs, including DoW and NRA. The capacity development plan will be based on (i) available ADB training resources, (ii) capacity development provision in ongoing and future ADB financed loans, and (iii) capacity development opportunities by other development partners.</td>
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13 H = High, S = Substantial, M = Moderate, N = Negligible or Low.
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<tr>
<th>Risk type</th>
<th>Risk Asst</th>
<th>Risk Description</th>
<th>Mitigation Measures</th>
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<tbody>
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<td></td>
<td></td>
<td>Malpractice and abuse of public financial management rules by public servants.</td>
<td>Key shortages will be addressed by using contracted staff, consultants or outsourced services.</td>
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<td>Act decisively to remove corruption in the payments system, including procurement.</td>
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<td>Where warranted, the disciplinary procedures detailed in PNG’s General Order 15 (Discipline) will be strictly followed. These apply to breaches of the PNG Public Service (Management) Act 1997, the Public Finances (Management) Act 1995 and the PNG Criminal Code and the Summary Offences Acts.</td>
</tr>
<tr>
<td>2. Entity-Specific Risks</td>
<td>M</td>
<td>Confusion of roles between DoW staff, HRMG and project consultants.</td>
<td>Clear organizational structure of EA (HRMG) will be established, particularly the extent of separation of roles and responsibilities between departments.</td>
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<td>Work plans with nominated core activities for all EA personnel will be developed.</td>
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<td>The role of the supervision consultants will differ markedly from Loan 1709-PNG, with the consultants being more accountable.</td>
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<td>NRA and Treasury are currently reviewing appropriation approaches and presentations.</td>
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<td></td>
<td>Transparency will be supported through provision of independent accounting support and the requirement that NRA financial statements and reports on project process are posted on the NRA website, which will be established with ADB support.</td>
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Proposed Highlands Region Road Improvement Program: Financial Management Assessment

<table>
<thead>
<tr>
<th>Risk type</th>
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<tbody>
<tr>
<td></td>
<td></td>
<td>Inadequate record-keeping, internal reporting and monitoring of outturns.</td>
<td>Strengthen internal management reporting and internal audit capacity. Targeted training and capacity building at all levels provided. Give serious attention to timely reporting and the follow up of external audit findings and recommendations.</td>
</tr>
<tr>
<td>3. Project-Specific Risks</td>
<td>H</td>
<td>The complex structure of program that will cover 5 provinces over a 10 year period (2008-2018). Program managers have previously placed insufficient importance on financial management arrangement, as evidenced by audit reports.</td>
<td>The MFF modality provides flexibility to adjust project design in response to experience. External accounting support will be provided to ensure sound financial management practices.</td>
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<tr>
<td>Overall Inherent Risk</td>
<td>S</td>
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</table>

2. Control Risk

26. Control Risk is the risk that the project’s accounting and internal control framework are inadequate to ensure project funds are used economically and efficiently and for the purpose intended, and that the use of funds is properly reported.

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Control Risk</td>
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</tr>
<tr>
<td>1. Implementing Entity</td>
<td>M</td>
<td>NRA: financial management policies and procedures are being established, but more remains to be done. Minor deficiencies and misinterpretation of ADB guidelines in disbursement and withdrawal of program funds by EA. DoW staff have been on a code of ethics course, but there is no explicit project policy of where/how to report fraud, waste, misuse of assets.</td>
<td>Support will be provided to NRA to establish sound financial management arrangements. EA/IAs to liaise regular with ADB to ensure that ADB guidelines are followed. Interagency coordination at all levels to discuss the portfolio performance of loan. Procedures for reporting fraud, waste, misuse of assets to be documented and implemented.</td>
</tr>
</tbody>
</table>

