Appendix 1
of Operational Manual for
“Education Improvement” Project
With Additional Financing

CENTER FOR EDUCATION PROJECTS

PROJECTS IMPLEMENTATION UNIT

FINANCIAL MANAGEMENT AND ACCOUNTING UNIT

FINANCIAL MANAGEMENT MANUAL

May 2022

Contents

LIST OF ABBREVIATIONS

DAs – Designated Accounts for the projects

EIP AF - Education Improvement Project with Additional Financing

FA – Fixed Assets

FMM – Financial Management Manual

GoA – Government of Armenia

IBRD - International Bank for Reconstruction and Development

IDA –International Development Association

IFRs – Interim Un-audited Financial Reports

LCAs – Local Currency Accounts for the projects

PIU – Projects Implementation Unit

Projects – all loan and grant projects implemented by PIU for the specified period

WB – World Bank

II INTRODUCTION

The financial management/accounting system including records and accounts, and prepared financial statements, must be adequate to reflect the operations, resources and expenditures, under the projects The system should meet the requirements of the Armenian legislation and respective policies and procedures of the WB, and comply with the legal covenants stipulated in the Grant/Financial/Loan agreements (legal agreements).

The financial management arrangements described in this FMM cover all the project activities except for specific arrangements for Pre-School Micro-Projects and CIF Sub-Projects for which the specific funds flow and control mechanisms are described in Pre-School Micro-Projects' and CIF Sub-Projects' Operational Manuals.

The Financial management system includes:

- Budgeting and planning
- Accounting
- Internal control
- Financial Reporting
- Funds Flow
- Auditing

Financial Management Manual (FMM) comprises policies and procedures to assist in ensuring the orderly and efficient management and control of all program resources, and to render proper accountability to all stakeholders. It is aimed at ensuring effective financial management of project assets, liabilities, funds, and expenditure together with the project accounting system for financial operations. It sets forth the policies and procedures for the guidance of all personnel charged with financial responsibilities. In sum, the policies and guidelines convey standards for sound financial management and administration for the program. In specific terms, the policies and procedures are designed to: It is aimed at ensuring the effective financial management of the project assets, liabilities, funds and expenses together with the project financial accounting system.

- Promote orderly, economic, efficient and effective operations consistent with project objectives;
- Prevent and detect fraud and errors;
- Ensure accuracy and completeness of the accounting records;
- Facilitate timely preparation of financial information and ensure that financial statements are fairly and accurately presented;
- Safeguard program assets; and
- Ensure compliance with applicable laws, financial policies and regulations.

The Financial Management Manual (FMM) and its further amendments should be agreed with the World Bank and are approved by the Minister of Education, Science, Culture and Sport as an appendix to OM.

III KEY REFERENCE DOCUMENTS

The projects will be managed according the requirements of the local legislation, the World Bank relevant policies, procedures and guidelines, the projects' legal agreements and the Project Appraisal Documents.

Other useful documents, which needs for managing disbursement, procurement of goods, works and services and referenced in the legal agreements are:

- General Conditions for Investment Project Financing 2017
- World Bank Disbursement Guidelines for Investment Project Financing dated February 2017
- Loan Handbook for World Bank Borrowers dated February 2017
- Guidelines: Procurement of Goods, Works, and Non-Consulting Services under IBRD Loans and IDA Credits & Grants, January 2011
- Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits & Grants by World Bank Recipient/Borrowers, January 2011
- Financial Management Manual for World Bank-Financed Investment Operations (March 2010): RM 3 - Financial Reporting and Auditing.
- Guidelines for Provision of Loans for Financing Investment Programs (February 2017).

IV FINANCIAL COVENANTS SPECIFIED IN THE LEGAL AGREEMENTS

The legal agreements specify the following financial covenants for the Borrower/Recipient:

- The Recipient/Borrower (through CEP PIU) shall require each beneficiary to (A) maintain a financial management system and prepare financial statements in accordance with consistently applied accounting standards acceptable to the Bank, both in a manner adequate to reflect the operations, resources and expenditures related to the Micro-project or Sub-project; and (B) at the Bank's or the Borrower's request, have such financial statements audited by independent auditors acceptable to the Bank, in accordance with consistently applied auditing standards acceptable to the Bank, and promptly furnish the statements as so audited to the Recipient/Borrower and the Bank;
- The Recipient/Borrower shall maintain (through CEP) a financial management system in accordance with the provisions of Section 4.09/5.09 of the General Conditions and Section 2.09 of the Standard Conditions.
- The Recipient/Borrower (through CEP) shall prepare and furnish to the Bank not later than forty-five (45) days after the end of each calendar semester, interim unaudited financial reports for the Project covering the quarter/semester, in form and substance satisfactory to the Bank.
- The Recipient/Borrower (through CEP) shall have the project Financial Statements audited in accordance with the provisions of Section 4.09 (b)/5.09 (b) of the General Conditions and Section 2.09 of the Standard Conditions. Each audit of the Financial Statements shall cover the period of one fiscal year of the Recipient/Borrower for the loan and credit. The audited Financial Statements for each such period shall be furnished to the Bank not later than six months after the end of such periods.

The compliance to the above financial covenants is facilitated through the FM procedures described in the FMM (except for the first covenant the compliance with which is facilitated through the FM procedures and described separately in the respective Pre-School Micro-Projects' and CIF Sub-Projects' Operational Manuals).

V PLANNING AND BUDGETING

The project annual budget is based on the Procurement Plan. The budget preparation process is a bottom up process, in which the following divisions will be included:

Administration – Projects Manager, Office manager
Operations – Heads of component/subcomponents
Finance – Financial Manager
Procurement – Procurement Officer

The Heads of component/subcomponents receive detailed reports about the performance of their divisions from the Finance department at the end of the current fiscal year. The Heads of component/subcomponents discuss the procurement plan for their divisions with the Procurement department for the next fiscal year. Based on the data the Heads of component/subcomponents make evaluations and foresee an action plan for the next fiscal year. The Financial Manager matches all this information with the expense reports, makes adjustments, prepares a preliminary budget by the all categories of expenditures and presents it for discussion with the Projects Manager, Procurement Officer and the Heads of component/subcomponents. After summarizing next year's budgeting process the complete budget financing application are submitted to the Ministry of Finance for the implementation of preparation works of the draft state budget for the next fiscal year.

The budget for the current fiscal year for each component/sub-component and for each payment category is approved by the Steering Committee. The Financial Manager is responsible for monitoring and supervision of the budget implementation. If any adjustments are required, the revised budget is also approved by Steering Committee, which is the Minister of Education, Science, Culture and Sport of the RA.

