

# Project Administration Instructions

PAI 5.09  
Revised November 2008  
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## SUBMISSION OF AUDITED PROJECT ACCOUNTS AND FINANCIAL STATEMENTS

### A. Introduction

1. This PAI outlines measures to ensure that audited project accounts and audited agency financial statements are received by ADB on time. Article 14 (xi) of ADB's *Articles of Agreement* (the Charter) provides that ADB loan proceeds be used only for the purposes for which the loan was approved with due attention to economy and efficiency. To meet these requirements, executing agencies (EAs) are to submit audited project accounts (APA) regularly during project implementation, and, in some cases, until the loan has been fully repaid. In addition, EAs of revenue-earning entities are to submit audited agency financial statements (AFS). This enables ADB to monitor loan use and satisfy itself of the project entity's financial viability.

2. A management letter, by reporting entity, is also required. The management letter is a report on the internal controls and operating procedures of the entity covering all aspects included during the normal course of the audit. For non-revenue generating EAs, that do not submit AFS, a management letter should be provided covering internal controls and procedures associated with the maintenance of project accounts and preparation of APA.

3. ADB's financial reporting and auditing requirements were reviewed in 2004 and adjusted to reflect the ongoing Harmonization Agenda. ADB's revised audit requirements as defined in the *Guidelines for the Financial Governance and Management of Investment Projects financed by Asian Development Bank* (the Financial Guidelines) are consistent with both the OECD-DAC *Good Practices Paper on Financial Reporting and Auditing (Dec 2002)* and the *Framework for Collaboration Among Participating Multilateral Development Banks on Financial Reporting and Auditing (Feb 2003)*.

### B. Measures for ADB-Financed Public Sector Projects

#### 1. Revenue-Earning Entities in the Public Sector

4. Generally, all revenue-earning EAs in the public sector prepare annual financial statements and have them audited by government-designated auditors as a statutory requirement. These EAs can finance proper accounting and auditing systems, and hire qualified accounting and auditing staff. Delays in submitting audited financial statements are usually due to parliamentary approval or government authorization being needed before their release. ADB processing missions are to ensure that governments give ADB "provisional" or advance copies of audited financial statements prior to parliamentary approval or government authorization. If an EA's audited financial statements are comprehensive and provide sufficient financial information on the funded project, the EA may not be required to send audited project accounts (this will be reflected in the loan or project agreement).

#### 2. Nonrevenue-Earning Entities in the Public Sector

5. Nonrevenue-earning EAs submit annual audited project accounts including the cash-flow statements to ADB. Usually, these project accounts are prepared at the project level by project accountants whose qualifications, in some cases, do not meet international requirements and who are unfamiliar with ADB's accounting and reporting requirements. Even if familiar, many of them are required

by law to maintain accounts based on their respective government accounting systems, which may differ from generally accepted international accounting standards. This makes it difficult for them to prepare separate project accounts acceptable to ADB and results in late submission or nonsubmission of project accounts for auditing. Late submissions of audited project accounts are also often caused by delays in the auditing of accounts by government-designated auditors. To mitigate risks associated with capacity constraints, government designated auditors should be notified of ADB's audit requirements during project processing.

### **3. Program Lending**

6. In the case of program loans, ADB does not require an audit opinion covering the use of program loan proceeds, unless the program includes discrete, identifiable investment components (for such components, the project audit requirements apply). This recognizes that funds provided to support adjustment costs are fungible. That said, ADB's wishes to see that the program loan proceeds are appropriately reflected in the accounts of the borrowing government and that such accounts are subject to external audit.

### **4. Technical Assistance for Capacity Building in Project Accounting**

7. Wide disparities exist in accounting and auditing facilities and standards among borrowers. To help borrowers avoid persistent difficulties in meeting ADB's requirements for separate project accounts, financial reporting and accounting systems are reviewed during project and program processing missions through the financial management assessment. Specific accounting and reporting requirements to ensure proper financial management of the project are discussed with the borrower, EAs and government auditors (if applicable) and are reflected in the loan covenants of the loan agreements. If accounting and auditing systems are found unacceptable, corrective measures are put in place using either ADB technical assistance (TA) funds if available, or assistance from other assistance agencies. In some cases, a regional TA covering several developing member countries may be appropriate.

8. The TA will assist in

- familiarizing the project accountants with ADB's accounting and reporting requirements;
- preparing the national project accounting manual that integrates government accounting procedures and ADB's project accounting requirements, including sample formats; and
- providing hands-on training in preparing project accounts in accordance with the national project accounting manual.

