

Financial Management Framework (Draft Report)

Sindh Municipal Services Delivery Program

**funded by United States Agency for International Development
(USAID) and Government of Sindh**

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ABBREVIATIONS

ADP	-	Annual Development Program
ASP	-	Assessment & Strengthening Program
AG	-	Accountant General
AGP	-	Auditor General of Pakistan
AGPR	-	Accountant General Pakistan Revenues
APPM	-	Accounting Policies and Procedures Manual
CGA	-	Controller General of Accounts
COA	-	Chart of Accounts
DAC	-	Departmental Accounts Committee
DCO	-	District Coordination Officer
EA	-	Executing Agency
FD	-	Finance Department
FM	-	Financial Management
F&A	-	Finance & Accounts Officer
FMRs	-	Financial Monitoring Reports
FRM	-	Financial Reporting Manual
F&A Officer	-	Finance & Account Officer
GPE	-	Governance Process Evaluation
GoS	-	Government of Sindh
IA	-	Implementing Agency
ICA	-	Internal Controls Assessment
LG	-	Local Governments
MoF	-	Ministry of Finance
MSDP	-	Municipal Services Delivery Program
NAM	-	New Accounting Model
NBP	-	National Bank of Pakistan
PC-1	-	Project Concept Paper
PD	-	Program Director
PSC	-	Program Steering Committee
PMU	-	Program Management Unit
PSDP	-	Public Sector Development Program
PIFRA	-	Project for Improvement of Financial Reporting and Auditing
SBP	-	State Bank of Pakistan
SOP	-	Standard Operating Procedure
SNE	-	Schedule of New Expenditures
SOEs	-	Statement of Expenditures
STR	-	Significant Transactions Review
TMA	-	Taluka Municipal Administration
USAID	-	United States Agency for International Development

1. INTRODUCTION AND BACKGROUND

1.1 Background

1. Government of Sindh (GoS) plans to implement Municipal Services Delivery Program (MSDP) in the Sindh Province with a cost of Rs 6,668.55 million (US\$ 76.65 million). Planning & Development Department (P&DD), GoS is responsible for execution of the Program. The program is proposed to be financed by a USAID grant amounting to Rs 5,742 million (US\$66 million). GoS will contribute PKR 926.5 million (US\$ 10.65 million) to the Program.

Program Goal: Sustained improvement in municipal service delivery to effectively address the basic needs of citizens located in small and medium towns in Sindh.

Objectives

- a) Improve basic service delivery and provide it in a more transparent and accountable manner.
- b) Upgrade provincial information systems for planning, operations and monitoring and evaluation (M&E).
- c) Establish a collaborative partner relationship between USAID and Provincial Governments for urban sector policy, program design and implementation.

1.2 Context

2. A pre-award assessment of the Planning & Development Department was carried out as part of the preparation of the MSDP. The assessment also covered areas like budgeting, accounting, finance and accountability with elaborate process pertaining to budget preparation and execution, financial controls and oversight. The assessment identified various risk factors in financial management, to cater these risks through Risk Management Framework¹ (RMF). During assessment need was observed to develop comprehensive financial management framework for Program Management Unit of MSDP.

3. The pre-award assessment indicates that the program is being prepared in a high financial management risk area; the risk is high due to a number of factors including staffing, budgeting process, recording and reporting of expenditure and internal auditing, low financial management (FM) capacity, use of outdated and manual systems at the provincial level. Hiring of adequate FM staff at competitive market rates, adoption of this FM Framework and concentrated FM arrangements in the Program Management Unit (PMU) together with targeted capacity building are the key mitigation steps recommended to minimize such a risk.

4. The below table presents summary of risk assessment conducted during pre-award assessment.

Risk Assessment based on Pre-Award Assessment	Rating
Staff Strength & Skills: Staff strength is considered adequate however, capacity building in the areas of computer literacy and budgeting techniques is needed. Compliance with the benchmark is assessed as medium risk.(PD 36) ²	Medium
Budgeting Process: Limitations of budgeting technique, weaker coordination among the departments, absence of centralized budget teams to prepare ADP and current budgets based on the assessed departmental priorities and limited use of MIS tools direct our assessment of the budgetary process to be rated as high risk. (PD 37)	High
Recording & Reporting of Expenditure: Based on our observations and findings	Low

¹ Commissioned by the USAID

² Pre award Assessment of Planning & Development Department pages reference

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accounting, recording and reporting of expenditure is adequately performed and hence compliance with the benchmark is assessed as low risk. (PD 38)	
Scope of Accountability: External Scope and frequency of audit functions by Auditor General and AG Office is sufficient. However, pre-audit by AG office cannot be construed as a sound internal audit function that is risk based and comprehensive enough to control risk and compliance issues. Hence compliance with the benchmark is assessed as medium risk. (PD 39)	Medium
Conflict of Interest in Audit function: Independence of accountability function is considered as adequate and hence compliance with the benchmark is assessed as low risk. (PD 39)	Low
Follow up of Audit Observations: the compliance with the benchmark is rated as low risk. (PD 40)	Low
Financial and budgeting information system: An automated Financial Information System is non-existent at departmental level hence compliance with the benchmark is assessed as high risk. (PD 40)	High
Overall Risk	High

