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REPORT OF INDEPENDENT AUDITORS

Asian Development Bank

In our opinion, the accompanying balance sheet and the related statements of revenue and expenses, of cash flows, and of changes in unexpended balances and capital present fairly, in all material respects, in terms of United States dollars, the financial position of the Asian Development Bank – Asian Development Fund at 31 December 1998 and 1997, and the results of its operations, its cash flows and the changes in its unexpended balances and capital for the years then ended, in conformity, with generally accepted accounting principles. These financial statements are the responsibility of the Bank's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

Our audits were conducted for the purpose of forming an opinion on the basic financial statement taken as a whole. The accompanying summary statements of loans as at 31 December 1998 and 1997 and of resources as at 31 December 1998 are presented for purposes of additional analyses and are not required parts of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

PricewaterhouseCoopers LLP

17 February 1999

ASIAN DEVELOPMENT BANK—ASIAN DEVELOPMENT FUND

BALANCE SHEET

31 December 1998 and 1997

Expressed in Thousands of United States Dollars (Note B)

	1998		1997	
ASSETS				
DUE FROM BANKS (Note B)		\$ 7,893		\$ 3,299
INVESTMENTS (Notes B and C)				
Government and government-guaranteed obligations	\$ 116,375		\$ 86,767	
Time deposits and other obligations of banks	1,319,512	1,435,887	882,349	969,116
LOANS OUTSTANDING (ADF-5) (Notes B and D)	14,324,035		12,266,102	
Less allowance for possible losses	6,267	14,317,768	5,577	12,260,525
ACCRUED REVENUE				
On investments	10,736		4,669	
On loans	36,959	47,695	31,693	36,362
DUE FROM CONTRIBUTORS (Notes B and E)		4,738,765		5,005,406
RECEIVABLE FROM ORDINARY CAPITAL RESOURCES		-		721
OTHER ASSETS		3,471		3,455
TOTAL		\$20,551,479		\$18,278,884
LIABILITIES, UNEXPENDED BALANCES, AND CAPITAL				
PAYABLE TO ORDINARY CAPITAL RESOURCES		\$ 12,101		\$ -
ADVANCE PAYMENTS ON CONTRIBUTIONS (ADF-6)		-		59,468
OTHER LIABILITIES		3,980		187
UNEXPENDED BALANCES AND CAPITAL				
Amounts available for loan commitments (ADF-6)				
Contributed Resources (Note B)	\$19,020,422		\$16,902,469	
Set-Aside Resources (Note G)	67,036		64,237	
Transfers from Ordinary Capital Resources and Technical Assistance Special Fund (Note A)	233,256		233,057	
	19,320,714		17,199,763	
Accumulated surplus (ADF-4)	1,177,152		1,067,453	
Accumulated other comprehensive income (ADF-4) (Note H)	37,532	20,535,398	(47,987)	18,219,229
TOTAL		\$20,551,479		\$18,278,884

See notes to financial statements (ADF-7).

ASIAN DEVELOPMENT BANK—ASIAN DEVELOPMENT FUND

STATEMENT OF REVENUE AND EXPENSES

For the Years Ended 31 December 1998 and 1997

Expressed in Thousands of United States Dollars (Note B)

	1998		1997	
REVENUE				
From loans (Notes B and D)		\$122,184		\$123,694
From investments (Notes B and C)				
Interest	\$59,542		\$33,167	
Net gain on sales	—	59,542	2	33,169
From other sources-net		<u>297</u>	<u>130</u>	\$156,993
		\$ 182,023		
EXPENSES				
Administrative expenses (Note F)		71,502		96,460
Provision for possible losses (Notes B and D)		<u>822</u>	<u>3,799</u>	100,259
		72,324		
EXCESS OF REVENUE OVER EXPENSES—				
NET INCOME		\$109,699		\$ 56,734

See notes to financial statements (ADF-7).