VI ACCOUNTING

A) PIU accounting system

The PIU accounting system consists of:

- Financial Control System
- Computerized Accounting System
- Reporting System

In general the Accounting Procedure consists of:

- Receiving, verifying and approving invoices and other supporting documents;

- making payments
- preparing withdrawal applications
- approving the transactions
- summarizing information at the end of the accounting period
- preparing reports
- conducting financial analysis

An accounting period is one month. It will end on the last calendar day of each month. The closing date for the accounting period is 15th of the following month.
Accrual basis is applied for the projects' reporting.

B) Description of Major Account Classification

As described briefly in the description of the Chart of Accounts, there are a number of different classifications of accounts available by type and function. Each account type is placed in a different position on the Chart of Accounts and the different classifications relate together in the operations of the accounting system.

Brief details of the broad classifications of accounts as are applicable to the projects and the Chart of Accounts developed are described here.

1. Cash and Cash Equivalents

The term "cash and cash equivalents" is used to designate money or its equivalent. In the projects, "cash" will consist of cash on demand in the Designated and projects bank accounts. "Cash equivalents" refer to short term, highly liquid investments that are readily/easily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. It is unlikely that the projects will hold such investments.

2. Receivables and Advances Given

The types of receivable accounts that the projects will probably have should relate to advances given to personnel and contractors/suppliers/grantees or claims against contractors/suppliers/grantors. A receivable from the Implementing Agencies may also be recorded upon recording the transaction that identifies the VAT (or other tax) payable by the PIU in order to recognize a claim to be settled in the near future. A receivable should be recorded as soon as the advance is given or a claim made which is likely to be realizable. The receivable should then be reversed in the future when the amount is, returned or applied against an expense (in cases of advances given) or the claim collected or settled.

Receivables should be recorded and carried in the accounts at their face value plus or minus, if appropriate, premiums or discounts, unearned interest income (finance charges), allowances for un-collectable amounts and other adjustments needed to bring them to estimated realizable value if applicable.

If is expected that a proportion of receivables will not be collected, an allowance should be made for the reasonably anticipated loss. The allowance for un-collectable amounts is created by recording a provision (expense) for un-collectable amounts. Receivables that are known to be un-collectable should be charged to the allowance amount. Due to the nature of the projects, it is unlikely that any receivables will not be collectable. If however this does appear likely in the future, the Accountant should create a provision and if amounts actually become un-collectable, this should be charged as an expense.

If a receivable is denominated in a currency different from the currency used in the reports, the carrying amount is being adjusted to reflect changes in the exchange rate. The portion of receivables that is due and expected to be finalized within one year should be classified as the "current" portion of receivables, and the remainder should be classified as "non- current or long term" receivables as being over one year in duration.

3. Inventory

The term "Inventory" is used in an accounting sense to mean assets that are:

(a) Held for direct operation in the ordinary course of business
(b) In the process of production
(c) In the form of materials and supplies to be consumed in the production process or in the rendering of services.

It is not expected that the projects will hold any inventory as defined above.

4. Prepayments

"Prepayments" usually refer to expenditure on goods, works or services before the goods are supplied, works are conducted or services are received.

Prepayments that are identifiable with specific future revenue should be charged to expense in the period in which the related revenue is recognized. Prepayments that relate to specific time periods should be recognized as an expense in such periods.
Material prepayments and significant deferred charges should be disclosed separately on the balance sheet or in a note. The proportion of prepayments and deferred charges relating to the operations of the current year (less than 12 months) should be classified as current and the balance classified as non-current or long term.

5. Fixed Assets

Normally, fixed assets are assets that:

(a) Have a useful life of at least one year or longer
(b) Are not consumed in the entity's business operations
(c) Are not for resale
(d) Are depreciable or amortized over time.

The cost of a fixed asset consists of various components including:

- The cost of acquisition (or fair market value)
- The cost of delivery, installation and commissioning costs
- The cost of improvements to the fixed asset.

Fixed assets can be classified as "tangible" or "intangible" assets. Tangible assets are assets that exist physically such as land, buildings, equipment and machinery. Intangible assets are assets that do not exist physically such as computer software, legal rights of ownership, patents, etc.

The main fixed assets that the projects records in the accounts include PIU vehicles, office furniture and fixtures, computer equipment, office equipment, as well as the accounting software purchased as an intangible asset. The purchased fixed assets are recorded in the PIU's Balance Accounts. PIU conducts the depreciation of those fixed assets. The fixed Assets provided to the PIU by the Ministry is recorded in the Ministry's Balance, and their depreciation is carried by the Ministry.

If a fixed asset type of item is purchased for the PIU with a low value item – i.e. less or equal to AMD 50,000, depending on the nature of the item being purchased it could be charged on expenditures immediately instead of being recorded as a fixed asset or should be recorded as a fixed asset for one year amortization period according to the legislation of RA.

6. Payables, Debt (Loans) and Accrued Liabilities

"Payables" are obligations that are usually fixed in amount and have a specified due date. Payables can include amounts due for goods and services as well as liabilities for the purchase of other assets.

"Debt" refers to loans and similar types of debt such as promissory notes incurred by an entity. It is unlikely that projects will incur such debt.

"Accrued liabilities" are generally obligations that have not yet been charged to the entity and accrue as time passes or upon the occurrence of a specific event. Accrued liabilities do not relate to asset purchase and therefore need to be estimated.

Payables for the purchase of assets should be recorded when the risks of ownership have passed to the purchaser. This usually occurs for goods or equipment purchased when title passes. For procurement contracts, the Financial Specialist will keep track of payment terms and milestones such as shipping, delivery and acceptance to record the account payable or open letter of credit liability. For purchase of PIU fixed assets, title will pass when the goods are physically received by the PIU and the account payable should be recorded at that time. As soon as a retention amount (for construction contracts) is withheld from payment of invoices, the retention liability should be recorded in the accounts. Obligations that accrue over time (such as Staff Salaries payable) should be recorded over the time period in a systematic and rational way. For the projects, this will mean that PIU wages payable should be recorded monthly as it is expected that wages will be paid monthly.

Payables and debt should be recorded at face value plus or minus any interest accrued to date. For accrued liabilities, the amount accrued should theoretically be the present value of the amount expected to be paid or the estimated costs to provide the goods or service at the time of satisfaction of the obligation. Payables and accrued liabilities should be classified as current if it is expected that they will be paid within one year. The balance should be recorded as non-current or long term. The portion of any debt that is due to be paid within one year should be classified as current, while the remaining part should be recorded as non-current or long term as it will fall due and be payable after one year.