1.3 Objectives

5. The primary purpose of this Financial Management Framework is to ensure that uniform accounting policy and procedures should be followed by Program Management Unit (PMU) for implementation of MSDP and all compliances should be under regulation of Government of Pakistan, Government of Sindh and the USAID. These requirements are based on the premise that sound project financial management brings together planning, budgeting, accounting, financial reporting, internal control, auditing, procurement, disbursement and the physical performance of the project with the aim of managing project resources properly and achieving the program's development objectives. Therefore, sound financial management is a critical ingredient of program success.

6. The FM Framework shall ensure that there is consistency, transparency and accountability on the part of those involved in managing and implementing MSDP. Further to improve timeliness in financial reporting, to ensure application of funds only limited to the purposes for which they were provided, to facilitate preparation of periodical funds withdrawal statements, and financial management reports for USAID. The FM framework is devised so as to reduce the risks associated with the degree of complexity related to the management and organization of MSDP. The project management should study this document and the FM staff dedicated for the program once on board may add annexes to incorporate peculiar FM aspects finalized during the program design.

7. ASP shall provide on-the-job training to the FM Staff of the PMU for implementation of the FM framework. Training of the newly hired FM staff shall be conducted by requiring public financial management specialist with aim to ensure that the FM framework is implemented in all areas of programs financial management. The specialist shall develop the facilitating training materials based on the FM Framework (Appendix A - SOPs for Finance and Accounting functions). The materials should support the skill based learning process and shall cover areas like project financial management, budget preparation and execution, accounting policies and procedures, program financial reporting, internal and external auditing.

2. PROGRAM MANAGEMENT AND OVERSIGHT

8. The MSDP will be implemented by a separate program management unit under P&D department. The P&D department will be the administrative department for overall supervision and policy guidelines of the program.

2.1 Program Steering Committee

9. In order to provide institutional connect between P&D department and PMU, a program steering committee has been notified to be chaired by the Additional Chief Secretary (ACS - Development). MSDP is periodically steered, reviewed and supervised by the steering committee³. The PSC is comprised of representatives of all stakeholders involved and committee having 18 members representing community, P&D department, Finance Department, Rehabilitation Department, Public Health Engineering Department, District Governments and USAID, shall provide oversight guidance and approvals required for smooth and timely implementation of program as well as carry out monitoring functions. The representative of USAID/Pakistan will attend all meetings of the PSC as an observer and may contribute to the program discussions.

2.2 Program Management Unit

10. PMU will be housed in P&D Department of GoS headed by a Program Director with Regional offices at Larkana, Sukkur and Mirpur Khas, to execute program activities. The Program Director shall be responsible for performance of PMU in respect of program activities. The Program Director shall have the overall responsibility for the program. He shall oversee financial management of MSDP and regularly review program progress by reviewing the financial reports. The paragraph⁴ 5.6 of “Manual of Accounting Principles (NAM)” describes the financial and accounting responsibilities of Program Director.

11. The Program Director shall report to the Steering Committee through ACS (Dev). He shall supervise the project staff and is expected to maintain a high degree of relationship with the Planning & Development Department and Finance Department of GoS. He shall also serve as the liaison person in respect of MSDP between the GoS and USAID. The Program Director have been made responsible

³ Steering committee was formed through notification SO(C-IV)SGA&CD/4-26/2011 dated 21st May 2011

⁴ These responsibilities are inline with the instructions issued later by MoF

- a) The Principal Accounting Officer will assign a Program Director to each project.
- b) The Program Director will be responsible for the performance and financial and accounting function of the project to which the Program Director is assigned.
- c) Responsibilities of the Program Director include:
 - (i) Ensuring compliance with financial and accounting policies and procedures issued by the Auditor-General and the Ministry of Finance
 - (ii) Ensuring proper recording of financial transactions
 - (iii) Ensuring compliance with the objectives of that project
 - (iv) Authorization and monitoring of expenditures
 - (v) Prompt, full and accurate reporting of financial information
 - (vi) Ensuring compliance with the limits of authorities
 - (vii) Furnishing the Auditor General with a copy of the monthly accounts
- d. The Program Director is responsible to the Principal Accounting Officer of the controlling entity.

for maintenance and operation⁵ of the account and to submit classified account statements to the Accountant General Sindh who consolidate the project accounts in the national accounts of the country.

2.3 Staffing Arrangements for Financial Management

12. The financial management activities in PMU will be headed by a the Director Finance & Compliance (F&C). The Director (F&C) shall report directly to the Program Director and shall be responsible for budgeting, accounting and disbursement functions, and administration of the FM team. Specific functions will include overseeing maintenance of accounting records and preparation of financial reports through a viable financial management system and maintenance of record of all transactions on a regular basis. In addition, he shall be responsible for liaison with auditors during annual audit.