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<tbody>
<tr>
<td>2. Funds Flow</td>
<td>H</td>
<td>Challenges have been encountered in managing disbursements. Warrants for Government counterpart funds have been issued late or for incorrect amounts. DoW has only one drawing account at the Bank of Papua New Guinea and over 100 bank accounts with signatories delegated DoW to the Provincial levels. There is typically a large backlog of bank reconciliations at headquarters and in the provinces.</td>
<td>Provide regular training on ADB’s disbursement policies. Develop exception report for project/program management to highlight untimely release of warrants by DoW for Government expenditures. Separate accounts to be maintained for all project components financed by ADB and the Government, and to be audited by an independent auditor. External accounting support to review execution of disbursements by project staff and improve procedures where needed. Direct payment procedures will be generally used for road improvement civil works contracts and for consulting services contracts. Given previous issues with record-keeping and supporting documentation, the ‘reimbursement with documentation’ procedures will be used to reimburse eligible expenditures rather than the statement-of-expenditure procedures. Imprest accounts will not be used.</td>
</tr>
<tr>
<td>3. Staffing</td>
<td>M</td>
<td>Staffing skills are satisfactory for book keeping, but staff responsibilities for the effectiveness of the accounting systems and reports could be improved. Staff turnover and a lack of financial management skills. No policy for rotation of staff duties. Lack of performance review process for staff with sanctions for poor staff performance (including financial breaches) being rarely used. Accounting staff have limited understanding of ADB requirements.</td>
<td>Accounting staff to be mentored to higher skills levels (program accountant needs to reach competence level of an international accounting technician qualification). Project staff remunerated at market rate to enable recruitment and retention of high calibre skilled staff. Rotation of accounting duties to be used where feasible. Performance management process to be developed in order to retain and reward the right calibre of skilled people. Strictly enforce the Public Service Code of Business Ethics and Conduct. Provide regular training on ADB’s procurement and disbursement processes.</td>
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<td>Risk Asst</td>
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<tr>
<td>4. Accounting Policies and Procedures</td>
<td>H</td>
<td>Diversity of accounting systems and charts of accounts used for DOW projects and activities. Project budgeting is carried out in some detail but the details are not used in performance reports. Account and bank reconciliations are not performed in a timely manner, which fundamentally undermines internal controls.</td>
<td>Common form of chart of accounts to be used for budgeting and accounting for all projects and trust accounts in the program, including economic items (income, expenditure, assets and liabilities), activities and outputs and funding sources. Employ qualified and trained staff who will undertake account and bank reconciliations on a periodic basis.</td>
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<tr>
<td>5. Internal Audit</td>
<td>H</td>
<td>There was no effective internal audit function for the previous project. In the past, financial weaknesses and irregularities were identified by the external auditor, inevitably at a late stage.</td>
<td>Accounting services to be contracted out to an independent accounting firm who will review bank and account reconciliations, check and report on the status of internal controls and record-keeping, and prepare monthly project accounts and report to Internal Audit Committee.</td>
</tr>
<tr>
<td>6. External Audit</td>
<td>M</td>
<td>The program is subject to annual audit. However, although the project provides the auditing firm with the annual project accounts in a timely manner (usually within 3 months after year-end), the audit process is drawn out leading to the covenant not being met on the timely provision to ADB of audited APAs.</td>
<td>Improved preparation of APAs by the PMU, and improved PMU record-keeping and reconciliations. The independent accounting firm at year-end, to prepare the annual project accounts (APA) and underlying working papers in preparation for the annual financial audit.</td>
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<tr>
<td>7. Reporting and Monitoring</td>
<td>H</td>
<td>Financial reports are produced but are often based on unreconciled accounts, and are provided late (particularly audited project accounts). There is no regular reporting to the management or to the Divisions and branches by the Finance and Budget Branch. The Branch considers all information can be viewed directly from FMS.</td>
<td>Timely and reliable reporting provided to all stakeholders: implementing agency, user agencies, donors, and program and project management. Reporting to stakeholders will be prompt after the period end. These will include expenditure comparisons of actual with budget, linked to project progress and forecasts of expected outcome, cash flow statements, and asset schedules. HRMG to prepare and submit to ADB quarterly and annual progress reports on project implementation and operation.</td>
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<td>Monitor compliance with loan covenants, including submission of audit project accounts.</td>
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<td>Risk type</td>
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<td>8. Information Systems</td>
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<td>The IT Branch is poorly staffed and resourced. The Oracle Financials system used by DoW is not up to date with upgrades. Moreover, HRMG relies on Excel spreadsheets and there is a risk that the HRMG may lose the unsupported system if there are further delays in the Integrated Financial Management System (IFMS). No back-up is taken of the access database that records expenditures on the ADB imprest account.</td>
<td>Recruitment of qualified IT staff and allocation of adequate resources to IT Branch as part of AusAID’s Transport Sector Support Program to strengthen capacity and improve service delivery. Given ongoing IFMS delays, DoW should examine options for sustaining existing financial management systems. Regular backups of all accounting systems and other appropriate security measures.</td>
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<td>Overall Control Risk</td>
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F. The Existing Project Financial Management System