To ensure that project accountants of ADB-financed projects use the manual, the manual must be formally adopted by the government as the official project accounting manual for all ADB-financed projects. To the extent possible, and to honor the spirit of harmonization, such a TA and/or manual should be prepared in consultation with development partners and if possible, manuals should be prepared for all projects financed through ODA.

9. The TA fact-finding mission consults the borrower to prepare the terms of reference for the consultant(s), and ADB engages consultants who are familiar with local accounting standards and ADB's accounting requirements.

## **5. Assistance by Regional and Resident Missions**

10. The regional and resident mission (RM) with suitably qualified staff may assist the EAs by providing guidance to meet ADB's requirements of the audited project accounts and agency financial statements.

## **6. Format for the Project Account**

11. Project accounting formats that meet disbursement and accounting requirements of both ADB and the government are prepared by closely coordinating with the borrower. To the greatest extent possible, one standard reporting format should be adopted that meets the requirements of all development partners working with either the EA, the sector or the Country. This reporting format should take into consideration the structure of the borrower's existing financial accounting and reporting systems. Sample accounting formats are provided in the knowledge management section of the Financial Guidelines. Immediately after signing the loan agreement, the borrower is advised of ADB's auditing requirements by issuing an audit letter in the format indicated in Appendix 1.

## **7. Including Project Components for Financing**

### **a. Training Project Accountants**

12. Hands-on training for preparing project accounts is arranged for project accountants if they are unfamiliar with ADB's accounting and reporting requirements. The cost may be included in the loan amount.

### **b. Using Private Auditors for Projects in the Public Sector**

13. For nonrevenue-earning projects, auditing is normally done by the government's designated auditing agency. This is often late, resulting in delayed submission to ADB. ADB's processing missions explore with the government the possibility of engaging a private auditing firm to audit project accounts if there have been delays. With the government's concurrence, loan funds may be used to finance a private auditing firm, if the borrower is not able to meet the cost. Alternatively, consideration will be given for institutional strengthening of the auditing agency under TA financing.

### **c. Financing of Translation Cost**

14. If translating into English is the major cause of delay in submitting audited project accounts and financial statements, the processing mission will include the cost of hiring domestic translators in the loan amount.

## **8. Submitting Unaudited Project Accounts and Financial Statements**

15. Unaudited project accounts and financial statements are submitted in addition to the audited ones if the EA has been persistently late in submitting them or if there is doubt that the EA can submit them on time. Submission of unaudited/draft financial statement may be requested but should not be used to determine compliance with loan and/or project agreement covenants.

## **9. Time Frame for Submitting Audited Project Accounts and Agency Financial Statements**

16. Unaudited project accounts and financial statements (if required) are submitted within three to six months after the close of the fiscal year.

17. Audited financial statements (for the EA, project accounts, and imprest funds as applicable) should be submitted to ADB not more than 6 months following the end of the fiscal year or project closing date (whichever is first). This reporting period could be extended to 9 months, for the following exceptions:

1. In cases of weak institutional capacity, submission of AFS/APA can be started at nine (9) months and later be reduced to six (6) months over the course of project implementation.
2. In cases of decentralization, the deadline could be extended up to nine (9) months if logistical considerations are such that they would impact the physical flow of information.

18. As State-Owned Enterprises (SOEs) are expected to behave as a corporate entity, and to operate on commercial principals, no exceptions beyond six (6) months should be considered for submission of AFS, APA, imprest funds, and statement of expenditure as applicable.

## **10. Actions for the EA**

19. For a complex project, establishing a centralized accounting unit in the EA is essential, particularly in the agriculture and social sectors where several independent project components are to be implemented by different implementing units. This ensures that the separate subproject accounts of each implementing unit will be maintained and coordinated for submission of the withdrawal applications.

20. The EA should ensure that audited project accounts and financial statements are submitted on time.<sup>1</sup> The EA is also to be involved in designing the project accounting format and understand the importance of project accounts as a management tool for monitoring project costs.

## **11. Action Plan To Improve Compliance**

21. To improve unsatisfactory compliance with the submission of audited project accounts and financial statements, ADB's approved action plan is as follows:

- sector division or RM systematically monitors compliance, send reminders to EAs before due dates, and follow up if the accounts are overdue;
- sector division or RM include a financial specialist or financial management specialist in the review mission to analyze the situation and offer supportive measures, if noncompliance is primarily attributable to problems at the EA level;

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<sup>1</sup> Inception missions notify the borrower and EA of the mandatory requirements for project accounting. A module has been added to the country project implementation and administration seminars organized by the Central Operations Services Office to alert seminar participants through the control officer.