13. The Director (F&C) will be supported in PMU by one Finance & Procurement Specialist and three (3) managers (Finance, Procurement and Compliance). The managers will be further supported by Assistants, in relation to regional offices, each office will allocate Finance & Account Officer and Assistant for financial management of the program. The reporting functions will be channeled by organizational charter as presented below. For the successful implementation of finance and accounting system and timely generation of various financial statements and reports provided in this framework, the project accounting staff shall require adequate training and supervision.

14. The organizational chart⁶ of MSDP is indicated Finance & Compliance section's management structure in PMU and section is responsible for financial⁷, procurement⁸ and human resource management of the program. The structure for financial management (finance and accounting functions) is presented in Figure 1:

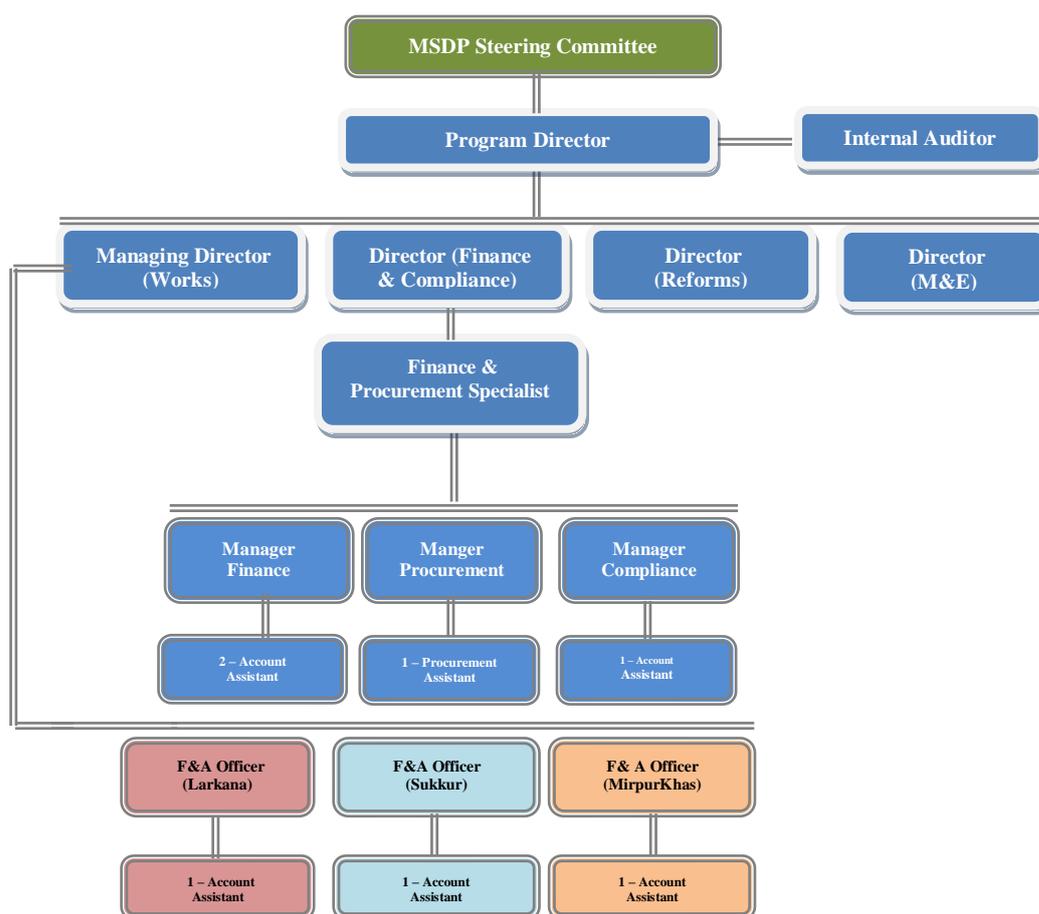
⁵ Ministry of Finance (MOF), vide letter dated July 27, 2011 has issued instructions regarding the maintenance and operation of revolving fund accounts opened for Donors credits/ loans/grant shall be observed by the Program Director.

⁶ Annexure D of PC-I for Sindh Municipal Services Development Program

⁷ In PC-I of MSDP internal auditor is positioned under Director (F&C) which is in contradiction of internal auditing charter, as internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. Therefore, internal auditor shall report directly to the Program Director.

⁸ Frameworks for Procurement and Human resource management will provide guidance to the management of MSDP relating to procurement, HR policies and practices.

