

## 2. User Instructions

### 2.1. Overview

2.1.1. This part of the Guidelines begins by describing ADB's operational lending approaches (lending modalities). It then proceeds to describe how these Guidelines apply to different ADB-financed projects, programs, and sectors. The resulting classification provides a basis for identifying step-by-step financial management requirements throughout the project cycle. In doing so, by first referring to this part, readers can quickly identify what needs to be done, by whom, and by when.

### 2.2. ADB Lending and Technical Assistance

2.2.1. ADB makes loans from its Ordinary Capital Resources (OCR) and from the Asian Development Fund (ADF). The ADF is designed to provide loans on concessional terms to Developing Member Countries (DMCs) with low per capita gross national product (GNP) and limited debt repayment capacity. The small size and location of countries may also constitute a criterion for ADF eligibility. The ADF is maintained by regular member contributions. ADB also provides technical assistance from its own resources and from special funds. These include the Technical Assistance Special Fund (TASF) and the Japan Special Fund (JSF).

2.2.2. ADB's Charter permits it to make, participate in, or guarantee loans to its DMCs, or their governments, to any of their agencies or political subdivisions, and to public or private enterprises operating within such countries, as well as to international or regional entities with economic development concerns in the region. Loans are made only for projects or programs of high developmental priority.

2.2.3. ADB has four primary types of lending:

- **Project Loans.** Among other things, project lending is aimed at developing energy, agriculture, transport and communications, and other basic infrastructure as well as health, education, and finance.
- **Sector Loans.** OM D3 (*Sector Lending*) sets out ADB policies in relation to sector lending. Sector lending is a form of ADB assistance to a DMC for project-related investments based on considerations relating to a sector or subsector as a whole in the DMC. The purpose of a sector loan is to assist in the development of a specific sector (or subsector) by financing part of an investment in the sector, planned by the DMC. A sector loan is expected to improve sector policies and strengthen institutional capabilities.

- Sector lending is particularly appropriate when a large number of subprojects in the sector (or subsector) are to be financed.
  - Technical assistance may be given for project preparation, sectoral studies, and/or institution building, prior to, or together with, the provision of the sector loan. Sector loans are ordinarily given to well-established institutions with experience in project implementation.
  - Sector loan proceeds will be utilized primarily to meet the foreign exchange costs of subprojects making up the loan. Recurring costs (e.g., fuel and essential supplies) and local currency expenditures or subprojects may also be financed under sector loans in accordance with relevant ADB policies (see OM H3).
  - ADB lending terms are the same for sector and project loans.
- **Program Loans.** OM D4 (*Program Lending*) sets out ADB policies in relation to program lending. Program loans are given by ADB to assist a DMC in developing a sector (or subsector) as a whole and improving a sector's performance through appropriate policy and institutional improvements over the medium to long term. Program loans are given only to DMC governments. Advisory technical assistance may be attached to a program loan to further study unresolved policy issues or to strengthen the capacity of key sector institutions. Although program lending differs from project lending in objectives, the procedural and administrative steps in processing a program loan are generally the same as those for projects.
  - **Private Sector Loans, Equity, and Guarantees.** OM D10 (*Private Sector Operations*) sets out ADB policies in relation to private sector lending. ADB assistance to the private sector in DMCs is designed to help in resource mobilization and more efficient use of investment funds for economic development. ADB support for the private sector in DMCs aims to: (i) create a favorable environment for the private sector in DMCs; (ii) strengthen financial institutions and capital markets; (iii) assist in privatizing public sector enterprises; (iv) catalyze external and domestic resource flows to infrastructure projects utilizing build-own-operate (BOO)/build-own-transfer (BOT) modalities; (v) invest in selected, productive private enterprise in accordance with sound banking principles; and (vi) assist economically attractive and financially sound private sector projects that require ADB financial support to complete the financing plan or to provide comfort to other lenders and investors. ADB assistance may be provided in one or more of the following forms: (i) loans to financial institutions to finance small- and medium-scale private enterprises, (ii) direct loans to medium- and large-scale private enterprises, (iii) equity investments in private enterprises including private financial institutions, (iv) underwriting of issues of equity or debt instruments on national or international securities markets, (v) assistance to infrastructure projects; (vi) equity investments; and (vii) guarantees of the debt-service obligations of private enterprises with or without counter-guarantee by a DMC government.