C) Computerized Accounting

A software Application "1C Accounting" is used for computerized accounting and reporting. It is fully-integrated accounting and financial management software with modules adapted to be used by organizations such as PIUs financed by WB. This software works according to the new Chart of Accounts (adopted by GoA). The Chart of accounts is attached ***/Annex 3/.***

1C Accounting Software uses multi-currency entry and reporting. The software automatically produces the Interim Un-audited Financial Reports (IFRs) except the SOE Withdrawal Schedule form. It also provides the reports to the GoA. The software ensures security and prohibits non-authorized access to the information.

The entries into the Software are made on daily basis and the reconciliation of the accounts at least once a month or after each transaction. .

Important considerations in the selection of accounting software were:

- the need for the software to accommodate the chart of accounts: enough fields, character positions and reporting capacity, given the need for flexibility as the project develops;
- the need to train staff in the use of software and the ways in which this can be achieved;
- the capacity of the supplier of the software to provide technical support for the product (proven mainstream products normally have strong technical support);
- the internal controls, security systems, drill-down features and audit trails provided by the software; and
- the capacity of the installed software to provide the timely and reliable information needed for project decision taking and reporting.

To achieve the above it was intended to ensure that the software:

- has good internal controls, is auditable and will provide transparency;
- has a good track record for reliability and is well supported technically;
- can provide data: for periodic reporting (monthly, quarterly, annual etc.); by unit or activity; by funding source and expenditure categories; by actual and budget for the period and accumulated to date; to show variance between actual and budget/plan for period, accumulated for year, and to date;
- has the capability to work in the language of the borrower, in addition to English; and
- has the ability to work in the currency of the borrower, in addition to that of the DAs.

There are no direct links between 1C and other computer programs employed in PIU, such as Client-treasury electronic system used between PIU and Treasury of RA. Bank transfers are entered into the Accounting Software manually from bank account statements printed from Client-treasury.
If the invoice received from supplier is in foreign currency, the transaction entry is also done in foreign currency. If the supplier’s invoice is in AMD, the entry is done in AMD with choosing the appropriate exchange rate from the database. The transactions journal reflects both AMD and foreign currency amounts. In the case of bank transfer the payment order is filled in AMD, and the bank automatically converts the appropriate amount of foreign currency by CB’s settlement rate of the transfer date. Backup of accounting database is done monthly on USB flash drives, which are stored in fireproof safe.
The Accounting software works in a local network and has 3 users: Financial Manager, Chief Accountant and Accountant. Each user has his or her personal user name and password, as well as the specific level of access to the software and database, designed to meet their functions. The Accountant can enter contract details, transactions and other accounting information from the basic documents into the database; create invoices, payment orders and some specific reports. The Accountant cannot delete or change any entered transaction or change the reporting period without the Chief Accountant’s authorization. In addition, the Chief Accountant can generate reports to the Ministry of Finance and Tax inspectorate. The Financial Manager can make changes in access levels of the Accountant and the Chief Accountant, can monitor the budget implementation, Disbursement categories and Projects Components, can verify prepared reports with source data, etc.

The Short Description of the Computerized Accounting System being used under the Projects is given in ***Annex 4***.

D) Changes in Accounting Policies and Estimates

A change in accounting by an entity may significantly affect the presentation of both the financial position and results of operations for an accounting period and the trends shown in comparative financial statements and historical summaries. The change should therefore be reported in a manner that will facilitate analysis and understanding of the financial statements. It should be noted that the correction of an error in previously issued financial statements is not deemed to be an accounting change but should still be disclosed if material.

If during the life of the projects there are any changes in accounting policy or accounting estimates or correction of previous errors that have a material effect, the Accountant should be aware of the necessity to disclose these facts when reporting and also in the financial statements.

1. *Change in Accounting Policy*

A change in accounting policy results from adoption or use of an accounting principle different to the one previously used for reporting purposes. A characteristic of a change in accounting policy is that it concerns a choice among two or more allowed accounting treatments.

2. Change in Accounting Estimate

Changes in estimates used in accounting are necessary consequences of periodic presentations of financial statements. The preparation of financial statements requires estimating the effects of future events. Distinguishing between a change in an accounting principle and a change in an accounting estimate is sometimes difficult. The effect of a change in accounting estimate should be accounted for in either the period of change if the change affects that period only, or in the period of change and future periods if the change affects both.

3. *Disclosures*

If changes in the accounting policy took place during the reporting period, it is necessary to disclose them together with the reasons for the change. If these changes have led to significant material and financial effects, it is necessary to disclose the nature and amount of the effects of the change on current year profit or loss. The nature of prior period adjustments related to the correction of an error should be disclosed in the notes to the entity's financial statements.

E) Correction of an Error in Previously Issued Financial Statements

Reporting a correction of an error in previously issued financial statements concerns factors similar to those relating to recording an accounting change. Errors in financial statements result from mathematical mistakes, mistakes in the application of an accounting standard, or oversight or misuse of facts that existed at the time the financial statements were prepared.
Errors in the FSs are subdivided into two categories:

a. Material Error – Error that affects the information presented by the unaudited Financial Statement – i.e. misstates projects expenditures, funding by funding sources, or bank account balances or other balance sheet items for more than 1% of actual amounts;

b. Immaterial Error – Error that does not affect information as presented above.
In the case when material error had occurred, the PIU shall notify recipient(s) of the Financial Statements on the nature and reason of the error. The PIU shall re-send the Financial Statements with an additional line (and/or, where appropriate, the explanatory notes) correcting the error in the previous financial statement.

If the material error, for any reason has occurred in the audited financial statements, the PIU shall contact the Auditor for correction of this error, and re-issue Audit Report.

If the error is not material, the note shall be sent to the recipient on the nature, reason and corrective measures described.

VII DISBURSEMENT ARRANGEMENTS AND FUNDS FLOW

The following disbursements methods may be used under the projects:

- Reimbursement
- Advance (special account)
- Direct Payment
- Special Commitment

Designated Accounts (DAs) and Local Currency Accounts (LCAs)

During the life of the projects, the DAs will be used to enable effective projects implementation and disbursement of WB funding. The DAs will act as a revolving account whereby the WB deposits an advance disbursement in this account and then replenishes the DAs on the basis of appropriate Applications for Withdrawals submitted.
For the Projects DAs are opened with RA Treasury for each fund separately. These accounts are denominated in the currency required by the legal agreement. Payments from the DAs are made in respective currency to foreign contractors and in AMD to local contractors through conversion of foreign currency into AMD by the purchase rate of the given currency of the Central Bank of Armenia for the date of payment. The local currency accounts (LCAs) are opened with the Treasury too to cover the payments from co-financing funds of the State budget
Transactions from all accounts opened in the Treasury of the RA were conducted according to the procedures of RA Government's degree No. 706-N, dated 15 June 2018The budgeted expenditure codes for each fiscal year and the contracts included in the relevant codes are entered into the Client-Treasury system, distributing the payments made within the framework of the given contract according to the funding sources and quarterly indicators, which are approved by the authorized body, the MoESCS.

