1. INTRODUCTION

1.1 OVERVIEW

Preamble

1.1.1 The African Development Bank is the premier financial development institution in Africa dedicated to combating poverty and improving the lives of the people of the continent and engaged in the task of mobilizing resources towards the economic and social progress of its regional member countries (Bank Group vision). The Bank Group comprises the African Development Bank (the Bank), the African Development Fund (ADF) and the Nigeria Trust Fund (NTF). The Bank recognizes that good governance is essential for sustained pro-poor growth and social and human development of the continent. This vision reflects the belief that unleashing the potential of the poor will substantially contribute to overall growth and enhance the quality of life for all.

1.1.2 The African Development Bank’s Guidelines for Financial Management and Financial Analysis of Projects describe and explain the Banks’ policies, procedures and approaches to the financial management and analysis of projects and programmes that the Bank finances. The Guidelines are intended to ensure the sustained operations of entities that implement projects and programmes within the Bank’s public sector operations. They do not apply to the Bank’s private sector lending window that has separate policies and guidelines, as well as approaches. The Guidelines replace the Bank’s Guidelines on the Financial Management and Financial Analysis of Projects that were approved by the Board in 2000.

1.1.3 The Bank has launched a number of initiatives to improve quality of projects, from inception to completion. Examples include the Quality at Entry Assessment (QEA) and the Showcase Projects Initiative (SPI). These Guidelines are complementary to such initiatives and incorporate state-of-the-art financial management and financial analysis practices adopted by the Bank as a direct outcome of its quality of projects initiatives. In addition, they reflect the results of both the 2005 Paris Declaration on Aid Effectiveness and the 2003 Rome Declaration on Harmonization as well as financial management and financial analysis practices adopted by other Multilateral Development Banks (MDBs) where these are in harmony with the Bank’s practices.

1.1.4 A separate ‘Handbook for Borrowers on Financial Management and Financial Analysis of Projects Financed by the African Development Bank’ that will summarize the policies and procedures contained in these Guidelines will be developed. The Handbook will benefit borrowers, EAs, auditors, task managers, consultants, and others whose work requires them to be familiar with the Bank Group’s policies and procedures.

1.1.5 For purposes of these Guidelines, unless otherwise indicated, “African Development Bank” (or Bank) means the African Development Bank, the African Development Fund, and the Nigerian Trust Fund. Also, unless stated otherwise, the requirements for executing agencies also apply to implementing agencies. “Loan” means a loan, credit or grant made available by the Bank.
Rationale

1.1.6 These Guidelines represent one of several initiatives that the Bank is taking to address poverty alleviation through improved financial management and financial analysis of projects it finances. The following key factors are driving this initiative:

- The Agreement Establishing the African Development Bank and the Agreement Establishing the African Development Fund require that the “Bank shall make arrangements to ensure that the proceeds of any loan made or guaranteed by it are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency.” The Agreement, also, requires that the Bank be guided by sound banking principles in its operations. Accordingly, the Bank has adopted specific requirements for financial reporting and management in relation to its loans and equity investments, including the borrower’s executing agencies.

- The international community, including the Bank, is supporting the development of guidelines, standards, and codes in relation to good financial management and governance. These guidelines, standards, and codes – to varying degrees – all involve improved accounting and auditing arrangements. They include Principles of Corporate Governance (OECD); Harmonizing Donor Practices for Aid Effectiveness (OECD); Code of Good Practices on Fiscal Transparency (IMF); Code of Good Practices on Transparency of Monetary and Financial Policies (IMF); Implementation of the Objectives and Principles for Securities Regulation Assessment Surveys (IOSCO); International Accounting Standards (IASB); International Standards on Auditing (IAASB); International Public Sector Accounting Standards (IPSASB) and Banking Supervision Guidelines (BCBS).

- The Bank issued its Bank Group Policy on Good Governance in December 1999. Over the last few years, the Bank has given due recognition to the issue of good governance for two main reasons. First, from a broader perspective, good governance, which promotes accountability, transparency, rule of law and participation and combats corruption, is central to creating and sustaining an enabling environment for development. Second, from the Bank’s perspective, good governance is inextricably related to the efficacy of the investment that the Bank helps to finance, and is in line with the Bank’s vision for sustained development for the continent into the 21st Century.

1.1.7 This is the second release of the African Development Bank’s Guidelines for Financial Management and Financial Analysis of Projects. The new Guidelines incorporate lessons learned by the Bank since it issued the first set of guidelines in 2000, and reflects the ongoing activities associated with the Harmonization Agenda.

