

OPERATIONS MANUAL BANK POLICIES (BP)

These policies were prepared for use by ADB staff and are not necessarily a complete treatment of the subject.

PROJECT ACCOUNTING, FINANCIAL REPORTING, AND AUDITING

A. Introduction

1. Article 14(xi) of the *Agreement Establishing the Asian Development Bank* (the Charter) requires ADB to take necessary measures to ensure that the proceeds of any loan made, guaranteed, or participated in by ADB are used only for the purposes for which the loan was granted and with due attention to considerations of economy and efficiency. In addition, Article 14(xiv) of the Charter requires ADB to be guided by sound banking principles in its operations.

B. Definitions

1. Accounting Standards

2. "Accounting standards" acceptable to ADB refer to a set of relevant, balanced, and internationally comparable accounting standards that are to be observed in the presentation of financial statements.

2. Auditing Standards

3. "Auditing standards" acceptable to ADB refer to internationally acceptable standards and essential procedures, together with related guidance, to be applied in the audit of financial statements.

3. Borrowers

4. The term "borrowers" also includes executing agencies responsible for implementation and operation of a project and its facilities.

C. The Policy

5. To fulfill the requirements of Article 14(xi) and (xiv) of the Charter, ADB requires borrowers to submit audited project accounts at regular intervals during implementation of a project and, in some cases, beyond the loan closing date. Similarly, in the case of revenue-earning entities, ADB requires borrowers to submit audited financial statements of the agency concerned. This enables ADB to monitor the use of loan proceeds and assess the financial position of the borrowers.

6. ADB requires that borrowers' financial management and accounting systems are adequate to generate reliable financial data relevant to each lending operation, including

the review and audit thereof. To this end, loan and project agreements include relevant financial management and audit covenants for compliance by borrowers.

OM Section J7/BP
Issued on 29 October 2003
Page 2 of 2

7. ADB requires the borrower and the project executing agency to prepare the required project accounts and financial statements for each fiscal year in accordance with accounting standards acceptable to ADB, and to have them audited by an independent auditor acceptable to ADB and in accordance with auditing standards that are also acceptable to ADB. Auditors are to comment on the executing agency's compliance with financial management and audit covenants.

D. Scope of the Policy

8. The policy applies to investment projects and project executing and implementing agencies. Consequently, the policy relates mainly to identifiable investment activities that have been undertaken with support from project, sector, and private sector loans. This also applies where program loans include discrete, identifiable investment components. The policy also applies to private sector operations and is likewise relevant to project preparatory technical assistance.

Basis: This OM section is based on:

ADB. Guidelines for the Financial Governance and Management of Investment Projects Financed by the Asian Development Bank.
Manila.

This OM section is to be read with OM Section J7/OP.

Compliance: This OM section is subject to compliance review.

For inquiries: Questions may be directed to the Director, Governance and Regional Cooperation Division, Regional and Sustainable Development Department.

OPERATIONS MANUAL OPERATIONAL PROCEDURES (OP)

These procedures were prepared for use by ADB staff and are not necessarily a complete treatment of the subject.

PROJECT ACCOUNTING, FINANCIAL REPORTING, AND AUDITING

A. Introduction

1. The audit is to provide an ex post review of an executing agency's accounts, financial statements, financial systems, records, transactions, and operations. It provides assurance of accountability, identifies weaknesses in internal controls, and makes recommendations for improvements. The following procedures are applied to ensure that ADB is provided with comprehensive, reliable, and timely information to enable it to fulfill its obligations under Article 14(xi) and (xiv) of the Charter.

B. Application of the Policy

1. Accounting and Auditing Standards

2. ADB promotes the use of International Accounting Standards (IAS) promulgated by the International Accounting Standards Board, and the International Public Sector Accounting Standards (IPSAS) published by the Public Sector Committee of the International Federation of Accountants. ADB recognizes that, given the varying levels of developing member country (DMC) development, it will take time to improve financial reporting practices to international standards and best practices. In this regard, ADB requires revenue-earning executing agencies to follow national accounting standards and practices, with the eventual objective of moving towards IAS-compliant accounting standards, as capacity allows and the situation warrants. In such cases, the variances between national standards and IAS, or IPSAS for nonrevenue-earning executing agencies, are to be quantified and disclosed in the notes to the financial statement and in the auditor's report.

3. ADB promotes the use of International Standards on Auditing (ISA) promulgated by the International Federation of Accountants, and the auditing standards of the International Organization of Supreme Audit Institutions (INTOSAI). While promoting the use of auditors that conform to ISA, ADB recognizes that in some DMCs auditors are obliged to apply generally accepted auditing standards that may not conform to the standards preferred by ADB but that have been prescribed by the laws of the DMC, or that have been adopted by public accountants or associations of public accountants in the DMC. In such cases, supplementary auditing and reporting procedures may be requested by ADB, if necessary, to confirm accountability and financial performance. In

addition, ADB expects auditors to indicate in their report the extent of differences, and the impact on the audit, of use of domestic auditing standards compared with the application of ISA.

OM Section J7/OP
Issued on 29 October 2003
Page 2 of 4

2. Project Accounting and Financial Reporting

4. During project processing, preferably at the project identification stage, agreement is to be reached between the borrower and the project team processing the project on the form, content, and timing of the annual project accounts and financial statements that are to be submitted for audit. Agreement is also to be reached on the timing of receipt by ADB of the audited project accounts and audited financial statements, together with any material information or explanation on matters not normally covered by an executing agency's accounts and financial statements.

