



Financial Management Technical Guidance Note

March 2015

Project Financial Reporting and Auditing

Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
AFS	–	audited entity financial statements
APFS	–	audited project financial statements
DMC	–	developing member country
FIL	–	financial intermediation loan
ISA	–	International Standard on Auditing
ISSAI	–	International Standards of Supreme Audit Institutions
SAI	–	supreme audit institution
SOE	–	statement of expenditures

For further information, contact the Financial Management Unit
(Operations Services and Financial Management Department)

Vice-President	B. Davis, Administration and Corporate Management
Director General	S. O'Sullivan, Operations Services and Financial Management Department (OSFMD)
Senior Advisor	K. Moktan, Financial Management Unit, OSFMD
Team leader	A. Kizilbash, Financial Management Specialist, OSFMD
Team members	B. Reid, Principal Financial Management Specialist, OSFMD S. Janardanam, Senior Financial Management Specialist, OSFMD J. Yanuario, Senior Financial Management Officer, OSFMD

In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.

CONTENTS

	Page
I. PURPOSE	1
II. PRINCIPLES	1
III. AUDITING REQUIREMENTS AND ARRANGEMENTS	1
A. Introduction	1
B. ADB's Auditing Requirements	2
C. Auditing Arrangements	3
IV. FINANCIAL REPORTING	5
A. Introduction	5
B. Project Financial Statements	5
C. Financial Intermediation Loans: Statement of Utilization of Funds	6
D. Treatment of In-kind Contributions	6
E. Entity Financial Statements	7
F. Consolidated or Combined Financial Reporting	7
V. AUDIT REPORTS, SUBMISSION, REVIEW AND PUBLIC DISCLOSURE	7
A. Auditor's Communication (the Audit Report)	7
B. Deadlines for Submitting the Audited Financial Statements	10
C. Review Arrangements	11
D. Public Disclosure	12

APPENDIX

1. Preparation of the Final Audited Project Financial Statements under the Cash Basis of Accounting: Sample Note to the Audited Project Financial Statements	13
--	----

I. PURPOSE

1. This Technical Guidance Note summarizes the requirements for presenting, auditing, submitting, and publicly disclosing financial reports for Asian Development Bank (ADB) loan- and grant-financed projects. This note is an interpretative guide and supplements the information contained in ADB's Operations Manual Section J7 *Project Financial Reporting and Auditing*¹, Project Administration Instruction (PAI) 5.07 *Financial Reporting and Auditing of Loan- and/or Grant-Financed Projects*², and the Guidelines on the *Financial Management and Analysis of Projects*³. These guidance materials, including frequently-asked-questions, are available on ADB's Financial Management webpage⁴. Please note that this interpretive guide is not a replacement for the exercise of professional judgment in determining compliance with ADB's requirements, keeping in view any unique project circumstances and the principles described in section II below.

II. PRINCIPLES

2. The nature and extent of required financial due diligence is guided by two basic principles:

- (i) obtaining sufficient fiduciary comfort as efficiently as possible, and
- (ii) minimizing the borrower's administrative costs of compliance and the cost of ADB's oversight.

III. AUDITING REQUIREMENTS AND ARRANGEMENTS

A. Introduction

3. The external audit of ADB-financed projects is essential to fulfill ADB's fiduciary responsibilities under ADB's Charter (the Charter)⁵ which states that

The Bank shall take the necessary measures to ensure that the proceeds of any loan made, guaranteed or participated in by the Bank are used only for the purposes for which the loan was granted and with due attention to considerations of economy and efficiency.

4. ADB requires high-quality financial statements for its projects to enhance the transparency, accountability and financial reporting discipline of its borrowers. Financial statements prepared and audited in accordance with recognized good practice provide relevant financial information to key stakeholders.

¹ ADB. 2015. Project Financial Reporting and Auditing. *Operations Manual*. OM J7/BP. Manila.

