

# I. FINANCIAL MANAGEMENT

## I.1 Introduction

1. The financial management system for the Vazhndhu Kaatuvom Project has been designed to ensure transparency and accountability and also inclusiveness in decision-making and allocation of financial resources to the villages.

## I.2 Financial Management Framework

2. The financial management framework consists of simplified arrangements to ensure transparency and accountability at all levels of the project’s proposed Institutional set up. The financial management framework for the project is given in Table 9.1.

**Table 9.1 Financial Management Framework**

Level	Institutional Arrangement	Key Financial Management Arrangements
<b>State Level</b>	Executive Committee of the “Vazhndhu Kaatuvom State Society” (State Society)	<ul style="list-style-type: none"> <li>• Develop, review, revise and approve financial management policies for the project</li> <li>• Approve annual budgets for the project</li> <li>• Review financial progress at the Apex level</li> <li>• Overall oversight of financial management functions</li> <li>• Approve and place the audited annual accounts for adoption by GB and file the same with the Registrar of Societies</li> <li>• Review and follow up audit reports</li> </ul>
	State Project Management Unit (SPMU) Project Director with Finance Specialist and Accounts Team	<ul style="list-style-type: none"> <li>• Compile annual budget of project based on annual action plan for SPMU and various DPMUs and submit the same to GoTN for sanction of the budget</li> <li>• Receive funds into its bank account from GoTN as per the allocated budget</li> <li>• Distribute funds to DPMUs on a timely basis as per agreed annual work plans</li> <li>• Institute mechanisms for proper accounting and auditing of project funds at state, district and village level;</li> <li>• Maintain database on district wise, component wise fund releases and expenditure</li> <li>• Compile and forward regular quarterly/annual financial reports to GoTN / GOI/IDA</li> <li>• Submit regular claims for reimbursement of project expenses</li> <li>• Implement capacity building measures for financial management for staff at SPMU and DPMU and</li> <li>• Develop policy and strategy for book keeping capacity building at the village level and implement the same</li> </ul>

<b>Level</b>	<b>Institutional Arrangement</b>	<b>Key Financial Management Arrangements</b>
<b>District Level</b>	Executive Committee of the District "Vazhndhu Kaatuvom" Society (District Society)	<ul style="list-style-type: none"> <li>• Develop, review and revise financial management policies for the project within the framework of the policies of the State Society</li> <li>• Review financial progress at the District level</li> <li>• Overall overview of financial management functions in the District</li> <li>• Facilitate linkages for easy flow of funds for the community to mobilize the community equity</li> <li>• Liaise with statutory auditors for the audit of the DPMU's accounts on an annual basis and place the audited accounts before the General Body of the District Society and filing of annual returns with the Registrar of Societies.</li> <li>• Appoint auditors for a sample audit of VPRCs and EAGs.</li> </ul>
	District Project Management Unit (DPMU): District Project Manager with Assistant Project Manager (Village Funds) .	<ul style="list-style-type: none"> <li>• Compile annual budget for the district and submit the same to the SPMU</li> <li>• Receive funds into its bank account from the SPMU as per allocated budget</li> <li>• Appraise Livelihood Business plan Proposals and verify milestone certificates and release payments to VPs, VPRCs and EAGs on a timely basis as per agreed activities and relevant contractual arrangements and utilize funds for its own activities at district level</li> <li>• Maintain database on village wise Business plan agreements, releases, expenditures, contributions, monthly financial statements etc.</li> <li>• Compile, prepare and forward regular monthly/quarterly financial monitoring reports to SPMU</li> <li>• Ensure regular and timely audit for district level and village level activities</li> <li>• Ensure implementation of capacity building activities for building skills in financial management for village level and cluster level institutions, etc.</li> </ul>
<b>Cluster Level</b>	Project Facilitation Team: Facilitator (Accounts and Monitoring)	<ul style="list-style-type: none"> <li>• Assist the VPRC in implementing the accountability framework (including public displays and external audit)</li> <li>• Train and provide hand-holding support to the VPRC Book Keeper in book keeping functions and in preparing monthly &amp; annual reports</li> <li>• Monitor the maintenance of books of accounts at the Village level</li> <li>• Assist the DPMU in verifying the milestone for release of instalments to VPRC/EAG</li> </ul>
<b>Village Level</b>	Grama Sabha	<ul style="list-style-type: none"> <li>• Approve VPRC Plan for the village</li> <li>• Approve Business Plan Completion Reports of EAGs</li> <li>• Appoint Social Audit Committee and call for action taken reports</li> </ul>
	Village Assembly	<ul style="list-style-type: none"> <li>• Approve updated VPRC Plan</li> <li>• Approve Livelihood Business plan Proposal</li> </ul>
	Village Panchayat	<ul style="list-style-type: none"> <li>• Sign MoU with DPMU for the initiation phase</li> <li>• Receive Rs. 35,000 as Initiation Fund and utilize the same for project initiation activities</li> <li>• Prepare and submit accounts for the Initiation Fund to DPMU</li> </ul>

