

ANSWERS TO ANALYZING LOAN DISBURSEMENT POLICIES

Scenario 1

The Executing Agency submitted a withdrawal application for payment by ADB of US\$250,000 to a contractor under a civil works contract. Payment was to be made in the beneficiary's local bank account in Manila. The payment instruction provided by the EA is as follows:

Payee's Name: Good Works Construction Company
Payee's Address: 16 Meralco Avenue, Mandaluyong, Metro Manila, Philippines
Bank Name: Metropolitan and Equitable Bank Corporation
Bank Address: No. 18 Pasay Road, Makati, Metro Manila, Philippines
Payees's Acct. No.: 1234-5678-910-001
SWIFT Code: PBCFGNNHKKS

Based on the above payment instruction, can ADB remit payment? If not, why?

ADB cannot execute payment because information on the correspondent bank is missing. Payee's Bank is located in the Philippines and not in the U.S. whose currency is claimed. Therefore, the name and address of Metropolitan and Equitable Bank's correspondent bank in the U.S. should be provided by the EA.

Scenario 2

Under an Emergency Rehabilitation Project, ADB has approved advance procurement action (ADPA) for civil works and retroactive financing (RF) for eligible expenses incurred and paid for by the Borrower from 15 July 2003 until loan effectiveness, and subject to a maximum amount of \$500,000.

The loan became effective on 10 May 2004. On 25 August 2004, the EA submitted a withdrawal application to ADB for reimbursement of \$10,000 for payment made on 15 October 2003 to a contractor under a civil works contract. The contract was awarded on 3 July 2003.

Is the payment made by EA on 15 October 2003 eligible for retroactive financing? Why or why not?

The payment is not eligible because even with retroactive financing, procurement activities including award of contract were undertaken prior to 15 July 2003, the cutoff date approved by ADB for ADPA and RF. Under para. 2.11 on ADPA of ADB's Guidelines on Procurement, ADPA is defined as: 'in cases where it is clearly shown that early contracting of goods or works would be a crucial and important factor in the timely completion of the project, issuance of invitations to bid or to prequalify may, with the prior approval of the Bank, be allowed before the approval of the project to be financed'. With ADPA, ADB therefore allows advance procurement actions but these should be undertaken on or after project appraisal. The correlation between RF and ADPA is clearly illustrated in the following chart.

Scenario 3

ADB organized a Trade and Customs Working Group Meeting in October 2004 in preparation for a Ministerial Conference on Transport and Trade in Central and South Asia. ADB engaged a Consultant for this activity to review relevant policies, as well as develop work plans and recommendations. The Working Group Meeting was funded under a Regional Technical Assistance Grant (RETA).

The work and recommendations of the Consultant was among the major topics of the Working Group Meeting and it was necessary for the Consultant to confer with the officials of the Economic Cooperation Organization at its headquarters in Tehran, Iran to carry out his assignment.

- a. Under these circumstances, should ADB finance the travel costs and other expenses incurred by the consultant to Iran?

Pursuant to Article 14 (ix) of ADB's Charter, any financing provided by ADB shall be used only for procurement in member countries of goods and services produced in member countries. As the travel to Iran would involve the incurring of expenses within a non-member country, the Charter provision would normally apply to prohibiting such travel. In this particular case, the issue was raised to the Office of General Counsel (OGC) who allowed the travel by the Consultant to Iran, on an exceptional basis, considering the importance of the travel to the Working Group Meeting and the minimal cost incurred. This was however not meant to be a precedent and OGC's position was that similar requests will not be permitted in the future in view of the Charter restriction.

- b. How should a similar problem be addressed in future?

OGC advised that should any travel to non-member countries be required under any Department's regional cooperation program, whether under RETA or otherwise, ADB Board approval will be required, as provided under Article 14 (ix) of the Charter. OGC further suggested that the Department should consider seeking Board approval for the travel, procurement, or work in non-member countries not on an individual TA-by-TA basis, but on a program or annual basis.

Scenario 4

In the Attachment to Schedule 3 of the Loan Agreement, withdrawal of loan funds under civil works category is usually expressed in "total expenditure" terms, e.g.,

Civil works 85% of total expenditure
(60% for foreign and 25% for local)

For other categories however such as equipment, consultants, training, etc., withdrawal of funds are expressed as direct foreign/local expenditure categories, e.g.,

Equipment (100% of foreign expenditure)
 (100% of local expenditure)
Consultants (100% of foreign expenditure)

Training (70% of local expenditure)
 (100% of foreign expenditure)
 (100% of local expenditure)

- a. Aside from civil works, would it be acceptable to use “total expenditure” approach for other categories? Why or why not?