ASIAN DEVELOPMENT BANK—ASIAN DEVELOPMENT FUND

STATEMENT OF CASH FLOWS

For the Years Ended 31 December 1998 and 1997

Expressed in Thousands of United States Dollars (Note B)

	1998	1997
CASH FLOWS FROM OPERATING ACTIVITIES		
Service charges on loans received	\$ 99,447	\$ 103,180
Interest on investments received	55,202	33,159
Revenue received from other activities	297	130
Administrative expenses paid	(58,680)	(89,075)
Net Cash Provided by Operating Activities	<u>96,266</u>	<u>47,394</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Net cash invested in time deposits and other obligations of banks	(383,566)	(325,357)
Sales of investment securities	738,558	758,112
Maturities of investment securities	5,900,540	7,175,198
Purchases of investment securities	(6,693,268)	(7,980,519)
Principal collected on loans	147,637	147,596
Loans disbursed	(1,121,384)	(1,137,067)
Net Cash Used in Investing Activities	<u>(1,411,483)</u>	<u>(1,362,037)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Drawn obligations of contributors encashed	1,328,876	1,313,237
Contributions received (returned) ¹	(5,137)	5,418
Cash received from (paid to) Ordinary Capital Resources and others-net	287	(297)
Net Cash Provided by Financing Activities	<u>1,324,026</u>	<u>1,318,358</u>
Effect of Exchange Rate Changes on Due from Banks	<u>(4,215)</u>	<u>(3,362)</u>
Net Increase in Due from Banks	4,594	353
Due from Banks at Beginning of Year	<u>3,299</u>	<u>2,946</u>
Due from Banks at End of Year	<u>\$ 7,893</u>	<u>\$ 3,299</u>
RECONCILIATION OF EXCESS OF REVENUE OVER EXPENSES—NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Excess of revenue over expenses-net income (ADF-2)	\$ 109,699	\$ 56,734
Adjustments to reconcile excess of revenue over expenses-net income to net cash provided by operating activities:		
Change in accrued revenue on investments and loans	(8,080)	(2,703)
Change in accrued/prepaid administrative expenses	12,822	(19,877)
Noncash payment of administrative expenses	-	27,262
Charges capitalized	(20,724)	(18,766)
Provision for possible losses charged	822	3,799
Amortization of discounts/premiums	1,727	947
Other-net	-	(2)
Net Cash Provided by Operating Activities	<u>\$ 96,266</u>	<u>\$ 47,394</u>

¹ In addition, nonnegotiable, noninterest-bearing demand promissory notes amounting to \$736,879 (\$455,736 - 1997) were received from contributing members.

See notes to financial statements (ADF-7).

ASIAN DEVELOPMENT BANK—ASIAN DEVELOPMENT FUND
STATEMENT OF CHANGES IN UNEXPENDED BALANCES AND CAPITAL
For the Years Ended 31 December 1998 and 1997

Expressed in Thousands of United States Dollars (Note B)

	Contributed Resources	Set-Aside Resources	Transfers from OCR & TASF	Accumulated Surplus	Accumulated Other Comprehensive Income	Total
Balance—						
1 January 1997	\$18,203,262	\$68,329	\$ 3,464	\$1,010,719	\$ 53,344	\$19,339,118
Comprehensive income for the year 1997 (Note H)				56,734	(101,331)	(44,597)
Change in amount available for loan commitment	(1,300,793)					(1,300,793)
Change in SDR value of set-aside resources		(4,092)				(4,092)
Transfer from Ordinary Capital Resources			230,000			230,000
Change in value of transfers from Technical Assistance Special Fund			(407)			(407)
Balance—						
31 December 1997	\$16,902,469	\$64,237	\$233,057	\$1,067,453	\$ (47,987)	\$18,219,229
Comprehensive income for the year 1998 (Note H)				109,699	85,519	195,218
Change in amount available for loan commitment	2,117,953					2,117,953
Change in SDR value of set-aside resources		2,799				2,799
Change in value of transfers from Technical Assistance Special Fund			199			199
Balance—						
31 December 1998	\$19,020,422	\$67,036	\$233,256	\$1,177,152	\$ 37,532	\$20,535,398

Accumulated Other Comprehensive Income (Note H)

For the Years Ended 31 December 1998 and 1997

Expressed in Thousands of United States Dollars (Note B)

	Accumulated Translation Adjustments	Unrealized Investment Holding Gains	Accumulated Other Comprehensive Income
Balance, 1 January 1997	\$ 53,251	\$ 93	\$ 53,344
Other comprehensive income in 1997	(101,431)	100	(101,331)
Balance, 31 December 1997	\$ (48,180)	\$ 193	\$(47,987)
Other comprehensive income in 1998	84,060	1,459	85,519
Balance, 31 December 1998	\$ 35,880	\$1,652	\$37,532

See notes to financial statements (ADF-7).

