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FINANCIAL MANAGEMENT AND SUSTAINABILITY

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General concepts and considerations



Overall Context

2018 Development Effectiveness Review:

Insufficient funds the most pressing barrier to sustainability.

Of the operations deemed less than likely sustainable, 86% cited insufficient financing and funding for operation and maintenance (O&M) as a factor affecting sustainability. This was a common constraint in almost all sectors. Inadequate capacity of agency and staff responsible for O&M and weak institutions and governance also reduced the likelihood that the outputs and outcomes would be sustained.

ADB President. PLANNING DIRECTIONS for 2019 and Preparation of Work Program and Budget Framework, 2020–2022:

Strengthening sovereign project financial management. *ADB will ... adhere to the highest standards of transparency and accountability, and to help build DMC capacity in financial management.*



Financial Management – Scope

Resource management

- Management capacity
- Accountability – reporting, auditing

Resource allocation

- Cost estimates
- Viability
- Sustainability



Benefits of strong FM systems

- ✓ Vital for realizing project benefits
- ✓ Good project management
- ✓ Good project FM = better entity FM capacity
- ✓ Good FM is one of the pillars for good governance



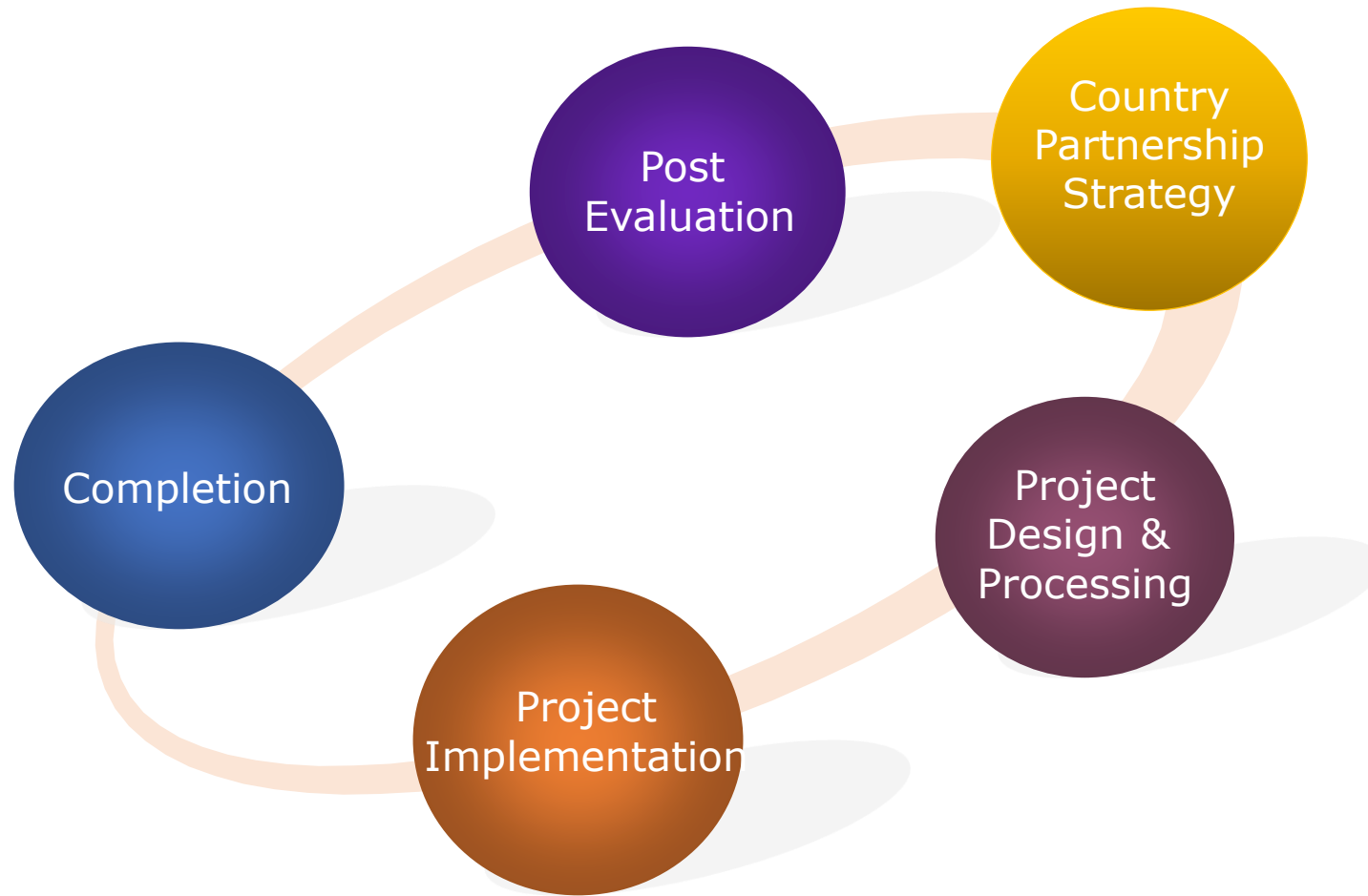
ADB Requirements

Article 14 of the Agreement Establishing the ADB (“The Charter”)

- Borrower able to meet obligations under loan
- Loan proceeds used for purposes intended
- Attention to economy and efficiency
- Guided by sound banking principles in operations



FM during Project Cycle



Due Diligence

exercising an appropriate degree of care

Financial Due Diligence

appropriate degree of care
*in assessing
financial management,
sustainability and viability*





Basis of ADB's
financial due diligence:

- ✓ Projects should NOT become a drain on public coffers



Scope of Financial Due Diligence

- *Financial Management Assessment*
- *Cost Estimates and Financing Plan*
- *Financial Analysis*
- *Financial Evaluation*
- *Funds Flow, Accounting and Audit arrangements*



Fiduciary Responsibility and Risk

Original

Fiduciary responsibility – a legal obligation of one party to act in the **best interest** of another.



Fiduciary risk – the danger that fiduciary responsibility is not fulfilled.

- ❖ Funds not used for intended purposes
- ❖ Value for money not achieved
- ❖ Property is uncounted for.