1. Strengths

27. The main strength of existing project FM (under Loan 1709-PNG) is that experience in project financial management has been built up over the nine-year period since the project was approved, but this experience has not always translated into effective financial management.

2. Weaknesses

28. The major weaknesses are:

(i) **Entity:** Entity arrangements do not emphasize the importance of the FM function or activities. Particular entity weaknesses include:
- staff turnover and a lack of appropriate FM skills; and
- diversity of accounting systems and charts of accounts used for DoW projects and activities.

(ii) **Reporting:** Financial reports are produced but are often based on unreconciled accounts, and are provided late (particularly audited project accounts). As a result:
- costs and progress of project activities have generally not been matched;
- information is often produced too late to be of real use; and
- personnel, bank and asset records have been neglected.

(iii) **Basic Accounting and Reconciliation:** Account and bank reconciliations are not performed in a timely manner, which fundamentally undermines internal controls.
G. Implementing Entity

29. The structures envisaged to manage and oversee Program implementation at this stage of the design process include each of the key public sector stakeholder agencies\(^{15}\), and have been designed to encourage accountability and minimize risks of corruption. Implementation of the road improvement component will be managed by the Highlands Road Management Group (HRMG), a group that already exists and is managing ongoing ADB projects\(^{16}\). The HRMG will comprise DoW and NRA operational personnel augmented by international and local consultants. The DoW will concentrate on rehabilitation and improvement activities and the NRA on the routine, periodic and emergency activities. The structure and composition of the HRMG is designed to augment the limited resources of the road maintenance and construction agencies. The staff shortages arise from the difficulty government agencies have in retaining and recruiting qualified staff due to the high demand for engineers in the private sector.

30. To foster sustainability, and in keeping with Paris and Kavieng Declaration commitments, Government procedures and documentation will be used in all implementation stages. In addition to direct implementation roles consultants will build capacity in key technical and management functions by training young professional staff seconded from NRA, DoW and provincial works authorities.

31. The HRMG will have two objectives.
   (i) To ensure that the project is implemented in accordance with the laws of PNG, Government’s regulations and the Bank’s Guidelines, exercising efficient, effective and economic implementation methodologies; and
   (ii) To establish a sustainable and systematic road maintenance operation through long term transfer of technology and assistance.

32. Construction will be contracted through performance-based international competitive bidding (ICB) contracts comprising upgrading and rehabilitation. HRMG will administer the implementation of the upgrading, rehabilitation, and maintenance subprojects under the Project, and it will strengthen DOW’s capacity to improve and rehabilitate roads and the NRA to plan and execute routine, periodic and emergency maintenance using performance based contracts.

33. In doing so, the project will develop and pilot methods in the preparation, tendering and administration of performance specified maintenance contracts.

34. The description of the proposed organizational structures is shown in Figure 1 below. The Program management and reporting structure and constituent projects are subject to further discussion.

\(^{15}\) The DOW, NRA and NRSC, as well as the Departments of Treasury, Finance, and National Planning and Monitoring (DNPM).

