OPERATIONS MANUAL
BANK POLICIES (BP)

These policies were prepared for use by ADB staff and are not necessarily a complete treatment of the subject.

PROJECT FINANCIAL REPORTING AND AUDITING

A. Introduction

1. Article 14 (xi) of the Agreement Establishing the Asian Development Bank (the Charter) requires the Asian Development Bank (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 approved and with due attention to considerations of economy and efficiency. In addition, Article 14 (xiv) of the Charter requires ADB to be guided by sound banking principles in its operations.¹

2. To fulfill these requirements, ADB requires borrowers to submit annual audited project financial statements and an audit report and, where applicable, an independent entity’s audited financial statements.

B. Definitions

3. The term “audit report” refers to the independent auditor’s opinion(s), the management letter, and other information that the auditor is required to provide in accordance with applicable auditing standards, through the exercise of professional judgment, or based on the auditor’s terms of reference, to those charged with the governance of the project and/or entity.

4. The term “audited entity financial statements” refers to the audited financial statements of the independent entity including notes to these financial statements.

5. The term “audited project financial statements” refers to the audited financial statements of the project including notes to these financial statements.

6. The term “audited statement of utilization of funds” refers to the special purpose statement prepared for projects where ADB funds credit lines for eligible subprojects through participating financial intermediaries.

7. The term “auditing standards” refers to the standards to be applied in the audit of financial statements.

8. The term “financial reporting standards” refers to a set of internationally comparable standards that are to be observed in the preparation and presentation of financial statements.

¹ The requirements also apply to grant financing for ADB projects.
9. The term "independent entity" refers to an executing or implementing agency that is a separate legal entity required by national law or regulation to prepare financial statements and have these statements audited. These include public corporations as well as private sector and other nongovernment entities.²

10. The term “management letter” refers to the formal communication from the auditor to client management highlighting deficiencies in internal control identified during the course of the audit.³

C. Policy

11. 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 these 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 to ADB the audited project financial statements and the audit report annually for each financial reporting period (fiscal year) from the date of loan effectiveness⁴ until the loan closing date.⁵

   (ii) When an independent entity’s annual financial statements are subject to audit under the statutory or regulatory requirements of the developing member country (DMC), or where these are required for project monitoring,⁶ such entity will submit to ADB the audited entity financial statements. When applicable, the audited entity financial statements will be submitted to ADB annually for each reporting period (fiscal year) from the date of loan effectiveness⁷ until the loan closing date or as agreed for the purpose of the project.

³ The management letter is provided in accordance with the requirements of International Standard on Auditing 265 (Communicating Deficiencies in Internal Control to Those Charged with Governance and Management).
⁴ In cases where the legal agreements provide for retroactive financing, the submission of the audited project financial statements and the audit report will be from the approved date of retroactive financing, i.e., the date when costs that were approved for retroactive financing were incurred.
⁶ This refers to monitoring of entity financial projections and financial performance indicators, which cannot be incorporated in project financial statements. 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 given financial performance indicator for a given period should be compared with prior periods and industry norms. See OM G2/BP, paragraphs 5 and 7.
⁷ The first audited entity financial statements will be for the first fiscal year that includes the date of loan effectiveness (or the date of retroactive financing, as applicable).
12. These requirements enable ADB to monitor the financial performance and position of the project and the use of loan proceeds, and assess whether ADB’s fiduciary requirements are being satisfied.

13. Public disclosure of the audited project financial statements including the auditor’s opinion on the audited project financial statements will be guided by ADB’s Public Communications Policy 2011.8

D. Scope of the Policy

14. This OM section applies to all ADB sovereign and sovereign-guaranteed projects processed in accordance with Operations Manual Section D11: Processing Sovereign and Sovereign-Guaranteed Loan Proposals sourced from the ordinary capital resources and/or special funds.9

Basis: This OM section is based on:


This OM section is to be read with OM section J7/OP and Staff Instruction on Due Diligence and Reporting Requirements for Technical Assistance.

For other background information and references, see:


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8 ADB. 2012. Public Communications. *Operations Manual*. OM L3/BP. Manila. ADB will reach an agreement with the borrower during project processing, on a country-specific basis, on the procedures for and timing of disclosure. This agreement will be incorporated into the legal agreement and documented in the project administration manual, as appropriate.