Figure 1: Financial Management Structure for MSDP



15. Appendix A gives detailed description of Job Summary, Qualification, Work Experience and Responsibilities of FM staff of MSDP. While adhering to the job descriptions, there will be the following macro level functions of FM team:

Macro level Functions of Financial Management Team	
Director (F&C) Finance & Procurement Specialist Manager Finance Manager Compliance	<ul style="list-style-type: none"> ▪ Financial Management of MSDP functions. ▪ Financial Management capacity building of FM Staff. ▪ Participation in discussions and planning during USAID Missions. ▪ Withdrawal Applications to the USAID for replenishment of Revolving Fund Account. ▪ Dedicated Liaison officer between USAID and MSDP. ▪ Compliance of statutory requirements. ▪ Disbursement to Regional Offices for establishment expenditure and other recurring cost. ▪ Any other tasks as assigned by the Program Director
3 – Finance & Accounts Officers (Larkana, Sukkur and MirpurKhas) and 1 Account Assistant for each	<ul style="list-style-type: none"> ▪ Financial Management of Regional Offices. ▪ Work closely with consultants/TMAs for sub-project implementation. ▪ Any other tasks as assigned by the Director (F&C)

3. FINANCIAL MANAGEMENT ARRANGEMENTS AND POLICIES

3.1 Funds Flow and Disbursement Arrangements

16. Keeping in view the institutional design of the MSDP, the payments and accounting will be the responsibility of the PMU for smooth implementation of the program.

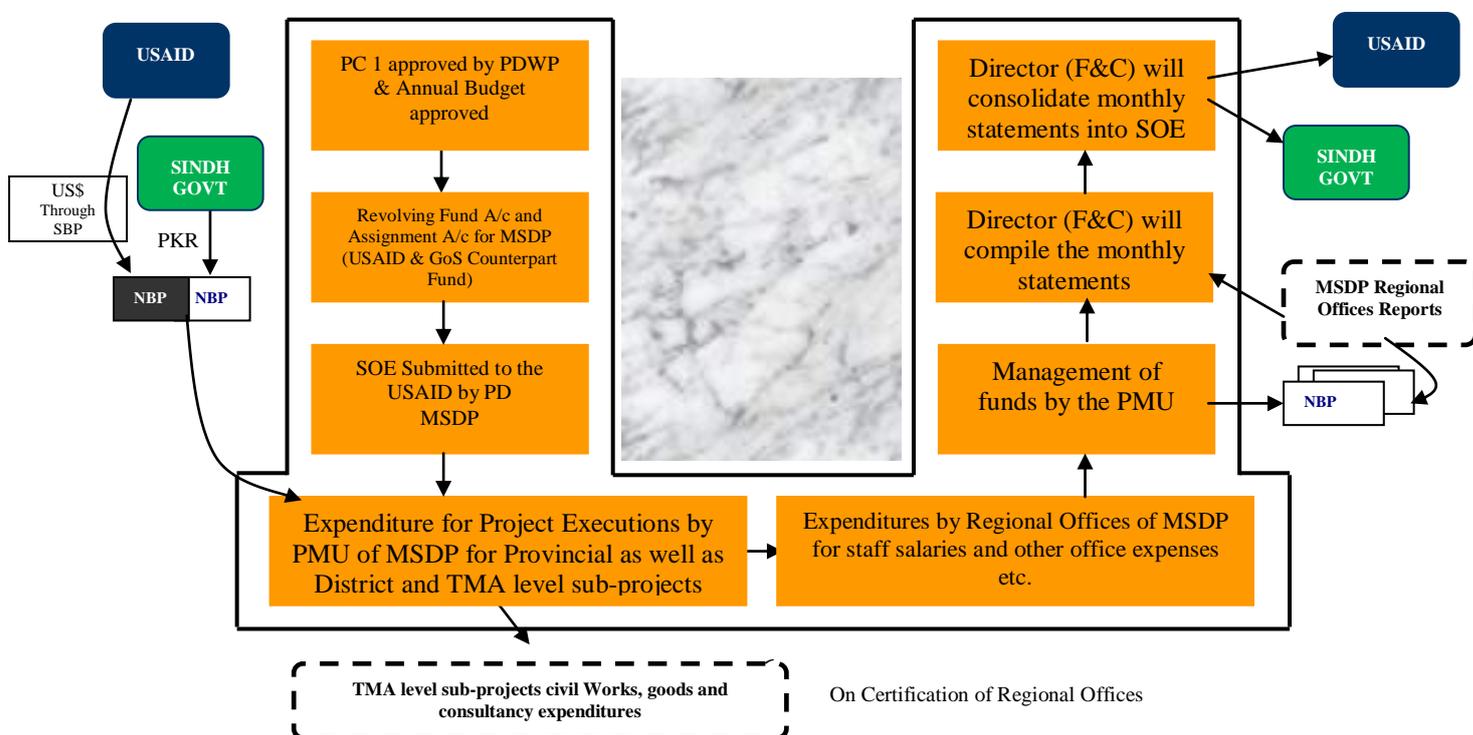
17. Each year the estimated project expenditures would be included in the Annual Development Program (ADP) of the GoS and reflected as an identifiable single head budget item. The estimated funding from the USAID will be included in the estimated receipts and accordingly appropriated to the MSDP through GoS Finance Department.