Accounting of the expenses and payments under the EIP are conducted from the WB and RA funds at 80% and 20% proportions respectively as recorded in IBRD Credit (8342-AM, 15 million USD) and IDA Financing (5387-AM, 9.8 million XDR) Agreements. Accounting of expenses and payments from the WB funds are executed in US dollars, with an equal proportion of IBRD and IDA funds 40% of each. Taking into account the XDR/USD exchange rate fluctuations, the proportion of funding from WB's each fund (40%) has been adjusted at the end of the EIP, keeping the total 80% share of WB financing.

Accounting of the expenses and payments in the frames of EIP with Additional Financing are conducted from the WB and RA funds at 80% and 20% proportions respectively, as stipulated in respective Loan Agreement.
For the implementation of EIP with Additional Financing pursuant to the Loan Agreement (withdrawal of loan funds in sub-item 1 a) of Section B, Part III), a Retroactive financing is defined under Category 1 (1. Goods, Works, Non-Consulting Services, Consulting Services, Training, and Project Operating Expenditures) for Eligible Expenditures starting from May 01, 2022, which should not exceed 450,000 Euros.
It is strictly prohibited to use any part of the DAs to finance the Government's contribution. If any ineligible expenditure is paid through the DAs, the WB is entitled to withhold any further deposits until the GoA has refunded the amounts. Funds should only be withdrawn from the DAs when eligible expenses must be paid. As mentioned above, if eligible payments are required to be paid from WB funds in local currency, an amount is transferred from the DAs and converted into local currency at the purchase rate of the given currency set by the Central Bank as of the payment date.
The maximum threshold for replenishing a special account under EIP with AF is 2 million Euros.
The initial advance to the DAs opened at the Treasury will be made upon the completion and submission of an Application for Withdrawal of the WB,
The persons whose signatures will be authorized in the Treasury are PIU Director, PIU Financial Manager and PIU Chief Accountant. Any payment order is prepared by the PIU Chief Accountant, authorized by the PIU Financial Manager with the second level signature and authorized by the PIU Director with the first level signature.

Payments from the WB funds could be made in two ways:
- From the DAs in the Treasury by electronic payment order via Client-Treasury;
- Directly by the WB, through direct payment method- based on electronic withdrawal applications via Client Connection System.

The withdrawal applications by which the amounts are claimed either for replenishment of DAs or for Direct Payment, are signed by the authorized signatories for the projects whose signatures are approved by the Minister of Finance of RoA.

Applications for withdrawal will be submitted periodically, (maximum period of three months).
To replenish the DAs in the Treasury withdrawal applications are prepared and submitted to the WB. They include:
- Application for Withdrawal;
- DAs Reconciliation Statement;
- Copies of Payment Certificates or Invoices if the contract price is above the threshold of the prior review:
- Statement of Expenditures, including the summary sheets where the payments from the DAs are completed for each disbursement category separately
- Bank Statements

In its turn, after completion of disbursement process the WB provides feedback by a Disbursement Summary on a monthly basis.

The PIU receives payment advices from the WB and downloads monthly disbursement summaries from the WB Client Connection system that give details about direct payments and replenishments into the DAs. The Chief Accountant performs monthly reconciliations against the projects records using these statements from the WB to ensure that all replenishments have been received and recorded and all direct payments requested have been processed accurately. In case of any inconsistencies, the source of inconsistency is found out. If the source of inconsistency is any activity implemented by the WB or RA Treasury appropriate communication is set up with the respective organization upon necessity. If the source of inconsistency is any activity implemented by PIU, the further procedures are conducted as described in Section VII e) *Correction of an Error in Previously Issued Financial Statements of FMM* are applied.

Payments from the DAs are made:
- Directly to the contractors (goods, services, works)
- Recipients of grants
- For operating costs of PIU to local suppliers as well as directly to PIU staff.

The details disbursement arrangements and the SOE thresholds are specified in Disbursement letter.

The authorized signatories for the Local Currency Accounts are the same as for the DAs.

The Local Currency Account in the Treasury will be used only for making the payments of GoA Co-financing for the Projects Those funds returned by local contractors by AMD and which were originally provided from WB funds are converted back into foreign currency and returned to the DAs.
The Treasury provides its services to PIU free of charge

To provide information on expenditures made, the electronic payment system of the Treasury provides daily statements of the accounts. Treasury account reconciliations are prepared by the Accountant and reviewed by the Financial Manager on a daily basis. In the case of any unusual items arising from such reconciliations they are analyzed for finding the source of discrepancy. The charts describing the procedures followed, controls applied as well as the flow of funds and documents under the Projects and the forms for the withdrawal applications for the Projects are presented in Annex 2.

VIII FINANCIAL REPORTING

Interim Un-audited Financial Reports (IFRs) are prepared each calendar semester (see ***Annex 5*** for the sample IFRs format). These reports will provide information about the operations of the projects over the reporting period. The IFRs will be stated in foreign currency stated in legal agreement, using information provided by the computerized accounting system and other information.
The reports shall be prepared by the assistance of Accounting Department staff and verified by the Financial Manager. The Director shall review all IFRs prior to submission to the WB. The types of IFRs and the staff responsible for the completion of these reports are listed below.

Financial Reports (to be prepared by the financial department staff)

(i) Summary of Project Sources and Uses of Funds - This report gives a summary of expenditure categories of the projects over the reporting period as well as information for the year to date and cumulatively over the projects life. A comparison of actual to planned figures is also shown with the variance stated. The Financial Manager shall ensure that the report

balances i.e. opening cash plus sources of funds less uses of funds and adjustments ties to the closing cash balances per the balance sheet at the end of the reporting period.

(ii) Summary of Use of Funds by Project Activity **-** This report shows the total expenses of the reporting period by projects activities (Details of actual, planned amounts and variances are shown and compared to the total amounts budgeted over the projects' life and per the Project Paper for EIP AF).
(iii) Project Balance Sheet/ A Statement of Financial Position **-** This report is prepared combining information from the computerized accounting software Balance Sheet and the summary of sources and uses of funds. The amounts to be included individually as sources and uses of funds are taken from the Summary Sources and Uses of Funds report.