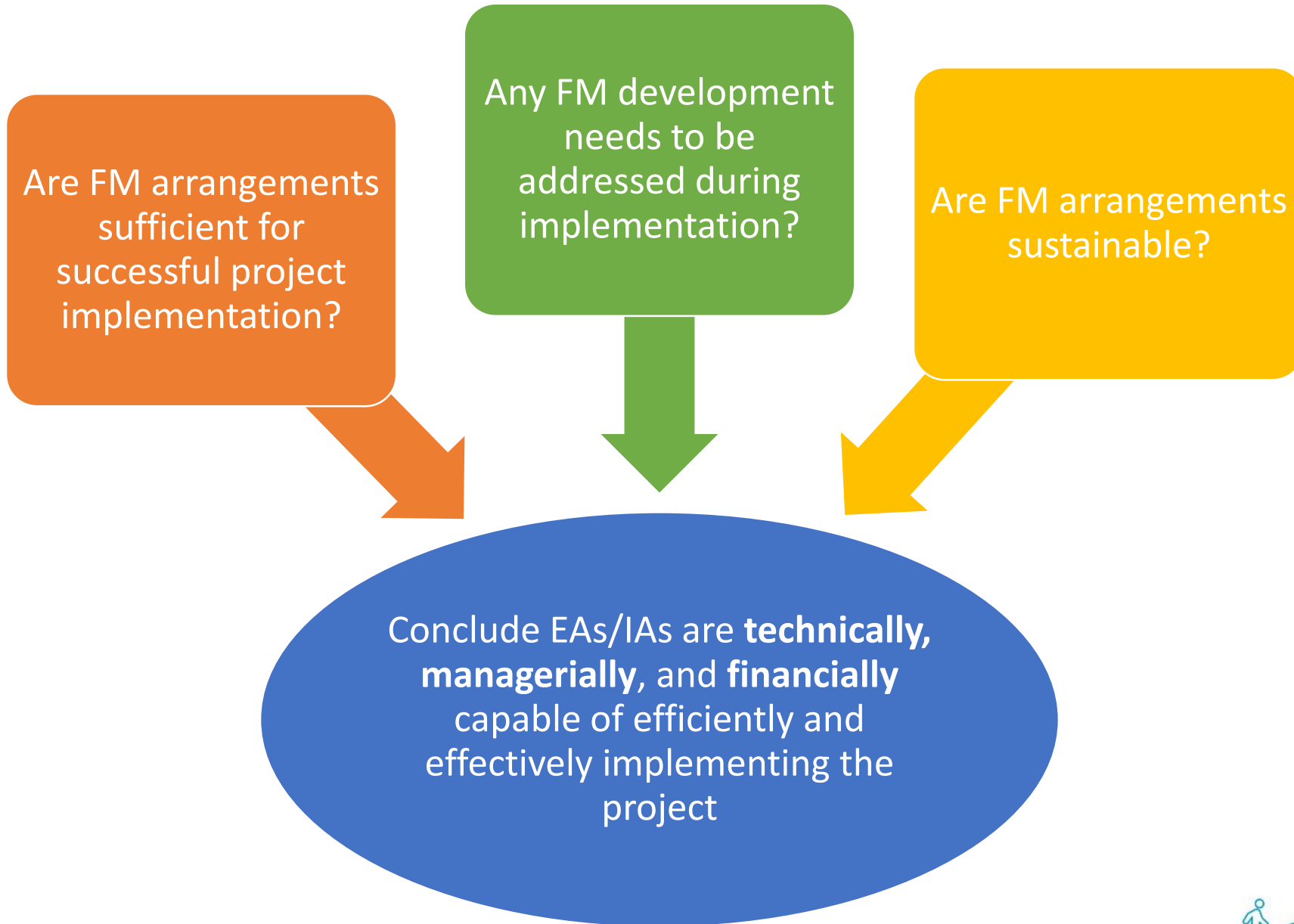
Resource management



Financial management assessment



Objective of FMA



Financial Management

Processes involving:

planning, organizing, directing, controlling
the financial activities and
managing resources.



Elements of Sound Financial Management

Planning and budgeting. Realistic, linked to policy, orderly and predictable.

Accounting and financial reporting. Records maintained, reports produced and disseminated.

Treasury management and funds flow. Adequate and timely funds are available.

Internal control (including internal audit). (i) monitor, evaluate, and validate results; and (ii) exercise control and stewardship of funds.

External audit. Adequate independent audit and verification arrangements are in place



Risk Assessment



Likelihood of Occurrence

Likely	Moderate Risk – Monitoring	High Risk – Mitigation
Unlikely	Low Risk – Documentation	Substantial Risk – Mitigation and/or Monitoring
	Low	High

Impact



Accountability Reporting and auditing



FM Reporting and Performance Management

Project Implementation => **Implement Agreed Arrangements**

Audited Project Financial Statements	annually, 6 months after fiscal year end
Audit Opinion on use of loan proceeds	annually, 6 months after fiscal year end
Management Letter	annually, 6 months after fiscal year end
Audited Entity Financial Statements	12 months after fiscal year end or within 1 month of their approval by the relevant authority, whichever is earlier
Audit Opinion on compliance with financial covenants	annually
Financial information in project progress report	monthly/quarterly/semi-annually, as agreed in PAM



Why Audited Financial Statements?

Accountability for use of public funds

Funds are used for the purposes intended

Due attention to economy and efficiency

To verify compliance with covenants

Reliable financial information

ADB's Access to Information Policy



Selection of the Auditor

Impartial and independent

- Not providing significant non audit services
- No close relationships or affiliations