² ADB. 2015. Financial Reporting and Auditing of Loan- and/or Grant-Financed Projects. *Project Administration Instructions*. PAI 5.07. Manila.

³ ADB. 2005. *Financial Management and Analysis of Projects*. Manila.

⁴ MyADB. Operations Services and Financial Management Department OpsPedia. *Financial Management*. http://myadb.asiandevbank.org/wps/myportal/home/departments/osfmd/financialmanagement/!ut/p/b1/jc7NDslgEATgR2KBQuixptKSKkQKark0PRhT05-L8fmljVere9vkm8mggBoCnHKSAuPoisLUvfp79-zngRuWP_C2cEfrqwID2FMOKmO2qnWNhYllmqi0IV4mCmPB9xqIL5Pd4aygyOI_efhyGfzKX1BYiXfG2IUIyeIC66SovaOx4wO2Jq5qY4Mu5_GGxiDIVD2SN288GJMI/dl4/d5/L2dJQSEvUUt3QS80SmtFL1o2X0ZGTkFKS0cxMDBGQzUwSUZIVUpPM0cwMDA1/

⁵ ADB. 1966. *Agreement Establishing the Asian Development Bank*. Manila. Article 14(xi).

5. Supreme audit institutions (SAIs) and private sector audit firms audit ADB-financed projects. Auditors, both public and private sector, play an important role in ensuring that ADB's Charter obligations are met.

6. ADB requires at the project processing stage that an agreement is made between the borrower and the ADB project processing team on audit arrangements, and the form, content, and timing of the annual project financial statements that are to be submitted for audit. This agreement will be recorded in a memorandum of understanding or aide-mémoire for the fact-finding mission, in legal agreement(s), and detailed in the project administration manual (PAM).

B. ADB's Auditing Requirements

7. ADB's guidelines require the borrower and the project's executing agency to have the project financial statements for each year prepared in accordance with acceptable financial reporting standards, audited by an independent auditor acceptable to ADB, and that the audit is conducted in accordance with auditing standards that are acceptable to ADB.

8. To ensure ADB is provided with reliable, comprehensive, and timely information, the following are required on an annual basis:

- (i) audited project financial statements (APFS) including 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. For financial intermediation loans, an audited statement of utilization of funds may be submitted in lieu of the audited project financial statements;
- (ii) specific additional auditor's opinions on:
 - a. use of loan proceeds – to confirm whether the borrower or executing agency has utilized the proceeds of the loan only for the purpose(s) of the project; and
 - b. compliance with financial⁶ covenants (where applicable) – to confirm the level of compliance for each financial covenant contained in the legal agreement(s) for the project. The auditor will also indicate, where applicable, the extent of any non-compliance by reference to the specified (required) and actual performance measurements for each financial covenant for the fiscal year concerned.
- (iii) management letter; and
- (iv) audited entity financial statements (AFS) in cases where (i) the executing or implementing agency is a separate legal entity whose annual financial statements are subject to audit under the developing member country's (DMC) statutory or regulatory requirements, or (ii) these are required for project monitoring⁷.

⁶ Auditors are expected to opine solely on financial covenants (for example, debt-service-coverage ratio, self-financing ratio, debt-equity ratio), in other words, only when the overall aspects of compliance relate to accounting and financial matters within the reasonable scope of an auditor's professional competence.

⁷ 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

9. ADB requires the financial statements, auditor's opinions, and management letter to be presented in the English language.

