

ASIAN DEVELOPMENT BANK

TAR:STU 33520

**TECHNICAL ASSISTANCE
FOR
STRENGTHENING FINANCIAL MANAGEMENT
AND GOVERNANCE
IN SELECTED DEVELOPING MEMBER COUNTRIES**

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ABBREVIATIONS

ADB	–	Asian Development Bank
CFAA	–	Country Financial Accountability Assessment
DMC	–	developing member country
EDRC	–	Economics and Development Resource Center
IAAS	–	International Accounting and Auditing Standards
IMF	–	International Monetary Fund
OECD	–	Overseas Economic Cooperation and Development
TA	–	technical assistance

NOTE

In this report, "\$" refers to US dollars.

I. INTRODUCTION

1. The recent financial crisis in Asia exposed a number of structural weaknesses in the affected countries. What began initially in 1997 as disturbances in the currency and capital markets in Indonesia, Republic of Korea, and Thailand, revealed deeper structural problems in the banking and corporate sectors owing largely to poor governance, lack of transparency, and weak supervision and regulation. In particular, weak corporate governance was partly responsible for poor investment decisions; risky financing practices; and the resulting large-scale, nonperforming loans in the financial sector and the growing number of corporate bankruptcies.

2. In the wake of the crisis, governments and the private sector throughout Southeast and East Asia face many complex problems and challenges in macroeconomic management, banking and capital markets management, and development of institutional capacity for the enforcement of a more effective regulatory and supervisory framework for sound corporate and financial governance. The Asian Development Bank (ADB) has been taking a number of initiatives to assist developing member countries (DMCs) in all these areas. In the case of good governance, the initiatives include the institution of controls to safeguard against corruption in its operations through a range of anticorruption policies and measures. In addition, the focus on improved governance in ADB operations integrates capacity-building initiatives to enhance the effectiveness of public administration and development management at the sector level and in national institutions in the DMCs. Where appropriate, institutional development of the local and provincial agencies and the private sector is also covered. Broader and deeper knowledge of financial management and prudent financial policies afford countries the stability, efficiency, and access needed for prosperity and poverty alleviation. A sound regulatory financial framework and its enforcement, capable institutions, skilled human resources, and effective monitoring and supervision are important preconditions to an efficient and resilient financial structure.

3. To promote sustainable growth, substantial resources and investments have to be allocated by both the private and public sectors. In this context, a sound financial architecture is both critical and a prime enabler of a strong economy. Such an architecture covering management, institutional mechanisms, and good governance practices needs to be developed in the DMCs to enable them to achieve the goal of sustainable economic growth. Quality accounting and auditing support, along with good governance, are principal tools for furthering accountability and transparency¹.

II. BACKGROUND AND RATIONALE

4. The crisis that affected a number of DMCs in 1997 highlighted the need to implement good governance in order to ensure the economic and financial viability of public and private sector entities in the DMCs. An important aspect for good governance is to have an effective system of financial management applied in the DMCs. The need for sound financial management and governance globally was highlighted recently by the Organization for Economic Cooperation and Development (OECD). Donor groups, such as G7 and G10², are

¹ The TA first appeared in *ADB Business Opportunities* (Internet Edition) in November 1999.

² Group of 7 (G7) is composed of Canada, France, Germany, Italy, Japan, United Kingdom, and United States, Group of 10 (G10) is composed of Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, United Kingdom, and United States.

also actively encouraging aid recipients to improve their financial management and governance through the use of international accounting and auditing standards. It is vital that developments along the line of financial management and governance are adapted to the requirements in internal control and transparency expected from global financial operations. ADB has, since the early 1980s, assisted several countries through provision of loans and technical assistance intended for the improvement of financial reporting, training, and improvement of auditing capabilities. The activities were undertaken on a country-by-country basis without a thorough assessment of the overall situation. The World Bank has, over the years, also provided similar forms of assistance. However, given the global push to improve financial management in the context of overall improvement in governance, a more coordinated approach is now called for.