2.2.4. ADB's Technical Assistance (TA) is classified into four development activities: (i) project preparatory technical assistance (PPTA) for assisting in the preparation of one or more projects, a program loan, or a sector loan, for financing by ADB and other external sources; (ii) project implementation technical assistance for assisting in the implementation, operation, and management of an ADB-financed project; (iii) advisory technical assistance for financing institution-building, plan-formulation, and sector-, policy-, and issues-oriented studies; and (iv) regional technical assistance (RETA), covering more than one DMC. OM D12 (*Technical Assistance*) sets out ADB policies in relation to technical assistance.

2.2.5. ADB encourages cofinancing. The cofinancing strategy comprises: (i) maximizing the amount of cofinancing from other official funding agencies, and (ii) increasing the flow of private capital through cofinancing to DMCs. The purpose of this strategy is to maximize the impact of ADB's assistance in the development of its DMCs and to mobilize additional resources for such development. Cofinancing funds come from (i) official funding agencies, (ii) export credit agencies, and (iii) commercial finance institutions.

### **2.3. Applying these Guidelines**

2.3.1. The provisions of these Guidelines apply to investment projects and project executing and implementing agencies. Consequently, they mainly relate to identifiable investment activities that have been undertaken with support from project, sector, and private sector loans. However, the provisions of these Guidelines will also apply where program loans include discrete, identifiable investment components. Nevertheless, for program loans with a list of ineligible items of imports (negative list), borrowers are required to submit a certificate in support of loan withdrawal applications. ADB also retains its rights to audit any accounts or to verify the validity of the certification provided by borrowers with each application (See paragraphs 11.8–11.11, *ADB Loan Disbursement Handbook*).

2.3.2. The revised Guidelines apply to private sector operations (PSO). In this respect, the Guidelines will be strengthened in future updates to take account of developments in this area and to reflect the guidance provided in the Credit Risk Manual that the Private Sector Operations Department (PSOD) is preparing.

2.3.3. These Guidelines are also relevant to PPTAs. PPTAs are designed and implemented prior to the beginning of a program or project. These guidelines strongly recommend that PPTA resources be used (in part) to appraise the financial aspects of

projects and project executing agencies and, where necessary, to develop sufficient financial management capacity to implement and manage the project.

## 2.4. Project Types and General Treatments

2.4.1. These Guidelines effectively classify projects, executing agencies, and implementing agencies into two distinct groups: (i) nonrevenue-earning; and (ii) revenue-earning (including public sector, private sector, and financial institutions). ADB, together with other international financial institutions (IFIs), including the other MDBs, is actively encouraging borrowers and EAs to adopt uniform standards of accounting and financial reporting. However, some time will be required to achieve a high level of uniformity.

2.4.2. In the case of nonrevenue-earning EAs in the public sector, ADB expects sound financial policies, adequate accounting records, proper internal control systems, timely reporting to management, and sound and timely auditing.

### Accounting Standards, Auditing Standards and Reporting Arrangements

2.4.3. **Accounting Standards.** Examples of accounting standards acceptable to ADB are the International Accounting Standards (IAS) published by the IASB, which are normally used for commercial entities, and the International Public Sector Accounting Standards (IPSAS) published by the Public Sector Committee of the International Federation of Accountants (IFAC-PSC). Financial reports may be prepared in accordance with national accounting standards that are judged to be acceptable by ADB. ADB, together with the other members of the MDB Technical Working Group on Financial Management Harmonization and the OECD-DAC, undertake to support the work of IFAC-PSC in developing an accounting standard for development assistance, was published in 2004.

2.4.3 (a) **Auditing Standards.** Examples of auditing standards acceptable to participating MDBs are those published by the International Organization of Supreme Audit Institutions (INTOSAI), and the International Standards on Auditing (ISA) issued by the International Audit and Assurance Standards Board (IAASB). ADB may also accept national audit standards that they consider to be consistent in all material respects with international standards, or where any material inconsistency with international standards is identified and disclosed.