10. Project management⁸ is responsible for the preparation and fair presentation of the project financial statements, and for maintaining sufficient internal controls to ensure that the financial statements are free from material misstatement, whether due to fraud or error. In addition, the project management is responsible for ensuring that (i) the loan proceeds are utilized only for the purpose(s) of the project; and (ii) the borrower or executing agency is compliant with financial covenants, where applicable. Project management must prepare and sign a Statement of Compliance affirming that:

- (i) the project financial statements are free from material misstatements including omissions and errors, and are fairly presented;
- (ii) the borrower or executing agency has utilized the proceeds of the loan only for the purpose(s) of the project;
- (iii) the borrower or executing agency was in compliance with the financial covenants of the legal agreements (where applicable);
- (iv) the imprest fund procedure, where applicable, has been operated in accordance with ADB's Loan Disbursement Handbook⁹;
- (v) adequate supporting documentation has been maintained to authenticate claims stated on the statement of expenditures (SOE), where applicable, for reimbursement of eligible expenditures incurred and liquidation of advances provided to the imprest account; and
- (vi) effective internal controls, including over the procurement process, were maintained.

C. Auditing Arrangements

11. ADB requires the project financial statements to be audited by an independent auditor whose qualifications, experience and terms of reference are acceptable to ADB.

12. Auditors must satisfy the following criteria:

- (i) be objective and independent of the control of the entity or project to be audited, and of the person or entity appointing them;
- (ii) for private sector auditors, must be members of a professional body of accountants affiliated with the International Federation of Accountants (IFAC);

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. See OM G2/BP, paragraphs 5 and 7.

⁸ Project management refers to the project management unit, or to the specific unit within the executing or implementing agency tasked with preparing, arranging and auditing annual project financial statements.

⁹ ADB. 2012. *Loan Disbursement Handbook*. Manila.

- (iii) conform to the International Standards on Auditing (ISA)¹⁰;
- (iv) be well-established and reputable;
- (v) be able to demonstrate experience in auditing financial statements of projects and entities comparable in type, nature, and complexity; and
- (vi) be able to propose personnel who have the necessary capabilities to complete the audit competently and on time.

13. Statutory requirements in some DMCs specify the use of government auditors (i.e., SAIs) where independence is normally assured under constitutional or legal provisions. If this is not the case, additional auditing arrangements may be required to remedy deficiencies. In cases where the SAIs sub-contract project audits to private auditors, care must be taken not to assume independence and to ensure that the private auditors meet the above criteria.

14. A country audit strategy should be formulated, preferably during country partnership strategy (CPS) preparation. The country audit strategy will be based on an assessment of auditing and accounting capacity in the DMC, the suitability of national accounting standards, and an indication of those auditors considered acceptable to ADB, including an assessment of the SAI, where applicable. Where possible, the country auditing strategy should be coordinated with other development partners to reach agreement on harmonization of financial reporting and auditing arrangements.

15. The borrower or executing agency will appoint an independent auditor at or before the start of project activities, and for each fiscal year until the project's loan closing date. The auditor's terms of reference prepared by the executing agency will include

- (i) the scope and details of the audit to be conducted;
- (ii) require the auditor to provide an opinion on the project financial statements and additional auditor's opinions on whether the proceeds of the loan have been utilized only for the purpose(s) of the project, and to confirm that the borrower or executing agency was in compliance with the financial covenants of the legal agreement(s), where applicable; and
- (iii) specify the submission timelines for all audit deliverables.

16. The auditor's terms of reference will be reviewed and approved by ADB prior to the auditor being appointed.

17. The cost of annual audits of project financial statements are eligible for ADB financing and may be included in the project cost estimates. Incremental audit costs (such as reporting on compliance with loan or grant covenants) may also be financed from the loan or grant. For projects with external financing, the cofinancier may request a separate audit of the project financial statements.¹¹ In such cases, the cost of annual audits of the external financing to be

¹⁰ 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.

¹¹ Where a project is co-financed with one or more multi- or bi-lateral financiers, the financial reporting and auditing requirements should be harmonized such that the borrower, executing and/or implementing agencies are required

undertaken by independent auditors will be funded by the financing partners whether as part of their contribution to the project or separately provided in accordance with the relevant cofinancing agreements.