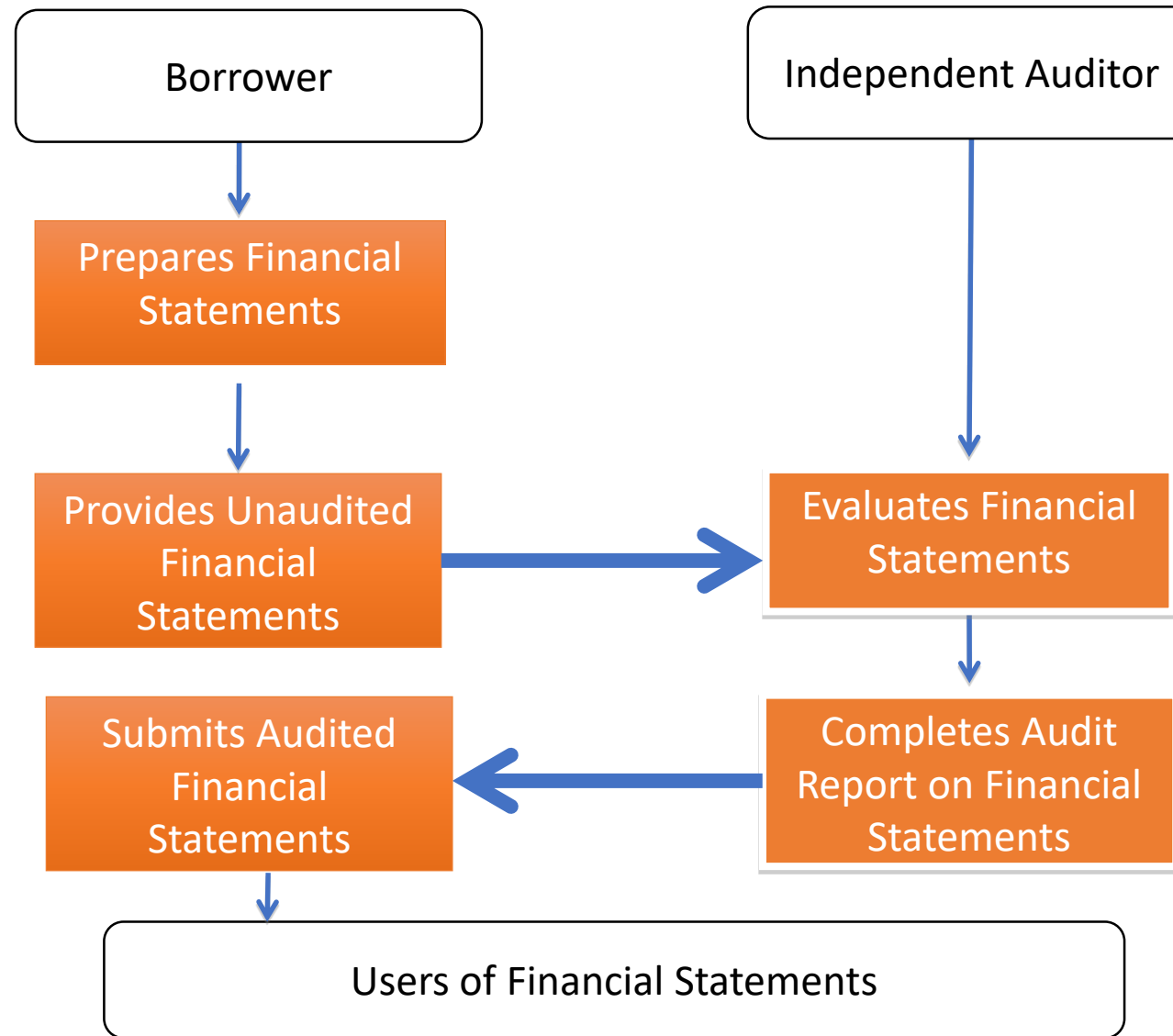
Well-established and reputable; use procedures conforming to international auditing standards

Demonstrate experience in auditing accounts and financial statements

Propose/assign the audit work to competent personnel



Responsibilities of the Borrower and the Auditor



Recurring Issues in APFS reporting



- Late submission
- Project Financial Statements are not complete (do not include required data)
- Audit Opinion not entirely in line with ISSAI/ ISA
- Auditor's opinions do not cover the following:
 - Use of loan proceeds
 - Compliance with financial covenants
- Non-submission of audited entity financial statements, where required
- No Management Letter
- No follow up of the implementation of the previous year's issues