18. Two separate bank accounts will be opened (*detailed procedure for opening of revolving fund account mentioned in MOF notification number F.2(1)-BR-II/2007-1618 dated July 27, 2011 annexed as Appendix E*) with the National Bank of Pakistan to facilitate disbursements. One US\$ account (revolving fund account) with title “USAID MSDP – Sindh Assignment Account” shall be opened for USAID, whereas one Rupee account (Assignment a/c) for the government counterpart funds respectively. All eligible program expenses would be financed through these accounts on the basis of agreed proportions. The USAID funds will be channeled through the SBP to the revolving fund account. The first time initial deposit into the revolving fund account would be made to kick off the program implementation, on the basis of three months' estimated expenditures and counterpart funds of government’s equity contributions will be deposited in the Rupee Assignment Account semi-annually in advance.

19. The Bank Accounts will be operated and maintained by the Program Director with a joint signatory. Funds from the USAID will be released against Withdrawal Applications accompanied by the Statement of Expenditures (SOEs). The reconciled and verified Project’s Statement of Expenditures in respect of the expenditures made by the PMU shall suffice, since the PMU will keep more detailed information for the audit purposes, including the original documents.

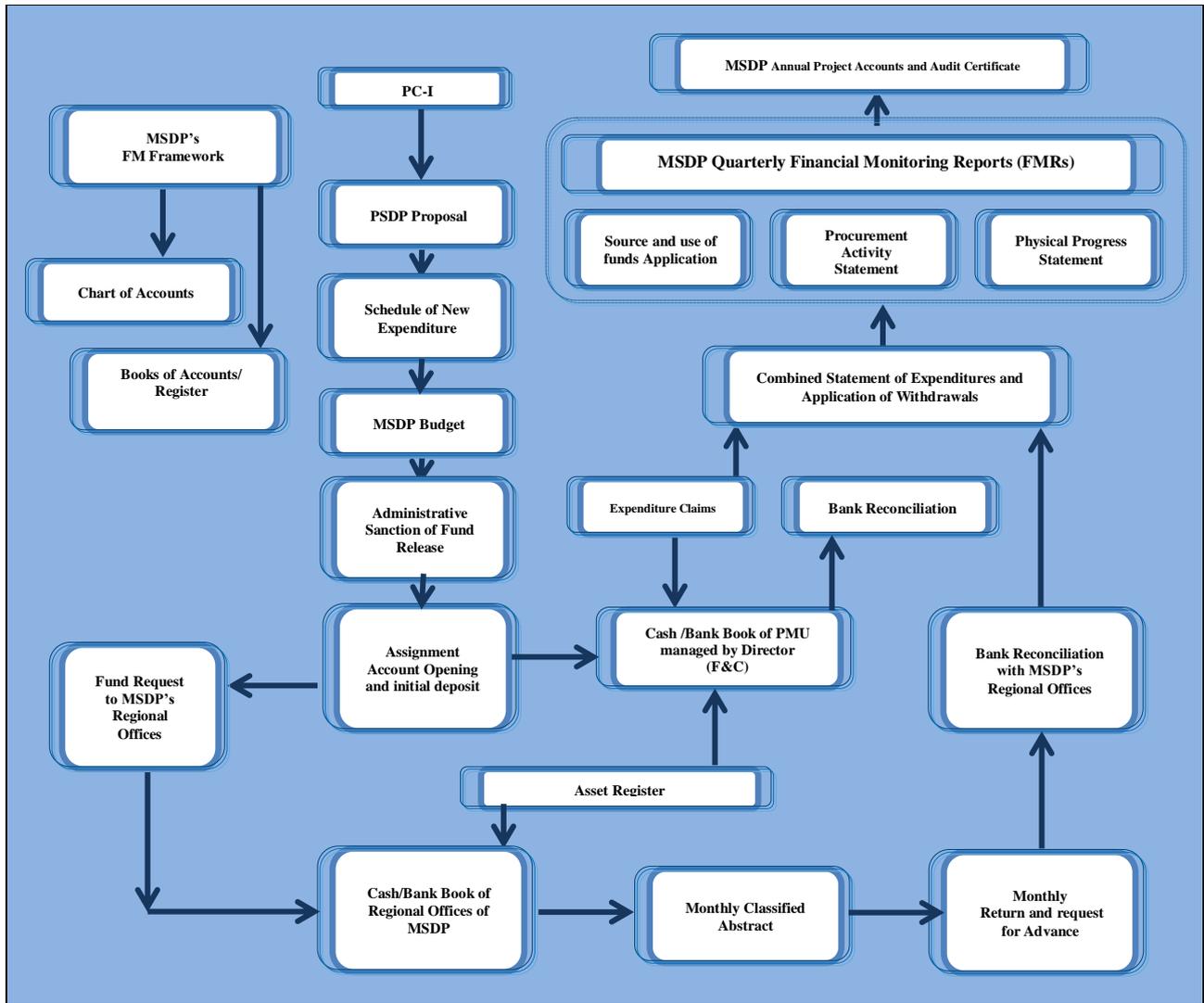
20. Further more details regarding fund flow and disbursement arrangements are reproduced in Appendix A (SOPs for Finance and Accounting Functions).