18. In cases where an SAI audits the project financial statements, the cost of the annual audits may be eligible for financing in line with the following considerations:

- (i) The SAI has an established practice for billing auditees – in other words, they have regular charge-out rates, billing processes, procedures, etc;
- (ii) The SAI has engaged private audit firms or auditors to conduct the audit, in which case, this is considered as an incremental cost associated with the audit; and/or
- (iii) The SAI can bill for incremental costs, travel costs, and out-of-pocket expenses associated with the audit.

IV. FINANCIAL REPORTING

A. Introduction

19. The auditor will verify that the financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), International Public Sector Accounting Standard (IPSAS) promulgated by the International Public Sector Accounting Standards Board (IPSASB), or national equivalents. The executing agency and/or implementing agency are responsible for preparing financial statements, not the auditor.

B. Project Financial Statements

20. Project financial statements will include all project-related expenditures, irrespective of funding source (except parallel cofinancing). Please refer to **Table 1** for the content of the project financial statements.

Table 1: Content of Project Financial Statements

For Cash-Based Financial Statements	For Accrual-Based Financial Statements
A statement of cash receipts and payments	A statement of financial position (balance sheet)
A statement of budgeted versus actual expenditures	A statement of financial performance (income statement)
A statement of imprest account (where applicable)	A statement of cash flows
A summary statement of expenditures (where applicable)	A statement of changes in net assets/equity (where applicable)
Significant accounting policies and explanatory notes	A statement of imprest account (where applicable)
Any additional schedules agreed (e.g., a summary of assets)	Summary statement of expenditures (where applicable)
	Statement of budgeted versus actual expenditures
	Significant accounting policies and explanatory notes
	Any additional schedules agreed

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 project administration manual. Where there is no agreement on the financial reporting and auditing requirements, the requirements for ADB's financing will follow this technical guidance note.

21. The notes to the financial statements will provide sufficient information and explanations in narrative form or through provision of appropriate schedules. Supplementary schedules may include a detailed list of inventories, a summary of long-term debts, and a summary of accounts receivable and accounts payable. These schedules and other additional disclosures may be provided separately or incorporated in the notes to the financial statements.

22. The annual project financial statements will include comparative and cumulative figures and be presented in the local currency with the basis for conversion of any foreign exchange transactions or commitments explicitly stated.

C. Financial Intermediation Loans: Statement of Utilization of Funds

23. In the case of financial intermediation loans (FIL) where ADB is funding credit lines for eligible sub-projects through participating financial intermediaries, an audited statement of utilization of funds may be submitted in lieu of the APFS. The audited statement of utilization of funds will indicate:

- (i) the opening balance;
- (ii) the name of financial intermediaries;
- (iii) details of sub-loans (committed lines of credit and amounts disbursed);
- (iv) closing balance (gross and net amounts);
- (v) comparative figures for prior year; and
- (vi) cumulative amount to date (gross).

24. The audited statement of utilization of funds will be also accompanied by adequate explanatory notes. These notes include the basis of preparation, reporting currency, undrawn external assistance, and details of sub-loans such as amounts committed, disbursed up to the previous year, disbursed during the current reporting period, cumulative disbursement, undisbursed commitments, percentage of loan utilized, etc.

D. Treatment of In-kind Contributions

25. In cases where in-kind contributions are presented in the project cost estimates during project processing, in-kind contributions will be disclosed in the APFS to enable comparability.

- (i) If in-kind contributions can be reliably measured and audited, they should be quantified and included in the project cost estimates, and valued and included in the APFS.
- (ii) If in-kind contributions cannot be reliably measured, such as the use of office space, these should be reflected as a footnote in the cost estimates tables, and discussed in a note to the APFS.

26. To enable reliable measurement, accurate records of physical contributions should be maintained (e.g., calculation of tax exemptions, pro-rata shares of staff salaries or utilities, total

hours of labor contributed by communities, value of goods contributed by communities). The auditor will include these in-kind contributions in the scope of audit. If the opinion is qualified due to the auditor's inability to reliably measure or quantify in-kind contributions, the qualification must be clearly described.