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1 Agreement Establishing the African Development Bank, Article 17 (h) and the Agreement Establishing the African Development Fund, January 1981, Article 15, paragraph 5.

2 In February 2003, a Harmonization Forum was jointly sponsored by five MDBs (African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, Inter-American Development Bank, and World Bank) and the Development Assistance Committee of the Organization for Economic Co-operation and Development (OECD-DAC). All MDB presidents attended the meeting. The closing statement, the Rome Declaration on Harmonization, Rome, Italy February 25, 2003, summarized progress and committed all participating institutions to specific activities to enhance harmonization. Subsequent to the Forum, the Islamic Development Bank joined the harmonization effort. In addition, an MDB Technical Working Group on Financial Management Harmonization was formed to foster increasing harmonization among the MDBs. On March 2, 2005, the Paris Declaration on Aid Effectiveness, Paris, France, was issued, to move forward the harmonization efforts.
1.1.8 The Harmonization Agenda has, at its core, the objective of improving aid effectiveness by reducing the transaction costs to the recipient country. Improved financial management systems, at the country level, and agreement from development partners to rely on these systems to the greatest extent possible are critical to the harmonization efforts. The Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD-DAC) has developed a number of good practice notes, including the Good Practice Paper on Financial Reporting and Auditing (December 2002) and the MDB Technical Working Group on Financial Management Harmonization have developed the Framework for Collaboration Among Participating MDBs on Financial Reporting and Auditing (February 2003).

1.1.9 These revised Guidelines serve two purposes. First, they provide guidance to Bank staff, consultants, and borrowers on the financial due diligence activities to be completed as part of the project appraisal process, namely financial analysis and financial management assessment. Second, they describe and explain Bank’s policies, procedures, and approach to the financial management of the projects/programmes that it finances. In addition to providing guidance on Bank’s financial due diligence activities, the Guidelines contain business processes and good practice examples of financial management and financial analysis practices adopted by the Bank and other Multilateral Development Banks (MDBs).

Objectives

1.1.10 The objective of these Guidelines is to provide Bank management and staff, borrowers, co-finance and investors with a comprehensive and understandable directory of standards of financial management and financial analysis for the assessment, implementation and operation of Bank funded projects, including:

- Detailed guidance covering standards of financial management of EAs and/or individual projects,
- Fundamental parameters, designs and measurement techniques to apply to the financial analyses of EAs and/or individual projects, and
- An innovative knowledge management section that includes financial tools, checklists and reference documents for use during the financial analysis and financial management assessment of projects and programmes.

1.1.11 The Guidelines will ensure that persons charged with providing the analysis required by the Bank have immediate access to the most effective and up-to-date tools for undertaking and completing their assignments by:

- Defining financial management requirements for the assessment of projects and borrower entities, EAs, investees and other organizations seeking Bank funding,
- Establishing norms for financial analysis of revenue earning and non-revenue earning projects,
- Achieving consistency in the presentation of findings and recommendations by Bank staff and borrowers in studies, reports and documents for which these forms of assessment and analysis are required,
- Explaining to borrowers the Bank’s project and institutional financial performance requirements to achieve successful implementation of projects and sustainability of ongoing operations, and
- Providing a knowledge management section for the guidance and training of Bank staff and borrowers.
1.1.12 The Bank’s financial analysts as well as borrowers’ and investees’ financial staff should at all times have access to these guidelines. The aim, in this regard, is to ensure that each project and entity is well maintained financially, and that borrowers, investees and Bank staff have access to identical information and guidance.

1.1.13 These Guidelines recognize that the analysis of projects should be carried out through an integrated approach including a through evaluation of the physical, economic, financial, stakeholder and risk aspects of each project in a single consistent framework or model. These guidelines holistically addresses project appraisal from a financial perspective and integrates the financial analysis of projects within the overall financial framework and financial management of the Executing Agency (EA). The financial implications of the physical solution chosen are addressed in the financial evaluation of the project, while the net financial benefits of the project are subjected to sensitivity analysis and discussed in the appraisal report. The evaluation of the economic and stakeholder aspects of projects are, however, outside the scope of these Guidelines and are addressed in the “Guidelines for Economic Analysis and Design of Bank Group Projects”. It is, however, imperative that during project appraisal, the teams conducting the economic and financial analysis of projects work closely together to ensure that economic analysis is built directly upon the financial cash flows of the project that has undergone a rigorous assessment in line with the requirements of these Guidelines.