ASIAN DEVELOPMENT BANK—ASIAN DEVELOPMENT FUND

SUMMARY STATEMENT OF LOANS

31 December 1998 and 1997

Expressed in Thousands of United States Dollars (Note B)

Borrower/Guarantor ¹	Loans Outstanding ²	Undisbursed Balance of Effective Loans ³	Loans Not Yet Effective ³	Total Loans	Percent of Total Loans
Afghanistan	\$ 30,598	\$ —	\$ —	\$ 30,598	0.15
Bangladesh	3,953,754	1,022,140	188,689	5,164,583	25.46
Bhutan	43,789	8,991	6,067	58,847	0.29
Cambodia	122,740	112,043	39,991	274,774	1.35
Cook Islands	20,115	2,740	—	22,855	0.11
Indonesia	653,464	184,037	—	837,501	4.13
Kazakhstan	37,443	21,746	—	59,189	0.29
Kiribati	3,311	—	10,238	13,549	0.07
Kyrgyz Republic	160,436	93,739	63,220	317,395	1.56
Lao PDR	512,320	215,462	20,977	748,759	3.69
Maldives	32,547	7,007	6,609	46,163	0.23
Marshall Islands	26,697	11,999	—	38,696	0.19
Micronesia, Federated States of	18,648	16,440	—	35,088	0.17
Mongolia	236,978	131,163	—	368,141	1.81
Myanmar	466,562	—	—	466,562	2.30
Nepal	1,019,827	282,808	55,968	1,358,603	6.70
Pakistan	3,774,316	1,125,020	217,249	5,116,585	25.22
Papua New Guinea	273,487	32,017	—	305,504	1.51
Philippines	822,724	240,911	—	1,063,635	5.24
Samoa	78,476	3,682	—	82,158	0.41
Solomon Islands	48,367	11,654	—	60,021	0.30
Sri Lanka	1,478,971	377,389	191,395	2,047,755	10.09
Tajikistan	—	—	19,995	19,995	0.10
Thailand	64,756	—	—	64,756	0.32
Tonga	32,357	5,908	4,792	43,057	0.21
Uzbekistan	460	19,893	—	20,353	0.10
Vanuatu	30,195	19,604	—	49,799	0.25
Viet Nam	380,697	804,860	386,701	1,572,258	7.75
BALANCE – 31 December 1998	14,324,035	4,751,253	1,211,891	20,287,179	100.00
Allowance for possible losses	(6,267)	—	—	(6,267)	—
NET BALANCE – 31 December 1998	\$14,317,768	\$4,751,253	\$1,211,891	\$20,280,912	—
BALANCE – 31 December 1997	\$ 12,266,102	\$ 4,800,747	\$ 1,407,250	\$ 18,474,099	—
Allowance for possible losses	(5,577)	—	—	(5,577)	—
NET BALANCE – 31 December 1997	\$12,260,525	\$4,800,747	\$1,407,250	\$18,468,522	—

1 Loans other than those made directly to a member or to its central bank have been guaranteed by the member with the exception of loans to the private sector amounting to \$16,209 (\$15,152 – 1997).

2 For all Special Funds Loans approved prior to 21 March 1974, the Bank charges interest (including a service fee of 3/4 of 1%) on amounts disbursed and outstanding ranging from 1% per annum to 3% per annum. For loans approved after 21 March 1974, the Bank levies a service charge on amounts disbursed and outstanding at the rate of 1% per annum.

