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REPORT OF INDEPENDENT AUDITORS

Asian Development Bank

In our opinion, the accompanying statement of financial position and the related statements of activities and changes in net assets, and of cash flows present fairly, in all material respects, in terms of United States dollars, the financial position of the Asian Development Bank – Japan Special Fund at 31 December 1998 and 1997, and the results of its activities and changes in net assets and its cash flows 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 amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP

17 February 1999

ASIAN DEVELOPMENT BANK—JAPAN SPECIAL FUND

STATEMENT OF FINANCIAL POSITION

31 December 1998 and 1997

Expressed in Thousands of United States Dollars (Note B)

	<u>1998</u>		<u>1997</u>	
ASSETS				
DUE FROM BANKS (Note B)		\$ 329		\$ 38,458
INVESTMENTS (Notes A, B, and C)				
Government and government-guaranteed obligations	\$ —		\$ 538	
Time deposits	<u>309,782</u>	309,782	<u>268,914</u>	269,452
EQUITY INVESTMENTS (Notes A, B, and D), net		216		373
ACCRUED REVENUE		3,279		460
OTHER ASSETS		4,362		3,207
TOTAL		\$317,968		\$311,950
LIABILITIES AND UNCOMMITTED BALANCES				
PAYABLE TO ORDINARY CAPITAL RESOURCES		\$ 512		\$ 856
ACCOUNTS PAYABLE AND OTHER LIABILITIES		36		90
UNDISBURSED COMMITMENTS (Notes B and E)		134,250		106,583
NET ASSETS (JSF-2) (Note B), represented by:				
Uncommitted Balances (Note F)				
Unrestricted	\$103,071		\$129,463	
Temporarily restricted (Notes A and G)	<u>24,464</u>		<u>34,642</u>	
		127,535		164,105
Net Accumulated Investment Income				
Temporarily restricted (Notes A and G)	<u>55,635</u>	183,170	<u>40,316</u>	204,421
TOTAL		\$317,968		\$311,950

See notes to financial statements (JSF-4).

ASIAN DEVELOPMENT BANK—JAPAN SPECIAL FUND
STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

For the Years Ended 31 December 1998 and 1997

Expressed in Thousands of United States Dollars (Note B)

	<u>1998</u>	<u>1997</u>
CHANGES IN UNRESTRICTED NET ASSETS		
CONTRIBUTIONS (Notes B and G)	\$ 46,479	\$ —
REVENUE FROM OTHER SOURCES	64	209
UNREALIZED HOLDING LOSSES ON EQUITY INVESTMENT	(152)	(259)
NET ASSETS RELEASED FROM RESTRICTIONS (Notes B and G)	26,926	17,138
Total	<u>73,317</u>	<u>17,088</u>
EXPENSES		
Technical assistance (Note B)	95,651	72,477
Administrative expenses	1,080	1,278
Provision for possible losses (Notes B and D)	134	—
Total	<u>96,865</u>	<u>73,755</u>
CONTRIBUTIONS AND REVENUE LESS THAN EXPENSES	(23,548)	(56,667)
EXCHANGE LOSSES (Note B)	(1,585)	(10,137)
DECREASE IN UNRESTRICTED NET ASSETS BEFORE TRANSLATION ADJUSTMENTS	(25,133)	(66,804)
TRANSLATION ADJUSTMENTS (Note B)	(1,259)	(15,787)
DECREASE IN UNRESTRICTED NET ASSETS AFTER TRANSLATION ADJUSTMENTS	<u>(26,392)</u>	<u>(82,591)</u>
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS		
CONTRIBUTIONS (Notes B and G)	16,068	—
REVENUE		
From investments (Notes B and C)		
Interest	\$ 16,560	\$ 2,534
Unrealized investment losses	—	(58)
	<u>16,560</u>	<u>2,476</u>
NET ASSETS RELEASED FROM RESTRICTIONS (Notes B and G)		
Project related	(25,846)	(15,860)
Administrative expenses	(1,080)	(1,278)
	<u>(26,926)</u>	<u>(17,138)</u>
INCREASE (DECREASE) IN TEMPORARILY RESTRICTED NET ASSETS BEFORE TRANSLATION ADJUSTMENTS	5,702	(14,662)
TRANSLATION ADJUSTMENTS (Note B)	(561)	(13,228)
INCREASE (DECREASE) IN TEMPORARILY RESTRICTED NET ASSETS AFTER TRANSLATION ADJUSTMENTS	<u>5,141</u>	<u>(27,890)</u>
DECREASE IN NET ASSETS	(21,251)	(110,481)
NET ASSETS AT BEGINNING OF YEAR	204,421	314,902
NET ASSETS AT END OF YEAR	<u>\$183,170</u>	<u>\$204,421</u>

See notes to financial statements (JSF-4).