Figure 2: Funds flow and financial tracking



21. Figure 3 presents information view of process dynamics in MSDP’s financial management. The objects are used to represent various key documents for the financial management of the program.

Figure 3: Process Dynamics in MSDP’s Financial Management



3.2 Budgeting

22. Budget Activities relating to preparation, compilation, approval and subsequent budgetary controls will be carried out by FM team at PMU office. The budget preparation exercise will be broken down into identifiable tasks. The budgeting of all MSDP expenditures shall be made part of the Government Budgeting Process. The New Accounting Model (NAM) - Chart of Accounts shall be utilized with facilitation to have separate codes for expenditure financed under the program. These codes may be used during the next budget cycle to facilitate the budget execution and reporting process for the entire program. Once budgets are approved these will be recorded in their respective accounts heads in the General Ledger system for monitoring purposes.

23. The Program Director shall prepare work-plans for the component activities to be implemented under the program. The work-plans will form the basis of the annual budgeting for the program components. The implementation of the program will be done in accordance with the estimated procurement plans prepared annually as part of program budget. Implementation includes adequate financial management, proper accounting of transactions and preparation of financial statements.

24. Detailed procedures for the preparation, appraisal and approval of development project proposals are set out in the 'Manual for Development Projects'⁹ issued by the Planning Commission and are applicable to all spending entities. MSDP sub-projects estimates shall only be prepared for projects approved in accordance with those procedures. Summary procedure for preparation, appraisal and approval of development project proposals is attached as **Appendix D** of this framework.

25. Budgetary controls for project and sub-projects will be controlled through FM section as GL data will be transferred on periodical basis, for compilation of accounting records and generation of various management reports related to budget utilization, variances and budgeted figures left for the remaining period.

26. To further integrate the MSDP budget within the overall government budgetary system the program budget will feed into the Medium Term Budgetary Framework maintained by GoS Finance Department.

27. The detailed guidelines and procedure for preparation and execution of budget is elaborated in SOPs annexed as **Appendix A**.

3.3 Accounting Policies

28. The cash basis of accounting shall be used except for major commitments and physical assets which will be recorded, by using separate registers for that purpose.

29. The PMU shall maintain adequate records and accounts to display sound accounting practices, and record the operations, receipts and expenditures of the program, thereby ensuring that all moneys received are properly accounted for and all payments are properly authorized, correctly made and accurately recorded.

30. Standard Operating Procedure (SOPs) applicable to the finance and accounting functions (FM team) has been developed as part of this FM framework and attached as **Appendix A** and project accounting extract from NAM as **Appendix C**. The SOPs and its stipulations are binding on the Program staff. It describes guidelines & procedures for the functional areas in the finance and

⁹ <http://www.planningcommission.gov.pk/mdp.html>

accounts, budgetary control, financial management/ accounting system, items of property, plant and equipment / fixed assets, development and establishment expenditure, books of account, journal voucher, payment voucher, receipt petty cash payment voucher, receipt voucher, budget and budgetary control etc., are covered in this document. It also provides in documented form the significant guidelines formulated by program management unit from time to time for guiding decisions and actions in these areas. It also describes the steps to be followed by the concerned designated staff of the finance and accounts function in the actual implementation of the prescribed procedures.

31. FM team for project management may use Integrated Country Systems (PIFRA) for financial management. The PMU for MSDP shall be provided with a computer terminal that is directly linked to the PIFRA transaction server of the CGA establishment (i.e. AGPR, AGs, DAOs and Treasuries). The MSDP's budgets will, remotely, be loaded into the system at the PMU by the Director (F&C). A sub-account of the consolidated fund shall be established for MSDP, representing the project's Designated (Revolving) Account. Each time a payment is processed through the system by the PMU, the transaction will be charged against the sub-account of the consolidated fund of the government and defaulted as a charge against the Bank account of the MSDP. This Bank account will be denominated as the sub-account of the consolidated fund.

32. A set of Standard Operating Procedures is developed for implementation of SAP System (PIFRA) for MSDP's Accounts and attached as **Appendix F**, these SOPs will be used by PMU while implementation of SAP system. The purpose of this document is to provide a step by step procedure to set up the Financial Management System in a manner compliant with the SAP system (PIFRA). The document covers the procedures for setting up the SAP terminal to the point where it is linked with the main server in the AGPR office, and financial management system under the SAP system is operational. The document also provides the necessary guidance to the end-user; however, training will have to be provided for smooth operation of the system.

3.4 Financial Reporting

33. FM team shall prepare the annual program accounts. Since the program will use Cash or Commitment Basis of accounting in sync with existing government practice, annual accounts will include the Receipts and Payments Account and an indirectly ascertained balance sheet with the details given in the notes.