MATURITY OF EFFECTIVE LOANS

<u>Twelve Months</u> <u>Ending 31 December</u>	<u>Amount</u>	<u>Five Years</u> <u>Ending 31 December</u>	<u>Amount</u>
1999	\$251,288	2008	2,489,609
2000	266,428	2013	3,311,878
2001	303,537	2018	3,835,841
2002	336,771	2023	3,659,918
2003	368,450	2028	2,502,391
		2033	1,347,848
		2038	<u>401,329</u>
		Total	<u>\$19,075,288</u>

SUMMARY OF CURRENCIES RECEIVABLE ON LOANS OUTSTANDING

<u>Currency</u>	<u>1998</u>	<u>1997</u>	<u>Currency</u>	<u>1998</u>	<u>1997</u>
Australian dollar	\$ 391,511	\$338,065	Japanese yen	8,092,001	6,565,422
Austrian schilling	125,068	105,557	Korean won	23	-
Belgian franc	142,441	102,114	Netherlands guilder	387,413	329,223
Canadian dollar	676,201	726,155	New Zealand dollar	26,613	25,941
Danish krone	94,504	77,519	Norwegian krone	73,271	76,938
Deutsche mark	1,056,399	869,562	Pound sterling	326,311	351,761
Finnish markka	73,716	61,669	Spanish peseta	49,337	39,239
French franc	482,818	380,903	Swedish krona	82,773	71,192
Italian lira	254,008	194,834	Swiss franc	188,977	163,970
			United States dollar	<u>1,800,650</u>	<u>1,786,038</u>
			Total	<u>\$14,324,035</u>	<u>\$12,266,102</u>

3 Loans negotiated before 1 January 1983 were denominated in current United States dollars. Loans negotiated after that date are denominated in Special Drawing Rights (SDR) for the purpose of commitment. The undisbursed portions of such SDR loans are translated into United States dollars at the applicable exchange rates as of the end of a reporting period. Of the undisbursed balances, the Bank has entered into irrevocable commitments to disburse various amounts totaling \$161,061 (\$117,703 - 1997).

ASIAN DEVELOPMENT BANK—ASIAN DEVELOPMENT FUND

STATEMENT OF RESOURCES

31 December 1998

Expressed in Thousands of United States Dollars (Note B)

	Effective	Effective		Amounts	Amounts		Amounts	Amounts
	Amounts	Amounts Committed		Not Yet	Available			
	Committed	At Exchange	At 31 Dec 1998	Available	For Loan	For Loan	Received	Receivable ²
	During	Rates Per	Exchange	For Loan	Commitments	Commitments		
	1998	Resolutions	Rates	Commitments				
CONTRIBUTED RESOURCES								
Australia	\$ -	\$ 1,139,532	\$ 821,815	\$ 71,098	\$ 750,717	\$ 750,717	\$ -	\$ -
Austria	20,674	144,706	170,965	18,719	152,246	152,246	-	-
Belgium	17,058	138,556	150,229	8,529	141,700	141,700	-	-
Canada	-	1,280,180	1,018,737	55,621	963,116	963,116	-	-
Denmark	-	154,229	162,252	10,657	151,595	151,595	-	-
Finland	-	100,391	90,204	7,889	82,315	82,315	-	-
France	-	831,755	854,659	113,373	741,286	791,653	(50,367)	(50,367)
Germany	-	1,132,547	1,338,879	146,534	1,192,345	1,192,345	-	-
Hong Kong, China	-	20,270	20,270	7,695	12,575	12,575	-	-
Indonesia	-	14,960	14,960	5,000	9,960	14,960	(5,000)	(5,000)
Italy	102,914	707,302	540,884	51,457	489,427	463,699	25,728	25,728
Japan	-	6,441,291	10,395,079	469,722	9,925,357	9,925,357	-	-
Korea, Republic of	35,541	77,170	58,441	17,770	40,671	40,671	-	-
Malaysia	-	10,000	6,708	3,354	3,354	6,708	(3,354)	(3,354)
Nauru	-	1,933	1,933	500	1,433	1,433	-	-
Netherlands	-	413,497	482,300	28,696	453,604	453,604	-	-
New Zealand	-	70,473	52,807	8,872	43,935	43,935	-	-
Norway	-	138,458	112,325	10,224	102,101	102,101	-	-
Spain	11,768	103,513	93,418	5,884	87,534	93,418	(5,884)	(5,884)
Sweden	-	249,844	184,989	16,499	168,490	168,490	-	-
Switzerland	-	214,910	264,842	28,306	236,536	236,536	-	-
Taipei, China	12,398	31,080	28,898	6,199	22,699	16,500	6,199	6,199
Thailand	2,753	4,000	2,753	1,376	1,377	2,753	(1,376)	(1,376)
Turkey	16,120	100,386	100,386	19,715	80,671	80,671	-	-
United Kingdom	-	725,477	683,133	55,666	627,467	627,467	-	-
United States	400,000	2,924,928	2,924,928	387,017	2,537,911	2,437,911	100,000	100,000
Total	619,226	17,171,388	20,576,794	1,556,372	19,020,422	18,954,476	65,946	65,946
SET-ASIDE RESOURCES								
(Note G)	-	-	67,036	-	67,036	-	-	-
TRANSFER FROM								
ORDINARY CAPITAL								
RESOURCES	-	-	230,000	-	230,000	-	-	-
TRANSFERS FROM								
TECHNICAL ASSISTANCE								
SPECIAL FUND ¹	-	-	3,256	-	3,256	-	-	-
TOTAL	\$619,226	\$17,171,388	\$20,877,086	\$1,556,372	\$19,320,714	\$18,954,476	\$65,946	\$65,946