Level	Institutional Arrangement	Key Financial Management Arrangements
<b>Village Level contd....</b>	VPRC: Secretary and Treasurer with Book Keeper	<ul style="list-style-type: none"> <li>• Sign financing agreements for VPRC Fund with DPMU</li> <li>• Receive funds from DPMU against VPRC financing agreements and deposit the same in project bank account to be operated by two members from among the SHG representatives who are members of VPRC, will be called Secretary and Treasurer</li> <li>• Plan, implement and supervise activities under VPRC fund</li> <li>• Engage an accountant and ensure that all project expenditures and income are accounted for in the books of accounts</li> <li>• Request for funds from DPMU along with milestones certificates</li> <li>• Provide all books of accounts and other records for project audit</li> <li>• Appoint Finance and Procurement Sub-committees with the approval of Village Assembly and entrust them with specific financial management and procurement functions</li> <li>• Ensure that all financial management and procurement decisions are documented in the Minutes Books of the VPRC, Finance and Procurement sub-committee meetings</li> <li>• Arrange permanent public display boards at a prominent place in the village, showing updated information on financial progress, VPRC and Livelihood Funds approved with beneficiary lists</li> <li>• Provide all financial information to SAC members</li> <li>• Assist VP in submitting applications for Incentive Funds</li> <li>• Assist the VP in implementing activities included in the Incentive Fund Proposal</li> <li>• Submit monthly, quarterly, half yearly and annual financial reports to DPMU through PFTs.</li> </ul>
	Economic Activity Groups Book Keepers	<ul style="list-style-type: none"> <li>• With the assistance of VPRC and PFT, prepare and submit village Livelihood plan to DPMU</li> <li>• Sign EAG Financing Agreements with DPMU</li> <li>• Open bank accounts, deposit own contributions and receive project funds</li> <li>• Implement and maintain books of accounts for all Business plan expenditures and income</li> <li>• Submit milestone certificates for completion of milestones as per agreed format and request for release of subsequent tranches from DPMU</li> <li>• Facilitate periodic audit of income and expenditures by EAGs by project auditors</li> </ul>
	Procurement Sub Committee	<ul style="list-style-type: none"> <li>• Guide VPRC, VP and EAGs in their procurement functions;</li> <li>• Ensure that the procurement guidelines elaborated in the COM are complied with;</li> <li>• Assist the VPRC, VP and EAGs to negotiate for highest quality and best prices</li> </ul>
	Finance Sub Committee	<ul style="list-style-type: none"> <li>• Guide VPRC, VP and EAGs in its financial management functions</li> <li>• Ensure that the financial and accounting guidelines as laid out in the FMM and COM are complied with</li> <li>• Facilitate the audit process</li> </ul>
	Social Audit Committee	<ul style="list-style-type: none"> <li>• Carry out periodic compliance checks of VP, VPRC, EAG Business plans</li> <li>• Certify all milestone certificates and submit regular reports to Village Assembly and the Gram Sabha</li> </ul>