34. The FM team of PMU will be responsible for preparing quarterly financial reports, and for submitting the reports to the Program Director. The PMU will furnish quarterly progress reports to USAID on program implementation, to be submitted within one month of the end of the quarter to which they relate, and such other reports and information relating to the Program as USAID may reasonably require.

35. **Financial Monitoring Reports (FMRs):** FMRs shall include a statement showing for the period and cumulatively (project life or year to date) cash receipts by sources and uses of funds by main expenditure classifications; beginning and ending cash balances of the program; and supporting schedules comparing actual and planned expenditures. It also provides information that is useful to the program management while also providing the USAID with sufficient information to establish whether:

- Funds disbursed to projects are being used for the purpose intended,
- Project implementation is on track, and
- Budgeted costs will not be exceeded.

36. Financial information shall be linked with information on physical progress and procurement, to give assurance that financial and physical progress is consistent. The monitoring of expenditures in relation to physical progress is a key aspect of ensuring that the program is under proper financial control.

37. Based on reporting requirements of USAID Activity Agreement¹⁰ following financial monitoring reports are developed and attached as **Appendix B**. The Director (F&C) will provide the following quarterly reports to the USAID and GoS, not later than 14 days after the end of the quarter:

- (i) Sources and Uses of Funds
- (ii) Uses of Funds by Project Activity
- (iii) Statement of Expenditures (SOEs)
- (iv) Physical Progress Reports

3.5 Internal Audit

An internal audit function shall be established in PMU-MSDP which shall report directly to the Program Director. It will be an important role of internal auditor to review program risk profiling (prepared by management) review risk assessment procedures and reporting on adequacy and effectiveness of risk assessment process. The scope of internal audit should be amplified to periodically and effectively review compliance with, and internal controls under, the program mandate. The internal audit should be an integral component of good governance and accountability. It should be a more process oriented and value added function of the management as well as an activity for continuous improvement and performance appraisal.

¹⁰ Article 9: Reporting And Monitoring

Section 9.01: Accounting Books, Records and Audits

The Grantee shall maintain, or cause to be maintained, in accordance with its laws and regulations, and generally accepted international accounting principles and practices, supporting documents of deposits to, withdrawals from, and uses of the accounts set forth in this Activity Agreement. Such documents shall be available for review and audit by USAID or its designees at the end of each fiscal year of the Grantee and at other such times as USAID may request, and for up to three years following the last withdrawal from the applicable separate accounts made in accordance with the provisions of this Activity Agreement. Additional review and audit requirements may be established in subsequent PILs. In addition, the Auditor General of Pakistan will audit the accounts set forth in this Activity Agreement and its use in accordance with U.S. Government auditing standards, or other internationally accepted standards, as provided under the Memorandum of Understanding, dated April 26, 2007, and executed by USAID/Pakistan, the USAID Regional Inspector General, Manila and the Auditor General of Pakistan.

Section 9.02: Monitoring and Reporting

Except as the Parties may otherwise agree in writing, the Grantee shall provide USAID with a minimum of quarterly reports on the uses of the funds in and the status of the accounts set forth in this Activity Agreement until the funds are fully withdrawn from such accounts and such funds, are applied to the agreed upon uses specified in this Activity Agreement and in any related PILs. Each such report will include information acceptable to USAID regarding all deposits into and withdrawals from the Separate Dollar Account and the Special Assignment Account, and the uses of such withdrawals, including deposits into the Separate Dollar Account and the Special Assignment Account and the prompt application of funds for the Activity, as set forth in this Activity Agreement and in any subsequent PILs regarding the use of these funds. The quarterly report will include copies of the corresponding bank statement(s) pertaining to the period covered by the report. Additional reporting requirements, frequency and formats may be established in subsequent PILs. The Grantee shall also report annually to USAID on the level of own source contributions (cash or in kind) contributions applied to the implementation of the Activity. The Grantee may use PC-3 form quarterly reports, if jointly agreed upon by the Parties, to fulfill its reports requirements.