\(^{16}\) Loan 1709-PNG and Supplementary Loans 2243/44-PNG.
Figure 1. Proposed Organizational Structures

PROGRAM STEERING COMMITTEE

Department of Works (DOW)

National Road Authority (NRA)

Project Management Unit (DOW)

Project Management Unit (NRA)

 PROGRAM SUPPORT CONSULTANT

Investigation, Design & Bid Documents

Investigation & Bid Documents

Procurement & Road Improvement Contracts

Procurement & Road Maintenance Contracts

Contract Administration (Construction)

Contract Administration (Maintenance)

Improvement Contracts Project 1

Improvement Contracts Project 2

Improvement Contracts Project 3

Improvement Contracts Project 4

Maintenance Contracts Project 1

Maintenance Contracts Project 2

Maintenance Contracts Project 3

Maintenance Contracts Project 4
Proposed Highlands Region Road Improvement Program: Financial Management Assessment

H. Fund Flow Mechanisms

35. The borrower will be responsible for implementing the project according to the loan agreement and other agreements. On its part, ADB will monitor the project and review its progress to ensure that the loan proceeds are spent as agreed upon. When a loan becomes effective, a loan account will be opened in ADB’s books in the name of the borrower and the loan amount is credited to that account. All disbursements under the loan will be carried out in accordance with ADB’s Loan Disbursement Handbook (2007, as amended from time to time). The last disbursement under the MFF will be made by 31 December 2018.

36. Direct payment procedures (where ADB, at the borrower’s request, pays a designated beneficiary directly) will be generally used for road improvement civil works contracts and for consulting services contracts. HRMG will maintain separate bank accounts for each project.

37. Given previous issues with record-keeping and supporting documentation, the ‘reimbursement with documentation’ procedures will be used to reimburse eligible expenditures rather than the statement-of-expenditure procedures. Imprest accounts will not be used.

<table>
<thead>
<tr>
<th>Responsible Person/ Unit</th>
<th>Activity</th>
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<tbody>
<tr>
<td>Borrower</td>
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<td>• completes the withdrawal application for each payment in different currency;</td>
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<td>• completes the corresponding Summary Sheet using a separate form for each category or subcategory;</td>
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<td>• attaches the contract or confirmed purchase order (PO) indicating the amount and due date; and</td>
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<td>• attaches the supporting documents to each withdrawal application.</td>
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<tr>
<td>ADB</td>
<td>• receives the accomplished forms and related supporting documents.</td>
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I. Personnel

38. Personnel arrangements and positions will be per the PPTA consultants report.

J. Accounting Policies and Financial Reporting

39. Appropriate International Financial Reporting Standards will be applied for project reporting (particularly IAS 7: Cash flow Statements). The cash basis of accounting will be adopted, with additional disclosures.

K. Internal and External Audit

40. In the past, the internal audit function has been less-than-fully effective given the lack of capacity, funding; and staff. Currently there are only three staff members within DoW, although there are six approved and funded positions. A review undertaken by Price Waterhouse Coopers (PWC) in 2005 recommended a sharp increase in staff ceilings and in the availability of resources, and for the provision of training for internal auditors. However, these recommendations have not been implemented due to the lack of funding in the recurrent budget. External audits were relied upon to identify financial weaknesses and irregularities, inevitably at a late stage.
41. Recognizing the financial management issues experienced under loan 1709-PNG, an independent accounting firm will be engaged to review bank and account reconciliations, check and report on the status of internal controls and record-keeping, and prepare monthly project accounts. The independent accounting firm will at year-end, prepare the APA and underlying working papers in preparation for the annual financial audit.

42. The project will be subject to an annual audit by an independent auditing firm, acceptable to ADB. However, although the project in the past has provided the auditors with the APAs in a timely manner (usually within 3 months after year-end), the audit process is drawn out leading to the covenant not being met on the timely provision to ADB of audited project accounts. There are several reasons for this, the main reason being the poor preparation of APAs by the PMU, and the poor state of PMU record-keeping and reconciliations. This means that the audit process is more laborious and time-consuming and involves a higher level of audit queries requiring resolution. The time taken to resolve these queries pushes the audit finalization beyond the covenanted period.