5. Sound financial governance requires the adoption of the International Accounting and Auditing Standards (IAAS)³ in the recording and preparation of financial reports. To avoid confusion and to ensure global consistency in the preparation and presentation of financial reports, there is a need to adopt a common set of standards under which financial reports are prepared and audited. Although a lot of work still needs to be done as regards institutional strengthening by the public and private sectors, steps in this direction will have to be initiated primarily by international financial institutions, including ADB, in close collaboration with private sector organizations and professional bodies. The DMCs have, by and large, reacted positively to a call from the donor groups to improve the quality of their financial management and governance practices. They see the benefit of having sound financial management and governance in place. They realize that this is needed for them to eradicate corruption and to enhance public confidence in their development efforts. This fact has been highlighted in several international forums, and most recently at the World Bank and International Monetary Fund (IMF) Annual Meeting in September 1999. The problem confronting these countries in improving their financial management and adopting IAAS is their serious lack of capacity and capability to take on this task. They have indicated that they will look to the multilateral development banks and other donors to assist them in their capacity building efforts in this regard. For the multilateral development banks and donors to assist the DMCs in their capacity building effectively, there is an urgent need to assess the currently available capability and capacity in these countries. The assessment should include, among other things, the availability of trained personnel, the existence of an organized accounting and auditing profession, and the level and source of assistance that is being provided to improve the current situation. Such an assessment and diagnostic work will enable ADB to have a good understanding of the prevailing situation in the accounting and auditing profession and regulatory framework in each DMC. With such knowledge and information base, ADB will be in a better position to develop meaningful and effective assistance programs covering these vital areas. ADB programs and projects divisions will be able to design more relevant and appropriate assistance packages for the concerned countries with the benefit of the information obtained from the technical assistance.

6. This assessment and diagnostic task is enormous, and there is broad consensus among the donor community that it has to be undertaken as a joint effort. The World Bank started this assessment through its Country Financial Accountability Assessment (CFAA) program and are currently drawing up an action plan to assist several DMCs in this effort. ADB has been asked to be an equal partner and take an active role in this activity. Undertaking the assessment and diagnostic reviews for all of ADB's 38 borrowing member countries, while necessary, will be time-consuming and can only be achieved over a long period. The work also must be undertaken in close collaboration with other donors (such as the World Bank and IMF) and the

³ It should be noted that the ADB currently does not mandate its DMCs to use IAAS, but encourages them to do so.

DMC Governments and their regulatory authorities. The pragmatic way forward, however, is to start the process in a limited way and expand coverage of the DMCs progressively in the coming years.

7. Under the TA, ADB will assess the situation in seven of its DMCs that are not covered by other donors and for which profiles are not currently available from other sources. Upon the completion of the initial work, the assessment and diagnostic review work are to be expanded to progressively cover other DMCs until a satisfactory profile of each DMC can be made. In selecting the seven countries, consideration will be given to such factors as (i) the involvement of other donors (to avoid duplication of effort), (ii) the extent of ADB's involvement in projects and programs, (iii) the commitment of the government and other relevant agencies and organizations to implement the proposed improvements in their accounting and auditing support, and (iv) geographic location to achieve diversity.

III. THE TECHNICAL ASSISTANCE

A. Objectives

8. ADB has, since 1995, demonstrated its stand on the importance of good governance, through effective financial management, for sustained economic development. The TA will carry out a diagnostic review of the existing accounting and auditing support and standards available in the selected DMCs. After carrying out this diagnostic analysis, the TA will assess the need for assistance to improve the current situation. The objectives of the TA are to (i) assess the capability and capacity within a selected DMC to provide efficient and effective accounting and auditing support to meet international standards and best practices; (ii) determine the existing accounting and auditing standards of the selected DMCs; (iii) assess the degree of deviation from the IAAS while identifying weaknesses and possible options; (iv) introduce the concepts of the international standards through workshops; (v) develop reference materials for potential users of the IAAS; and (vi) determine the level and type of assistance needed by the selected DMCs in order to provide acceptable accounting and auditing support to the private and public sectors (the TA framework is in Appendix 1).