- operations coordination division/unit or RM deals with noncompliance during the country portfolio review mission (CPRM), if the cause is outside of the individual EAs responsibility; compliance is reviewed again during subsequent country programming missions, and the results are reflected in the proposed lending level;
- sector division or RM issues a formal warning, and suspend replenishment of imprest accounts, processing applications for reimbursement or commitment letters, and approval of the award of new contracts when submission of audited project accounts and financial statements is delayed by more than six months (partial compliance is considered as not complied with) (para. 24);
- regional department recommends suspending the loan if submission of audited project accounts or agency financial statements is delayed by more than one year (this is brought to the borrowers' attention at loan negotiations and recorded in the minutes) (para. 25 and PAI 4.04);
- ADB continues to assist by using proceeds of loans or TAs to train project accountants, strengthen government audit agencies, prepare national project accounting manuals, use private auditors, and finance translation costs;
- processing mission assesses the EAs capability; describes the proposed accounting, auditing, and translation arrangements; recommends an appropriate submission period; and makes necessary provisions in the project cost estimates contained in the report and recommendation of the President (RRPs);
- sector division or RMs ensure that submitted audited project accounts and financial statements are promptly and thoroughly reviewed (para. 27);
- sector division or RMs update the PPRs to reflect the latest status of compliance with submission of audited project accounts and financial statements;
- sector division or RMs review the periods stipulated in loan agreements for submitting audited project accounts and financial statements (they reflect the capabilities of the EAs and best practices in the sector) and recommend changes to loan covenants as a last resort; and
- the principal financial management specialist, RSGR, is the overall coordinator of ADB's initiative to ensure sound project financial management of ADB-financed projects.

## **C. Monitoring Compliance with Submission**

### **1. Three Months before the Due Date**

22. The sector division or RM concerned reminds the EA and implementing agency (IA) three months before APA or AFS is due.

## **2. On the Due Date**

23. When the APA or AFS is not received by the due date, the sector division or RM immediately writes to the EA and IA stating that the APA or AFS is overdue and, if it is not received within six months, requests for new contract awards and disbursement such as new replenishment of imprest accounts, processing of new reimbursement, and issuance of new commitment letters will not be processed.

## **3. Six Months after Due Date**

24. When the APA or AFS is not received within six months after the due date, the sector division or RM will hold processing of requests for new contract awards and disbursement such as new replenishment of imprest accounts, processing of new reimbursement, and issuance of new commitment letters. The sector division or RM then informs the EA and IA of ADB's actions and advises that if the situation is not remedied within next six months, the loan may be suspended. The Operations Coordination Division/Unit (OCD/U), Central Operations Services Office (COSO), Loan Administration Division (CTLA), Office of the General Counsel (OGC) and Office of Cofinancing Operation (OCO) if the project is cofinanced should likewise be informed.

## **4. Twelve Months after the Due Date**

25. When the APA or AFS is not received within 12 months after the due dates, the sector division or RM determines whether the loan is to be suspended and advises the OCD/U accordingly. With joint reference to the Regulations,<sup>2</sup> the regional department recommends loan suspension to the vice-president for the region concerned and advises COSO, CTLA, OCO if the project is cofinanced, and OGC of the vice-president's decision. Procedures for suspension follow PAI 4.04, Suspension and Cancellation of Loans.

## **5. Reporting Requirements**

26. Project performance reports (PPRs) record all actions taken. COSO monitors the compliance status through the PPRs and reminds sector divisions or RMs concerned of the above cases through automatic E-mail notification to take actions where necessary.

## **D. Procedure for Review of the APA and AFS**

27. Upon receipt of the APA or AFS, the sector division or RM promptly acknowledges the receipt and reviews it within four weeks of receipt to determine if the quality is satisfactory and that it fully complies with the provisions of the loan and project agreements. The sector division or RM submits a brief report to the director, sector division or country director, RM indicating the findings of the review and recommendations. The auditor's opinion (e.g. Unqualified/Qualified) and the salient points of problems