5. When it is likely that an executing agency will be unable to submit to ADB the audited project accounts and financial statements at the agreed upon time, unaudited project accounts and financial statements are to be provided by the executing agency until such time as the audited ones are made available.

3. Appointment of Auditors and Scope of Audit

6. An executing agency for an ADB-financed project is to have the project accounts and financial statements, and, where required, those of the executing agency itself, audited each fiscal year in accordance with the agreed upon auditing standards by independent auditors whose qualifications, experience, and terms of reference are acceptable to ADB.

7. An executing agency is to appoint an independent auditor at or before the start of project activities, and for each fiscal year in which the project is implemented or operated. The terms of reference for the auditor are to be prepared by the executing agency, will include the scope and detail of the audit to be conducted, and will require the auditor to provide an opinion on the project accounts and financial statements within a specified period of time from receipt of the accounts and statements. The terms of reference are to be reviewed and approved by ADB prior to the auditor being appointed. The scope of the engagement as set out in the terms of reference is to require the auditor to provide a management letter with reference to the executing agency.

8. In case of a change in auditor, the borrower or executing agency is to advise ADB of the needed change and the reasons for it, and to seek ADB's concurrence prior to any change being made.

4. Acceptability and Qualifications of Auditors

9. Auditors assigned by the borrower or executing agency must satisfy the following criteria:

- (i) Auditors must be impartial and independent of the control of the entity to be audited and of the person or entity appointing them. In particular, auditors must not be otherwise employed by; serve as directors of; or have family, financial, or close business relationships with the entity during the period covered by the audit.

OM Section J7/OP
Issued on 29 October 2003
Page 3 of 4

- (ii) Auditors must be well-established and reputable; use procedures and methods that conform to ISA or the auditing standards of the INTOSAI, or the generally accepted auditing practices of the DMC (supplemented where necessary with additional auditing and reporting procedures); and employ adequate numbers of staff with the required qualifications, experience, and competence.
- (iii) Auditors must be able to demonstrate experience in auditing accounts and financial statements for projects and entities comparable in type, nature, and complexity to the assignment to be undertaken.
- (iv) Auditors must propose (and assign) the audit work to personnel who have the necessary capabilities to complete it competently and on time.

10. If auditors who meet the requirements in paragraph 9 and are acceptable to ADB are not available in the DMC, the borrower or executing agency is to appoint suitable foreign auditors, preferably to work in collaboration with a local auditor.

11. ADB prefers borrowers and executing agencies to engage auditors who conform to ISA. It is recognized, however, that in some DMCs auditors apply domestic, generally accepted auditing standards that may not conform to, or fully comply with, ISA but that have been prescribed by the DMC's law, or have been adopted by public accountants or an association of accountants in the DMC. ADB has made assessments of the adequacy of domestic auditing standards in some DMCs, and staffs are to examine these assessments and gauge the variances from ISA prior to agreeing on auditing standards for a project. In DMCs where assessments by ADB are not available, staffs are to endeavor to evaluate existing auditing standards in the country during project preparation, and present an assessment of variances from ISA. Based on these assessments, ADB may request supplementary auditing and reporting procedures where it considers that domestic standards are inadequate.

5. Government Auditors

12. In DMCs, statutory requirements may specify the use of the government auditor. In such cases, ADB still requires the auditor to be independent and competent, to have the capacity and professional capability to provide audit reports and opinions of the quality required by ADB, and to be acceptable to ADB. The independence of a government auditor whose position is established under constitutional or legal provision designed to ensure independence is normally assured. The constitutional and organizational framework under which a government auditor functions is, therefore, to be

examined to determine if independence of the auditor is assured, and if this is not so, then ADB requires that additional auditing arrangements be made to remedy the deficiency.

6. Auditors' Opinions and Reports

13. A borrower is required to submit copies of audited project accounts and financial statements, together with the report and opinion of the auditor, immediately after completion of the audit. The audit opinion is to include a confirmation on the executing agency's compliance with each financial covenant contained in the legal documents for

OM Section J7/OP
Issued on 29 October 2003
Page 4 of 4

the project. The auditor is to indicate, where present, the extent of any noncompliance, by reference to the specified and actual performance measurements for each financial covenant for the fiscal year concerned. The audited project accounts and financial statements are to be accompanied by any other material issued by the auditor that relates to the audit and its interpretation, including the management letter. The management letter, submitted by the auditor to the appointing authority, describes any material deficiencies or weaknesses in the accounting system or in the overall system of internal control and audit of a project or its executing agency. An audit opinion is also to be made by the auditor, and copied to ADB by the borrower, regarding the use of the imprest account and statement of expenditures procedures where these have been employed.

7. Loan Agreements

14. Loan agreements are to include a provision requiring executing agencies to submit to ADB the audited (and unaudited or interim, if required) project accounts and financial statements pertaining to the project and executing agency's accounts, prepared in the English language, within reasonable periods of time, taking into account the fiscal year of the DMC. The obligation to submit audited project accounts, financial statements, auditor's opinion, and reports including the management letter to ADB is to remain in force until the loan is closed unless the loan agreement provides otherwise.

8. Financing Audit Costs

15. The costs of annual audits may be included in the project cost estimates and are eligible for financing under the ADB loan if the audit costs are incremental. In cases where only part of the audit cost is incremental (such as auditing to higher standards required by ADB or reporting on compliance with loan covenants, or when borrowers require foreign exchange to finance the cost of audits), these may be financed from the loan.

Basis: This OM section is based on OM Section J7/BP and the documents cited therein.

Compliance: This OM section is subject to compliance review.

For inquiries: Questions may be directed to the Director, Governance and Regional Cooperation Division, Regional and Sustainable Development Department.

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