B. Scope

9. The TA will involve an in-depth study of the key issues relating to accounting and auditing support in the selected DMCs, identify gaps and weaknesses that need to be addressed to improve accounting and auditing support, and develop assistance programs in collaboration with other donors to rectify the identified weaknesses with a view to improving the accounting and auditing support being provided. Seven DMCs will be selected in consultation with ADB's two programs departments, the Office of the Pacific Operations, and the relevant operational divisions responsible for this activity. To ensure that there is no duplication of effort, the country selection will also take into account the activities of other organizations involved in similar activities.

10. The TA will be organized into 4 parts.

11. **Part One: Country Case Studies on Available Accounting and Auditing Support and Structure.** This part will examine the current accounting and auditing structure and systems adopted in the selected DMCs. It will also (i) analyze the political, institutional, and

regulatory and legal framework on accounting and auditing practice of each selected country and the level of enforcement of existing laws, rules, and regulations; (ii) identify gaps and weaknesses in accounting and auditing support available and deviations from international standards; and (iii) identify alternative options to remedy the identified weaknesses, with the objective of eventually doing away with these.

12. **Part Two: Conduct of Workshops.** This part will disseminate the findings of the country research through in-country workshops. Each workshop will provide a cross-section of views on the findings of the research and will establish ways to move forward to improve financial management and governance in the country. An awareness program on IAAS will be given through the workshops. Representatives of government agencies, professional bodies, donors, and other interest groups will be invited to attend the workshops.

13. **Part Three: Development of Reference Materials.** This part involves the development of materials that will serve as references for current and future accounting and auditing practitioners as regards the prevailing capabilities and capacity in delivering sound accounting and auditing support based on IAAS. In developing the reference materials, consideration will be given to (i) alternative transition systems and associated benchmarks as well as underlying institutional prerequisites, and (ii) production of materials in the local language if the information can thereby be better disseminated.

14. **Part Four: Formulation of Action Plan.** The fourth part will assess the roles that ADB and other funding agencies can play in improving the current situation in the selected DMCs. The roles could include policy intervention, projects and program assistance, and mobilization of cofinancing resources to address the identified problems and weaknesses. This activity will be undertaken in close consultation with the governments, regulatory authorities, representatives of the accounting and auditing professions, and other local interest groups and funding agencies. At this stage of the TA, the firm commitment of the selected DMCs to implement the findings and recommendations of the study will be sought. Finally, the findings of the TA will be disseminated and debated at a conference in Manila and the developed action plan will be finalized for immediate implementation.

C. Cost Estimates and Financing Plan

15. The estimated cost of the TA is \$400,000 (Appendix 2). The study will be financed by ADB on a grant basis from the ADB-funded TA program.

D. Implementation Arrangements

16. Two international consultants specializing in multisectoral accounting and auditing practice will be engaged for six person-months each to conduct individual country studies for the seven selected countries and to prepare country reports. The consultants will prepare an issues paper, and the consolidated report integrating the findings and implications of the individual country reports. The consultants will be engaged in accordance with ADB's *Guidelines on the Use of Consultants*. Both consultants will be engaged on an individual basis and will work under the supervision of the Lead Financial Specialist in Economics and Development Resource Center (EDRC). The study will be supervised and coordinated by EDRC, working closely with staff of ADB's programs departments, the Office of the Pacific Operations, Central Operations Services Office, Controller's Department, Office of the General Auditor, and other relevant departments and individuals. This coordination will be done through an

interdepartmental advisory panel to be established for the TA. The outline terms of reference for the consultants is in Appendix 3.

17. The TA will commence in early March 2000 and conclude in early September 2000. The workshops will be held progressively during the course of TA implementation and a final conference will be held in Manila in late August 2000. The findings of the workshops and conference will be compiled for dissemination within ADB, the participating DMCs, and the donor community. ADB staff will participate in the workshops and conference as resource persons to ensure that ADB's commitment to improving financial management and governance is adequately reflected.

IV. THE PRESIDENT'S DECISION

18. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance, on a grant basis, in an amount not exceeding the equivalent of \$400,000 for the purpose of Strengthening Financial Management and Governance in Selected Developing Member Countries, and hereby reports such action to the Board.

TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Project Targets	Project Monitoring Mechanisms	Assumptions and Risks
Goal			
To improve financial management and governance in selected developing member countries (DMCs).	Strengthened financial management capacity of accounting and auditing practitioners for more efficient use of resources and greater accountability and transparency among institutions in different sectors.	Feedback from governments, executing agencies, and professional bodies.	Governments of selected DMCs accept the findings of the study and adopt proposed changes.
Purpose			
1. Assess the capability and capacity within selected DMCs to provide efficient and effective accounting support to meet international standards and best practices.	Improve public and private sector governance through effective design and implementation of policy and regulatory measures.	Draft reports, supporting data and documents.	Reliability of information and responses received.
2. Determine the existing accounting and auditing standards of the selected DMCs and assess the degree of deviation from the International Accounting and Auditing Standards (IAAS).	Identify gaps and weaknesses in the current practice.	Feedback from governments, executing agencies, and professional bodies.	Data availability.
3. Introduce the concepts of IAAS through workshops.	Enhance awareness and develop competencies among the DMCs.	Feedback from governments, executing agencies, and professional bodies.	Receptiveness of DMCs to policy changes.
4. Develop reference materials on improved financial management and governance.	Introduce IAAS to current and future practitioners.	Progress reports, submission of reference materials.	Commitment and involvement of the DMCs in improving financial management and governance.
5. Determine the level and type of assistance needed by the selected DMCs in order to provide acceptable accounting and auditing support.	Identify assistance and intervention needed by DMCs that will promote sound accounting and auditing practice.	Feedback from governments, executing agencies, and professional bodies.	Receptiveness of DMCs to improve accounting and auditing support.
Outputs			
1. Country reports and a consolidated report establishing capabilities of selected DMCs in the application of sound financial management and governance.	<ul style="list-style-type: none"> • 7 individual country reports. • 1 consolidated report . 	Progress reports.	Data availability. Involvement of the DMCs, including representatives of the government and professional organizations.
2. In-country workshops and international conference.	<ul style="list-style-type: none"> • 7 in-country workshops. • 1 international conference. 	Feedback from governments, executing agencies, and professional organizations.	Active involvement and participation of DMC representatives.
3. Develop reference materials on improved financial management and governance.	<ul style="list-style-type: none"> • 500 sets of reference materials. 	Progress reports, feedback from governments and professional organizations.	Information will be shared with future accounting and auditing practitioners and other donors.
4. Formulation of action plan	Action plan on the role of the Asian Development Bank (ADB) and other donors in improving financial management.	Progress reports.	Acceptance of individual roles and implementation of action plan.

Reference in text: page 3, para. 8)

Design Summary	Inputs	Project Monitoring Mechanisms	Assumptions and Risks
Activities			
1. Country Case Studies and Reports Prepare inception report on study approach, work plan, and schedules for discussion and approval. Review relevant documents on accounting and auditing regulatory framework. Survey and interview selected agencies and institutions. Prepare issues paper on existing accounting and auditing standards. Formulate framework for implementation of findings in country reports.	\$215,000 <ul style="list-style-type: none"> • 6 person-months of consultant services. • country research/activities. • procurement of equipment. • miscellaneous administration and support services 	Detailed work plans and terms of reference, progress reports, submission of draft issues paper, and framework of action plan.	Data availability. Commitment and involvement of the DMCs, including representatives of the government and professional organizations.
2. Workshops and conference <ul style="list-style-type: none"> • 7 in-country workshops; and • international conference in Manila. 	\$110,000 <ul style="list-style-type: none"> • 2 person-months of consultant services. 	Feedback from government, agencies, and professional bodies.	No disruptions in workshop. Availability of materials. Open and candid discussion of relevant issues is achieved. Receptiveness to policy changes. Availability of materials.
3. Reference materials on improved financial management and governance.	\$45,000 <ul style="list-style-type: none"> • 2 person-months of consultant services; and • translation, materials/supplies for reproduction of materials. 	Feedback from government, agencies, and professional bodies.	Availability of materials.
4. Formulation of action plan. Assessment of the role of ADB and other donors in improving the current financial management and governance situation in the seven DMCs.	\$30,000 <ul style="list-style-type: none"> • 2 person-months of consultant services. 	Progress reports.	Plausible identification of individual roles of the different institutions. Country commitment to implement reforms.