L. Information Systems

43. The Information Technology Department of DoW supports and provides advice for the Divisions and the provinces. It supports IT infrastructure and the FMS centrally and in the provinces. It manages the local area network and wireless area network to ensure the system is running and operating well.

44. One issue of concern is that the Department’s FMS is currently not supported by Oracle Financials (as upgrades have not been purchased and implemented) and there is a risk that the Department may lose the unsupported system if there are further delays in the IFMS implementation. Further delays in the IFMS project therefore have significant potential impacts on the Department’s current FMS.

M. Procurement

45. Governance risks in relation to procurement will be minimized by following ADB’s Procurement Guidelines February 2007. International competitive bidding procedures will be followed for all contracts over $3 million for civil works and $0.5 million for goods. National competitive bidding will be used for contracts under these thresholds. Shopping can be used for goods with contract values lower than $100,000, as appropriate. A detailed procurement plan has been prepared with contracts being packaged to attract international contractors as well as promoted the national contracting industry.

N. Disbursement Arrangements

46. The loan proceeds will be disbursed in accordance with ADB’s Loan Disbursement Handbook (2007, as amended from time to time). The last disbursements under the MFF will be made by 31 December 2018. Direct payment procedures will generally be used for road improvement civil works contracts and for consulting services contracts. HRMG will maintain separate bank accounts for each project. Reimbursement with documentation procedures will be used to reimburse eligible expenditures.
O. Action Plan

1. Overall

47. The following are proposed actions:

(i) Agree on the management and reporting structure of the projects and activities within DoW and NRA.
(ii) Develop common form of chart of accounts to be used for budgeting and accounting for all projects and trust accounts in the program, including economic items (income, expenditure, assets and liabilities), activities and outputs and funding sources.
(iii) Develop performance management policies in order to retain and reward the right calibre of skilled people. Develop work plans with nominated core activities for all EA personnel.
(iv) Contract out accounting services to an independent accounting firm and provide capacity development of auditing functions within EAs.
(v) DoW and NRA submit audited APAs and financial statements not more than 6 months after the close of the fiscal/financial year, as specified in loan agreement, to sector division or resident mission for their review and necessary action.
(vi) Provide regular training on ADB’s procurement and disbursement processes.
(vii) Develop and implement procedures for reporting fraud, waste, misuse of assets.

2. For HRMG

(i) Select a suitable accounting package and design, and implement an improved accounting and reporting system for the program and its constituent projects.
(ii) Given ongoing IFMS delays, HRMG to examine options for sustaining existing financial management systems.
(iii) Train managers and accounting staff to use new financial management systems.

3. For NRA

(i) ADB will provide technical assistance to establish robust financial management arrangements, including for record-keeping, internal controls, payables, receivables, budgeting, accounting, project management, and bank and trust account management.
(ii) Independent accounting support will be continued to ensure, among other things, timely and rigorous reconciliations, orderly record keeping, and strict adherence to financial management policies and internal controls, and to ensure an orderly and timely year-end process for the preparation and audit of annual project accounts.

P. Assurances/Covenants

1. Right of Audit

48. HRMG will ensure that contracts financed from the Facility will include provisions specifying the right of ADB to audit and examine the records and accounts of HRMG and all
contractors, suppliers, consultants, and other service providers as they relate to the Project(s) under the Facility.

2. Financial Management

49. HRMG and NRA will engage independent accounting support to build capacity and to ensure, among other things, timely and rigorous reconciliations, orderly record keeping, and strict adherence to financial management policies and internal controls, and to ensure an orderly and timely year-end process for the preparation and audit of annual project accounts.

3. Governance and Anticorruption

50. The Government will ensure that (a) the Program is carried out in compliance with all applicable PNG anticorruption regulations, and ADB’s Anticorruption Policy (1998, as amended to date); (b) all HRMG and NRA staff actively participate in the training in PNG’s anticorruption regulations and ADB’s Anticorruption Policy; and (c) a website is developed and maintained to disclose the audited annual project accounts, project progress, and procurement activities.