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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. 86% cited insufficient financing O&M.*

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



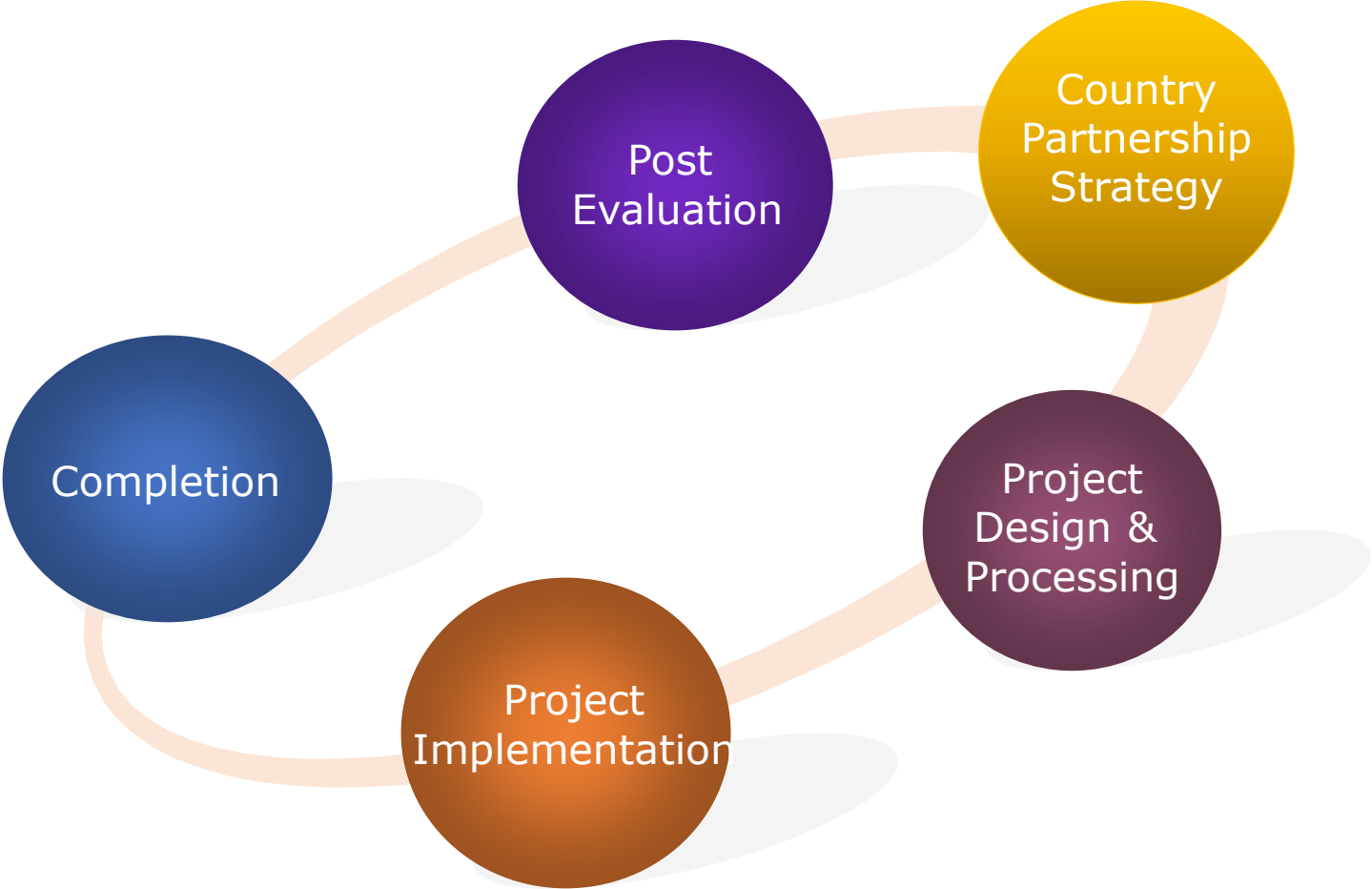
# ADB Requirements

## 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*







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## 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 unaccounted for