Attachment to Schedule 3 is used as basis of withdrawal of loan funds and the financing percentages are presented in a prescribed form to facilitate withdrawals. The “total expenditure” approach is usually used for civil works because the foreign exchange component is not ‘direct’ but ‘indirect foreign cost’. For instance, the currency of payment in a civil works contract awarded to a local contractor would be in local currency. However, this contract would have indirect foreign cost components, which have been estimated during appraisal of the project. In order to charge this indirect foreign cost to the foreign currency component of the loan, Controller’s (CTL) would need the percentage of payment that would be charged to foreign. We obtain this percentage in the attachment to Schedule 3. In the above example, for civil works category, CTL would pay 85% of the claim, out of which 60% would be charged as foreign cost while 25% local cost. The ‘direct foreign/local expenditure’ approach on the other hand is used mainly for equipment; consultancy, training or other categories which involve direct foreign costs. For instance, international consultancy contracts involve direct foreign costs where ADB would pay foreign currency. In this case, the claims for foreign costs and local costs need to be separate as the currencies are different. So in the allocation example shown above, when we receive the claim of the consultants in foreign currency, we would pay 100% and charge it to foreign costs while if the claim of the consultants is in local currency, we would pay 100% and charge it to local cost. The same is true for equipment. However, even if a local manufacturer wins the bid in which payment would be in local currency, as long as the equipment is procured using ICB or IS, we would pay 100% ex-factory price (exclusive of local taxes) and charge the payment to local currency cost.

“Total expenditure” approach could be used for other categories other than civil works if ‘indirect foreign cost’ components are involved. For equipment procured under LCB or direct purchase for instance, this approach would be appropriate to use to capture the indirect foreign component of the cost of equipment.

- b. What is the significance of the two approaches?

As clarified above, these two approaches are used to ensure that the claims of contractors, suppliers and other payees are disbursed properly and appropriately into the foreign and local currency components in accordance with the RRP and loan agreement. This is important because the loan has local currency ceiling. If charging to local cost does not properly follow the agreed cost estimate tables, local currency ceiling may either be exceeded or underutilized and this will not be beneficial to the Borrower.

Scenario 5

The Ministry of Finance representing the Government is guarantor for an OCR loan, the borrower of which is the Metropolitan Water Corporation (MWC). MWC,

through the Ministry of Finance, submitted a letter to ADB proposing cancellation of loan proceeds. The milestone events were as follows:

<u>Milestone Events</u>	<u>Dates</u>
- Discussion with Mission. Mission agreed.	18 September 2003
- MWC letter through Ministry of Finance received by ADB.	20 May 2004
- ADB Management approved the Cancellation	12 June 2004
- ADB sent telex to MWC advising approval of cancellation.	14 June 2004
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- a. Should ADB allow the cancellation of loan proceeds?

As provided in Section 8.01 of the Loan Regulations, the Borrower, after consultation with ADB and with concurrence of the guarantor, if any, and by notice to ADB, cancel any amount of the loan, which has not been withdrawn. It is therefore the Borrower's right to cancel loan proceeds. Under Section 8.03 of the Loan Regulations, ADB may also, by notice to the Borrower and guarantor, if any, cancel an unwithdrawn amount of the loan subject to certain conditions as detailed in the Regulations.

- b. The Borrower insists that the date of effectivity of the loan cancellations be 18 September 2003 as consultation and discussion about the cancellation were discussed on that date with the Bank Mission who agreed on the cancellation. Is the Borrower right?

If the cancellation is initiated by the Borrower, the effective cancellation date is when ADB receives the Borrower's notice of cancellation. In this particular case, it is 20 May 2004.

- c. Does the date of effectivity of cancellation have any financial application on the Borrower? If so, in what case and how?

For OCR loans, there is financial implication because of the payment of commitment charges. If a loan is cancelled immediately, the Borrower would be paying lesser commitment charges. In this particular case, the Borrower lost about 8 months in payment of commitment charges between the date the cancellation was discussed (September 2003) and the date the letter of the Borrower was received by ADB (May 2004).

Scenario 6

An Imprest Account was approved under a loan. The Executing agency submitted a letter to ADB requesting that it be allowed to maintain the Imprest in a

savings account in a commercial bank. Under such account, any idle balance above a certain ceiling amount is automatically transferred to a fixed deposit, which would earn higher interest than normal savings account. The EA justified that any interest earnings would be used to finance eligible expenditures under the project.

Should ADB agree to the request of the EA?

No. The imprest account facility is provided to the EAs for timely disbursement of the Bank's share of eligible expenditures. In principle, the imprest funds should not be kept in an interest-bearing account that would earn income because the balance in the account should be kept at a minimum level that is sufficient to meet short-term disbursement needs. The imprest account procedure should also be applicable uniformly to all ADB projects and in all borrowing countries. If ADB were to agree to the EA's proposal, it would be very difficult for ADB to monitor how the interest earnings would be utilized by the EAs and whether the interest income earned were as a result of corrupt practices or otherwise. If imprest accounts were deliberately kept in high interest-bearing accounts, it would lead most likely to overestimation of project expenditure needs and would constitute a clear deviation of the purpose for which the imprest account is provided.

Scenario 7

The closing date for a loan is 31 October 31, 2004. The Borrower's request for extension of the loan closing date to 30 April 2005 was disapproved by ADB. Meanwhile, the services of a Consultant under a consultancy contract would be completed only by March 2005. Will the services of the Consultant until March 2005 be eligible for bank financing? Why or why not?

No. In principle, after the scheduled closing date and without any extension, ADB provides only three months grace period to wind up disbursements. However, disbursement will be made only for expenses incurred for goods and services delivered or completed before or on closing date. In exceptional cases and with strong justification, ADB may allow some flexibility in the application of this policy but this needs the endorsement of the Project Department concerned and CTL.