2.4.4. The following table illustrates these categorizations and associated treatments:

Sector:	State-Owned (Public Sector)		Private Sector
Type of Project, Executing Agency or Implementing Agency:	Nonrevenue-Earning	Revenue-Earning	Private Sector
		Financial Institutions	
Broad Guidelines Approach and Requirements:	<ul style="list-style-type: none"> <li>• Sound financial policies</li> <li>• Adequate accounting records</li> <li>• Proper internal control systems</li> <li>• Timely reporting to management</li> <li>• Sound and timely auditing</li> <li>• Gradual improvements in financial reporting as capacity allows</li> </ul>	<ul style="list-style-type: none"> <li>• Move towards best practice private sector management, internal control, and governance arrangements</li> <li>• Ensure that ongoing operations are sustainable</li> <li>• Compliance with National Accounting Standards</li> <li>• Move towards reporting in accordance with IASs</li> </ul>	

## 2.5. Overview of Project Processing Steps

2.5.1. Once a project is identified by agreement between a government and ADB, it is processed and implemented. The various steps from project identification to completion comprise what is known as the project cycle. Further details and indicative timetables for the project cycle are available from [www.adb.org/Projects/cycle.asp](http://www.adb.org/Projects/cycle.asp). The steps in a typical ADB-financed project include (i) project identification, (ii) fact-finding to establish project feasibility, (iii) appraisal to assess project soundness and viability, (iv) consideration and approval by ADB's Board of Directors, and (v) project implementation, within the guiding framework of ADB's loan administration procedures. Many ADB-financed projects are also subject to operations evaluation when completed.

2.5.2. The first step of project identification is generally undertaken during the preparation of the Country Strategy and Programs (CSPs). CSPs are usually prepared every 5 years for each DMC and are updated annually, in consultation with member governments.

2.5.3. In appraising a project, its technical, financial, economic, social, environmental, production, marketing, management aspects, and loan conditionalities are closely examined. This helps to pinpoint specific steps necessary to ensure its smooth and efficient implementation and operation. ADB loans are often channeled through (i) existing agencies, (ii) government departments, (iii) semigovernment and public enterprises, (iv) and to the private sector, often through national development banks.

2.5.4. Loan approval by ADB does not mean that the amount of the loan is immediately transferred to the borrower in a lump sum. The loan is disbursed to meet expenditures under the loan agreement, as and when they are incurred. Specific procedures are laid down in the loan documents and in ADB's *Loan Disbursement Handbook*.

2.5.5. Normally, the loan documents allow 90 days for the loan to become effective. The preparatory work for construction (including recruitment of consultants, preparation of tender documents and detailed designs, procurement of equipment, and selection of contractors for construction) may take from 12 to 18 months or longer. Usually, these activities cannot begin until the loan becomes effective. However, certain preliminary steps in the procurement of goods and selection of consultants may begin at an earlier stage to speed up project implementation. Implementation time generally ranges from 2 to 5 years and depends on the type and nature of the project. The progress of project implementation is assessed by ADB review missions, which visit the project about twice a year throughout the implementation period.

## **2.6. Step 1: Identification and Early Preparation**

2.6.1. When compared with the needs of its borrowing members, ADB resources are limited. Consequently, projects are selected carefully. Before any project is identified for ADB financing, ADB staff review a country's economy, particularly its national and sectoral development programs, and determine the prospects for its success. Country programming missions visit DMCs regularly to discuss topics of mutual interest with government officials and select suitable projects for ADB assistance.

2.6.2. Since the levels of economic growth, and the priorities for development vary from one DMC to another, ADB tries to select those projects which will most effectively contribute to the economic and social development of the country concerned, in conformity with the country and ADB strategies.

2.6.3. Once it is confirmed that the project investment is justified, ADB evaluates the project. In some cases, especially in the smaller and less-developed DMCs, project identification may require the help of outside experts. If so, ADB can provide technical assistance to a DMC to help it identify and prepare a project for possible ADB financing. The following table identifies relevant activities during project identification and early project preparation.