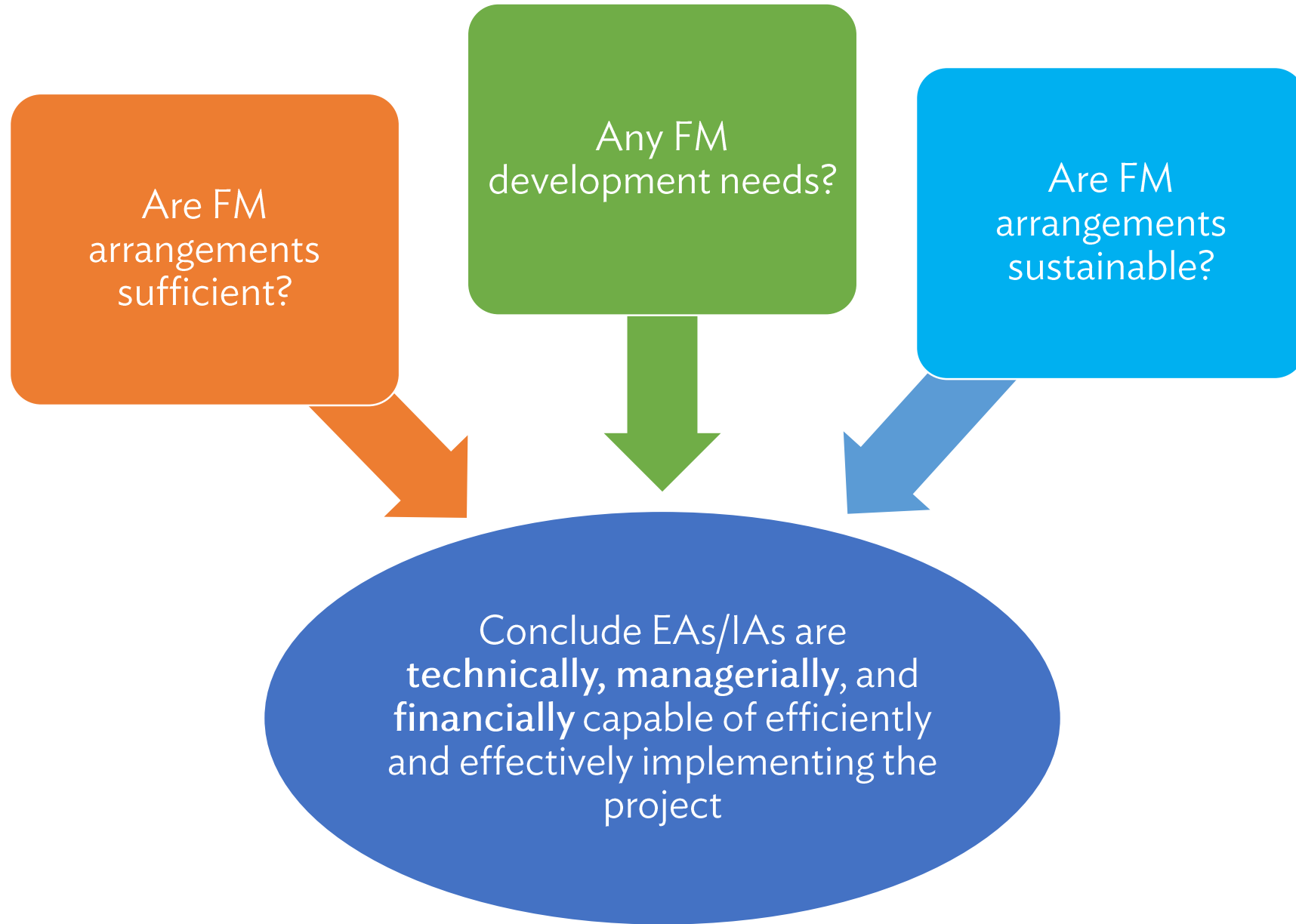
# Resource management



# 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.

Accounting and financial reporting.

Treasury management and funds flow.

Internal control (including internal audit).

External audit.





