FINANCIAL DUE DILIGENCE IN SOVEREIGN OPERATIONS

A.  Scope

1. Article 14 (vi) of the Agreement Establishing the Asian Development Bank (the Charter) requires the Asian Development Bank (ADB) to pay due regard to whether the borrower and its guarantor, if any, will be able to meet their obligations under the loan contract. Article 14(xi) requires ADB to take necessary measures to ensure that the proceeds of any loan made, guaranteed, or participated in by ADB are used only for the purposes for which the loan was granted and with due attention to considerations of economy and efficiency.\(^1\) Article 14(xiv) requires ADB to be guided by sound banking principles in its operations (endnote i).

2. This Operations Manual applies to (i) all projects processed, irrespective of whether they are financed by an ADB loan, a grant from the Asian Development Fund (ADF), or any combination of ADB loan, ADF grant, and loan or grant cofinanced from trust funds and other external sources that are administered by ADB, following the provisions of Operations Manual section D11 (Sovereign Operations), unless otherwise provided in other sections of the Operations Manual or staff instructions on respective financing modalities; (ii) technical assistance operations processed following the provisions of Operations Manual section D12 (Technical Assistance), if the technical assistance implementation is delegated (partially or entirely) to the executing and/or implementing agencies; and (iii) knowledge partnerships and other partnership arrangements with development partners. This Operations Manual section does not apply to nonsovereign operations, which are covered by Operations Manual section D10 (Nonsovereign Operations), or policy-based loans, which are covered by Operations Manual section D4 (Policy-Based Lending).

B.  Policy

3. ADB’s project preparatory activities include four financial due diligence activities, namely, the preparation of (i) financial management assessments of the executing and implementing agencies;\(^2\) (ii) cost estimates and a financing plan; (iii) a financial analysis of the executing and implementing agencies; and (iv) where applicable, the financial evaluation of the project (or project components). Sufficient analysis is required to determine whether the project is financially viable and sustainable, whether the executing and implementing agencies are financially

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\(^1\) The term “loan” includes grants for this purpose.

\(^2\) The terms “executing and/or implementing agency” and “executing and implementing agencies” will include the borrower, if the context so requires, for the purposes of financial due diligence activities such as financial management assessment, financial viability and sustainability assessments, and/or the development of financial covenants. The terms will also include the executing and/or implementing agency of technical assistance that has been delegated partial or full implementation responsibility, knowledge partners under knowledge partnerships, and development partners under other partnership arrangements.
sustainable and have acceptable financial management arrangements that, as part of the overall
arrangements in place for implementing the project, provide reasonable assurance that ADB’s
loan proceeds are used only for the purposes for which they are approved with due attention to
considerations of economy and efficiency.

4. The results of the financial due diligence and the identified risks to the financial
management capacity, the project’s financial viability or sustainability, and the entity’s financial
sustainability should be reported along with recommended mitigation measures in the project
documents (e.g., the report and recommendation of the President, the project administration
manual, the risk assessment and risk management plan, technical assistance report, and other
technical assistance or knowledge partnership documents). Financial covenants for monitoring
the risks and the agreed mitigating measures should be incorporated in the legal agreements in
consultation with the project counsel from the Office of the General Counsel, as appropriate and
to the extent appropriate.

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Basis