ASIAN DEVELOPMENT BANK—JAPAN SPECIAL FUND

STATEMENT OF CASH FLOWS

For the Years Ended 31 December 1998 and 1997

Expressed in Thousands of United States Dollars (Note B)

	<u>1998</u>	<u>1997</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Contributions received	\$ 62,547	\$ —
Interest on investments received	13,738	3,563
Interest on bank account	—	177
Technical assistance disbursed	(69,012)	(71,689)
Administrative expenses paid	(1,446)	(822)
Other—net	(1,666)	(632)
Net Cash Provided by (Used in) Operating Activities	<u>4,161</u>	<u>(69,403)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Net cash withdrawn from (invested in) time deposits	(43,904)	85,544
Sales of investment securities	63,478	79,410
Maturities of investment securities	—	17,521
Purchases of investment securities	(63,070)	(74,690)
Net Cash Provided by (Used in) Investing Activities	<u>(43,496)</u>	<u>107,785</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Cash paid to Ordinary Capital		
Resources and others—net	(139)	(329)
Effect of Exchange Rate Changes on Due from Banks	1,345	(23)
Net Increase (Decrease) in Due from Banks	(38,129)	38,030
Due from Banks at Beginning of Year	38,458	428
Due from Banks at End of Year	<u>\$ 329</u>	<u>\$ 38,458</u>
RECONCILIATION OF DECREASE IN NET ASSETS TO		
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:		
Decrease in net assets (JSF-2)	\$(21,251)	\$(110,481)
Adjustments to reconcile decrease in net assets		
to net cash provided by (used in) operating activities:		
Unrealized investment losses	152	317
Translation adjustments	1,820	38,304
Gain on sale of investments	—	(411)
Provision for possible losses charged	134	—
Change in undisbursed commitments	27,667	1,446
Amortization of discounts/premiums	(3)	1,085
Other—net	(4,358)	337
Net Cash Provided by (Used in) Operating Activities	<u>\$ 4,161</u>	<u>\$ (69,403)</u>

See notes to financial statements (JSF-4).

ASIAN DEVELOPMENT BANK—JAPAN SPECIAL FUND

NOTES TO FINANCIAL STATEMENTS

31 December 1998 and 1997

CONTINUED

NOTE A—NATURE OF OPERATIONS

The Japan Special Fund (JSF) was established in March 1988 when Japan and the Bank entered into a financial arrangement whereby Japan agreed to make an initial contribution and the Bank became the administrator. The purpose of JSF is to help developing member countries (DMCs) of the Bank restructure their economies and broaden the scope of opportunities for new investments, thereby assisting the recycling of funds to DMCs of the Bank. While the JSF resources are used mainly to finance technical assistance (TA) operations, these resources may also be used for equity investment operations in the Bank's DMCs. Under the agreement between the Bank and the Government of Japan, the Bank may invest the proceeds of JSF pending disbursement. The revenue from such investments, if retained by the Bank, may only be used to pay for direct and identifiable costs incurred in the administration of JSF.

NOTE B—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES*Presentation of the Financial Statements*

The financial statements of the JSF are presented on the basis of unrestricted and temporarily restricted net assets.

JSF reports the contributions of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When the donor restriction expires, that is, when a stipulated time or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statement of Activities and Changes in Net Assets as net assets released from restrictions.

Investments

All investment securities held by JSF are reported at estimated fair value, with realized and unrealized gains and losses included in revenue. 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.).

Contributions

Contributions by Japan are included in the financial statements from the date indicated by the government of Japan that funds are expected to be made available. Contributions which are restricted by the donor for specific TA projects/programs are classified as temporarily restricted contributions. Those without any stipulation as to specific use are accounted for as unrestricted contributions and reported as such.

Technical Assistance to Member Countries

Technical assistance is recognized in the financial statements when the related project is approved and becomes effective. Upon completion of the TA project, any undisbursed amount is written back as a reduction in TA for the period and the corresponding undisbursed commitment is eliminated accordingly.