9 This section does not apply to (i) nonsovereign operations, which are covered by ADB. 2013. *Nonsovereign Operations*. *Operations Manual*. OM D10/BP. Manila; (ii) policy-based loans, which are covered by ADB. 2013. *Policy-Based Lending*. *Operations Manual*. OM D4/BP. Manila; or (iii) results-based lending, which is covered by ADB. 2013. *Piloting Results-Based Lending for Programs*. Manila. This section should also be used as a guide when processing high-value and complex technical assistance not administered by ADB, or where an advance payment facility is provided, in accordance with the Staff Instruction on Due Diligence and Reporting Requirements for Technical Assistance.

Compliance: This OM section is subject to compliance review.

For inquiries: Questions may be directed to the Senior Advisor (Financial Management), Operations Services and Financial Management Department.
PROJECT FINANCIAL REPORTING AND AUDITING

A. Introduction

1. The following requirements ensure that the Asian Development Bank (ADB) is provided with comprehensive, reliable, and timely information to enable it to meet its obligations under Article 14 (xi) and (xiv) of the Agreement Establishing the Asian Development Bank (the Charter). Further details are contained in the Project Administration Instructions and the Project Financial Reporting and Auditing (Financial Management Technical Guidance Note).

B. Application of Policy

1. Financial Statements

2. ADB requires the annual submission of audited project financial statements and an audit report for each financial reporting period (fiscal year) from the date of loan effectiveness until the loan closing date within 6 months from the end of the fiscal year. For financial intermediation loans, an audited statement on the utilization of funds may be submitted in lieu of the audited project financial statements for financial reporting and auditing purposes. The audited project financial statements and audit reports will be presented in English.

3. When an independent entity’s annual financial statements are subject to audit under the statutory or regulatory requirements of the developing member country (DMC), or where these are required for project monitoring, such entity will submit to ADB the audited entity financial statements. When applicable, the audited entity financial statements will be submitted to ADB annually for each reporting period (fiscal year) from the date of loan effectiveness until the loan closing date, or as agreed for the purpose of the project. These financial statements will be submitted to ADB in English within 1 month of their approval by the relevant authority.

4. For all projects, ADB requires the preparation of a comprehensive set of annual project financial statements by the executing or implementing agency under acceptable financial

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1 In cases where the legal agreements provide for retroactive financing, the submission of the audited project financial statements and the audit report will be from the approved date of retroactive financing, i.e., the date when costs that were approved for retroactive financing were incurred.

2 For financial intermediation loans with nonfinancial components, audited project financial statements for the nonfinancial components will be prepared in accordance with Operations Manual section J7/BP, para 11.

3 This refers to monitoring of entity financial projections and financial performance indicators, which cannot be incorporated in project financial statements. 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 given financial performance indicator for a given period should be compared with prior periods and industry norms (Operations Manual section G2/BP, paras, 5 and 7).

4 The first audited entity financial statements will be for the first fiscal year that includes the date of loan effectiveness (or the date of retroactive financing, as applicable).
reporting standards. ADB accepts financial statements prepared in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board, International Public Sector Accounting Standards (IPSAS) promulgated by the International Public Sector Accounting Standards Board (IPSASB), or national equivalents.5

5. The financial management assessment undertaken during project processing 6 will include an agreement between the borrower and ADB on the form, content, and timing of the project financial statements that are to be audited. These arrangements will be set forth in the memorandum of understanding or aide-mémoire for the fact-finding mission and detailed in the project administration manual (PAM).7

2. Auditing Standards

6. ADB recognizes the use of the International Standards on Auditing (ISA) as issued by the International Auditing and Assurance Standards Board and requires borrowers and executing agencies to engage auditors conforming to ISA. In that connection, ADB also accepts (i) national auditing standards when deemed sufficiently equivalent to ISA, and (ii) the ISA-based International Standards of Supreme Audit Institutions as issued by the International Organisation of Supreme Audit Institutions.


7. ADB will reach an agreement with the borrower, on a country-specific basis,8 on the procedures for and timing of disclosure of the audited project financial statements for sovereign projects, including the auditor’s opinion on the audited project financial statements. The management letter, additional auditor’s opinions, and the audited entity financial statements, if applicable, will not be disclosed.9 The audited project financial statements and the auditor’s opinion on the audited project financial statements will be disclosed no later than 14 calendar days of ADB’s confirmation of their acceptability.

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5 National standards are considered equivalent to IFRS or IPSAS, and are acceptable to ADB, if their application results in sufficient and reliable financial information (including disclosures in the notes to the financial statements) that conforms in all material respects with the form and substance of financial statements prepared using IFRS or IPSAS. For instance, financial statements prepared under the accounting principles generally accepted in the United States of America are considered national equivalents of the international standards. The assessment of the national standards is part of the financial management assessment and is detailed in the PAM.