# Risk Assessment



	Likely	Moderate Risk – Monitoring	High Risk – Mitigation
Likelihood of Occurrence	Unlikely	Low Risk – Documentation	Substantial Risk – Mitigation and/or Monitoring
		Low	High
		Impact	



# Accountability Reporting and auditing



# FM Reporting

Audited project financial statements, opinion on use of loan proceeds, management letter

Audited entity financial statements and opinion

Audit opinion on compliance with covenants

Periodic progress reports



# Why Audited Financial Statements?

Accountability

Intended purpose

Economy and  
efficiency

Covenant  
compliance

Public Disclosure



# Selection of the Auditor

## Impartial and independent

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

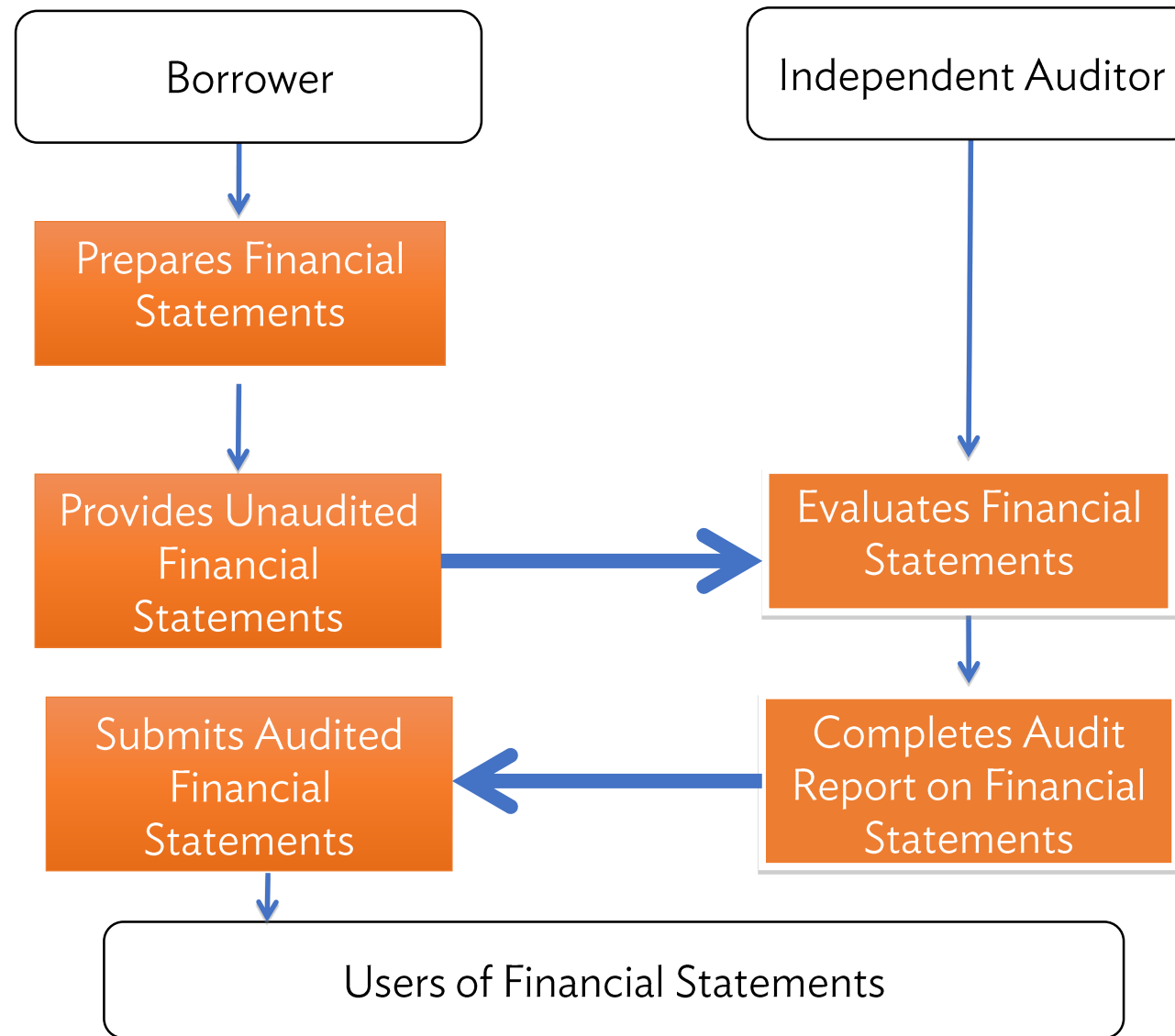
Well-established and reputable; use procedures conforming to international auditing standards