Functional Currency and Reporting Currency

The functional currency of JSF is the Japanese yen, while the reporting currency is the United States dollar. The financial statements are expressed in thousands of current United States dollars.

Translation of Currencies

Assets, liabilities, and uncommitted balances are translated from the functional currency to the reporting currency at the applicable rates of exchange at the end of a reporting period. Contributions included in the financial statements during the year are translated at the applicable exchange rates as of the respective dates of commitment. Revenue and expense amounts in Japanese yen are translated for each semimonthly period at the applicable rates of exchange at the beginning of each period; such practice approximates

ASIAN DEVELOPMENT BANK—JAPAN SPECIAL FUND

NOTES TO FINANCIAL STATEMENTS

31 December 1998 and 1997

the application of average rates in effect during the period. Exchange gains or losses on currency transactions arise on translation differences between the date a project/program is committed and the timing of disbursements. Exchange gains or losses are charged or credited to operations.

Equity Investments

Equity investments with readily determinable fair values are reported at fair value. The Bank makes provisions for possible loss of value quarterly based on Management's evaluation of potential losses on investments without readily determinable fair values.

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 JSF 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:

Currency	1998	1997
Japanese yen	\$ —	\$152,367,000
United States dollar	309,782,000	117,085,000
Total	\$309,782,000	\$269,452,000

Starting November 1997, liquid funds denominated in yen were converted into United States dollar denominated investments. This has resulted in an increase in the return on investments noted below.

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 was 5.08% (0.68% – 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—EQUITY INVESTMENTS

The Bank used JSF resources to make an equity investment in India in 1990 totalling \$216,000 at 31 December 1998 (\$373,000 – 1997). The investment is reported at its estimated fair value and the unrealized loss of \$152,000 (\$259,000 – 1997) is included in income for the year.

NOTE E—UNDISBURSED COMMITMENTS

Undisbursed commitments are denominated in United States dollars and represent effective TA for projects/programs which have not been disbursed. During 1998, an amount of \$9,169,000 (\$3,266,000 – 1997) representing completed and cancelled TA projects has been written back as a reduction in TA of the period and the corresponding undisbursed commitment has been eliminated. The fair value of undisbursed commitments approximates the amounts outstanding because JSF expects that disbursements will substantially be made for all the projects/programs covered by the commitments.

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NOTE F—UNCOMMITTED BALANCES

Uncommitted balances are composed of amounts which have not been committed by the Bank as at 31 December 1998. These balances include TA projects/programs that had been approved but which had not yet become effective.

As of 31 December 1998 and 1997 these balances were as follows:

	<u>1998</u>	<u>1997</u>
Uncommitted balances	\$127,535,000	\$164,105,000
TA projects/programs approved by the Government of Japan and the Bank but not yet effective	(35,108,000)	(49,243,000)
TA projects/programs approved by the Government of Japan and not yet effective	<u>(29,050,000)</u>	<u>(44,236,000)</u>
Uncommitted balances available for new commitments	<u>\$ 63,377,000</u>	<u>\$ 70,626,000</u>

NOTE G—CONTRIBUTIONS AND TEMPORARILY RESTRICTED NET ASSETS

All contributions for the years ended 31 December 1998 and 1997 were received during the respective years. Some of the contributions received were with the restriction that they were to be utilized for specific TA projects/programs. Such contributions were classified as temporarily restricted support.

Temporarily restricted uncommitted balances are available for the following purposes as of 31 December 1998 and 1997:

	<u>1998</u>	<u>1997</u>
Environment-Related Activities	\$13,917,000	\$20,113,000
Private Sector Promotion	5,458,000	8,760,000
Gender and Development	4,809,000	5,586,000
Training/Symposium	<u>280,000</u>	<u>183,000</u>
Total	<u>\$24,464,000</u>	<u>\$34,642,000</u>

Accumulated investment income net of accumulated administrative expenses has been categorized as temporarily restricted net assets because, under the terms of the agreement between the Bank and the donor, it may only be used for the defrayment of the Fund's administrative expenses.

Net assets released from restrictions relate to commitments for TA satisfying the conditions specified by the donor and, in the case of accumulated investment income, to defray the administrative expenses of the Fund.

NOTE H—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.

ASIAN DEVELOPMENT BANK—JAPAN SPECIAL FUND**NOTES TO FINANCIAL STATEMENTS****31 December 1998 and 1997**

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 statement of financial position 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, equity investments, and undisbursed commitments, respectively.
