Financial Management Assessment (FMA) - Asian Development Bank

Objective and features

1. Objective

FMA aims to assess the capacity of executing and implementing agencies and their financial management systems to implement ADB-financed operations.

2. Institutional coverage

Project level, executing and implementing agency level at national and subnational level (in beneficiary country).

3. Technical coverage

FMA assesses the capacities of executing and implementing agencies and their systems for planning and budgeting, accounting, internal controls, reporting, cash and payments, and auditing.

4. Application method

Custodian.

Methodology

5. Methodology

FMA consists of a questionnaire that covers the following areas:

- Fund flow arrangements
- Staffing
- Accounting policies and procedures – segregation of duties, budgeting systems, payments, cash and bank, safeguard over assets, other offices and implementing entities, contract management, and accounting
- Internal audit
- External audit – entity level and project level
- Reporting and monitoring
- Information systems.

Reponses to each question under each section is given based on the evidence collected during the assessment. Part of the FMA approach entails striking a balance between the efficiency of the mitigation measure and the cost of implementing it. The assessment includes a risk mitigating matrix that determines how and when to mitigate the risks.

6. Benchmarking system

FMA identifies and assesses financial management and internal control risks, based on the degree of impact and the likelihood of occurrence using the following scale: High – likely to occur, high impact if risk occurs; Substantial – unlikely to occur, high impact if risk occurs; Moderate – likely to occur, low impact if risk occurs; Low – unlikely to occur, low impact if risk occurs.

FMA proposes risk mitigation and management strategies to address the identified risks: High – risk avoidance, mitigation, transfer recommended; Substantial – risk avoidance, mitigation, monitoring recommended; Moderate – risk monitoring recommended; Low – risk documentation and identification.

7. Linkage to PEFA framework

PEFA assessments are referred to as a source of information for FMA for relevant areas.

8. Complementarity with PEFA framework

FMA extends to identification of risk of fraud and corruption. FMA can be applied to individual institutions or to groups of institutions making up a sector.

Development and use

9. Development and coordination

FMA has been developed to identify the risks within the executing and implementing agencies who are identified to implement the projects financed by ADB. The ADB team together with the executing and implementing agency identify the risks, agree on the mitigating actions, and support the agency in strengthening its financial management system.

The tool originated from WB's financial management arrangements, guidelines, and manual (2005). The Asian Development Bank, African Development Bank, and Inter-American Development Bank customized the scope of WB's financial management manual to develop their risk assessment framework.

In cofinancing arrangements, the lead financier is responsible for the financial due diligence. Reports and subsequent recommendations are shared with ADB.

10. Assessment management

An FMA is conducted after discussions with the executing and implementing agencies on the scope of the project. The following steps are followed in conducting an FMA:

1. Desk review of existing PFM assessments followed by an on-site mission.
2. Assessment of financial management systems and capacity of the executing and implementing agencies, including potential strengths and weaknesses and their usability in project implementation.
3. Risk assessment and preparation of a risk management plan.
4. Initial draft of the project's funds flow, accounting, reporting, control, and auditing arrangements.
5. Development of appropriate covenants to address and monitor the issues.

FMA is performed by the Regional Department project team, with support from consultants. In appropriate cases, the support of the Financial Management staff from the Procurement, Portfolio and Financial Management Department may be sought.

FMA is a dynamic assessment, and should be reviewed and updated regularly during implementation, particularly in reference to implementation of risk mitigation measures and capacity development initiatives.

Some of the external information resources referred to during the FMA are PEFA reports (A01), Report on Observance of Standards and Codes – Accounting and Auditing (D14), financial management capacity assessments by WB or other multilateral or bilateral development partners, country procurement assessment reports, reports on websites (such as Bloomberg, and Standard and Poor).

Custodian quality assurance procedures apply. There is an interdepartmental review process within ADB.

11. Uses by the government and members of the PFM community

FMA is an internal ADB tool which is mainly used to:

- identify risks in executing and implementing agencies' financial management systems and/or practices that may lead to non-achievement, or sub-optimal achievement of project outcomes and/or outputs;
- identify risks that could lead to the use of ADB resources for unintended purposes, whether due to leakage or inefficiency;
- develop a practical risk management plan to address financial management risks at the project level that may, otherwise, adversely affect the achievement of project development outcomes; and
- evaluate the adequacy of existing financial management arrangements for implementing ADB-supported projects, and if needed, propose modification and/or strengthening.

FMA constitutes one of the four components of ADB's requirements for financial due diligence in relation to sovereign investment projects.

12. Sequencing with other tools

A "D" rating in any of the PEFA (A01) indicator can trigger a risk assessment in that specific area. Inputs from the SAI PMF (B25) assessments are also used to identify areas that need to be strengthened.

13. PFM capacity building

Based on the results of the gap analysis, the issues are identified, and measures are taken to strengthen the capacity of PFM functions (such as accounting and auditing) at agency level.

14. Tracking of changes and frequency of assessments

Project teams should update the earlier FMA in the case of the second or subsequent tranches in a multitranche financing facility, or for second or subsequent loans to the same executing or implementing agency. If the assessment findings are categorized as high risk, the assessment is updated twice a year, and if it is categorized as medium risk, the FMA is updated once a year. The intensity of the mission during the update - site visit or desk review - is dependent on the risk identified during the initial FMA assessment. Even in the case of first-time executing or implementing agencies, diagnostic work performed by other development partners, if it is recent, may be updated. Each assessment update tracks the changes in the risk profile.

Performed before ADB's financing operation, FMA is agency-level, project-level type of assessment. FMA is to be conducted for all projects and for implementing agencies. During processing of the project, assessment is conducted, and risk is identified. Update of that risk assessment and mitigation measures is performed, that is, high risk requires a constant update at least twice a year while low risk requires an update every other year. There are other elements that influence the update of an assessment. Every year, ADB requires audited project and, when available, entity financial statements. Once these are submitted, and if those audits are qualified, then issues that trigger an increase in the risk are identified and, accordingly, the risk management plan is updated.

15. Resource requirements

An FMA cost can vary from US$5,000 to US$15,000. Factors that affect the cost of the assessment are complexity of the project, the number of executing and implementing agencies, and the number of experts needed to conduct the assessment. The time taken for an FMA depends on complexity, the number of implementing agencies, and the experience of implementing agencies in implementing externally funded projects. Processing of an FMA with medium complexity and two implementing agencies would take around three weeks.

Implementation support and monitoring and updating of the FMA could take three to five days every mission (desk review, site visit) depending on the capacity and performance of the implementing agency. The assessment requires an expert with prior experience in conducting FMAs and knowledge in financial discipline (with chartered accountancy or equivalent designation). Control and supervision of the FMA exercise rests with the ADB staff even though some of the work may be outsourced.

Transparency

16. Access to methodology

ADB Technical Guidance Note on Financial Management Assessment is *available*.

17. Access to assessment results

The FMAs conducted for all projects are available by querying for relevant search parameters on the *ADB website*.