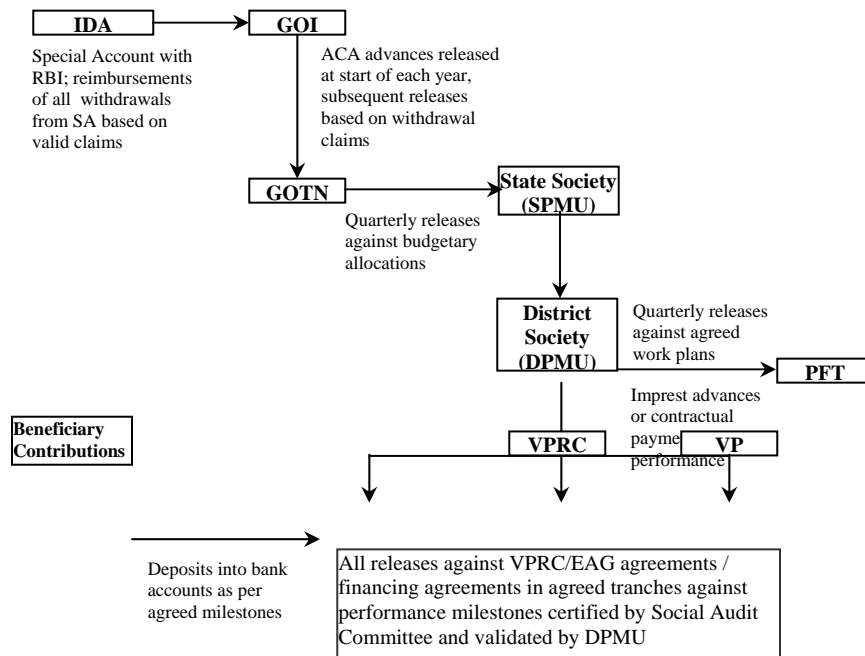
### I.3 Planning and Budgeting

3. The project’s planning process will follow a ‘bottom-up’ approach i.e. it will grow out of village level plans and get consolidated into district and state level annual work plans. The project planning process for each financial year will follow the budgeting cycle of the state and will be completed when the project estimates are included in the state budget, presented and approved by the State Legislature as ‘demand for grants’ through the Annual Appropriation Act. Supplementary or additional grants are approved by subsequent appropriation acts. The project will be budgeted as a separate line item in the State budget and the funds will be released to the State and DPMUs in line with standard State financial procedures.

### I.4 Funds Flow

4. The funds for project implementation will be channelised to the project implementation agencies including the VPRC and the fund flow envisaged for the project is summarized in Figure 9.1.

**Figure 9.1 – Fund Flow Arrangement**



5. The basis for release of funds to the different levels of the project and the nature of accounts at these levels of the project are summarized in Table 9.2.

**Table 9.2 Summary of Fund Flow Arrangements**

Fund flow level	Basis of release	Nature & operation of accounts
GOI to GOTN	<ul style="list-style-type: none"> <li>Disbursement from IDA credit initially as per traditional system of replenishment and reimbursement with full documentation and against statement of expenditure</li> <li>After successful demonstration of regular, timely and adequate FMRs, disbursement could be converted to report based at the option of GOTN and GOI</li> <li>About 4 months of initial estimated disbursements from IDA credit will be allocated to the Special Account</li> <li>Initial deposit will be credited into Government of India's Special Account by the World Bank. An equivalent amount will be transferred by the GOI to the consolidated fund of the State (GOTN) under the new back to back financing arrangement accepted by GOI.</li> <li>Subsequent fund releases from the Bank to GOI and GOI to the GOTN will be based on the Reimbursement applications submitted by the project on a quarterly basis to the Bank through the CAAA</li> </ul>	A special account maintained in the Reserve Bank of India
Government of Tamil Nadu to State Society	<ul style="list-style-type: none"> <li>VKSS will prepare annual budgets and submit it to Government of Tamil Nadu</li> <li>Government of Tamil Nadu will include estimates in their budget estimate and obtain sanctions from the Assembly.</li> <li>The VKSS will draw funds from the state treasury (on the basis of approved budget) on a quarterly basis (through the Director of Social Welfare) and deposit funds in the savings bank account of VKSS.</li> <li>VKSS will submit quarterly Financial Monitoring Reports to the World Bank.</li> <li>VKSS will maintain computerized accounting system (based on an off the shelf accounting package) and follow a simple and accurate accounting system.</li> </ul>	Savings Bank Account of the VKSS
State Society to District Society	<ul style="list-style-type: none"> <li>District Society will prepare annual budgets and submit it to State Society</li> <li>Funds will be transferred from the State to the DPMU under the following components Village Fund, Institutional Strengthening at District Level &amp; Project Management</li> <li>District Society will maintain computerised system of accounting, in line with the accounting system at VKSS.</li> </ul>	Savings Bank Account of the District Society
District Society to VPRC	<ul style="list-style-type: none"> <li>District Society will transfer the first installment of VPRC funds to VPRC upon submission of VPRC Plan approved by Gram Sabha and signing of VPRC Financing Agreement. The amount of first instalment will be calculated as under:</li> <li>40 % of {(Total no. of non tribal families x 0.25 Rs.5717). In case the no. of tribal families is less than fifty, the tribal component will be computed as 40% of (No. of tribal families x Rs.9575) and added to the above amount to arrive at the total first instalment amount. In case separate tribal VPRC has been constituted (no. of tribal families is more than fifty) the first instalment amount will be arrived as 40% of (No. of tribal families x Rs.9575) and the funds will be released to the tribal VPRC directly or 40% of the VPRC Plan whichever is less.</li> <li>The second instalment of 40% will be released based on submission of request for release and satisfactory completion of agreed milestones in the VPRC Financing Agreement as certified by Social Audit Committee.</li> <li>The last instalment of 20% will be based on submission of request letter and satisfactory completion of agreed milestones (performance &amp; financial indicators) in the VPRC Financing Agreement as certified by Social Audit Committee.</li> <li>The submission of the monthly financial report will be required as a pre-condition for release of subsequent instalments against the individual sub-project agreements.</li> <li>VPRC will maintain simplified books of accounts with the help of the Book Keeper</li> </ul>	VPRC's Bank A/c. The account will be operated jointly by the Secretary and Treasurer of the VPRC
District Society to EAG	<ul style="list-style-type: none"> <li>The VPRC will appraise and approve the Livelihood Business plan Proposals and will forward it to the District Society for compliance check</li> <li>The District Society, after compliance check, will release the Livelihood Funds to the EAG in tranches as per the EAG Financing Agreement and Livelihood Fund guidelines</li> <li>The EAG will maintain proper books of accounts</li> <li>The EAG will submit quarterly report of expenses to the DPMU through the VPRC</li> <li>The EAG will maintain a separate set of books for implementing Livelihood Business plan Proposal.</li> <li>The EAG will engage a bookkeeper for the purpose or one of the EAG members who are well trained in accounting can maintain the books.</li> </ul>	EAG's Bank account operated by Secretary and Treasurer of EAG