Activity	Responsibility <sup>a</sup>		Project Type <sup>b</sup>				
	Consultants and/ or Financial Analyst	Executing Agency	General	Non-revenue-Earning	Revenue-Earning	Private Sector	Financial Institution
• If project is not identified in the Country Strategy and Program (CSP), then Concept Paper is prepared for Management approval.	✓	...	...	...	...	...	...
• Possible project types	...	...	3.2	...	...	...	...
• Begin preparing forecasts	✓	✓	3.4.1	...	...	...	...
• Inform borrowers of ADB accounting and auditing requirements.	✓	...	5.3	...	...	...	...
• Undertake preliminary consideration of EA/IA financial policies and financial management systems (OM G2 [identify unacceptable arrangements]).	✓	...	4.2.1, 4.2.4, 4.2.4.4, 4.2.6	4.2.9	4.2.8	4.2.8	6.2, 6.3
• Review accounting and auditing arrangements.	✓	...	5.2, 5.3, 5.4	...	...	...	...
• Review earlier ADB reviews of, and World Bank certification of, Executing and Implementing Agencies.	✓	...	4.1	...	...	...	...
• Consider the information requirements to support financial analyses.	✓	...	4.3	...	...	...	6.4
• Where available, review Country Diagnostic Study of Accounting and Auditing (DSAA).	✓	...	4.2.5	...	...	...	...
• Identify consulting requirements for institutional strengthening.	✓	...	2.3, 4.2.2	...	...	...	...
• Financial Analyst's responsibilities during project appraisal.	✓	...	4.2.4.2	...	...	...	...
• Project Preparation Report	✓	...	3.7.2	...	...	...	...
• Ensure that PPTA TORs reflect financial management needs.	✓	...	3.7.2	...	...	...	...

<sup>a</sup> A "✓" identifies who has the key responsibility each step. "..." indicates "not applicable".

<sup>b</sup> The section number where the requirements and related guidance can be located is provided in the table. "..." indicates that no information is available, or that the general requirements apply to the project type.

EA = executing agency, IA = implementing agency, PPTA = project preparatory technical assistance, TOR = terms of reference

## 2.7. Step 2: Loan Preparation

2.7.1. Loan preparation involves justifying the technical feasibility, economic viability and financial soundness of a project. This preparation phase can be undertaken by the government or any other agency, but ADB can also assist by providing technical assistance grants to the government. Using the grants, ADB hires consultants to undertake a project feasibility study. The consultants' work is closely monitored by ADB staff and the draft final report is reviewed at a meeting attended by representatives of the government, ADB and the consultants. The following table identifies relevant activities during loan preparation.

Activity	Responsibility <sup>a</sup>		Project Type <sup>b</sup>				
	Consultants and/or Financial Analyst	Executing Agency	General (All Projects)	Non-revenue-Earning	Revenue-Earning	Private Sector	Financial Institution
<b>(i) Consultants' Stage</b>							
• Obtain copies of annual financial statements for 5 previous financial years (if possible).	✓	...	...	...	5.3.7	5.3.7	5.3.7
• Prepare Project Cost Estimate Table.	✓	✓	3.4.3	...	...	...	6.4
• Prepare Financing Plan.	✓	✓	3.4.6	...	...	...	...
• Forecast annual net cash flows.	✓	✓	3.4.7	...	...	...	...
• Prepare financial cost-benefit analysis.	✓	...	3.5	...	...	...	...
• Undertake sensitivity and risk analysis.	✓	...	3.5.4	...	...	...	...
• Review EA/IA financial policies and financial management systems. Identify deficiencies and corrective actions (OM G2).	✓	...	4.2.1, 4.2.4, 4.2.4.4, 4.2.6	4.2.9	4.2.8	4.2.8	6.3, 6.4
• Review financial objectives and cost-recovery systems.	✓	...	4.3.1-4.3.3	...	...	...	...
• Prepare financial tables (forecast financial statements).	✓	✓	4.3.4-4.3.7	...	...	...	...
• Identify key financial objectives and select appropriate performance measurement indicators and covenants.	✓	...	...	...	4.4	4.4	4.4
• Consider governance aspects (OM C4).	✓	...	4.2.3	...	...	...	...
• Determine loan covenants (Preliminary).	✓	✓	3.6	...	...	...	6.4