(iv) Reports on DAs Statements **-** The report shows the amount advanced to the DAs by the WB and eligible expenditures paid from this account during the reporting period. Any interest earned on the bank account and bank fees or commissions paid should also be shown. A reconciling difference may be necessary in certain situations, for example, if ineligible expenditure has been paid out of the DAs and must be reimbursed by the Borrower, or if there are any eligible expenditure from previous periods that has not been refunded yet. These reconciling differences are carried forward to the next reporting period’s report until a resolution is reached.

(v) *Statement of Expenditure (SOE) Withdrawal Schedule* – This report reflects the amounts disbursed under SOE procedure.

The PIU shall prepare and furnish to the WB not later than forty five (45) days after the end of each reporting period, in accordance with the provisions of Section 2, sub-item I) of Additional instructions for Disbursement and Financial Information Letter.
The full version of the reports is submitted for CEP PIU Director’s approval prior to submission to the WB for downloading it on the WB Client Connection platform. A hard-copy of submitted reports and notifications of their acceptance should be printed and filed at the Financial Department.

At the end of fiscal year, similar reports should be run for the entire financial year, which will form the basis of the documentation to be provided for the audit to be undertaken. Before finalizing the period, particular care should be taken that all relevant expenses are accrued for and all closing balance reports are reflected.

The PIU also submits periodic reports to the GoA, to the Ministry of Finance of RA, to the Ministry of Education, Science, Culture and Sport, to the Audit Chamber of RA, to the RA State Revenue Committee, etc. according to the format and periodicity specified by the above mentioned state bodies.
Various reports are prepared to the management of the PIU upon request using the Computerized Accounting system (Statement of Expenditures, Statement of Accounts Payable and Accounts Receivable, Statement of Counterpart Funding as of the end of each month, etc.).

IX INTERNAL CONTROL SYSTEM

Internal control is the process designed to provide reasonable assurance that the objectives of the project are being achieved in the following areas: (i) effectiveness and efficiency of the

operations; (ii) reliability of the financial and administrative reporting; and (iii) compliance with the applicable laws and regulations.
Based on the requirements of the contract a responsible person/contract coordinator is appointed who is responsible for the receipt of the deliverables/goods/outputs of the contract. In case of time based contracts the contract coordinator is also responsible for checking the accuracy and relevance of supporting documents to the requirements of the contract, including timesheets and other documents depending on the type and content of the contract. The contract coordinator is also responsible for the supervision of timely and proper implementation of the activities anticipated in the contract.

At a minimum, the procedures should include the following measures:

- Reliable personnel with clear responsibilities.
- Segregation of duties: (a) separation of operational responsibility from recordkeeping responsibility, (b) separation of the custody of assets from accounting, (c) separation of the authorization of transactions from the custody of related assets, and (d) separation of duties within the accounting function.
- Proper authorization, with clear general and specific authorization procedures. (General authorization usually applies to routine type operations while specific authorization is required when there is a need for deviation from the limit set by general authorization.)
- Adequate records management system.
- Physical safeguard: Use of safe, locks, guards, limited access, and access by authorized persons to provide security for program assets.
- Independent check: the procedures should be made subject to random independent reviews by internal auditors (if such function exists in the unit) and regular independent reviews by external auditors.

1. Contracts

Contracts are the signed formal documents between the PIU and any organization or individual who undertakes works, provides services or goods, that defines the rights and responsibilities of the parties The PIU in its turn is obligated to pay for these services received, for the works performed and for the goods supplied in accordance with the provisions outlined in the contracts
Contracts are to be signed by the Director of PIU, and the authorized representative of the contractor.
Authorized contracts, completed with all applicable information, are entered into the Contracts Log (Excel spreadsheet). Contracts are registered with ID code (reference number) having the following format.

NN/YY, where

NN – is a numeric code representing the sequential number of the contracts signed in particular year;
YY – is a numeric code representing the year of signing the contract;
Besides, the ID code can include specific code indicating the direction of the signing Contract/ after the above mentioned numeric codes (For example, PSP, CIF).

In addition the Contracts Log provides information concerning each contract according to the ***Annex 1.*** Based on the specifics of the contract, additional columns for specific information can be added to the Contracts Log.

- Contractor's name
- Contract brief description
- Contract number
- Signing date
- Amendments Number, Date
- Contract completion date (planned)
- Contract completion date (changed)
- Contract completion date (actual)
- Contract currency
- Contract value
- Contract value (changed)
- Deadline of submission of invoices (reports) by stages
- Deadline of submission of invoice (reports) by stages /changed
- Portion by stages (%)
- Time remaining to submission of reports/invoices
- Invoice number
- Invoice currency
- Invoice date
- Invoice amount
- Invoicing status
- Days for payment after submission
- Penalty for delayed payment by PIU
- Payment due date
- Actual payment date
- Amount paid
- Time remaining to payment due date
- Payment status
- Cumulative amount invoiced to date
- Cumulative amount paid to date
- Amount remaining to be paid to date under the invoices
- Amount remaining to be paid to date under the contract
- Expenditure component name
- Expenditure category
- Notes

Terms of completion and payment conditions have to be clearly indicated in the contract. The PIU Director has to approve any amount to be paid against any invoice. The Contracts Log should be updated for all payments made so that these registers show an accurate position and status of each contract. The Contracts Log will be maintained also in 1C Accounting Software.

2. Receipt of Goods/Works/Services

The receipt of goods/works/services requires different procedure depending on the fact whether the receiver is PIU or another beneficiary. The respective steps are described below:

- In case the receiver is PIU, the receipt of goods/works/services is conducted by the Contract Coordinator as it is described above in the Section X. If the Contract Coordinator is not anticipated in the contract, the receipt of goods/works/services is conducted by the PIU Director and/or PIU respective staff member (for example, the receipt of computer equipment should be done by PIU Director and IT specialist of PIU).

- In case the receiver is another beneficiary than PIU, the receipt of goods/works/services is conducted by an acceptance document. The details of the received goods/works/services are indicated in the acceptance document; including the name and description of the goods/works/services, in case of goods – detailed technical descriptions, quantities, unit prices, total prices, and serial numbers if available. The acceptance document is signed between Supplier and Receiver as they are defined in the contract signed between PIU and Supplier. One copy of the signed acceptance document is submitted to the PIU. After receipt of all acceptance documents signed between Supplier and all Receivers according the contract, PIU and Supplier prepare and sign a final/summary act. The final payment is conducted after signing the final /summary act based on the invoice. The PIU respective staff members conduct site visits on sample basis, during which check availability and relevance of received/submitted goods/works/services to the requirements of the contract.