Implementation of FM Arrangements

Financial Management Risk Mitigating Measures	Implementation of FM Action Plan
Cost Estimates	Actual vs. Budget Analysis and Cost Estimates update
Project Financing Plan	Availability of counterpart funds; Disbursements procedures
Financial Reporting and Audit	Regular reporting of financial results of the project; managing of Auditor contract; timely submission of Project and Entity Audit Reports
Financial Covenants - Ratio Analysis	Analysis and forecast of financial ratios, monitoring of entity financial position



Resource Allocation



Cost estimates and financing plan



Cost estimates Guiding Principles

The foundation for project financing

Prepared at concept stage then refined and updated during implementation

Follow cost categories/chart of account of EA

Practicability of collecting actual incurred costs during implementation

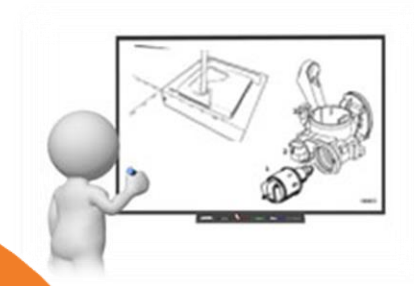
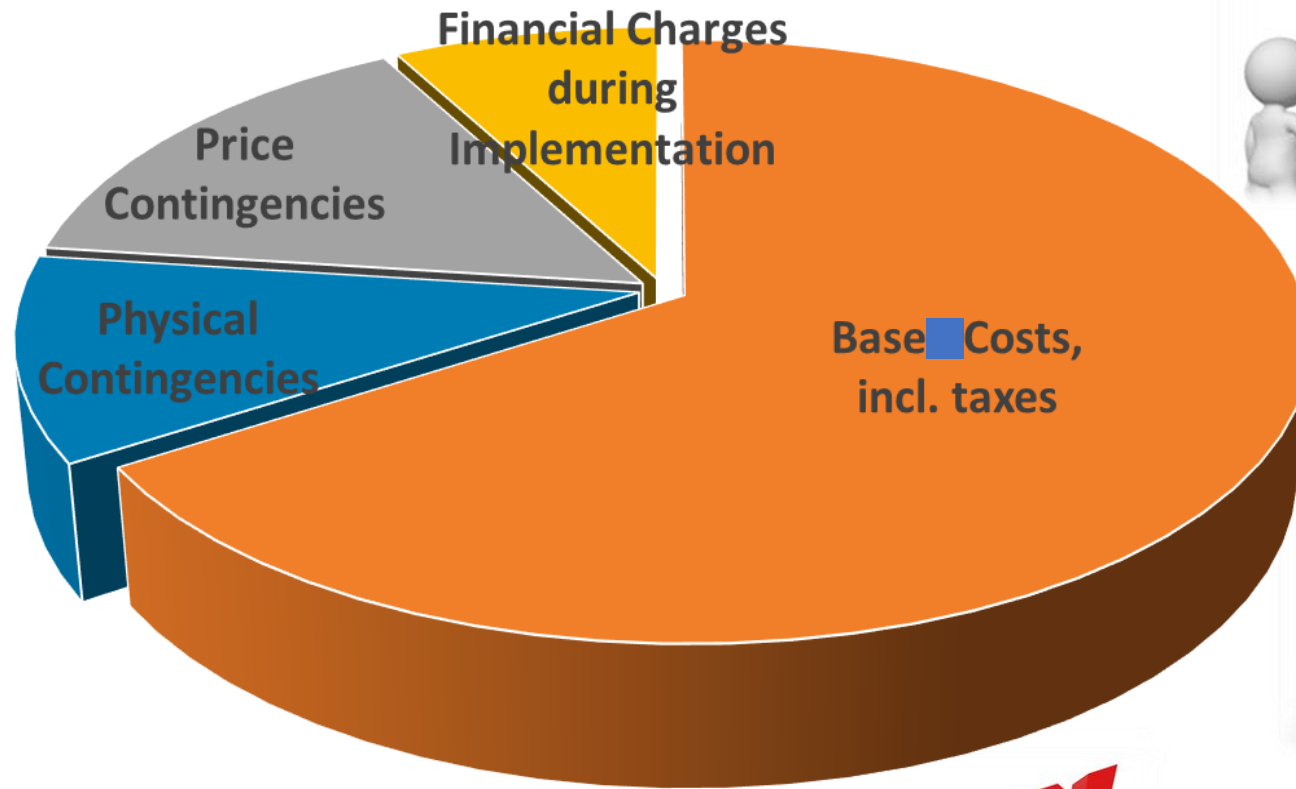
Prepared using spreadsheet packages