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<sup>2</sup> Ordinary Operations Loan Regulation (Applicable to LIBOR-Based Loans Made from ADB's Ordinary Capital Resources) dated 1 July 2001; Ordinary Operations Loan Regulations (Applicable to Loans Made by ADB from Its Ordinary Capital Resources) dated 1 July 1986; Regulations of the Asian Development Fund dated 15 April 1997; Special Operations Loan Regulations (Applicable to Loans Made by ADB from Its Special Funds Resources) dated 7 December 1982.

including remedial actions taken or to be taken are to be reflected in PPRs. OCD/U, COSO, and CTLA are informed of the results of the review only if

- the APA, AFS, or accompanying auditor's report is unacceptable (if so, the sector division or RM notifies the EA immediately by letter);
- the auditor's report contains significant findings that affect the use of loan proceeds or implementation of the project (or other accountability issues);
- the auditor's report contains any unacceptable findings on imprest accounts and statement of expenditures; or
- the financial covenants are not complied with.

#### **E. Remedies for Poor Compliance**

28. The following helps improve compliance<sup>3</sup> with submitting an APA or AFS:

- Sector division or RM analyzes poor compliance due to the lack of capacity or capability of EA or other EA constraints, during field review missions, and offer supportive measures.
- The CPRM investigates poor compliance due to capacity and capability constraints at the borrower or audit authority level. The CPRM reviews the status of compliance, determines causes of poor compliance, agrees on time-bound measures to improve compliance, and reminds the borrower that failure to redress the situation affects the sector or country lending level.
- ADB continues providing loans or TA to build the capacity of project accountants and strengthen the borrower's agencies handling audit and project financial management responsibilities. ADB can also assist in financing translation<sup>4</sup> costs and costs for using private auditors as an interim measure.
- Loan processing missions describe in their back-to-office reports, memorandum of understanding, and RRP the proposed accounting, auditing, and arrangements for translation or recruiting private auditors, make provisions in the project cost estimates as necessary for strengthening measures, and recommend appropriate submission periods for APA or AFS based on the EAs' financial management capability. The processing missions are to assure that minimum standards of accounting and auditing capacity acceptable to ADB are in place prior to loan approval, or will be in place before loan effectiveness.
- Sector divisions or RMs consult the lead financial management specialist who is primarily responsible for financial management, when formulating measures to improve EA compliance.

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<sup>3</sup> Projects with "partly complied" or "not complied" categories.

<sup>4</sup> ADB does not accept APA and AFS in the local language. Article 39 (1) of ADB's Charter provides that ADB's working language shall be English. The loan and project agreements provide that the audited accounts and related statements will be in the English language.

## **F. Compliance Status**

29. Sector divisions or RMs monitor compliance in submitting acceptable APA or AFS and records status details in the PPRs. The status will fall into one of the following six categories.

- (i) Complied is
  - when the sole EA submitted acceptable APA or AFS in English by the due date; and
  - where all EAs submitted acceptable APA or AFS in English by the due date.
- (ii) Partly complied is
  - where several EAs are involved and only one or a few submitted acceptable APA or AFS either by the due date or late.
- (iii) Complied late is
  - when APA or AFS meets the complied status but is submitted late.
- (iv) Not yet due is
  - when APA or AFS is not yet due and is only applicable until the first APA or AFS for the project becomes due.
- (v) Not required is
  - If submission of APA or AFS is not included in the loan covenants, and is only applicable to some exceptional program loans.
- (vi) Not complied is
  - when APA or AFS is submitted in the local language;
  - when APA or AFS is submitted but has material audit qualifications;
  - when the sole EA submitted partial or incomplete APA or AFS;
  - when only unaudited project accounts and financial statements are submitted.

30. The compliance classification system applies during implementation. This means that if by the due date, APA or AFS is not submitted, the compliance status is classified as “not complied”. It is reclassified as “complied late” when the requirements are met after the due date. Similarly, if the prescribed requirements are submitted on time, the compliance status is classified as “complied”. APA or AFS should be submitted for each accounting period.

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**SAMPLE AUDIT LETTER**

ASIAN DEVELOPMENT BANK

REGIONAL DEPARTMENT  
Sector Division / Regional or Resident Mission

[Date]<sup>1</sup>

[The Borrower]  
Dear Sir or Madam:

Subject: **[Loan No. and Project Title]**  
**FINANCIAL REPORTING AND AUDITING REQUIREMENTS**

This letter is to ensure your timely compliance with the loan covenants and the quality of financial information as required by ADB. ADB's *Handbook for Borrowers on the Financial Governance and Management of Investment Projects Financed by the ADB* (the Booklet) is enclosed to guide you.