¹ Includes translation adjustments amounting to \$216 as of 31 December 1998.

² Negative amounts represent contributed resources received in advance of their due dates and therefore not yet available for loan commitments.

See notes to financial statements (ADF-7).

ASIAN DEVELOPMENT BANK—ASIAN DEVELOPMENT FUND

NOTES TO FINANCIAL STATEMENTS

31 December 1998 and 1997

CONTINUED

NOTE A—NATURE OF OPERATIONS

The Asian Development Fund (the Fund) was established on 28 June 1974 to carry out more effectively the special operations of the Bank by providing resources on concessional terms which are made available almost exclusively to the poorest borrowing countries.

The resources of the Fund have been subsequently augmented by six replenishments, the most recent of which became effective in September 1997 in a total amount equivalent to US\$2,657,777,000 to cover the operational requirements for the four-year period from January 1997. In 1997, unallocated net income in the amount of \$230,000,000 held in the surplus account of the Bank's Ordinary Capital Resources was allocated to the Fund to supplement donors' contributions.

NOTE B—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES*Functional Currencies and Reporting Currency*

The currencies of contributing member countries are functional currencies. The reporting currency is the United States dollar, and the financial statements are expressed in thousands of current United States dollars.

Translation of Currencies

Assets, liabilities, amounts available for loan commitments and advance payments on contributions are translated from their functional currencies to the reporting currency generally at the applicable rates of exchange at the end of a reporting period. Revenue and expense amounts are translated for each semimonthly period generally at the applicable rates of exchange at the beginning of each period; such practice approximates the application of average rates in effect during the period. Translation adjustments relating to set-aside resources *see Note G*) are recorded as notional amounts receivable from or payable to Ordinary Capital Resources. Other translation adjustments are charged

or credited to "Accumulated translation adjustments" and reported in "UNEXPENDED BALANCES AND CAPITAL" as part of "Accumulated other comprehensive income." Exchange gains or losses on currency transactions among functional currencies are included in revenue.

Investments

All investment securities held by the Bank are considered by Management to be available for sale and are reported at estimated fair value, with unrealized gains and losses excluded from revenue and reported in "UNEXPENDED BALANCES AND CAPITAL" as part of "Accumulated other comprehensive income." Estimated fair value generally represents market value. Cost or amortized cost is used to approximate fair value for certain short-term investments not traded in the market (time deposits, etc.). Realized gains and losses are included in revenue from investments and are measured by the difference between average cost or amortized cost and the net proceeds of sales.