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



# Resource Allocation





# Cost estimates and financing plan



# Cost estimates Guiding Principles

The foundation for project financing

Prepared at concept stage, regularly updated

Follow chart of account of EA

Practicability of collecting actual data



# Cost estimates Guiding Principles

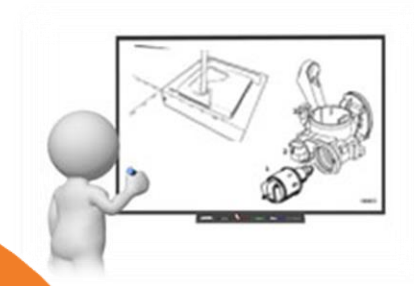
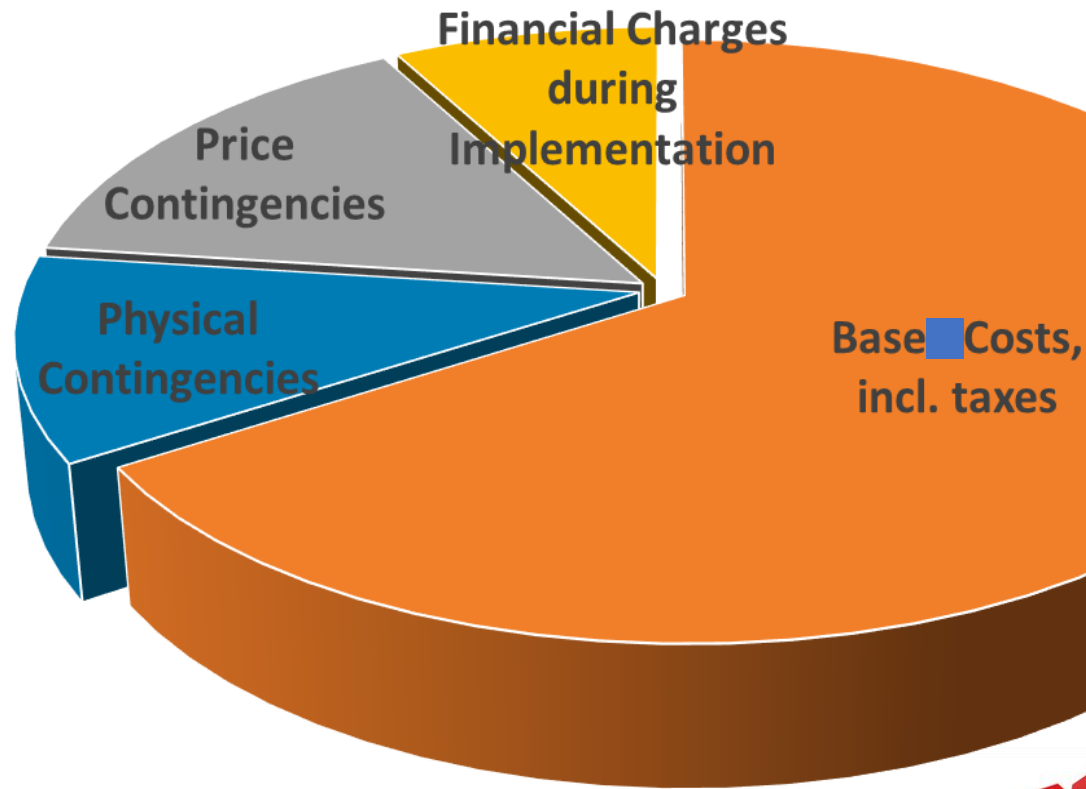
Prepared using spreadsheet packages