## I.5 Financing Agreements for Village Fund Release

6. About 90% of the Project Funds are earmarked as Village Funds, which will be directly released to the VP, VPRC and EAG. The fund releases are formalized through signing of Financing Agreements and MoUs specifying mainly the number and percentage of installments and release conditions as summarized in Table 9.3.

**Table 9.3 Financing Agreements**

Fund Flow		Name of Agreement	No. of Installments & Percentages	Pre-conditions for signing Agreements
From	To			
State Society	District Society	MoU between VKSS and VKDS	According to District Level Annual Work Plan	<ul style="list-style-type: none"> <li>Registration of the District Society</li> <li>Appointment of District Project Manager and Team members</li> <li>Opening separate bank account</li> </ul>
District Society	Village Panchayat (for Initiation Fund)	MoU between VKDS and VP	Single installment of Rs. 35,000	<ul style="list-style-type: none"> <li>Gram Sabha adopts key project non negotiable principles</li> </ul>
District Society	VPRC	VPRC Fund Financing Agreement between VKDS and VPRC	In 3 installments as per the approved VPRC Plan of 40%, 40% and 20%, each installment is bifurcated between Capacity Building Fund and Special Assistance Fund, the main sub-components of the VPRC Fund	<ul style="list-style-type: none"> <li>The VPRC and SAC have been constituted as per Community Operational Manual guidelines and trained on initial modules of Community Operational Manual – covering guidelines for VPRC Fund, Financial Management and Procurement guidelines</li> <li>The VP has submitted accounts of the initiation fund to the DPMU</li> <li>Participatory identification of the poor completed and list approved by Gram Sabha</li> <li>Opening of separate bank account</li> <li>The VPRC Plan approved by Gram Sabha and compliance checked by DPMU</li> </ul>
District Society	EAG	EAG Financing Agreement between VKDS and EAG	In 2 installments as per the Livelihood Business plan Proposal	<ul style="list-style-type: none"> <li>EAG has been constituted as per Community Operational Manual guidelines and trained on Community Operational Manual</li> <li>Livelihood Business plan Proposal prepared, approved by Village Assembly, appraised by VPRC and compliance checked by DPMU</li> <li>Arrangement for mobilization of equity portion of the proposed investment done</li> </ul>
District Society	VP (for Incentive Fund)	Incentive Fund MOU	In 2 installments of Rs. 3 lakhs each	<ul style="list-style-type: none"> <li>Successful implementation of Vazhndhu Kaatuvom Project within 3 years of formation of the VPRC as evidenced by external evaluation using eligibility criteria</li> </ul>

7. The terms and conditions for releasing funds the Village Panchayat initiation fund, are elaborated in an MoU to be signed between Village Panchayat and District Society as given in **Attachment I.1.**

8. The VPRC Fund consists of Capacity Building Fund and Special Fund, which will be directly released to the VPRC. The VPRC will sign the VPRC Financing Agreement with the District Society for accessing the VPRC Fund once the VPRC Plan is prepared and approved by Gram Sabha. The terms and conditions for releasing VPRC Fund are elaborated in the VPRC Fund Financing Agreement given in **Attachment I.2.**