Loans

Loans of the Fund are extended to eligible developing member countries, bear only a service charge and require repayment over periods ranging from 35 to 40 years. The Fund requires borrowers to absorb exchange risks attributable to fluctuations in the value of the currencies disbursed. It is the policy of the Fund to place in nonaccrual status loans made to eligible developing member countries if the principal or service charges with respect to any such loans are overdue by six months. When loans are in nonaccrual status, the related unpaid service charges are reversed and are deducted from revenue. Service charges on nonaccruing loans are included in revenue only to the extent that payments have actually been received by the Fund. The Bank follows a policy of not taking part in debt rescheduling agreements with respect to public sector loans. In case of private sector loans, the Bank may agree to debt rescheduling only after alternative courses of action have been exhausted.

ASIAN DEVELOPMENT BANK—ASIAN DEVELOPMENT FUND

NOTES TO FINANCIAL STATEMENTS

31 December 1998 and 1997

The Bank determines that a loan is impaired and therefore subject to provisioning when principal or service charges are in arrears for one year for public sector loans made to or guaranteed by a member country (unless there is clear and convincing evidence warranting the deferment or acceleration of such provisioning) and six months for private sector loans. If the present value of expected future cash flows discounted at the loan's effective interest rate is less than the carrying value of the loan, a valuation allowance is established with a corresponding charge to provision for possible losses.

The Bank's periodic evaluation of the adequacy of the allowance for possible losses is based on its past loan loss experience, known and inherent risks in existing loans and adverse situations that may affect a borrower's ability to repay.

Contributed Resources

Contributions by member countries are included in the financial statements as amounts committed from the date Instruments of Contribution are deposited and related formalities are completed.

Contributions are generally paid or to be paid in the currency of the contributor either in cash or notes.

Accounting Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities as at the end of the year and the reported amounts of income and expenses during the year. The actual results could differ from those estimates.

Statement of Cash Flows

For the purposes of the statement of cash flows, the Fund considers that its cash and cash equivalents are limited to "DUE FROM BANKS."

NOTE C—INVESTMENTS

The currency compositions of the investment portfolio as of 31 December 1998 and 1997 expressed in United States dollars were as follows:

<u>Currency</u>	<u>1998</u>	<u>1997</u>
Australian dollar	\$ 142,529,000	\$127,944,000
Austrian schilling	27,998,000	22,063,000
Belgian franc	23,922,000	39,743,000
Canadian dollar	99,276,000	65,862,000
Deutsche mark	40,890,000	22,671,000
French franc	118,489,000	101,124,000
Italian lira	81,671,000	67,546,000
Japanese yen	178,867,000	132,097,000
Netherlands guilder	26,222,000	15,721,000
Norwegian krone	22,123,000	16,958,000
Pound sterling	233,076,000	137,839,000
Spanish peseta	33,291,000	23,527,000
United States dollar	343,458,000	145,926,000
Others	64,075,000	50,095,000
Total	<u>\$1,435,887,000</u>	<u>\$969,116,000</u>

The amortized cost and estimated fair value of the investments by contractual maturity at 31 December 1998 were as follows:

	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Due in one year or less	\$1,378,755,000	\$1,378,755,000
Due after one year through five years	37,218,000	37,960,000
Due after five years through ten years	18,262,000	19,172,000
Total	<u>\$1,434,235,000</u>	<u>\$1,435,887,000</u>

CONTINUED

Additional information relating to investments in government and government-guaranteed obligations is as follows:

	<u>1998</u>	<u>1997</u>
As of 31 December:		
Amortized cost	\$114,723,000	\$86,574,000
Estimated fair value	116,375,000	86,767,000
Gross unrealized gains	1,652,000	253,000
Gross unrealized losses	-	60,000
For the years ended 31 December:		
Change in net unrealized gains/losses	1,459,000	100,000
Proceeds from sales	738,558,000	758,110,000
Gross gains	1,000	3,000
Gross losses	1,000	1,000

The annualized rate of return on the average investments held during the year, based on the portfolio held at the beginning and end of each month, excluding unrealized gains and losses, was 4.56% (3.93% – 1997). If unrealized gains and losses were included, the annualized rate of return would have been 4.67% (3.94% – 1997).