Ownership, currency and timeliness

Cash vs. Accrual based accounting



# The Components of Project Cost Estimates



# Costs and Procurement

## Cost Estimates

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



## Procurement

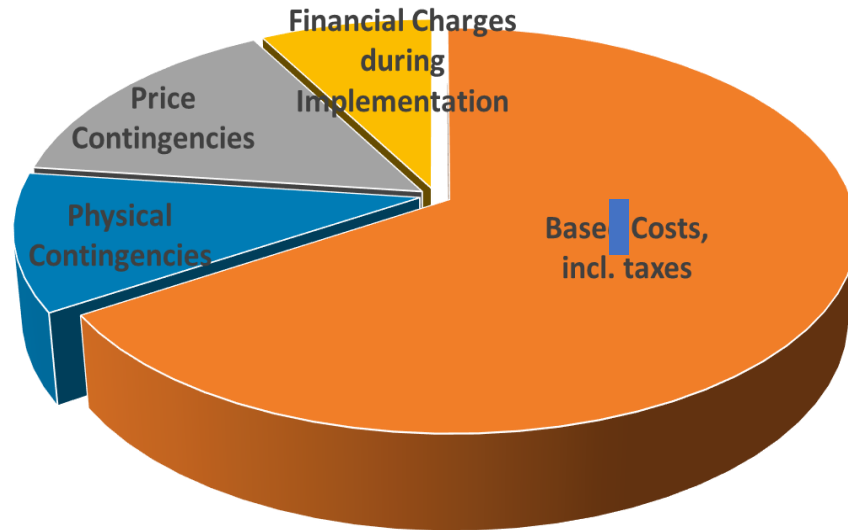
- Prices vs. Cost Estimates
  - Delays in procurement