Ownership, currency and timeliness

Cash vs. Accrual based accounting



The Components of Project Cost Estimates



TAX

A 3D white figure is running towards the large, bold, red text 'TAX'.



Costs and Procurement

Cost Estimates

- Accuracy (e.g., schedule of rates)
 - Timing
- Speed of project processing



Procurement

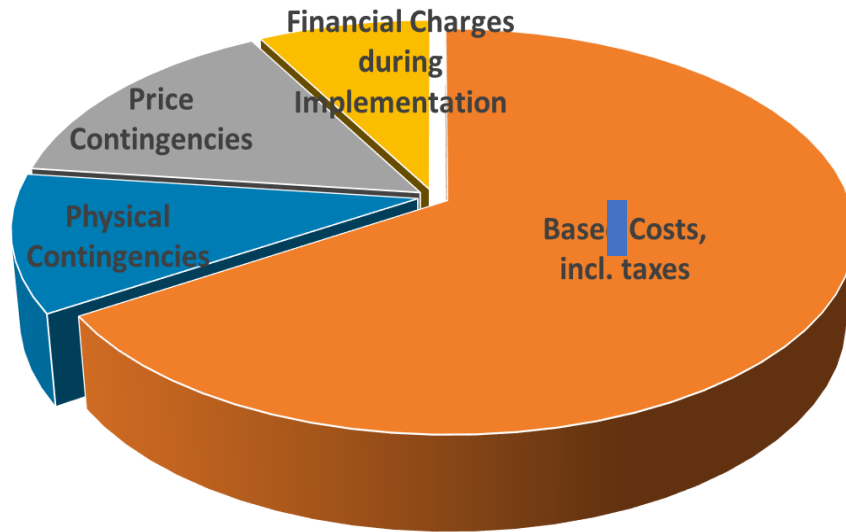
- Prices vs. Cost Estimates
- Delays in procurement