Activity	Responsibility <sup>a</sup>		Project Type <sup>b</sup>				
	Consultants and/or Financial Analyst	Executing Agency	General (All Projects)	Non-revenue-Earning	Revenue-Earning	Private Sector	Financial Institution
• Review accounting policies (OM J7 and GP 43).	✓	✓	5.2.3	...	...	...	...
• Determine financial reporting requirements and timetable (Preliminary) (OM J7 and GP 43).	✓	✓	5.3	...	...	...	6.6.1, 6.6.2
• Determine auditing arrangements (Preliminary) (OM J7 and GP 43).	✓	✓	5.3, 5.4	...	...	...	6.6.3
• Financial Analyst's responsibilities during project appraisal.	✓	...	4.2.4.2	...	...	...	...
• Complete Appraisal Checklist.	✓	...	3.3	7.7	7.8	7.9	7.10
• Prepare First Draft of RRP.	✓	...	3.7.3	...	...	...	...
• Review RRP (Financial Checklist).	✓	...	7.6	..	...	...	...
<b>(ii) Preparatory Reports</b>							
• Supervisory Actions (PAI 1.01)	✓	...	3.7.4.1	...	...	...	...
• Preparation of Cost Estimates	✓	...	3.7.4.1	...	...	...	...
• Project Inception Mission (PAI 6.02).	✓	...	3.7.4.1	...	...	...	...
<b>(iii) Project Budget Briefing</b>							

<sup>a</sup> A "✓" identifies who has the key responsibility each step. "..." indicates "not applicable".

<sup>b</sup> The section number where the requirements and related guidance can be located is provided in the table. "..." indicates that no information is available, or that the general requirements apply to the project type.

EA = executing agency, IA = implementing agency, RRP = Report and Recommendation of the President

## 2.8. Step 3: Project Examination

2.8.1. Project feasibility, as presented in the consultants' report, is then examined by ADB, first through a fact-finding mission and then through an appraisal mission.<sup>2</sup> The mission teams, in consultation with the government, examine the project's technical, financial, economic, environmental and management aspects, and potential social impact. Loan terms and conditions are discussed. Following the examination at the field, the appraisal mission team prepares a report and draws up a draft loan agreement for negotiation. The following table identifies relevant activities during project examination.

<sup>2</sup> No separate fact-finding mission will be required if there is sufficient agreement between ADB and the Government during the project design processes to permit the preparation of a comprehensive draft RRP for MRM (ADB. 2002. Business Processes for the Reorganized ADB, para 41.)

Furthermore, if a project is adjudged at MRM to be sufficiently prepared to go directly into loan negotiations, the MRM may decide that: (i) appraisal has been completed (no further mission is required); and (ii) the SRC meeting be waived.

Activity	Responsibility <sup>a</sup>		Project Type <sup>b</sup>				
	Consultants and/or Financial Analyst	Executing Agency	General (All Projects)	Non-revenue-Earning	Revenue-Earning	Private Sector	Financial Institution
<b>(i) Fact-Finding Mission</b>							
• Review EA/IA financial policies financial management systems, and auditing arrangements and identify deficiencies and corrective actions (OM G2, OM J7, and GP 43).	✓	...	4.2.1, 4.2.4, 4.2.4.4, 4.2.6, 5.3	4.2.9	4.2.8	4.2.8	...
• Review Appraisal Checklist.	✓	...	3.3	7.7	7.8	7.9	7.10
• Update RRP	✓	...	3.7.3	...	...	...	...
• Review RRP (Financial Checklist).	✓	...	7.6	...	...	...	...
• Financial Analyst's responsibilities during project appraisal.	✓	...	4.2.4.2	...	...	...	...
• Review Mission Report.	✓	...	3.7.4.1	...	...	...	...
<b>(ii) Management Review Meeting</b>							
<b>(iii) Appraisal Mission</b>							
• Review EA/IA financial policies and financial management systems and identify deficiencies and corrective actions (OM G2, OM J7, and GP 43)	✓	...	4.2.1, 4.2.4, 4.2.4.4, 5.3	...	...	...	...
• Review Appraisal Checklist,	✓	...	3.3	7.7	7.8	7.9	7.10
• Update Project Cost Estimates,	✓	✓	3.4.3	...	...	...	...
• Update RRP,	✓	...	3.7.3	...	...	...	...
• Review RRP (Financial Checklist),	✓	...	7.6	...	...	...	...
• Financial Analyst's responsibilities during project appraisal	✓	...	4.2.4.2	...	...	...	...
<b>(iv) Staff Review Committee (SRC)</b>							
<b>(v) Board Consideration</b>							