IMPROVEMENTS:  
Project Readiness Facility



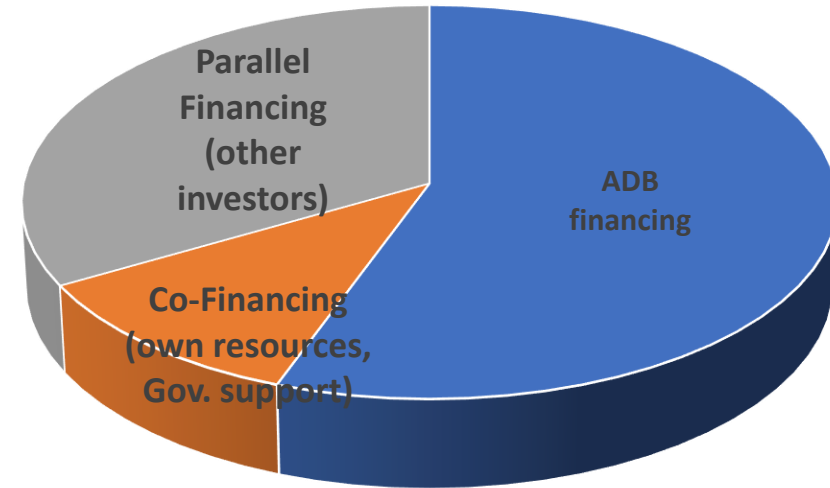
# Project Financing

## Cost Estimate



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## Financing Plan



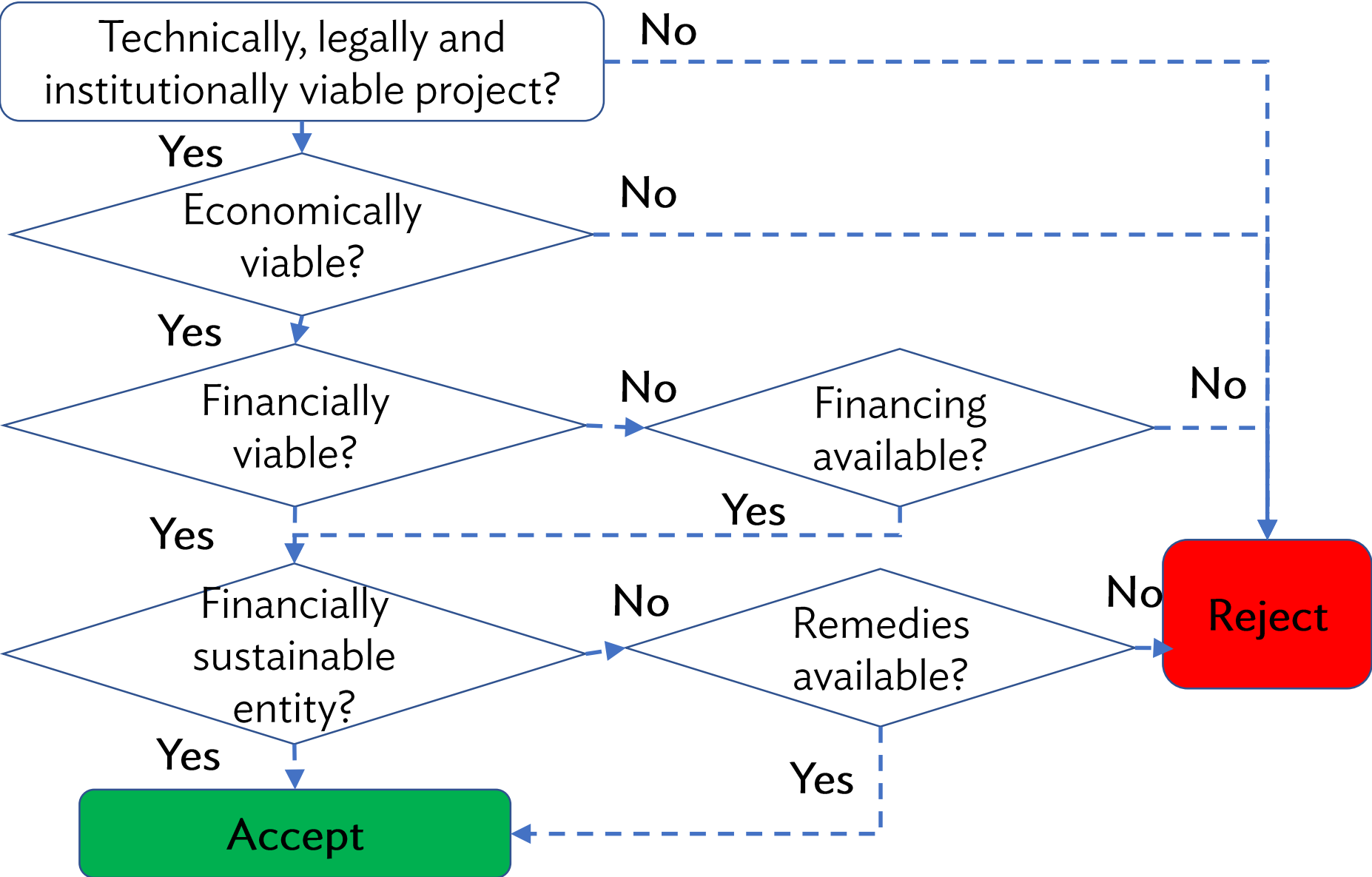
Circular relationship between Financing Plan and Cost Estimate:  
FCDI depend upon source of funds, but  
the total cost needs to be determined to establish the total finance needed



# Sustainability analysis



# The investment decision-tree







Just after project completion



5 Years after project completion



# SUSTAINABILITY



## SUSTAINABLE DEVELOPMENT GOALS



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

Summary Performance Scorecard, 2019	
Development Progress in Asia and the Pacific (Overall Level 1)	
Item	ADB CA
Poverty	70%  50%  20%  50%  50%  0%  0%
Other development outcomes	36%  64%  0%  0%  83%  0%  0%
ADB's Development Effectiveness (Overall 2-4)	
ADB's Contributions to Development Results (Level 2)	
Country assistance programs successfully completed	
Results in Strategy 2020 core operational areas achieved	
ADB's Operational Management (Level 3)	
Operations satisfactorily implemented	
High-quality country strategies and operations prepared	
Development finance mobilized and transformed	
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	

(G) = progressed above the baseline, (O) = no significant progress, (R) = declined from the baseline, (B) = good, (P) = mixed, (D) = poor.  
 ADB = Asian Development Bank, CA = ADB development assistance.  
 Source: ADB Strategy, Policy and Review Department.

## CORPORATE RESULTS FRAMEWORK



# 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







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