IMPROVEMENTS: Project Readiness Facility

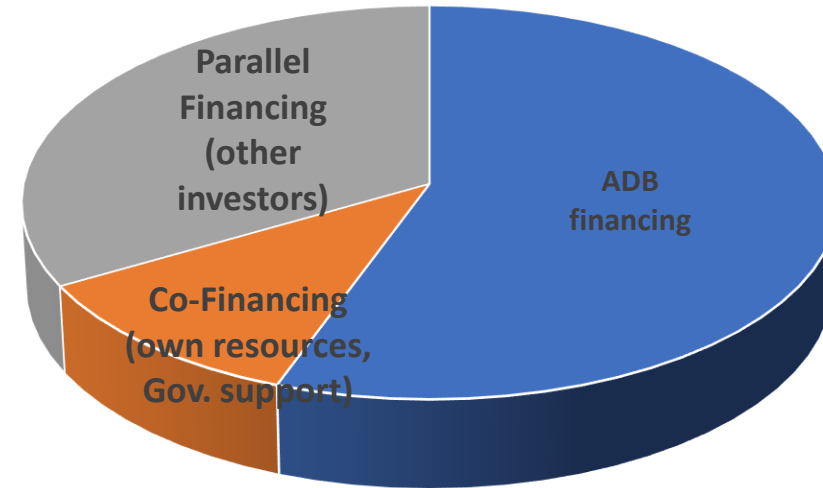


Project Financing

Cost Estimate



Financing Plan



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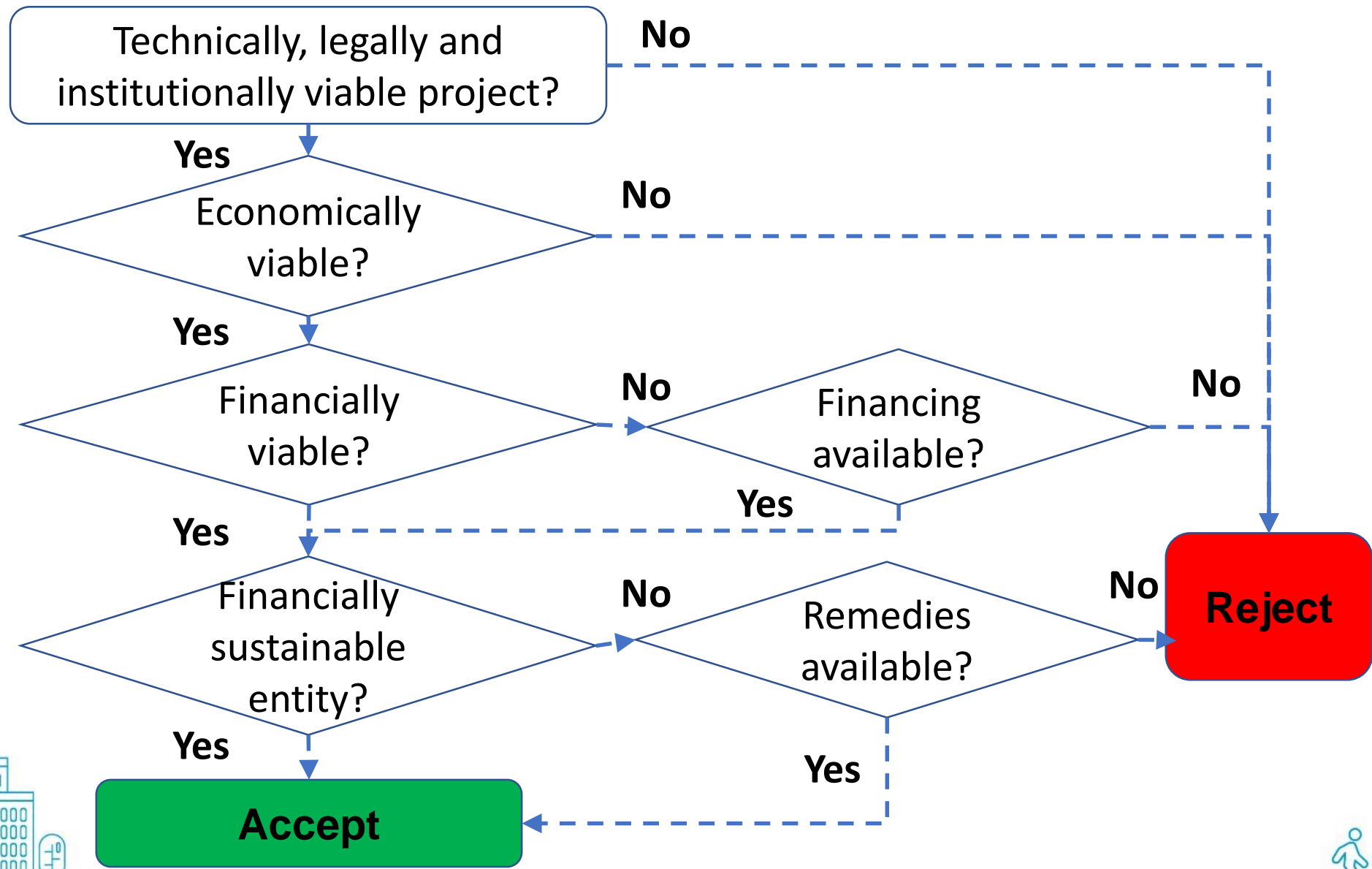
Circular relationship between Financing Plan and Cost Estimate:
FCDI depend upon source of funds, but
the total cost needs to be determined to establish the total finance needed



Sustainability analysis



The investment decision-tree



Key objective - Sustainability

From analysis of historical and projected financial information, assess

- Capacity to fund recurrent costs.
- Remain a going concern.