Investments are governed by the Investment Authority approved by the Board of Directors. The main investment management objective is to maintain security and liquidity. Subject to these parameters, the Bank seeks the highest possible return on its investments.

NOTE D—LOANS AND LOAN LOSS PROVISION

Loans

Loans are fair valued using an entry value method. Under this method, fair value is determined based on the terms at which a similar loan would currently be made by the Bank to a similar borrower. Such terms generally include a service charge of 1% and a final maturity of about 40 years.

For such loans, fair value approximates the carrying amount. The estimated fair value of loans is not affected by credit risks because the amount of any such adjustment is not considered to have a material effect based on the Bank's experience with its borrowers.

Undisbursed loan commitments and an analysis of loans by countries as of 31 December 1998 are shown in ADF-5.

The principal amount outstanding of public sector loans in nonaccrual status as of 31 December 1998 was \$492,379,000 (\$61,341,000 – 1997) of which \$22,253,000 (\$8,620,000 – 1997) was overdue. Overdue charges on these loans totalled \$6,960,000 (\$2,460,000 – 1997). Loans in nonaccrual status resulted in a reduction of \$5,740,000 (\$736,000 – 1997) in revenue from loans for the year ended 31 December 1998. The loans in nonaccrual status as of 31 December 1998 were four loans made to Afghanistan and twenty-seven loans to Myanmar. (Four loans to Afghanistan and twelve loans to Solomon Islands were in nonaccrual status as of 31 December 1997).

Private sector loans outstanding as of 31 December 1998 were \$13,885,000 (\$13,518,000 – 1997), net of accumulated provision for possible loan losses as of 31 December 1998 of \$2,324,000 (\$1,634,000 – 1997), and there were no undisbursed loan commitments (nil – 1997).

Loan Loss Provision

The Bank makes provision for possible losses on loans to the private sector based on an evaluation by the Bank of the collectibility of loans outstanding.

The Bank makes provision for possible losses on loans made to the public sector when principal or service charges are in arrears for a year or more unless there is clear and convincing evidence warranting the deferment or acceleration of such provisioning. The amount of any loss provision is determined by comparing the carrying value of the loan to the present value of expected cash inflows discounted at the loan's effective interest rate.

ASIAN DEVELOPMENT BANK—ASIAN DEVELOPMENT FUND

NOTES TO FINANCIAL STATEMENTS

31 December 1998 and 1997

During the 1998 financial year, no loan loss provisions (\$3,943,000 – 1997) were made against public sector loans while \$822,000 (write back of \$144,000 – 1997) has been provided against private sector loans.

Information appertaining to loans which are subject to loan loss provisions as at 31 December 1998 and 1997 were as follows:

	<u>1998</u>	<u>1997</u>
Loans without loss provisions	\$14,277,229,000	\$12,222,964,000
Loans subject to loss provisions	<u>46,806,000</u>	<u>43,138,000</u>
Total	<u>\$14,324,035,000</u>	<u>\$12,266,102,000</u>
Average amount of loans subject to loss provisions	\$ 46,962,000	\$ 45,302,000
Related service charges recognized on such loans	\$ 151,000	\$ 158,000
Cash received on related service charges on such loans	\$ 149,000	\$ 189,000

The changes in the allowance for possible loan losses during 1998 and 1997 were as follows:

	<u>1998</u>	<u>1997</u>
Balance – 1 January	\$ 5,577,000	\$ 1,778,000
Provision during the year	822,000	3,799,000
Translation adjustments	(132,000)	–
Balance – 31 December	<u>\$ 6,267,000</u>	<u>\$ 5,577,000</u>
Made up of:		
Against public sector loans		
Afghanistan	\$ 3,943,000	\$ 3,943,000
Against private sector loans	<u>2,324,000</u>	<u>1,634,000</u>
Total	<u>\$ 6,267,000</u>	<u>\$ 5,577,000</u>

NOTE E—NOTES OF CONTRIBUTORS

Notes of contributors are nonnegotiable, noninterest-bearing and, subject to certain restrictions imposed by applicable Board of Governors' resolutions, encashable by the Bank at par upon demand.