3. Payment Approval Process.

The approval process of the completion of the job has the following steps:

1. Contractor submits report on completion of contractual obligations, according to the implementation schedule of the Contract.
2. PIU’s appropriate Component/Subcomponent Head checks the report and approve it.
3. Contractor and PIU’s Director sign Acceptance Act if it is anticipated in the contract. In case the Acceptance Act is not anticipated in the contract, Contractor submits the invoices only to CEP PIU.
4. Within the frames of the Contracts concluded with individuals, the Contractor and PIU’s Director sign an acceptance/performance act.
5. PIU’s Accountant checks the arithmetical accuracy of the documents, its validity to the Contract payment schedule, conducts revisions if necessary, and submits to the PIU's Financial Manager for signing. In the case if inaccuracies are observed in the invoice or if the invoice respective data do not match with the acceptance certificate/act data, the Accountant with the prior discussion of those inaccuracies with the Financial Manager, contacts the Contractor and requires submitting the corrected invoice,
6. PIU’s Director signs the invoice.
7. PIU’s Accountant prepares: (i) payment order through e-Client-Treasury payment system , the funds storage related documents through e-Client-Treasury payment system
8. PIU’s Financial Manager checks the payment orders and submits it to the Director’s approval.
9. PIU’s Director approves the payment. The applications for withdrawal (must be signed electronically by the authorized signatories who are:

The Minister of Education, Science, Culture and Sport or General Secretary of the Ministry of Education, Science, Culture and Sport, Deputy Minister of Finance or Head of Public Management Department of the Ministry of Finance.

4. Financial control system

Supporting documents

All transactions must be reflected by supporting documentation to provide objective and verifiable data. The process of registration and numbering of the supporting documents is the first step for record keeping and providing an audit trail. Supporting documents are prepared either internally or externally.
Source documents can be classified into invoices, purchase requisitions, travel expense forms, etc.

a) Invoices

Invoices are bills for goods or services received. In cases when no electronic invoices are available from vendors, internally prepared invoices are used. Invoices must be completed properly to indicate the date, vendor source, description of the product or service, purpose, quantity, unit cost and total amount.
Approval of the purchase should be made by the PIU Director.
All invoices are enumerated by ID code "JV" – which represents the sequential number of invoices. After all the invoices are registered, they are posted into the computerized accounting system called 1C Accounting Software. The system allows posting of transactions through journal entries to separated accounts.

b) Purchase Requisition

Purchase Requisitions are prepared by the PIU Office Manager, taking into account the purchasing needs for office supplies, materials, accessories or fixed assets and are submitted to the Finance Department; moreover purchase requisitions should be prepared separately according to operating expenses of budget items and should contain information on the type, quantity and estimated cost of the required service or product; The Financial Management Department has to analyze the purchase requisitions and make sure that appropriate budget funds are available. The Office Manager submits the filled in purchase requisitions for PIU's Director approval. Based on the approved purchase requisitions, the Office Manager sends an order to the relevant supplier, who along with the supplied goods presents the invoice for bank transfer.
When requisitions are completed and authorized, they are kept in a Purchase Requisition Folder with the attached copies of base documents for purchasing goods or services.

c) Travel Expenses

Business trip certificates are used for travel outside Yerevan within the territory of the Republic of Armenia or during business trips abroad. These certificates are numbered consecutively Both in country and international business trip costs (hotel, per diem and travel) are reimbursed based on norms and procedures established by the GoA Decree No. 2335-N dated 29.12.2005. The staff of project components/subcomponents analyzes the implementation of the works under their components/subcomponent and based on their annual work plan prepare an annual activity schedule, including information on business trips: for monitoring/promotion/needs assessment, observations and other purposes. The schedule for site visits is discussed and agreed with the PIU Director by the Component Heads.

5. Cash payments

Since January 2008 no petty cash is maintained and there is no cash register at the PIU. In cases where cash payment is required for the purchase of goods or services, it is done through reporting person. The latter submits the receipt or the check for the payment for the purchase of goods or services to the Finance department, on the basis of which the report on the expenditure of the reporting amounts is prepared and submitted to the PIU's Director

approval. Depending on the nature of the transaction, if necessary, the transfer to the reporting person can be made prior making the payment for the purchase of goods or services, based on the relevant report verified by the PIU Director.
The statement on the expenditures of the reporting amounts is the basis for reimbursement of the amount spent on the reporting person's bank account or for a refund of the overpaid amount.

6. Controls over fuel procurement and distribution

During the projects' period the fuel suppliers are selected through price request, selecting the supplier offering the lowest price. The quantity of the fuel to be ordered is determined after considering the planned travel for the period and comparing it with the planned amount for the fuel for the reporting period. The seasonal factors and traffic conditions are also considered.
The quantity and the amount of the procured fuel is agreed with the Financial Manager, and approved by PIU’s Director. The vouchers are received by the FM division along with the supplier’s invoice for the payment.
The FM division registers the fuel distribution through the fuel allocation requisitions provided by the Office Manager, where the date and the quantity (in liters) of fuel received, car registration number and the car type, the driver’s name and signature as well as the fuel distributor's name and signature are recorded. The office manager maintains Vouchers Records book, where the monthly records of waybills indicating the dates of issuing and returning of the waybill, the sequential number of the waybill, the registration number of the car, the driver’s name and signature and the signature of the office manager are recorded.
The waybill records the initial and final figures of odometer, the actual mileage, starting and ending fuel balances, amounts of fuel received and consumed during the waybill period (1 month) signatures of the driver and Office Manager. At the end of each month the filled in waybills are being submitted to PIU’s Director approval. The waybill also shows daily travel log of the cars, travel destinations, daily mileage driven, as well as bears signatures of the driver and the Office Manager.
The FM division is responsible for voucher distribution. The office manager is responsible for the verification and record of the odometer indications, which along with the mileage passed are recorded into the waybill. The office manager is also responsible for the supervision of the use of cars only for project related activities and during working hours or in another period according to the PIU Director's instruction. In particular the office manager records the odometer indications at the end of the current working week and at the beginning of the next working week taking into account the permitted mileage (e.g. the distance between the office and the driver's place). According to the drivers' labor contracts the cars are under the responsibility of drivers in terms of its use only for project related activities and during working hours or in another period according to the PIU Director's instruction. He prepares quarterly reports on fuel usage and balances and submits them to the accounting staff. The accounting staff records the fuel purchase and usage amounts on quarterly bases into the accounting system.

7. FA control.

The internal control of FA such as furniture, equipment, machinery and other capital assets are to be maintained by the Office Manager and Accountant. All employees are responsible and accountable for FA in their possession.
Any internally constructed or donated equipment will be reported to accounting if the item has value of AMD 50,000 or more. A complete description of the property, date manufactured and received, number of items, cost or estimated value and a statement that it was internally constructed or donated will be included in the report.