9. The VPRC Plan will contain in addition to the Capacity Building and Special Fund Proposals likely livelihood opportunities, which will be taken up for detailed Livelihood Business plan Proposal preparation by EAGs. The Livelihood Business plan Proposals will be appraised by the VPRC utilizing external technical assistance. The DPMU will do the compliance checking and clear the Livelihood Business plan Proposals. The Livelihood Funds for implementing the Business plan Proposals will be directly released to the EAG. The terms and conditions for releasing Livelihood Funds to the EAGs are elaborated in Livelihood Financing Agreement known as EAG Financing Agreement as given in **Attachment I.3.**

## **I.6 Training and Capacity Building**

10. **SPMU and DPMU Staff:** The financial and accounting staff at the State and District level will be trained in the requirements of accounting and reporting under the project by the CB Agency. Modules will be prepared by the Agency and training will be included in their annual calendar. As the project is implementing computerized financial management system, the staff will be trained to operate the computerized systems. The Specialist Financial Management will have the overall responsibility of building capacity of DPMU and cluster level staff.

11. **Cluster level:** The Accounts and Monitoring Facilitator at the PFT will be exposed to the financial management aspects at the village level, as included in the COM. In addition they will be given functional training on accounting for one week. He will in turn give training to the VPRC/ EAG bookkeeper. There will also be refresher trainings given periodically during the project period. The Asst. Project Manager, Village Funds will have the primary responsibility of building the capacity of Facilitator Accounts and Monitoring in the PFT.

12. **Village Level:** The office bearers of the VPRC, Finance and Procurement Sub Committee members, Social Audit Committee members etc. will be trained on how to manage funds, maintaining books of accounts and financial records, financial reporting, financial accountability, maintaining transparency etc. The Assistant Project Manager (Village Funds) in the District Team will have the key responsibility in coordinating with the Accounts and Monitoring Facilitator in the PFT in building the capacity of the

bookkeeper at the village level and also to constantly give handholding support to them. Provision of books of accounts, development of standard training modules, training of trainers etc. will be done in building the financial management and accounting capacity at the village level.

### **I.7 Financial Management Manual (FMM)**

13. A FMM (which is an integral part of the PIP) has been prepared detailing the accounting and financial reporting (FMR) requirements for the SPMU and DPMU. The FMM elaborates the accounting and financial management processes such as funds flow, budgeting and audit arrangements. The financial and accounting policies contained in these manuals shall supplement the policies adopted for State Society and District Societies.

### **I.8 Accounting Policies and Procedures**

14. At the State and District Level: SPMU and DPMUs will maintain their accounts on cash basis following double entry book keeping principles. VPRC, EAGs and VPs will be required to maintain accounts for funds received under the project, including their own contribution and will be monitored on a memorandum basis by the project.

15. State and District Societies will be the primary accounting centers under the project. Double entry accounting system will be followed and accounting practices will be in line with consistently applied national Accounting Standards, in each of the accounting centers.

16. All release of funds from State Society to DPMUs against approved district level work plans will be recorded as grants in the respective books of accounts. On consolidation of the district and state accounts, actual expenditures at each level will be reflected as per monthly/quarterly financial reports. The compilation of financial statements of District and State Societies will be carried out on a regular basis (monthly, quarterly, annual and cumulative over project period) to prepare project level consolidated statements and will be used for preparation of withdrawal claims and monitoring of project financial progress by the Project management, GoTN and World Bank.

17. Materials and other assets purchased will be recorded as expenditures at the time of purchase itself. However, an asset management system (asset register) for assets procured under the project would provide guidelines for its classification, custody, security, disposal and annual verification procedures.



18. All releases of funds for approved and appraised VPRC Plans and Livelihood Business plan Proposals to VPRCs and EAGs by the VKDS will be against financing agreements and will be recognized as expenditures as these payments will be based on achievement of performance and financial indicators.

19. Release of initiation funds to VPs of Rs. 35,000 will be treated, as advance and actual expenditure will be recorded in DPMU based on reports from VPs. VP will submit utilization certificate to the DPMU to support their claims for expenditure against initial advance of Rs. 35,000.

20. Other releases of funds to suppliers/SOs/NGOs etc. will be accounted for as advances in the books of accounts and adjusted to expenditures only on submission of expenditures.