The Bank currently expects that the notes outstanding at 31 December 1998 will be encashed in varying amounts over the nine-year period ending 31 December 2007.

Notes of contributors are fair valued using an entry value method whereby fair value is determined based on the terms at which notes are currently being accepted from contributors. On this basis, the fair value of outstanding notes of contributors approximates their carrying amount.

NOTE F—ADMINISTRATIVE EXPENSES AND ADMINISTRATION CHARGE

Administrative expenses include an administration charge from Ordinary Capital Resources amounting to \$71,475,000 (\$96,452,000 – 1997). The charge represents an apportionment of all administrative expenses of the Bank (other than those appertaining directly to ordinary operations and special operations) based on the number of loans and equity investments approved during the year.

NOTE G—SET-ASIDE RESOURCES

Pursuant to the provisions of Article 19, paragraph 1(i) of the Articles of Agreement Establishing the Asian Development Bank (the Charter), the Board of Governors has authorized the setting aside of 10% of the unimpaired "paid-in" capital paid by member countries pursuant to Article 6, paragraph 2(a) of the Charter and of the convertible currency portion paid by member countries pursuant to Article 6, paragraph 2(b) of the Charter as of 28 April 1973, to be used as a part of the Special Funds of the Bank. The capital so set aside was allocated and transferred from the Ordinary Capital Resources to the Fund as Set-Aside Resources.

The capital stock of the Bank is defined in Article 4, paragraph 1 of the Charter, “in terms of United States dollars of the weight and fineness in effect on 31 January 1966” (the 1966 dollar). Therefore, Set-Aside Resources had historically been translated into the current United States dollar (the Bank’s unit of account), on the basis of its par value in terms of gold. From 1973 until 31 March 1978, the rate arrived at on this basis was \$1.20635 per 1966 dollar. Since 1 April 1978, at which time the Second Amendment to the Articles of Agreement of the International Monetary Fund (IMF) came into effect, currencies no longer have par values in terms of gold. Pending the Bank’s selection of the appropriate successor to the 1966 dollar, the Set-Aside Resources have been valued for purposes of the accompanying financial statements in terms of the Special Drawing Right (SDR), at the value in current United States dollars as computed by the IMF. As of 31 December 1998, the value of the SDR in terms of the current United States dollar was \$1.40803 (\$1.34925 – 1997). On this basis, Set-Aside Resources amounted to \$67,036,000 (\$64,237,000 – 1997). If the capital stock of the Bank as of 31 December 1998 had been valued in terms of \$12,063.50 per share, Set-Aside Resources would have been \$57,434,000.

**NOTE H—COMPREHENSIVE INCOME
AND ACCUMULATED OTHER
COMPREHENSIVE INCOME**

In 1998, the Bank adopted Statement of Financial Accounting Standards (SFAS) No. 130 – Reporting Comprehensive Income issued by the Financial Accounting Standards Board. SFAS No. 130 establishes standards for reporting and display of comprehensive income and its

components (revenues, expenses, gains, and losses) in a full set of general-purpose financial statements. Comprehensive income has two major components: net income and other comprehensive income. Other comprehensive income include such items as unrealized gains and losses on available-for-sale securities and foreign currency translation adjustments. The 1997 financial statements have been reclassified for comparative purposes.

**NOTE I—FAIR VALUE OF FINANCIAL
INSTRUMENTS**

Fair value of a financial instrument is defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

The fair value of financial instruments that are short-term approximates their carrying amounts.

If available, quoted market values are used to determine fair values. Financial instruments for which market quotations are not readily available are valued using methodologies and assumptions which necessarily require the use of subjective judgments. Accordingly, the actual value at which such financial instruments could be exchanged in a current transaction, or whether they are actually exchangeable is not determinable.

The Fund’s balance sheet carrying amounts are considered to approximate fair values for all significant financial instruments. See Notes B, C, D, and E for discussions with respect to investments, loans, and notes of contributors, respectively.