7 The financial management risk rating concluded by the financial management assessment will be reflected in the PAM.

8 This requirement applies to sovereign projects for which the invitation to negotiate was issued on or after 2 April 2012. During project processing, regional departments will arrange meetings as appropriate with the Ministry of Finance, the ministry responsible for foreign-financed projects, and the supreme audit institution to discuss the application of ADB’s public disclosure requirements in light of any relevant provisions in the country’s constitution, laws, and procedures. Country-level arrangements will be recorded in the memorandum of understanding or aide-mémoire, and will form the basis of project-level arrangements to be incorporated into the legal agreement and detailed in the PAM.

9 This type of information would generally fall under public communications policy exceptions to disclosure. ADB. 2011. Public Communications Policy 2011. Manila. Para. 97(iv) and/or 97(v).
4. Appointment of Auditors and Scope of Audit

8. The executing agency for an ADB-financed project will have the project financial statements audited each fiscal year in accordance with the agreed auditing standards by independent auditors whose qualifications, experience, and terms of reference are acceptable to ADB.

9. ADB’s auditing requirements include the following:

   (i) audited project financial statements that include an auditor’s opinion on whether the project financial statements present fairly, in all material respects, or give a true and fair view of, the project’s financial position, its financial performance, and cash flows;

   (ii) specific additional auditor’s opinion(s) on whether (a) the proceeds of the loan were used only for the purpose(s) of the project; and (b) the borrower or executing agency was in compliance with the financial covenants of the legal agreement(s), where applicable;

   (iii) a management letter; and

   (iv) audited entity financial statements, where applicable.

5. Legal Agreements

10. The legal agreements will include a provision requiring the executing and/or implementing agency to submit to ADB the annual audited project financial statements and the audit report, as well as a provision for ADB’s disclosure of the audited project financial statements and the auditor’s opinion on the audited project financial statements. The audited project financial statements and audit reports will be presented in English and submitted to ADB within 6 months from the end of the financial reporting period (fiscal year) of the project.

11. When an independent entity’s annual financial statements are subject to audit under the DMC’s statutory or regulatory requirements, or where these are required for project monitoring, the legal agreements will include a provision requiring such entity to submit to ADB annual audited entity financial statements. Such annual audited entity financial statements will be submitted to ADB in English for each reporting period (fiscal year) from the date of loan effectiveness until the loan closing date, or as agreed for the purpose of the project. These

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10 This refers to monitoring of entity financial projections and financial performance indicators, which cannot be incorporated in project financial statements. Financial performance indicators are used to evaluate an entity’s liquidity, solvency, return on investment, operating performance, asset utilization, and market measures. To be meaningful, a given financial performance indicator for a given period should be compared with prior periods and industry norms (Operations Manual section G2/BP, paras. 5 and 7).

11 The first audited entity financial statements will be for the first fiscal year that includes the date of loan effectiveness (or the date of retroactive financing, as applicable).
financial statements will be submitted to ADB within 1 month of their approval by the relevant authority.

6. Financing Audit Costs

12. The costs of annual audits of project financial statements are eligible for ADB financing and should be included in the project cost estimates in the report and recommendation of the President and the PAM. Incremental audit costs may also be financed from the loan. For projects with external financing, the cofinancier may request a separate audit of the project financial statements. In such cases, the cost of annual audits of the external financing to be undertaken by independent auditors will be funded by the financing partners whether as part of their contribution to the project or to be separately provided in accordance with the relevant cofinancing agreements.

7. Application of Requirements

13. Where necessary, guidance on the application of this section of the Operations Manual, including with respect to project-specific requirements and application, should be sought from the Operations Services and Financial Management Department.

Basis: This OM section is based on OM Section J7/BP and the documents cited therein.

Compliance: This OM section is subject to compliance review.

For inquiries: Questions may be directed to the Senior Advisor (Financial Management), Operations Services and Financial Management Department.

5 August 2015 Prepared by the Operations Services and Financial Management Department and issued by the Strategy and Policy Department with approval of the President.

This supersedes OM Section J7/OP issued on 7 June 2012.

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12 Where a project is cofinanced with one or more multilateral or bilateral financiers, the financial reporting and auditing requirements should be harmonized such that the borrower, executing and/or implementing agencies are required to submit only one set of audited project financial statements and audit report to all financiers. These harmonized requirements will be set forth in the PAM. Where there is no agreement on the financial reporting and auditing requirements, the requirements for ADB’s financing will follow this section of the Operations Manual.