1.1.14 The Guidelines are prepared from the point of view that at each stage of the Bank’s project cycle – from the identification of a project, followed consecutively by its preparation, appraisal, negotiation, supervision and issuance of a completion report, and, where appropriate, by a post-evaluation report – appropriate financial analysis and management techniques are adapted to suite each sector in which the Bank operates and to generate management information for timely decision making. This includes, where necessary, the identification by Bank staff of the need for design and installation of suitable financial management systems by borrowers to assure all interested parties that the project will have reasonable and continuing prospects of financial viability. Financial viability needs to be confirmed by timely, accurate financial reporting by borrowers and investees and by timely and rigorous project supervision by financial analysts.

1.1.15 The Bank’s public sector project portfolio contains a wide array of projects ranging from revenue-earning operations to non-revenue-earning operations; financial intermediaries (FIs); utilities and transportation entities, as well as many specialized entities associated with agriculture. It is impossible for any set of guidelines, such as these ones, to provide guidance for all situations that a financial analyst is likely to face. These Guidelines will, therefore, require adaptation of financial management and financial analysis techniques to meet specialized needs. These adaptations include sector and project-specific financial analysis, financial performance measurement, design and operation of financial management systems, including accounting, financial reporting and auditing systems.

1.1.16 The advice, directions, and recommendations in these Guidelines should not be regarded as a substitute for initiative on the part of Bank staff, which should always be exercised when situations arise that require resourcefulness, imagination and sound professionalism.

1.2 USER INFORMATION

Preamble

1.2.1 This section of the Guidelines begins by describing the Bank’s operational lending approaches (lending modalities). It then proceeds to describe how these Guidelines apply. The
resulting classification provides a basis for identifying step-by-step financial management requirements throughout the project cycle. In doing so readers can quickly, by first referring to this section, identify what needs to be done, by whom, and by when. The section concludes by introducing the structure of the Guidelines.

**Bank Lending and Technical Assistance**

1.2.2 The Bank makes loans from its Ordinary Capital Resources (OCR), from the African Development Fund (ADF) and from the Nigeria Trust Fund (NTF). The ADF and NTF are designed to provide loans on concessional terms to Regional Member Countries (RMCs) with low per capita gross national product (GNP) and limited debt repayment capacity. The ADF is maintained by regular member contributions. The Bank also provides technical assistance from its own resources and from special funds.

1.2.3 The Agreement Establishing the Bank permits it to make, participate in, or guarantee loans to its RMCs, or their governments, to any of their agencies or political subdivisions, and to public or private enterprises operating within such countries, as well as to international or regional entities concerned with economic development in the region. Loans are made only for projects or programs of high developmental priority.

1.2.4 The Bank has three primary public sector types of lending:

- **Project Loans:** Among other things, project lending is aimed at developing energy, agriculture, transport and communications, and other basic infrastructure as well as health, education, and finance.
- **Sector-Wide Approach (SWAp):** The purpose of a SWAp is to assist in the development of a specific sector (or sub-sector) by financing part of an investment program in that sector. A SWAp is expected to improve sector policies and strengthen institutional capabilities. Technical assistance may be given for project preparation, sector studies, and/or institution building, prior to, or together with, the provision of the SWAp.
- **Program Loans:** Program loans are given by the Bank to assist an RMC in supporting its budget as a whole while focusing policy dialogue on improving a sector’s performance through appropriate policy and institutional improvements over the medium to long term. Advisory technical assistance may be attached to a program loan to further study unresolved policy issues or to strengthen the capacity of key sector institutions. Although program lending differs from project lending in objectives, the procedural and administrative steps in processing a program loan are generally the same as those for projects.

1.2.5 The Bank’s Technical Assistance (TA) is classified into four development activities:

- **Project preparatory technical assistance (PPTA) for assisting in the preparation of one or more projects including a program loan or a SWAp, for financing by the Bank and cofinancing by other external sources,
- **Project implementation technical assistance for assisting in the implementation, operation, and management of a Bank-financed project,
- **Advisory technical assistance for financing institution-building; plan-formulation; and sector, policy, or issues-oriented studies, and
- **Regional technical assistance, covering more than one RMC.

1.2.6 The Bank encourages cofinancing. The cofinancing strategy comprises: (i) maximizing the amount of cofinancing from other official funding agencies, and (ii) increasing the flow of
private capital through cofinancing to RMCs. The purpose of this strategy is to maximize the impact of the Bank’s assistance in the development of its RMCs and to mobilize additional resources for such development. Cofinancing funds come from (i) official funding agencies; (ii) export credit agencies; and (iii) commercial finance institutions.

**Applying these Guidelines**

1.2.7 The provisions of these Guidelines apply to investment projects and project executing and implementing agencies within the public sector. Consequently, they relate mainly to identifiable investment activities that have been undertaken with support from project, and sector loans. However, the provisions of these Guidelines will also apply where program loans include discrete, identifiable investment components.