E. Entity Financial Statements

27. 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 monitoring¹², such entity will submit to ADB the audited entity financial statements.

28. The purpose of this requirement is to allow ADB to monitor the use of loan or grant proceeds and to satisfy itself of the on-going financial viability and sustainability of the project and the executing or implementing agency. In particular, related financial statements would be required to substantiate compliance with any corporate-related financial covenants that are incorporated into the legal agreement(s) (e.g., debt-service-coverage ratio, self-financing ratio, number of days in accounts receivable).

F. Consolidated or Combined Financial Reporting

29. In cases where the project has a number of separate and distinct components implemented by more than one executing or implementing agency, ADB may accept consolidated project financial statements in lieu of the financial statements prepared by each executing or implementing agency, to ensure that the financial information submitted is not fragmented, and hence more reliable, and also collated in a more cost effective manner.

30. The annual APFS may also be incorporated within an independent entity's financial statements. In this case, the entity financial statements which clearly reflect project-specific financial information are acceptable for submission.¹³

V. AUDIT REPORTS, SUBMISSION, REVIEW AND PUBLIC DISCLOSURE

A. Auditor's Communication (the Audit Report)

31. The audit report is a means by which the auditor fulfills its responsibility to those charged with governance. The structure, form and content of the audit report will vary from auditor to auditor and from jurisdiction to jurisdiction. At a minimum, however, it will include the necessary auditor's opinions, 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.

¹²This 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. See OM G2/BP, paragraphs 5 and 7.

¹³Where project financial statements are integrated as part of the entity's financial statements, the project components must be identifiable through disclosure or supplementary schedule summarizing the sources and uses of funds of the project. In addition to the auditor's opinion on the financial statements of the entity, separate auditor's opinion will be provided on the project.

32. Given the provisions of ADB's Public Communications Policy, 2011 (PCP)¹⁴, it is recommended that auditors provide a separate standalone opinion on the project financial statements, and a separate opinion for all specific additional requirements (see paragraph 36).

1. Auditor's Opinions

33. The auditor's opinion on the financial statements will state the auditing standards or practices under which the audit was conducted. 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. If national auditing standards do not conform to internationally acceptable auditing standards, supplementary auditing and reporting procedures will be requested.

34. The auditor's opinion will also contain a clear expression of the auditor's opinion as to whether the financial statements present fairly, in all material respects, or give a true and fair view of the project's or entity's financial position, its financial performance and cash flows. When forming an opinion and reporting on the project financial statements, the auditor shall apply the requirements of ISA 700 "Forming an Opinion and Reporting on Financial Statements"¹⁵ for a clean opinion, or ISA 705 "Modifications to the Opinion in the Independent Auditor's Report"¹⁶ for a modified opinion (qualified, adverse or disclaimer of opinion), or their national equivalents.

35. Where the audit report has been issued under ISA 800¹⁷ or ISSAI 1800¹⁸ "Special Considerations — Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks", it shall include the mandatory Emphasis of Matter paragraph alerting users of the audit report that the project financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for a different purpose. The auditor shall include this paragraph under an appropriate heading.

36. The assurances required by ADB will be governed by the International Standard on Assurance Engagements (ISAE) 3000 "Assurance Engagements other than Audits or Reviews of Historical Financial Information"¹⁹ issued by the IASB, ISSAI 4200 "Compliance Audit Related to the Audit of the Financial Statements"²⁰ issued by the International Organisation of Supreme Audit Institutions (INTOSAI), or national equivalents. ADB requires a reasonable assurance engagement to be conducted under these standards. Limited assurance engagements are not acceptable.

¹⁴ ADB. 2011. *Public Communications Policy*. Manila.

¹⁵ IAASB. 2015. Forming an Opinion and Reporting on Financial Statements. *International Standard on Auditing 700 (Revised)*. New York.