COST ESTIMATES
(\$)

Item	Cost
1. International Consultants	
a. Remuneration	180,000
b. Travel and Per Diem	75,000
2. Country Activities (Field Work/Research)	18,000
3. Country Workshops	14,000
4. ADB Staff Travel (as resource persons)	20,000
5. Communications, Materials, Secretarial Support, and Translation Services	13,000
6. Equipment	5,000
7. Conference (to disseminate and discuss findings)	45,000
Subtotal	370,000
8. Contingency	30,000
Total	400,000

Source: Staff estimates

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

1. Two individual chartered accountants or people with equivalent qualifications and extensive experience in the diagnostic analysis of accounting and auditing matters, particularly of developing countries, will be engaged. The consultants will (i) carry out a diagnostic study of the existing accounting and auditing capabilities in the selected DMCs and the extent of use of International Accounting and Auditing Standards (IAAS) in the preparation of financial reports by public and private sectors, (ii) identify gaps and weaknesses of the existing practice and recommend how the situation may be improved with regards to financial management and governance, (iii) conduct in-country workshops to discuss individual country findings of the study and introduce IAAS to practitioners, (iv) conduct a conference to discuss the consolidated report on the findings of the study for the development of an action plan of assistance needed to improve accounting and auditing capabilities in the selected DMC, and (v) prepare a set of reference materials on sound financial management and governance based on the application of IAAS.
2. The consultants will work under the supervision of the Lead Financial Specialist (Economics Development and Resource Center) of the Asian Development Bank (ADB), with relevant ADB Staff, and with the accounting and auditing professional organizations (where they exist) of the selected DMCs as well as the DMCs' governments and their regulatory authorities.
3. The terms of reference of the consultants will include the following:
 - (i) Carry out a detailed review of the accounting and auditing practices followed in the selected DMCs. Identify deficiencies in the current system and assess how best these may be rectified. In this process, care should be taken not to duplicate work of other organizations. Build on earlier work carried out either by donors or other professional organizations to facilitate the most comprehensive understanding of the accounting and auditing situation in the country. The assessment should include the availability of qualified human resources, local training facilities for accountants and auditors, availability of data, extent of the use of information technology, the existence of local accounting and auditing standards, and the extent to which these differ from the IAAS. Identify gaps and weaknesses and assess how best these may be rectified.
 - (ii) Determine if an organized accounting and auditing professional body exists in the country. Where any accounting professional bodies exist, examine the legal framework within which they operate, including their reporting structure and the extent of their independence. In countries that have no organized professional body, examine the possibility of establishing professional institutions, and what actions and resources are needed for this purpose.

- (iii) Establish if any other donor is assisting the concerned country to develop accounting and auditing capabilities. If such assistance is available, assess the level of the assistance, any gaps that exist, and the role that ADB can play in collaborating with other donors to improve the situation in the country.
- (iv) Prepare individual country reports of the findings on the foregoing activities.
- (v) Assist ADB staff in disseminating the findings of the country research through in-country workshops. The purpose of such workshops is described in the main text of this report.
- (vi) The findings of the research of all the seven DMCs will be disseminated and discussed at a conference to be participated by relevant ADB staff, government representatives of the participating DMCs, and other interest groups and donors. The consultants' findings will be discussed and debated at this conference and an action plan developed to improve financial management and governance of the selected DMCs. The consultants will work closely with the relevant ADB staff to organize this conference and following the conference to help prepare a comprehensive report covering the overall findings of the TA.
- (vii) Assess if there is a need to translate the reference materials for a specific country. If the need is determined, arrangements will then be made for the translation of the relevant materials in the local language.
- (viii) Carry out any other related work assigned by the Lead Financial Specialist.