An asset disposition form will be submitted to Accounting unit in the case when FA are sold or traded-in for new equipment. The PIU Director should approve this form. The Accountant will delete the item from the asset records and record any gain or loss on the disposition. The Accounting unit should be notified about worn out or obsolete property with no cash value on the asset disposition form with the description, serial number and condition. The asset will be removed from the Asset records. In case of missing or theft of any asset the Accounting unit should be notified as soon as possible in a report including the description, serial number of the lost item. In such cases, the asset will be removed from the asset records by Accountant. A FA register will be maintained by the PIU's Accountant to record all fixed assets used by the PIU – the register will be maintained in 1C Accounting Software. The details included in the FA register will include description of FA, purchase date, purchase price, number allocated to the fixed asset and location of asset.

8. Maintaining Asset Record

Office Manager executes assigning and attaching asset number tags to the property. Accounting maintains of all FA, and detailed description of each asset.

At the end of each year all FA of the projects will undergo stocktaking. This will be done by the PIU Office Manager together with a responsible staff members. The stocktaking will check for the availability, physical conditions and state of use of the assets. After each stocktaking a list of all FA used by PIU will be prepared, which will be approved by the PIU Director. The list will contain the asset's registered number, name, Identification number (if applicable), measurement unit, number of units, unit price, total price, acquisition date and base document.

9. Pay and Payroll Matters

The Chief Accountant prepares the Payroll sheet, which is verified by the Financial Manager, and approved by the Director. Salaries are calculated based on monthly timesheets prepared by the Office Manager and approved by the Director of the PIU. Salaries are calculated according to the rate as specified in the employment contract for each employee. Overtime hours are paid for time worked in excess of 40 hours per week according to the RA legislation. The head of each component/subcomponents should inform the office manager about the expected overtime of their employees prior to authorizing overtime for their employees. By the order of the PIU Director and in accordance with the provisions of the RA Labor Code, PIU employees may be provided with premium / bonuses.

Salaries are calculated and paid in AMD according to the Payroll.

10. Importance of Timely Payments

It is essential that all payments be processed on a timely basis. The Accounting unit is responsible for ensuring the timeliness of the payments. The Financial Manager should monitor the budget and cash flow needs over several months in order to plan payments and estimate funding requirements from WB and the Implementing Agencies.

11. Bank guarantee letters

The Chief Accountant accepts the bank guarantee letters received, verifies the accuracy, reliability and acceptability of the guarantee letters, and reconciles with the terms and conditions in the respective contract. The Chief Accountant registers the bank guarantee letters in Bank Guarantee Letters Log (refer to Annex 6) which are updated/monitored at least once a month. The bank guarantee letters are kept in a fireproof safe.

12. Retentions and Advance Payments

The standard bidding documents and contracts for civil works generally provide for certain percentage of retention to be kept back from each invoice payable under the projects. The Accountant must ensure that this amount is deducted from each payment, and that those amounts are paid to the contractor at the end of the warranty period if the terms of the contract are met. Similarly when advance payments are made, the Chief Accountant must ensure that this amount is reduced against invoices received and decreased from future payment requests of the contractor/supplier/grantee.

X DOCUMENTS FILING AND ARCHIVING PROCEDURES

The PIU has a sufficient mechanism for documents filing procedures and submitting them for archiving with the aim of ensuring proper tracking and safe keeping of the overall documentation, internal distribution of data and information, tracking of assignments and performance.

CEP PIU staff is responsible for maintaining the documents within its competence. The original copies of financial and all supporting documents are kept in FM Division. Documents related to other PIU departments can also be stored in the relevant departments. The supporting documentation for each payment is filed using a chronological numbering system.

Archiving Procedures: According to the RA Law on Archiving after the completion of the project and audit for the final fiscal period all documents related to the completed project are archived by the National Archive of RA. Further maintenance of archived documents is conducted according to the respective regulations and legislation of RA.

XI AUDIT ARRANGEMENTS

The selection of the audit firm for the audit of the Financial Statements of the Projects is carried out by PIU based on the list of eligible audit firms approved by the World Bank. The audit of the Projects is conducted by independent private auditors, on Terms of References (TOR) acceptable to the World Bank. The auditing standards to be used by auditor are the International Standards on Auditing (ISA) issued by International Auditing and Assurance Standards Board (IAASB) of International Federation of Accountants (IFAC). Each audit of the Financial Statements within the Project should cover the period of one fiscal year, for exceptional cases (only if a small amount has been disbursed and the audit period is less than 18 months) the World Bank may provide waiver to combine audit of project financial statements for two years. The audited Financial Statements for each such period shall be furnished to the WB not later than six months after the end of such period.

The audit reports for the project within one month of their receipt from the auditors will be posted on the PIU website: www.cfep.am

The annual project financial statements will comprise of the followings[1]:

a) a Summary of Funds received, showing the World Bank, Project funds from other donors, and counterpart funds separately.

b) a Summary of Expenditures shown under the main project headings and by main categories of expenditures, both for the current fiscal year and accumulated to-date;