¹⁶ IAASB. 2015. Modifications to the Opinion in the Independent Auditor's Report. *International Standard on Auditing 705 (Revised)*. New York.

¹⁷ IAASB. 2010. Special Considerations—Audits of Financial Statements Prepared In Accordance with Special Purpose Frameworks. *International Standard on Auditing 800 (Revised)*. New York.

¹⁸ INTOSAI. 2007. Special Considerations—Audits of Financial Statements Prepared In Accordance with Special Purpose Frameworks. *International Standards of Supreme Audit Institutions*. Mexico.

¹⁹ IAASB. 2013. Assurance Engagements Other than Audits or Reviews of Historical Financial Information. *International Standard on Assurance Engagements 3000 Revised*. New York.

²⁰ INTOSAI. 2010. Compliance Audit Guidelines - Compliance Audit Related to the Audit of Financial Statements. *International Standards of Supreme Audit Institutions*. Johannesburg.

37. The auditor's opinions will include, at a minimum, the following elements: (i) title, (ii) addressee (executing agency and/or borrower), (iii) identification of the financial information audited, (iv) management's responsibility, (v) description of the auditor's responsibility, (vi) expression of an opinion, (vii) auditor's signature, (viii) date of the auditor's report, and (ix) the auditor's address.

38. The auditor will, during the course of the audit, pay particular attention to the following:

- (i) The use of external funds in accordance with the relevant legal and financing agreements.
- (ii) The provision of counterpart funds in accordance with the relevant agreements and their use only for the purposes intended.
- (iii) The maintenance of proper books and records.
- (iv) The existence of project fixed assets and internal controls related thereto.
- (v) Where reasonable assurance has been provided using ISAE 3000 or ISSAI 4200, the assurance report must contain, among others:
 - A statement that the engagement was performed in accordance with ISAE 3000 or ISSAI 4200,
 - Subject matter,
 - Criteria for measurement,
 - A summary of the work performed, and
 - The auditor's conclusion.
- (vi) On the imprest fund procedure (where applicable), audit procedures are planned and performed to ensure (i) the imprest account (and any sub-accounts) has been managed in accordance with ADB's Loan Disbursement Handbook²¹, (ii) the cash balance of the imprest account (and any sub-accounts) is supported by evidence, (iii) the expenditures paid from the imprest account (and any sub-accounts) comply with the approved project purpose and cost categories stipulated in the loan agreement, and (iv) the amount of expenditures paid from the imprest account (and any sub-accounts) comply with the disbursement percentages stipulated in the loan agreement.
- (vii) Adequate supporting documentation has been maintained to authenticate claims stated in the SOE for reimbursement of eligible expenditures incurred and liquidation of advances provided to the imprest account (where applicable).
- (viii) On the SOE procedure (where applicable), audit procedures are planned and performed to ensure (i) the SOEs have been prepared in accordance with ADB's Loan Disbursement Handbook²², (ii) the individual payments for expenditures stated in the SOE are supported by evidence, (iii) the expenditures stated in the SOEs comply with the approved project purpose and cost categories stipulated

²¹ Footnote 9.

²² Footnote 9.

in the loan agreement, and (iv) the amount of expenditures stated in the SOEs comply with disbursement percentages stipulated in the loan agreement.

- (ix) Any weaknesses in internal controls over the procurement process.

2. The Management Letter

39. ADB requires the executing agency and/or implementing agency to provide a copy of the auditor's management letter. At the minimum, this will include:

- (i) any weaknesses in the accounting and internal control systems that were identified during the audit, including any irregularity in the use of the imprest fund and SOE procedures (where applicable);
- (ii) any identified internal control weaknesses related to the procurement process such as, over the bidding, evaluation and contract management domains;
- (iii) recommendations to rectify identified weaknesses;
- (iv) management's comments on the audit recommendations along with the timeframe for implementation;
- (v) the status of significant matters raised in previous management letters;
- (vi) any other matters that the auditor considers should be brought to the attention of the project's management; and
- (vii) details of any ineligible expenditure²³ identified during the audit. Expenditure is considered ineligible if it refers to expenditures incurred for purposes other than the ones intended under the legal agreement(s); expenditures not allowed under the terms of the legal/financing agreements; and expenditures incurred in violation of applicable government regulations.