1.2.8 These Guidelines are also relevant to PPTAs. PPTAs are designed and implemented prior to the beginning of a program or project. PPTA resources should be used to include appraisal of the financial aspects of projects and the financial management of project executing agencies and, where necessary, to develop sufficient financial management capacity to implement and manage projects.

1.2.9 The Bank’s activities are guided by policies and guidelines that have been approved by its Board and operationalized through the Operations Manual (OM). In the event of any differences between these Guidelines and the OMs, the OMs take precedence.

**Project Types and General Treatments**

1.2.10 These Guidelines effectively classify projects, executing agencies, and implementing agencies into two distinct groups: (i) non-revenue earning; and (ii) revenue-earning (including public sector, and financial intermediaries). The Bank, together with other international financial institutions (IFIs), is actively encouraging borrowers and EAs to adopt uniform standards of accounting and financial reporting. However, some time will be required to achieve a high level of uniformity.

1.2.11 In the case of non-revenue-earning EAs, the Bank expects sound financial policies, adequate accounting records, proper internal control systems, timely reporting to management, and sound and timely auditing.

1.2.12 The Bank requires revenue-earning EAs to follow International Financial Reporting Standards (IFRS)/International Accounting Standards (IASs). The Bank, however, recognizes that certain RMCs follow national accounting standards and practices, with the eventual objective of moving towards IFRS/IAS compliant accounting policies, as capacity allows and the situation warrants. Given the varying levels of RMC development, it will take time to improve financial reporting practices to international standards and best practices. Financial analysts should determine during project processing the extent to which international standards are used by the executing agency and/or the project as the basis for accounting and reporting, taking into account that in future updates, these Guidelines will be strengthened to take account of developments in the private sector lending window of the Bank.

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3 Several provisions of these Guidelines apply to identifiable investment activities that have been financed through the Bank’s private sector loans. There are, however, many aspects of the Bank’s private sector operations that the financial management concepts introduced in these Guidelines do not apply, for example, as regards investment projects that involve equity participation and venture capital. It is hoped that in future updates, these Guidelines will be strengthened to take account of developments in the private sector lending window of the Bank.
the country’s capacity and capability. In exercising this discretion, financial analysts are responsible for ensuring that the Bank’s funds are utilized for the purpose intended and in an effective and efficient manner.

An Overview of Project Processing Steps

1.2.13 Once a project is identified by agreement between a government and the Bank, it is processed and implemented. The various steps from project identification to completion comprise what is known as the project cycle. The steps in a typical Bank financed project include project identification; preparation to establish project feasibility; appraisal to assess project soundness and viability; consideration and approval by the Bank’s Board of Directors; and finally, project implementation. Many Bank-financed projects are also subject to operations evaluation when completed.

1.2.14 The first step of project identification is generally undertaken during preparation of the Results-Based Country Strategy Paper (RBCSP). RBCSPs are usually prepared every three years for each RMC and are updated annually, in consultation with member governments.

1.2.15 In appraising a project, its technical, financial, economic, social, environmental, production, marketing, management, and loan conditionalities are closely examined. This helps to pinpoint specific steps necessary to ensure its smooth and efficient implementation and operation.

1.2.16 Loan approval by the Bank does not mean that the amount of the loan is immediately transferred to the borrower in a lump sum. The loan is disbursed to meet expenditures under the loan agreement, as and when they are incurred. Specific procedures for disbursement are laid down in the loan documents.

1.2.17 Normally, the loan documents allow 180 days for the loan to become effective. The preparatory work for construction (including recruitment of consultants, preparation of tender documents, detailed designs, procurement of equipment, and selection of contractors may take several months or longer. Usually, these activities cannot begin until the loan becomes effective. However, certain preliminary steps in the procurement of goods and selection of consultants can begin at an earlier stage to speed up project implementation. Implementation time generally ranges from two to five years and depends on the type and nature of the project. The progress of project implementation is assessed by Bank review missions, which visit the project up to twice a year throughout the implementation period.

Step 1: Identification and Early Preparation

1.2.18 When compared with the needs of its borrowing members, Bank resources are limited. Consequently, projects are selected carefully. Before any project is identified for Bank financing, Bank staff reviews a country’s economy, particularly it’s national and sector development programs, and determine the prospects for its economic success. Country programming missions visit RMCs regularly to discuss topics of mutual interest with government officials and select suitable projects for Bank assistance.