21. Release of Incentive Funds to VPs will be in two installments and releases will be treated as expenditure as release will be subject to VPs satisfying agreed criteria established by the project.

22. Accounting entries will be made in the books of accounts of SPMU and DPMUs for the beneficiary share of the subproject costs. All accounting entries for beneficiary contributions will be made on the basis of milestone certification, except for the upfront cash deposits, which will be accounted for on the basis of evidence of bank deposit slips and bank passbooks.

23. The DPMU will pay the salaries of the PFT members who are contracted directly on a monthly basis by credit to their Bank accounts. Similarly their mobility allowance, TA / DA etc. will also be paid directly by the DPMU by credit to the PFT members' Bank accounts. An imprest account will be given by the DPMU to the PFT to meet their monthly administrative expenses. At the end of every month, the PFT will submit their imprest claim to the DPMU along with bills and vouchers in original and the DPMU will reimburse the expenses to the PFT.

24. Village Level: For the pre-existing institutions like VPs, the standard prevalent accounting mechanism will be used to account for project funds. While the design of the accounting system does not envisage separate sets of books of accounts for VP, the project related expenditures will need to be separately identified and classified as per the chart of activities/components.

25. VPRC, EAGs and VPs will maintain accounts for funds received from the project, including their own contribution and will be monitored on a memorandum basis by the project.

26. In the EAG books of accounts, assets both acquired and constructed will be valued at total gross cost of the subproject, including beneficiaries' contribution. The books of accounts will reflect all receipts and expenditures for the subproject costs (including beneficiaries' own cash/labor/material contributions as well as funds raised from Banks and MFIs)

27. VPRC will maintain the following simple accounts, records/registers:

- Day Book with Cash and bank columns
- General Ledger
- Minutes Book
- Procurement register
- SAC Comments and Rectification Register
- Community Contribution Register
- Advances Register.

28. The VPRC will retain and safe keep cheque and bank pass books, and all vouchers, bills, receipts, contracts and supporting documents. The bank passbooks will be regularly updated and bank reconciliation statements will be prepared. The Treasurer of the VPRC will be the custodian of the Bank Pass books and cheque books and will operate the bank account along with the Secretary.

29. Community Operational Manual (COM): covers in detail the process of managing the community level finances and maintaining accounts. The COM contains details of the fund flow, accounting and reporting requirements of VPRC and EAGs. Formats of the books and registers have been given in the Community Operations Manual.

## **I.9 Internal Control**

30. The Handbook for accounting and administrative procedures is being prepared with delegation of financial powers, authorities and payment responsibilities. The handbook will also include administration of salary and other incentive systems including travel guidelines.

31. The Project Director will issue office orders and guidelines from time to time. The FMM has elaborated the approval processes for specific project activities. The

project will review these arrangements periodically and make suitable amendments as needed for smooth project implementation.

32. The other key internal control mechanisms are:

- Performance standards for certification of milestones and release of payments
- Each accounting unit will close the books of accounts within a specified number of days of the close of each month, reconcile its balances with bank statements and books of accounts and forward the same to the next level of authority in the institutional hierarchy, and State Society will provide oversight on the qualitative and timeliness aspects of the reporting.
- At the VP, VPRC, and EAG levels, recording of all financial decisions in the minute books, public displays of financial information, access of accounting records to all members and social audit procedures will ensure that transparency and oversight functions are maintained.

#### **I.10 Audit Arrangements**

33. **Statutory Audit** : SPMU and DPMU Levels: As per the requirements of the State's Societies Registration Act, the executive committee of the VKSS will appoint an independent firm of chartered accountants to conduct annual audit of the project i.e. the State and all District societies. The auditor will also audit and certify the compiled consolidated annual report for the whole project. The audit would cover all project operations. The TOR for audit is given in **Attachment I.4**.

34. The audit report will consist of:

- (i) financial statements and
- (ii) audit opinion confirming whether the project financial statements have been prepared in accordance with consistently applied Accounting Standards issued by the ICAI and give a true and fair view of the operations of the project during the year and that the withdrawals from the World Bank Grant made on the basis of SOEs together with the FMRs, procedures and internal controls involved in their preparation, can be relied on to support the related withdrawals.

35. Additionally, the auditor will be required to provide a management letter to project management-highlighting areas which require improvement. The audit will be conducted as per the national audit assurance standards issued by the ICAI.

36. The audit report with the management letter will be submitted to World Bank within six months of the close of each financial year. The form of annual financial statements to be certified will also be covered in the TOR. The timetable for audit reports are given in Table 9.4.