SUSTAINABILITY



SUSTAINABLE DEVELOPMENT GOALS



ACHIEVING A PROSPEROUS, INCLUSIVE, RESILIENT, SUSTAINABLE ASIA AND THE PACIFIC

Summary Performance Scorecard, 2017

Development Progress in Asia and the Pacific (Section 1 Level 1)		ADB		CA	
Item	ADB	CA	ADB	CA	CA
Poverty	70% ↑ 10% ↑ 20%	50% ↓ 50%	50%	0%	0%
Other development outcomes	36% ↑ 64% ↑ 0%	17% ↓ 83%	0%	0%	0%
ADB's Development Effectiveness (Section 2 Levels 2-4)					
ADB's Contributions to Development Results (Level 2)					
Country assistance programs successfully completed			●	●	
Results in Strategy 2030 core operational areas achieved			●	●	
ADB's Operational Management (Level 3)					
Operations satisfactorily implemented			●	●	
High-quality country strategies and operations prepared			●	●	
Development finance mobilized and transferred			●	●	
ADB operations focused on strategic agendas and core operational areas			●	●	
ADB operations promote drivers of change			●	●	
ADB's Organizational Management (Level 4)					
Sufficient staff resources maintained, and staff motivation and diversity increased			●	●	
Budget efficiency and adequacy improved			●	●	
Business process efficiency and client orientation improved			●	●	

● = progressed above the baseline, ↑ = no significant progress, ↓ = declined from the baseline, ● = good, ○ = mixed, ○ = poor

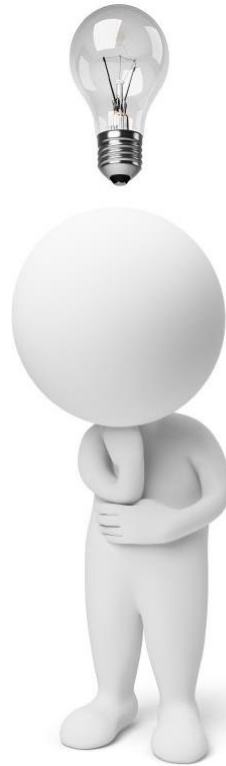
ADB - Asian Development Bank, CA - ADB operational assistance
Source: ADB Strategy, Policy and Review Department

CORPORATE RESULTS FRAMEWORK



CRUMBLING INFRASTRUCTURE

- Reason: chronic underfunding of O&M for roads
- It is easy to borrow money for capital works, but very difficult to borrow for O&M



Road-sweeping machines imported to clean city streets dumped for want of maintenance

City Municipal Corporation imported 12 road-sweeping machines 8 years ago for \$2,400,000 (MDB loan).

8 years later, all machines now unused in garage.

Reason: Lack of budget to maintain the machines, or even for drivers.

WHY Sustainability MATTERS



Evaluate Project Sustainability

Can the project fully meet its O&M costs, and also debt service, from its revenues?

Would it require top-ups – by way of subsidy / cash injection from its parent or viability gap funding from the government?

ADB will include realistic covenants to secure such additional funds and project sustainability



Types of Financial Analysis

Entity Type	Financial Analysis
General Government Sector Unit	Incremental recurrent cost analysis
Public or private corporation, NGO	Financial statement analysis



Incremental Recurrent Cost Analysis

Incremental cost requirement

- Additional working capital
- Operating and maintenance costs

Resource availability

- Tariff / Sales revenue
- Viability gap funding
- Subsidies
- Other sources

Fiscal headroom of the government / EA/IA in nominal terms (with inflation)



Financial evaluation



Project Financial Evaluation — When is it Required?

Each component to be independently evaluated

Full cost recovery objective is essential

For partial cost recovery, only recurrent cost analysis



Project Financial Evaluation Approach

- 1 • Prepare cost estimates
- 2 • Forecast incremental cash flows
- 3 • Compute WACC
- 4 • Compute FNPV and FIRR
- 5 • Conduct sensitivity analysis
- 6 • Evaluate financial sustainability





Thank you.