1.2.19 The levels of economic growth and the priorities for development vary from one RMC to another. The Bank selects those projects which will most effectively contribute to the economic and social development of the country concerned. The Bank’s approach is consistent with the 2005 Paris Declaration in that programs and projects selected for Bank support are part of the RMC’s national development strategy.
1.2.20 Once a project has been identified and included in the Bank’s program for that RMC, the Bank evaluates the project. In some cases, especially in the smaller and less-developed RMCs, project identification may require the help of outside experts. If so, the Bank can provide technical assistance to a country to help it identify and prepare a project for possible Bank financing.

**Step 2: Loan Preparation**

1.2.21 Loan preparation involves assessing the technical feasibility, economic viability, environmental impact and financial soundness of a project. This preparation phase can be undertaken by the government or any other agency. The Bank may also assist by providing technical assistance grants to fund the project preparation studies. The Bank uses PPTAs to hire consultants to undertake a project feasibility study. The consultants’ work is closely monitored by Bank staff and the draft final report is reviewed at a meeting attended by representatives of the government, the Bank and the consultants.

**Step 3: Project Examination**

1.2.22 Project feasibility is examined by the Bank, first through a preparation mission and then through an appraisal mission. The mission team, in consultation with the government, examines the project’s technical, financial, economic, environmental and management aspects and potential social impact. Loan terms and conditions are discussed. Following the examination in the field, the appraisal mission team prepares a report and draws up a draft loan agreement for detailed negotiation.

**Step 4: Loan Negotiations**

1.2.23 After detailed loan negotiations with the government, the loan proposal is submitted to the Bank’s Board of Directors for approval. The loan agreement is then signed by the Bank’s President and representatives of the government and the executing agency. The loan takes effect once specified loan conditions are met.

**Step 5: Project Implementation**

1.2.24 The project is implemented by the EA according to the agreed implementation schedule and procedures. Project supervision consultants may be recruited, the detailed engineering design and bidding documents are prepared, machinery and equipment are procured, and civil works are constructed and installed. Bank staff reviews the implementation in close coordination with the borrower and the EA. The Bank disburses the loan for approved expenditures, as provided in the loan agreement.

**Step 6: Project Completion**

1.2.25 After the project facilities are completed and commissioned, the Bank prepares a project completion report (PCR) to document the implementation experience. The Bank undertakes separate post-evaluations of projects on a selective basis. In these cases, it prepares post-evaluation project performance audit reports that assess project formulation and implementation; economic, financial, and social benefits; and environmental impacts as well as identifies lessons learned from the project experience.
Project File

1.2.26 Financial Analysts should maintain a permanent project file for each project/programme. The project file must contain all relevant financial information gathered during fact-finding, appraisal, and project supervision (either originals or copies). This information should include details of original and amended financial policy decisions affecting the project and the EA. Also included in the file are the assumptions and basic calculations underlying financial analysis, financial performance indicators, and the design of financial covenants. The file must also include copies of all computer files that have been used to develop project-specific financial projections and analyses. The financial management assessment report and the related supporting documentation should also be included in the file.

Structure

1.2.27 In addition to this introduction the Guidelines comprise of six chapters as follows:

- **Chapter 2 – Financial Management** – advises on institutional and systems requirements and relevant financial management/governance considerations. Individual sections address key topics such as governance, money laundering and terrorist financing, anticorruption, forms of implementing agency, scope of the financial analysts work, use of country financial management systems and assessing Executing Agencies.

- **Chapter 3 – Financial Analysis and Appraisal of Projects** – advises on the key features that a borrower and a financial analyst need to know to participate in the preparation and appraisal of an investment project. It describes the preparation of project cost tables. In addition, it discusses loan covenants in the context of the 2005 Paris Declaration and provides some guidance on the types of loan covenants that may be applied.

- **Chapter 4 – Monitoring and Evaluation** – advises on the requirement to monitor the implementation and operation of Bank financed projects’ resources as well as subsequent performance measurement and evaluation. It discuses the preparation of financial forecasts and the various tools available to monitor the performance of an EA.

- **Chapter 5 – Reporting and Auditing** – focuses on the Bank’s requirements for financial reporting and auditing of projects, EAs and Implementing Agencies (IAs).

- **Chapter 6 – Financial Intermediaries** – describes the particular applicability of these Guidelines to Financial Intermediaries.

- **Chapter 7 – Knowledge Management** –This section includes a wide variety of guidance materials including selected websites, checklists and descriptions of accounting and auditing standards. It also includes examples of auditors’ opinions, and a questionnaire to check the adequacy of financial statements from an audit perspective. Additionally, the section contains best-practice guidance and sector-specific case studies. Space and presentation constraints limit the Knowledge Management section of the hardcopy version of these Guidelines.