

## OPERATIONS MANUAL POLICIES AND PROCEDURES

---

These policies and procedures were prepared for use by ADB staff and are not necessarily a complete treatment of the subject. This *Operations Manual* is issued by the Strategy, Policy and Partnerships Department (SPD) with the approval of the President and is subject to compliance review. Questions may be addressed to the director of the Public Financial Management Division in PPF.

### FINANCIAL REPORTING, AUDITING, MANAGEMENT, AND MONITORING IN SOVEREIGN OPERATIONS

#### A. Scopes

1. *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 in a position to meet their obligations under the loan contract (article 14 (vi)) and to take the 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 approved and with due attention to considerations of economy and efficiency (article 14 (xi)) (endnote 1). Article 14 (xiv) also requires ADB to be guided by sound banking principles in its operations. To fulfil these requirements, ADB requires borrowers to submit annual audited project financial statements and audited financial statements of independent entities, carry out other due diligence, and perform monitoring activities.

2. This *Operations Manual* section 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 in accordance with *Operations Manual* section D12 (Technical Assistance), if the technical assistance implementation is delegated (in part or entirely) to the executing and/or implementing agencies; and (iii) knowledge partnerships and projects implemented through other development partners.<sup>1</sup> This *Operations Manual* section does not apply to policy-based loans processed under *Operations Manual* section D4 (Policy-Based Lending) or nonsovereign operations processed under *Operations Manual* section D10 (Nonsovereign Operations).

#### B. Definitions

3. Unless indicated otherwise, the following terms used in this *Operations Manual* have the following meanings:

- (i) auditing standards: the standards to be applied in the audit of the financial statements.

---

<sup>1</sup> For technical assistance projects implemented through knowledge partnerships and projects implemented through other development partners, suitable financial reporting and auditing arrangements should be agreed in advance for each such activity.

## OPERATIONS MANUAL POLICIES AND PROCEDURES

---

- (ii) borrower: in addition to borrowers under ADB loans and loans administered by ADB, also includes grant recipients and executing and implementing agencies.
- (iii) financial closing date: the date on which all project-related financial transactions financed from the loan account are finalized and the respective loan account is closed in ADB's books.<sup>2</sup>
- (iv) financial reporting period (also referred to as the fiscal year): usually the 12-month period for which the borrower prepares its annual financial statements.
- (v) financial reporting standards: a set of internationally comparable standards that are to be observed in the preparation and presentation of financial statements.
- (vi) independent entity: a nonmember borrower, executing agency, or implementing agency that has a legal identity separate from the government and operates to produce goods or services for the market, but it is not a general government sector unit—a government-owned or controlled unit that is primarily engaged in nonmarket operations (e.g., a government ministry and/or department, local government bodies).
- (vii) loan: includes ADF grants and any loans and grants cofinanced from trust funds and other external sources and administered partly or entirely by ADB.
- (viii) loan closing date: the date on which ADB may terminate the right of the borrower to make withdrawals from the loan account as specified in the loan agreement.<sup>3</sup>
- (ix) management letter: the formal communication from the auditor to those charged with the governance of the entity being audited, highlighting deficiencies in internal control identified during the audit. It may also be accompanied by suggestions for addressing such deficiencies.
- (x) project: as defined in the legal agreement(s), financed by all sources of financing, including results-based lending programs. For technical assistance projects delegated for full or partial implementation, the scope will be limited to the value of the amount delegated, including all sources of financing.

### C. Policy

#### 4. ADB requires the following for all projects:

- (i) The borrower will maintain separate financial records for each project and prepare annual project financial statements in accordance with financial reporting standards acceptable to ADB. For financial intermediation loans, an annual statement of utilization of funds may be prepared in lieu of the annual project financial statements for financial reporting and auditing purposes. The borrower will have the annual project financial statements audited by an independent auditor acceptable to ADB in accordance with auditing standards that are acceptable to ADB. The borrower will submit audited statements to ADB annually<sup>4</sup> in English for

---

<sup>2</sup> ADB. 2017. *Staff Instruction on Business Processes for Loan Disbursement*. Manila (footnote 24).

<sup>3</sup> ADB. 2017. *Staff Instruction on Business Processes for Loan Disbursement*. Manila (footnote 23).

<sup>4</sup> Except as may otherwise be agreed between ADB and the borrower.