40. In cases where a management letter is not received for the entity as a whole, then a management letter covering internal controls and procedures associated with the preparation of the project financial statements is required and will be submitted together with the APFS.

B. Deadlines for Submitting the Audited Financial Statements

41. The APFS should be submitted to ADB annually within 6 months following the end of the fiscal year from the date of loan effectiveness until the loan closing date. On an exceptional basis, this reporting deadline may be extended to up to 9 months from fiscal year-end after concurrence by the Operations Services and Financial Management Department (OSFMD), in cases of decentralization where logistical considerations impact the physical flow of information. The financial management assessment during project processing will include the justification for the extension of the reporting deadline.

²³ If the auditor reports any ineligible expenditure in the management letter, the details of the findings should include the funding source to which the observation relates.

42. As state-owned enterprises are expected to operate on commercial principles, no extensions beyond 6 months will be considered for APFS submissions.

43. The submission of the APFS is required for all projects regardless of size or number of financial transactions that occur within a year. However, in exceptional cases supported by sufficient justification, the borrower, executing agency and/or implementing agency may request for a deferment of the submission of the first APFS. A request for deferment will be processed in accordance with PAI 5.07 *Project Reporting and Auditing of Loan- and Grant-Financed Projects*. The final APFS will include all eligible expenditures incurred up to the loan closing date. Please refer to **Appendix 1** for an illustrative example in this regard.

44. The AFS of an independent entity 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 within 1 month of their approval by the relevant authority.

45. The auditor can help facilitate the process of early submission by agreeing with the executing agency on the period of time within which an auditor's report is to be provided in order to meet the deadline.

C. Review Arrangements

(i) Reviewing the Audited Project Financial Statements

46. When reviewing audit submissions, ADB reviewer will consider four principal features: (i) form and timeliness of the report; (ii) quality and nature of the auditor's opinion; (iii) audit scope, significant financial reporting policies, audit modifications, and other matters addressed by the auditor; and (iv) substance of the emphasis of matter paragraph, if any.

47. The auditor's opinion will not be the basis for determining the acceptability or non-acceptability of the submitted APFS. In the case of any modification to the auditor's opinion, and when there is an emphasis of matter paragraph, the ADB reviewer will determine the implication of the modification and/or emphasis of matter. Of particular concern are issues pertaining to use of project funds. Any qualifications in the auditors' opinion will be reviewed as soon as possible and used as a basis to develop an action plan for future rectification. If the borrower or executing agency is unable or unwilling to take corrective action, the ADB sector or country director, after investigating the reasons, will follow the actions recommended in cases of noncompliance with covenants provided in the Regulations²⁴ and in PAI 4.03 *Suspension and Cancellation of Loans*.

48. The rejection of APFS or audit reports is an exceptional event. The project team leader should consult with the Financial Management Unit (OSFM) of OSFMD before taking such a step.

2. Reviewing Management Letters

49. The ADB reviewer will review each management letter and note any matters to which the auditor has drawn attention that may adversely affect project implementation, the operations

²⁴ ADB. 2001. *Ordinary Operations Loan Regulations*. Manila; ADB. 2005. *Special Operations Grant Regulations*. Manila; ADB. 2006. *Special Operations Loan Regulations*. Manila.

of the executing and implementing agency, and the level of fiduciary risks to which the project and ADB are exposed. The review will note the executing and implementing agencies' response to the auditor's findings and any action taken to address the issue. Failure to act or inadequate action taken by the executing agency and/or implementing agency will prompt the sector or country director to pursue appropriate measures that will fully address the situation.