37. Village Level: VPRC as community-based organization will have more of a social audit than a statutory audit by a CA firm. The project will engage CA firms at the district or regional level, to conduct a six monthly audit of the VPRC's and VPs on sample basis (of the separate account for project funds) and a one-time audit of EAGs on completion of the sub-projects. TORs for audit of the village level institutions such as VPRC, VPs and EAG will be agreed with the Bank. The District societies will maintain a updated database of the audit reports of the village level entities and take follow up action on delayed or inadequate reports, audit observations etc. However, as a demonstration of good practice, the audit of VPRCs and EAGs will be taken up on a sample basis adopting 10 % sample or as proposed by the project.

38. *Internal Audit* : An internal auditor will be appointed by the General Body of the State and District Societies for performing audit on a quarterly basis. The internal audit will review the project financial management systems and adherence to Government Orders, approved Financial and administrative guidelines, adequacy of internal controls, adherence to the financing agreements with village level implementing entities and review mechanisms in place to conduct regular audits of VPRCs and EAGs and follow up of audit observations.

39. *Social Audit* The Social Audit function carried out by the Social Audit Committee directly appointed by the Gram Sabha will be on all aspects of quality, quantity and procurement with specific reference to the project principles and non-negotiables. The Social Audit Committee reports its findings directly to the Gram Sabha along with recommendations for rectifying short falls. The social audit will ensure transparency and accountability of project implementation at the village level.

40. The capacity of SAC will be increased through a specific capacity building exercise for SAC members to undertake audit on the project principles for better functioning of VPRC and EAG.

41. The SAC will certify the utilization of each installments of funds released to the VPRC and EAG and certify achievement of milestones. Thus SAC certification will be a pre-requisite for release of village funds to VPRC and EAGs.

## **I.11 Reporting and Monitoring**

42. The monthly reporting formats from each of the accounting centers have been designed to provide summarized monthly financial information on the fund flows, balances in cash/bank, status of advances and expenditures classified by project components/activities, disbursement categories, procurement methods etc. These reports will be compiled by the DPMU on monthly and quarterly basis to provide meaningful FMRs. An important aspect of the reports would be that the information on the number of village-wise Livelihood Business plan Proposal approved, amount of the Business plan Proposal, releases made against the agreed milestones, community contributions received, status of financial reports submitted by the VPRCs will be monitored. These

reports will be prepared from the start of the project, submitted to World Bank within 45 days of the close of the quarter and used by the project at the State and District level and by World Bank for monitoring and management decision making.

43. VPRCs will be required to submit regular statements of expenditures summarizing sources and uses of funds against the plans in order to build accountability and demonstrate the presence of adequate accounting and book-keeping arrangements consisting of:

- The sources and uses of funds, indicating the balances in cash/bank;
- Community Contributions in cash and kind; and
- Physical progress of works/activities.

44. The report will be discussed among the VPRC members before submitting it to the DPMU through the PFT. The submission of the monthly financial report will be required as a pre-condition for release of subsequent installments against the individual business plan agreements.

45. The detailed formats for the reports at all levels are provided in the Financial Management Manual. The summary details of various reports to be generated at the different levels are given in **Table 9.4**.

**Table 9.4 Summary of Project Financial Reports**

No	Name of Statement	Originating From	Submitted to	Frequency
1	Financial Management Report	State Unit	World Bank	Quarterly
2	Statement of Expenditures	State Unit	World Bank	Quarterly
3	Annual Audited Financial Statements	State Unit	World Bank	Annual
4	Financial Management Report	DPMU	State Unit	Quarterly
5.	Monthly financial accounts	DPMU	State Unit	Monthly
No	Name of Statement	Originating From	Submitted to	Frequency
6	Statement of Expenditures	DPMU	State Unit	Quarterly
7	Annual Audited Financial Statements	DPMU	State Unit	Annual
8	Monthly Financial Report	VPRC	DPMU	Monthly
9.	Quarterly Financial Report	EAG	DPMU	Quarterly
10.	Profit and Loss Account	EAG	DPMU	Half yearly

## **I.12 Public Display of Information**

45. The financial management arrangements at the village level will ensure adherence to principles of transparency and accountability. In addition to social audit arrangements, a simple summary of the accounts will be publicly displayed in the village. In addition, the books/registers, vouchers and bank passbooks would be open for perusal by members.

## **I.13 Computerized Accounting System**

46. The project will use an off the shelf accounting package that is Tally package at the State and District units with a consistent and uniform chart of accounts. This will enable timely consolidation of the accounts and preparation of consolidated financial reports for project.