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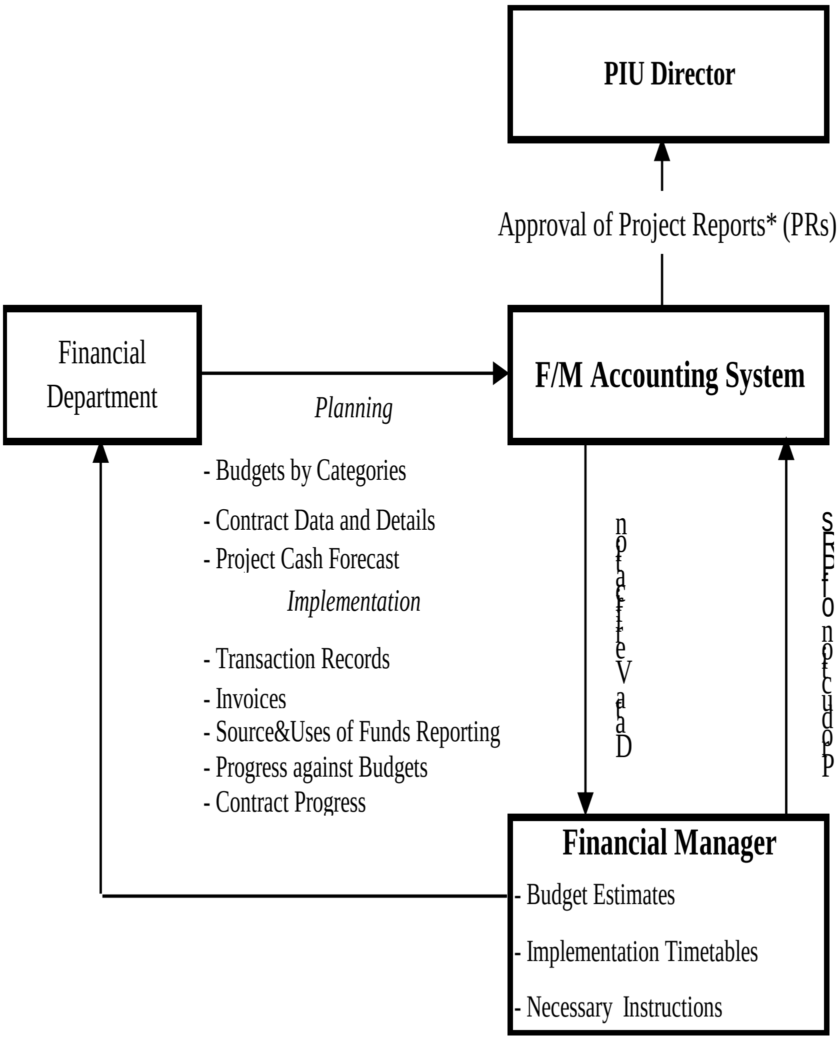
c) a Summary of Summary Reports or SOEs used as the basis for the submission of withdrawal applications;
d) A Statement of Designated Accounts;
e) a Balance Sheet showing Accumulated Funds of the Project, bank balances, other assets of the Project, and liabilities, if any; and
f) Notes, comprising a summary of significant accounting policies and other explanatory notes.

The sample of terms of reference for the audit of projects is attached. /Annex 7/.

XII FINANCIAL MANAGEMENT UNIT AND STAFF

1. Organization of Financial and Management Accounting System



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2. Monitoring of Plans Against Actual

The information system ensures that the generated reports satisfy the projects' reporting requirements arrangements for maintaining effective communication with government, supervisory agencies, suppliers, projects beneficiaries, the Bank and other donors; and clear procedures for preparing, signing and dispatching the financial information required by the Bank.

The arrangements of actual projects activities against plan, and regular evaluations will be done by the Financial department in close collaboration with the Heads of components/subcomponents. They will enable management and staff to assess the quality and performance of the internal control system.

3. Procurement Controls

The Financial Manager will work in close collaboration with the Procurement Specialists to ensure compliance with the requirements of the internal control system in particular that:

- contract amounts and other terms are recorded from the agreed contracts and that subsequent changes are both in accordance with the contract provisions and properly approved and adjusted to the amounts in the contract records and the Financial Manager should ensure that all changes to the contracts affecting the payment terms and conditions are reviewed and approved by the Accounting unit staff prior to signing the amendments to the contracts;
- amounts invoiced and approved are noted showing date of approval including amounts payable, paid and deferred for future payment; and
- payments against contracts are noted beside the relative contract showing date of payment (explanations should be made where payments have been delayed).

4. Conflict of Interest and Reporting lines in case of suspected fraud, waste or misuse of projects resources or property

Conflict of interest shall be interpreted but in no way limited to the following: any past, present or prospective economic, financial and private direct and/or indirect (through relatives or partners) interest, as well as ownership or other links with the PIU staff or companies, projects developers and individuals involved in projects financed directly by the PIU.

It is expected that all officers, trustees, and staff of the PIU will at all times adhere to the highest ethical standards in all matters.

Where any officer, trustee, or staff member, or any spouse (or other person with whom one cohabits), or lineal descendant or ascendant of same respectively, is an officer, director, or staff member of, or has a financial interest in, any other association or other organization (including any vendor of goods or services) with which PIU has entered into, or is considering entering into, any contract or other transaction, such officer, trustee, or staff member shall disclose in writing to the PIU Director all material facts as to the relationship or interest. Individuals with conflicts of interest must recluse themselves from participating in any part of the decisions related to the transaction giving rise to the conflict.

No officer, trustee, or staff member shall use, for financial or other advantage, confidential or proprietary information accessed by virtue of his or her position with PIU. Information does not need to be marked as "proprietary" or "confidential" before this policy applies. Types of information PIU considers proprietary or confidential include, for example, computer programs and databases, such other information as personnel files, research and development information, strategic plans, technical information, financial information, and advice of accountants and legal counsel. Only individuals to whom proprietary and confidential information must be disclosed in the performance of duties have a need to know this information.

Each case of fraud, waste or misuse of projects resources or property identified by the PIU employee shall be reported in writing to its direct supervisor or to the PIU Director if the issue is neglected or unsettled by the supervisor. Should the PIU Director fail to undertake any action for suspending such fraud, waste or misuse, the issue shall be submitted to Board member/members in writing by the same employee with sending a copy of such notification to the person having committed an act of fraud, waste or misuse.

5. Responsibilities and tasks of Financial Management Unit's staff

The Financial Management Unit of PIU consists of three specialists:

- ⇨ Financial Manager
- ⇨ Chief Accountant
- ⇨ Accountant

Financial Manager

The Financial Manager is responsible for the overall oversight of the financial management arrangements under the projects, including accounting, budgeting, reporting, internal controls, external auditing, replenishment of WB special account and co-financing account and disbursements. The Financial Manager is also responsible for keeping control over utilization of the materials, manpower, financial resources and financial reporting in strict conformity with Government and WB regulations. Financial Manager is working under direct supervision of the PIU Director.

Chief Accountant

Chief Accountant is responsible for all standard accounting and bookkeeping, for operating computerized accounting system for the PIU, for reporting in accordance with Armenia accounting, tax legislation requirements, as well as for providing assistance to the Financial Manager in making payments, in conducting financial control over the contracts and Program related activities, in preparing budgets, in withdrawal of applications, IFRs, etc. Chief Accountant is working under direct supervision of the Financial Manager.

Accountant

Accountant is responsible for all standard accounting and bookkeeping, for operating computerized accounting system for the PIU, for reviewing financial statements submitted under grant projects, as well as for providing assistance to the Financial Manager in making payments, preparing budgets, SOEs, IFRs, etc. Accountant is working under direct supervision of the Financial Manager.

XIII ANNEXES

Annex 1. Contracts Log
Annex 2. Disbursement arrangements and Funds flow
Annex 3. Chart of Accounts
Annex 4. Technical Specifications of the Accounting Software
Annex 5. Sample Interim Un-Audited Financial Reports (IFRs)
Annex 6. Bank Guarantee Letters Log
Annex 7. Project Sample Auditor’s Terms of Reference (TOR)
Annex 8. Accounting Forms to be Used by the PIU