3. Reviewing the Audited Financial Statements

50. The review of an independent entity's AFS is aimed at determining the entity's continuing capability to implement, operate and maintain the ADB-financed project. This will include reviewing the auditor's opinions, any matters deemed relevant by the auditors for disclosure, and analyzing the financial information provided in the financial statements including disclosures in the notes to the financial statements.

51. The review will also include an assessment of compliance by the entity with the financial covenants in the legal agreement(s), where applicable.

52. The ADB reviewer will be alert to movements or trend in movements over time, and in financial indicators that may have any adverse effect on the project's success such as declining institutional capability, signs of decline in the entity's financial performance, and threats to the entity's continuing operations (as a going concern). Such issues will be highlighted when documenting the results of the review and will be communicated to the sector or country director together with the proposed recommendations aimed to address the issues.

D. Public Disclosure

53. ADB's public communications policy²⁵ requires posting on its website of the annual APFS for sovereign projects for which the invitation to negotiate was issued on or after 2 April 2012. The procedures for disclosing these APFSs are discussed and agreed with each borrower and made part of the loan agreement for each project.

54. For DMCs where the APFS are to be submitted first to a government legislature (hence risking substantial delays in submission to ADB), unaudited project financial statements will be submitted to ADB within the agreed timeframe. However, unaudited financial statements should not be used to determine compliance with the financial covenants. The executing or implementing agency should submit the audited financial statements and related documents to ADB within the timeframe agreed with ADB. OSFMD and OGC will be consulted if there is any proposed revision to the financial covenants.

55. Only the auditor's opinion on the audited project financial statements, and the audited project financial statements and associated notes will be disclosed. The additional auditor's opinions, the AFS, and the management letter will not be disclosed²⁶.

²⁵ Footnote 14.

²⁶ This type of information would generally fall under public communications policy exceptions to disclosure. ADB. 2011. *Public Communications Policy*. Paragraph 97(iv) and/or 97(v).

**Preparation of the Final Audited Project Financial Statements
under the Cash Basis of Accounting
Sample Note to the Audited Project Financial Statements²⁷**

Note xx: Other Information: Total Estimated Expenditures at Loan Closing Date

The total estimated project expenditures as of 30-September-2014 (**reporting date**) amounts to **LCU xxx**. Of this amount, **LCU xxx** refers to amounts specified in the invoices, contracts, and other documents that are paid after the reporting date, and which amounts relate to funding of the expenditures incurred and committed as of 30-September-2014 (**loan closing date**).

**Table 1: Schedule of Total Estimated Project Expenditures
In LCU millions**

	Expenditures Recorded and Paid to 30-Sep- 2014 ^a (a)	Estimated Expenditures Paid Subsequent to 30-Sep-2014 ^b (b)				Total Estimated Expenditures Incurred to 30-Sep- 2014 ^c (c) = (a) + (b)
		ADB	Governme nt	Cofinancier 1	Cofinancier n	
Audit fees	0.0	10.0	0.0	0.0	0.0	10.0
Civil works	100.0	20.0	30.0	0.0	0.0	150.0
Consulting services	100.0	20.0	10.0	0.0	0.0	130.0
Project management	50.0	0.0	10.0	0.0	0.0	60.0
.
Total	300.0	40.0	40.0	0.0	0.0	380.0

^a The cumulative total project expenditures that have been paid and reported in the project financial statements to loan closing date (30-September-2014).

^b The amount of project expenditures that have been incurred or committed but remains unpaid as of loan closing date [30-September-2014]. These amounts were estimated from outstanding invoices, contracts, and other supporting documents, and include retention monies payable as of loan closing date [30-September-2014].

^c The sum of the project expenditures incurred or committed to loan closing date (30-September-2014), whether paid or unpaid.

²⁷ ADB. 2015. Financial Reporting and Auditing of Loan- and Grant-Financed Projects. *Project Administration Instructions*. PAI 5.07. Manila. Paragraph 21 and footnote 13.