## **I.14 Community Contribution and Cost Sharing Arrangement**

47. The project envisages contribution by way of cash and kind by the community members towards the VPRC Fund and Livelihoods Fund activities. The operational expenses required for operating and maintaining all assets and facilities created under the project are to be borne by the community members to the extent of 100%. The cost sharing arrangement for the VPRC Fund and Livelihood Fund are summarized in Table 9.5.

**Table 9.5. Equity contribution for Various Components of Village Fund**

<b>Category of beneficiaries</b>	<b>Rate of Beneficiary Contribution (Minimum)</b>	<b>Community and Equity Contribution (Minimum)</b>
Skill Development Fund to groups	5 %	
Skill development for individuals	10%	
Skill development for disabled/vulnerable	nil	
Livelihood Business plan Proposal for target poor	10 % *	40 %
Livelihood Business plan Proposal for most vulnerable, Disabled and tribals	NIL	30 %
Livelihood Business plan Proposal for Non Poor	30 %	70 %

\* Beneficiary contribution includes cash contribution of at least 5 %.

Note : Equity contribution means the proportion of the investment in livelihood Business Plan need to be raised from Banks, and accredited MFIs, SHGs, PLFs, line departments etc.

## I.15 Disbursement Arrangement

48. Disbursements from IDA credit would initially be made in the traditional system (replenishment and reimbursement with full documentation and against statement of expenditure) and could be converted to Report based disbursements at the option of the GoTN and GoI after successful demonstration of regular, timely and adequate FMRs.

49. The actual disbursement until now and estimated disbursement are summarized in **Table 9.6** . The IDA share of disbursement is given in **Attachment I.5**

**Table 9.6 Disbursement Details**

Comp No.	Component Description	Mar 05 to Mar 06	April 06 to Mar 07 **	April 07 to Mar 08	April 08 to Mar 09	April 09 to Mar 10	April 10 to Mar 11	April 11 to Mar 12	Total
		Actual	Actual & Est	Estimate	Estimate	Estimate	Estimate	Estimate	
A 1	Forming and Strengthening of Village Institutions	1.17	46.50	135.75	224.95	124.63	110.00		<b>643.00</b>
A 2	Village Fund		104.40	1087.72	1957.48	1781.00	490.00	306.40	<b>5727.00</b>
B	Institutional Strengthening Support at State and Districts level	3.76	15.40	66.93	66.16	69.08	50.00	44.07	<b>315.40</b>
C	Total Project Management cost ( C1 + C2 )	11.38	56.20	88.60	92.41	96.29	80.00	60.72	<b>485.60</b>
	<b>Total Expenditure</b>	<b>16.31</b>	<b>222.50</b>	<b>1379.00</b>	<b>2341.00</b>	<b>2071.00</b>	<b>730.00</b>	<b>411.19</b>	<b>7171.00</b>

\*\* Actual up to 31/1/07 + estimate for 2 months

50. A Special Account would be maintained in the Reserve Bank of India; and would be operated by the DEA, GoI. The authorized allocation of the Special Account would be determined in consultation with LOA that represents about 4 months of initial estimated disbursements from the IDA Credit. The Special Account would be operated in accordance with IDA'S operational policies.

51. State Society will compile financial information from DPMUs and prepare reimbursement claims on a monthly basis. The Society will also be responsible for submission of withdrawal applications to CAA&A in DEA for onward submission to the Bank for replenishment of the special account or reimbursement.

52. The disbursement procedures for fund releases to the VPRC and EAGs will follow Fiduciary Management for Community-Driven Development Projects: Reference Guide (May 2002).

53. Releases to VPRC and EAGs will be treated as expenditure at the time of disbursements as these disbursements will be against agreed milestones as per financing agreements between DPMU and VPRCs/EAGs. Release of Incentive Funds to VPs will be in two installments and releases will be treated as expenditure as release will be subject to VPs satisfying agreed criteria established by the project.

54. Other Disbursements will be made on the basis of statement of expenditure for (a) civil works for contracts not exceeding US\$500,000 (b) goods and equipment for contracts not exceeding US\$ 500,000; (c) consultants for contracts not exceeding US\$ 50,000 for individuals and US\$ 100,000 for firms; and (d) incremental operating costs to the SPMU.

55. Retroactive Financing: GoTN has requested for retroactive financing of US\$1.5 million to meet the expenditures incurred since February 29, 2005, including those that are anticipated upto the Credit signing. The activities to be covered under the retroactive financing are consistent with the financing categories as agreed with IDA.