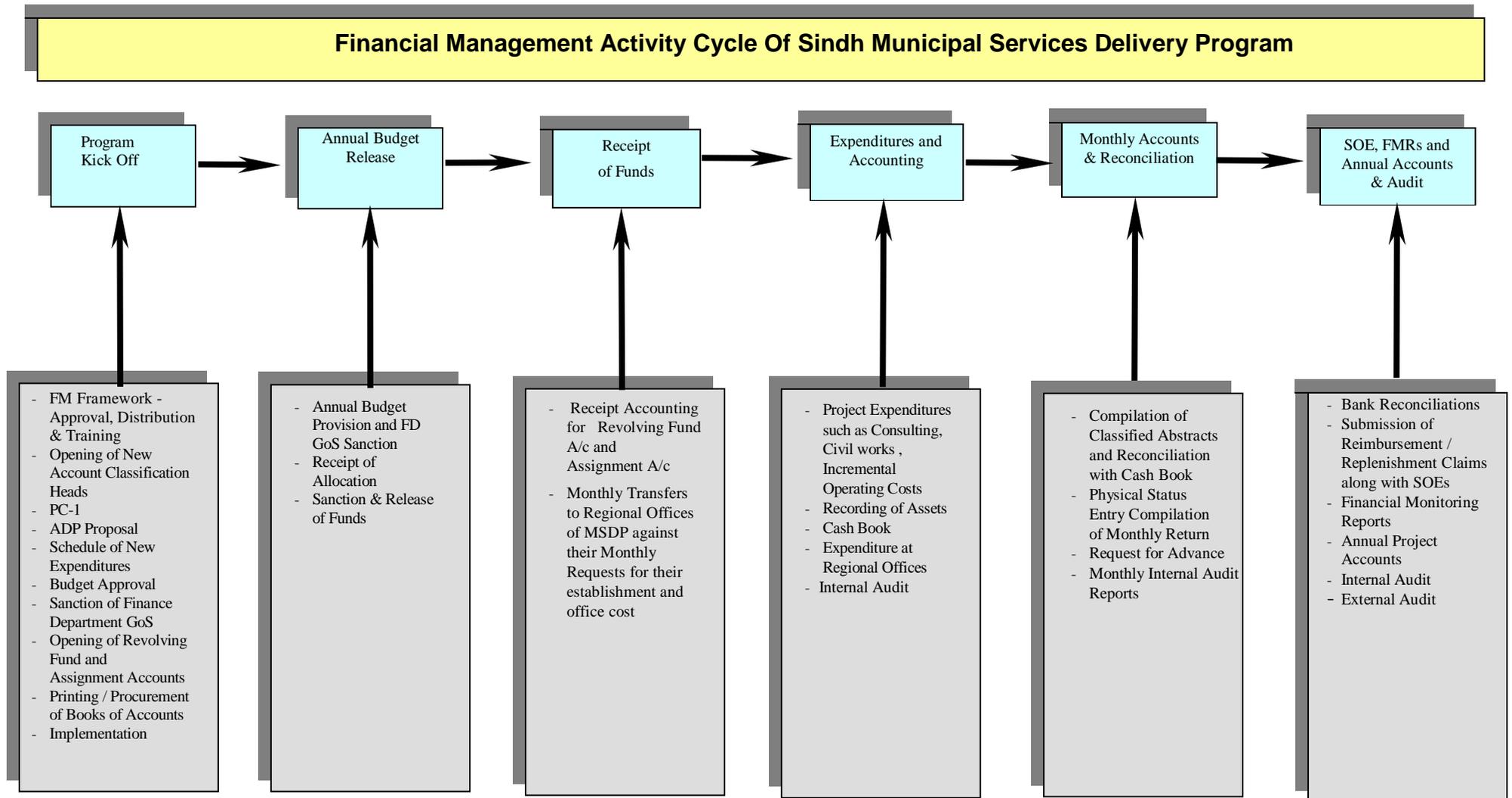
3.6 External Audit

38. The MSDP management and P&DD of GoS shall ensure that the program is audited yearly by the Auditor General of Pakistan (AGP) and by any other external auditor, as required by the donor. The MSDP SOPs shall also ensure that the audit reports are managed to be sent to the donor within six months. These audited statements would be submitted to the USAID and P&D department of GoS within six months after the close of the fiscal year. The annual audit reports will consist of an overall opinion on the Program Financial Statement and a management letter. The detailed scope of external audit is mentioned in Appendix A.

3.7 Financial Management Activity Cycle

39. Figure 4 presents a checklist of activities in the MSDP's financial management cycle starting from kick-off of FM activities to the generation of first annual financial statements. The figure describes the FM cycle which will be executed through FM team of PMU (housed in P&D Department) at provincial level and Regional Offices at District Level with participating TMAs.

Figure 4: FM Activity Cycle



APPENDICES

Following Appendices are attached with this FM frame work:

Appendix A: Standard Operating Procedure (SOPs) for Finance & Accounting Functions

- A-1: Job Descriptions of Finance & Accounting Staff
- A-2: Accounting Forms (Extracted from NAM)

Appendix B: Financial Monitoring Reports

- B-1: Source & Use of Funds
- B-2: Source & Use of Funds by Program Activities
- B-3: Physical Progress Reports for Municipal Infrastructure Up-grade (Construction Activities)
- B-4: Physical Progress Reports for Other Program Activities (Non-Construction)
- B-5: Monthly Reports from Regional Offices of MSDP

Appendix C: Project Accounting – Extract from NAM

Appendix D: Summary Procedure for preparation, appraisal and approval of Development Project

Appendix E: MOF notification issued for Revolving Fund Account dated July 27, 2011

Appendix F: SOPs for implementation of SAP System (PIFRA) for MSDP's Accounts

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