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<sup>b</sup> The section number where the requirements and related guidance can be located is provided in the table. "..." indicates that no information is available, or that the general requirements apply to the project type.

EA = executing agency, IA = implementing agency, RRP = Report and Recommendation of the President

## 2.9. Step 4: Loan Negotiations

2.9.1. After negotiations with the government, the loan proposal is submitted to ADB's Board of Directors for approval. The loan agreement is then signed by the ADB President and representatives of the government and the executing agency. The loan takes effect once certain conditions are met.

## 2.10. Step 5: Project Implementation

2.10.1. The project is implemented by the EA according to the agreed schedule and procedures. Project consultants are recruited, the detailed engineering design and bidding documents are prepared, machinery and equipment are procured, and civil works are constructed and installed. ADB's regional divisions review the implementation in close coordination with the borrower and the EAs. ADB disburses the loan for approved expenditures, as provided in the loan agreement. The following table identifies relevant activities during project implementation.

Activity	Responsibility <sup>a</sup>		Project Type <sup>b</sup>				
	Consultants or Financial Analyst	Executing Agency	General (All Projects)	Non- revenue Earning	Revenue- Earning	Private Sector	Financial Institution
• Update project Cost Estimates.	✓	✓	3.4.3	...	...	...	...
• Review financial reports (PAI 5.09)	✓	...	5.5	...	...	...	...
• Review auditors' reports (PAI 5.09)	✓	...	5.6	...	...	...	...
<b>(I) Supervision Reports</b>							
• Review Mission Report (PAI 6.02).	✓	...	3.7.4.1	...	...	...	...
• Loan Administration Mission Report (PAI 6.03).	✓	...	3.7.4.1	...	...	...	...
• Supervision Report (PAI 6.02)	✓	...	3.7.4.2	...	...	...	...
• Progress reporting (PAI 5.10)	✓	...	3.7.4.1	...	...	...	...
• Provision of local-cost financing by borrower (PAI 5.08)	✓	...	3.7.4.1	...	...	...	...
• Project administration review (PAI 6.01)	✓	...	3.7.4.1	...	...	...	...
• Examination of audited accounts: APAs and AFSs (PAI 5.09)	✓	...	3.7.4.1	...	...	...	...
• Staff responsibilities for day-to-day loan administration (PAI 1.02)	✓	...	3.7.4.1	...	...	...	...

<sup>a</sup> A "✓" identifies who has the key responsibility each step. "..." indicates "not applicable".

<sup>b</sup> The section number where the requirements and related guidance can be located is provided in the table. "..." indicates that no information is available, or that the general requirements apply to the project type.

APA = audited project accounts, PAI = Project Administration Instruction, AFS = agency financial statements.

## 2.11. Step 6: Project Completion

2.11.1. After the project facilities are completed and commissioned, ADB prepares a project completion report (PCR) to document the implementation experience. ADB's Operations Evaluation Department (OED) evaluates projects on a selective basis. It prepares project performance audit reports that assess project formulation and implementation; economic, financial, and social benefits; and environmental impacts.

Activity	Responsibility <sup>a</sup>		Project Type <sup>b</sup>				
	Consultants or Financial Analyst	Executing Agency	General (All Projects)	Non- revenue- Earning	Revenue- Earning	Private Sector	Financial Institution
<b>(i) Completion Reports</b>							
<ul style="list-style-type: none"> <li>Project Completion Report (PAI 6.07)</li> </ul>	✓	...	3.7.4.1, 3.7.4.2	...	...	...	...

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<sup>b</sup> The section number where the requirements and related guidance can be located is provided in the table. "..." indicates that no information is available, or that the general requirements apply to the project type.

PAI = project administration instruction.