

FINANCIAL MANAGEMENT and GOVERNANCE AND ANTICORRUPTION

DMC Orientation
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Andrew Head
Principal Financial Management Specialist

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What is Financial Due Diligence?

➤ Due Diligence

- Exercising an appropriate degree of care in preparing and appraising projects

➤ Financial Due Diligence

- Broad descriptor covering financial management assessment and financial analysis activities

ADB's Charter

- Due regard to the prospects that the borrower will be in a position to meet their obligations under the loan agreement
- Necessary measure to ensure that the proceeds of any loan are used for their intended purposes
- Due attention to considerations of economy and efficiency
- Guided by sound banking principals

Why is it Financial Due Diligence Important?

- Fiduciary responsibility
- Project Viability
- Project Sustainability
- Financial and Economic

Financial Viability and Sustainability

- Financial Analysis: Comparison of financial benefits (FIRR) to financial costs (WACC) [financial viability]; affordability
- Financial Management Assessment: Capacity of executing agency to effectively manage its financial resources [financial sustainability]
- Public Financial Management: Capacity of Government to effectively manage its financial resources [financial sustainability]

Financial Due Diligence Issues

- Program/Policy based lending
 - Charter still applies
 - Review of PFM systems
- Revenue generating versus non revenue generating
 - Financial analysis for non revenue generating looks at affordability
- Covenants
 - Covenants in and of themselves are not sufficient to ensure sustainability

Financial Management Assessment (FMA)

- Objective – to assess whether or not financial management arrangements are sufficient for purposes of recording transactions, preparing reliable financial statements and for safeguarding assets
- Issues or weaknesses identified need to be taken into consideration either through project design or implementation arrangements

Financial Structuring

- PPP
- Sub Sovereign Lending
- Multi-Tranche Financing Facility
- Local Currency Lending
- Co-Financing
- Securitization

Financial Due Diligence Tools

- Guidelines for Financial Management and Analysis of Projects
- Handbook for Borrowers
- Financial Due Diligence Methodology Note
- Financial Management Assessment Questionnaire
- ADB's Auditing Requirements

Financial Due Diligence Methodology Note

➤ Covers:

- Financial Management Assessment
- Preparation of Cost Estimates
- Preparation of Financing Plan
- Financial Analysis
- Financial Evaluation
- Ratio and Sensitivity Analysis
- ADB's Auditing requirements

Governance and Anticorruption

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Governance and Sustainable Development?

- Poor governance, weak institutions and corruption practices are a threat to sustainable development and therefore poverty reduction
- “ADB recognizes the importance of good governance for equity and pro-poor development. ADB works with partner countries and other donors to strengthen country-led governance and anticorruption programs”

➤ Sept 2006

President Kuroda, 74th Meeting of the Development Committee, Singapore

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Governance Policy

- Approved in 1995, a policy review was undertaken in 2000 and the implementation reviewed in 2005
- Governance involves both public and private sector
- Four basic elements of good governance: accountability, transparency, predictability and participation; and
- Need for flexible country-specific approaches
- Emphasis on institutional and capacity development

Anticorruption Policy

- Adopted by ADB in 1998 and clarified in 2004
- Definition: *ADB defines corruption as the abuse of public or private office for personal gain.*
- Three objectives of the policy:
 - support competitive markets and effective public administration,
 - support explicit anticorruption efforts, and
 - ensure ADB-financed projects and its staff adhere to the highest ethical standards.

Review of the Implementation of the Governance and Anticorruption Policies

➤ Key Findings:

➤ Policies only partially implemented

➤ Two main causes:

- Policies too wide –resources spread too thinly
- We have not invested enough to mainstream the policies in our sector work

Four Critical Action Areas Identified:

- Fill significant gaps in compliance with the Policies
- Build strong partnerships with focus on strengthening country public financial management and procurement systems
- Use of country/sector assessments to determine focus and identify priorities
- Adopt longer term flexible arrangements for institutional and capacity development to address governance and corruption issues

Second Governance and Anticorruption Action Plan (GACAP II)

- GACAP II approved 31 July 2006
- Three governance themes:
 - Public financial management
 - Procurement
 - Combating corruption
- Themes will apply to national and sub-national levels of government and will focus on operationally relevant sectors

GACAP II – Risk Based Approach

- As part of our strengthened approach to country partnership strategies:
 - Governance institutional and corruption risk assessments in key operational sectors
 - Country public financial management and procurement system assessments

GACAP II

➤ Outcomes:

- Governance, institutional and corruption risks inherent in forward sector roadmaps will be known
- Issues which could limit ability to rely on country systems will be identified
- Results could assist client Government's in prioritizing actions and investments needed to strengthen systems and reduce risks over time

GACAP II – Implementation at the Country Level

- Gradual implementation – “learn by doing”
- Most logical and efficient to start with the Sector assessments (rather than focusing at the project level)
- Assessments will be conducted initially in two operationally relevant sectors in five new country partnership strategies
- Criteria for selecting sectors: (i) ADB’s forward lending program; (ii) perceived level of risk in the sector; (iii) country factors; and (iv) Government’s priorities.

GACAP II – Summary

- Borrowing countries bear the bulk of financial and development risk associated with ADB loan financed projects
- GACAP II provides an opportunity to work together to:
 - Identify opportunities for business process reform, capacity development priorities and reduce vulnerability to corrupt practices
 - Support the process of moving towards country systems
 - Create the groundwork for program based or sector wide approaches
 - Support the ongoing work of inspectorates, supreme audit institutions and anticorruption agencies

Q&A



THANK YOU

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