ADB, by its Charter, is required to ensure that the proceeds of any loan made, guaranteed, or participated in by ADB are used for the purposes for which the loan was approved. ADB requires accurate and timely financial information from its borrowers to be assured that expenditure was for the purposes stated in the loan agreement.

For this particular loan, the requirements are stipulated in sections \_\_\_\_\_<sup>2</sup> and \_\_\_\_\_<sup>3</sup> of the Loan Agreement of \_\_\_\_\_ between ADB and [the Borrower] and sections \_\_\_\_\_<sup>4</sup> and \_\_\_\_\_<sup>5</sup> of the Project Agreement<sup>6</sup> of \_\_\_\_\_ between ADB and [name of the EA].<sup>7</sup> Copies of the Loan/Project Agreements are enclosed for onward transmission by your office to your EA and the auditor(s), together with a copy of this letter.

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<sup>1</sup> The audit letter, with the loan and project agreements, is sent to the borrower when the auditor has been appointed or when the agreements are sent by the program department to the Ministry of Finance or other authority of the borrower.

<sup>2</sup> Specify section no. in the loan agreement on maintaining project accounts and records.

<sup>3</sup> Specify section no. in the loan agreement on the audit requirements.

<sup>4</sup> Specify section no. in the project agreement on maintaining project accounts and records.

<sup>5</sup> Specify section no. in the project agreement on the audit requirements.

<sup>6</sup> If there is a project agreement.

<sup>7</sup> When more than one project agreement, provide similar information.

The following are the main requirements:

- ADB requires the EA to maintain separate project accounts and records exclusively for the Project to ensure that the loan funds were used only for the objectives set out in the Loan or Project Agreements. The project accounts comprise the following:<sup>8</sup>

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The first set of project accounts to be submitted to ADB covers the fiscal year ending \_\_\_\_\_. As stipulated in the Loan or Project Agreements, they are to be submitted up to \_\_\_\_\_ months after the end of the fiscal year. For this loan, the deadline is by \_\_\_\_\_. A sample report format with explanatory notes, is attached as Annex A.

- The accounts and records for the project are to be consistently maintained by using sound accounting principles. Please stipulate that your external auditor is to express an opinion on whether the financial report has been prepared using international or local generally accepted accounting standards and whether they have been applied consistently.

ADB prefers project accounts to use international accounting standards prescribed by the International Accounting Standards Committee. Please advise your external auditor to comment on the impact of any deviations, by [name of the Executing Agency] from international accounting standards.

- Please ensure that your external auditor specifies in the Auditor's Report the appropriate auditing standards they used, and direct them to expand the scope of the paragraph in the Auditor's Report by disclosing the key audit procedures followed. Your external auditor is also to state whether the same audit procedures were followed for all supplementary financial statements submitted.

ADB wishes that auditors conform to the international auditing standards issued by the International Federation of Accountants. In cases where other auditing standards are used, request that your external auditor to indicate in the Auditor's Report the extent of any differences and their impact on the audit.

- The external auditor's opinion is also required on whether
  - the proceeds of the ADB's loan have been utilized only for the project as stated in the Loan Agreement;

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<sup>8</sup> Listed are standard accounts required from nonrevenue-earning entities. Try to identify specific titles of financial statements expected to be submitted by the Borrower and EAs. For revenue-earning entities, the submissions consist of the entities' audited financial statements. For nonrevenue-earning entities, the submissions consist of audited project accounts.

- the financial information contains data specifically agreed upon between [name of the Borrower or EA] and ADB to be included in the financial statements;
  - the financial information complies with relevant regulations and statutory requirements;
  - compliance has been met with all the financial covenants contained in the Loan or Project Agreements;
  - Imprest Account/ Second Generation Imprest Account(s) funds have been correctly accounted for; and
  - documents and controls on the use of the Statement of Expenditures (SOE) procedure are adequate.
- The Auditor's Report is to clearly state the reasons for any opinions that are qualified, adverse, or disclaimers.
  - Actions on deficiencies disclosed by the external auditor in its report are to be resolved by [name of Borrower or Executing Agency] within a reasonable time. The external auditor is to comment in the subsequent Auditor's Report on the adequacy of the corrective measures taken by [name of Borrower or EA].

Compliance with these ADB requirements will be monitored by review missions and during normal project supervision, and followed up regularly with all concerned, including the external auditor.

Yours sincerely,

Director /  
Country Director  
(Sector Division/  
Regional or Resident Mission)

cc: (EA)  
(External auditor of the Borrower or EA)