## OPERATIONS MANUAL POLICIES AND PROCEDURES

---

each financial reporting period or part thereof from the date of loan effectiveness until all expenditures incurred from all sources of financing are accounted for up to the loan closing date and fully reconciled with the ADB disbursements, as reported in ADB's financial records.<sup>5</sup> The audited statements include the (a) audited project financial statements together with the auditor's report thereon; (b) management letter; (c) an additional opinion on the use of loan proceeds; and (d) an opinion on compliance with any financial covenants linked to the annual entity financial statements, together with the computation of the covenants.

- (ii) When an independent entity's annual financial statements are subject to audit under the statutory or regulatory requirements of the developing member country or these are required for project monitoring,<sup>6</sup> such entity will submit to ADB the annual audited entity financial statements in English.<sup>7</sup> When applicable, the audited entity financial statements will be submitted to ADB annually for each reporting period commencing with the fiscal year in which the date of loan effectiveness falls until the fiscal year in which the financial closing date falls, or as agreed for the purpose of the project. If the legal agreements include financial covenants linked to the annual audited entity financial statements, the auditor's opinion on compliance with such covenants, together with the computation of the covenants, should also be submitted to ADB every year.
- (iii) For technical assistance projects delegated for partial or full implementation to the executing and/or implementing agency, the executing and/or implementing agency will maintain separate financial records for each project following financial reporting standards acceptable to ADB and prepare and submit annual project financial statements for each financial year or part thereof,<sup>8</sup> from the later of the technical assistance effectiveness date and the date of delegation to the earlier of the date when the delegated components were completed and all expenditures accounted and the technical assistance closing date, such that they fully reconcile with ADB's disbursements as reported in ADB's financial records. The audits should be performed by an independent auditor acceptable to ADB following auditing standards that are acceptable to ADB.

---

<sup>5</sup> In cases where the legal agreements provide for retroactive financing, the coverage of the audited project financial statements and the audit report will be from the date expenditures are incurred during the permitted retroactive financing period.

<sup>6</sup> If an independent entity is covered by this requirement, the legal agreement will reflect this requirement as a covenant. This facilitates the monitoring of entity financial projections, governance, and financial performance indicators, which cannot be assessed from project financial statements. The entity financial statements and the independent auditor's report provide information on the financial governance of the entity and the environment in which the ADB-supported project will operate. Financial performance indicators are used to evaluate an entity's liquidity, solvency, return on investment, operating performance, asset utilization, and market measures and may be incorporated as financial covenants. To be meaningful, a financial performance indicator for a given period should be compared with prior periods and industry norms.

<sup>7</sup> This refers to those independent entities that are executing or implementing agencies or borrowers under the legal agreement.

<sup>8</sup> Except as may otherwise be agreed between ADB and the borrower.

## OPERATIONS MANUAL POLICIES AND PROCEDURES

---

5. Public disclosure of the audited project financial statements, including the auditor's opinion on the audited project financial statements, will be guided by requirements in the legal agreement(s) and ADB's Access to Information Policy.<sup>9</sup>
6. The borrower is responsible for implementing the project, monitoring its progress, evaluating results on completion, and meeting the contractual obligations as set out in the legal agreements. The borrower will maintain acceptable financial management arrangements that provide reasonable assurance that the proceeds of any loan made, guaranteed, or participated in by ADB are used only for the purposes for which they were granted and comply with financial covenants incorporated in the legal agreements.<sup>10</sup> The borrower will furnish periodic progress reports with financial information as agreed in the project administration manual.
7. In conducting its monitoring and implementation support, ADB will review the borrower's financial management performance and compliance with the financial covenants. It will periodically assess the project financial performance and review the sufficiency of financial management arrangements, risks, and implementation status, updating project information and identifying the needed follow-up actions. ADB will monitor the timeliness of the receipt of periodic financial information, annual project and entity financial statements, and related audit reports and review their content and quality. Following completion, ADB will review the project financial results and performance and include, if relevant, lessons learned and good practices in the project completion report.

---

### Basis

<sup>i</sup> ADB. 1966. [Agreement Establishing the Asian Development Bank](#). Manila.

---

<sup>9</sup> ADB. 2018. [Access to Information Policy](#). Manila.

<sup>10</sup> Financial management arrangements are the planning, budgeting, accounting, internal control, funds flow, financial reporting, and auditing arrangements of the borrower and agency or agencies responsible for project execution and implementation. The financial management arrangements for the project may rely on the borrower or agencies' existing institutions and systems, with due consideration of the capacity of those institutions.