7. KNOWLEDGE MANAGEMENT

7.1 INTRODUCTION

7.1.1 This Knowledge Management, section of the African Development Bank Group’s Guidelines for Financial Management and Financial Analysis of Projects is intended to provide Financial Analysts and other readers with background information supporting the positions presented in the Guidelines. In addition, this section provides references to pronouncements, websites and learning materials that, is hoped, will form a collection of learning tools and knowledge enhancement for users of the Guidelines. It is anticipated that this part of these guidelines will be updated, on an ongoing basis, with new and emerging best practices.

7.1.2 These Guidelines are available on the web and in a CD-ROM. This hardcopy version omits a significant portion of the information available in this Chapter of the CD-ROM version. Importantly, new and emerging best practices in financial management and financial analysis of projects will first be updated in the web-based version. Users are, therefore, advised to consult regularly, the web-based version of these Guidelines to keep abreast of current updates.

7.2 USEFUL WEBSITES

Regulatory and Standard-Setting Bodies

Bank for International Settlements (BIS) http://www.bis.org
Financial Accounting Standards Board (FASB – United States) http://www.fasb.org
International Accounting Standards Board (IASB) http://www.iasc.org.uk
International Federation of Accountants (IFAC) http://www.ifac.org

Professional Bodies

Association of Chartered Certified Accountants http://www.accaglobal.com
International Auditing and Assurance Standards Board (IAASB) http://www.ifac.org/iaasb/index.php
International Federation of Accountants (IFAC) http://www.ifac.org

The Regional Federation of Accountants and Auditors

AFROSAI - African Organization of Supreme Audit Institutions Email: afrosai@ids.tg
ARABOSAI - Arab Organization of Supreme Audit Institutions http://www.arabosai.org
Eastern Central and Southern African Federation of Accountants http://www.ecsafa.org
INTOSAI - International Organization of Supreme Audit Institutions http://www.intososai.org
# International Organizations

<table>
<thead>
<tr>
<th>Organization</th>
<th>Website</th>
</tr>
</thead>
<tbody>
<tr>
<td>International Federation of Accountants (IFAC)</td>
<td><a href="http://www.ifac.org">http://www.ifac.org</a></td>
</tr>
<tr>
<td>International Organization of Securities Commissions (IOSCO)</td>
<td><a href="http://www.iosco.org">http://www.iosco.org</a></td>
</tr>
<tr>
<td>Organisation for Economic Co-operation and Development (OECD)</td>
<td><a href="http://www.oecd.org">http://www.oecd.org</a></td>
</tr>
<tr>
<td>World Trade Organization (WTO)</td>
<td><a href="http://www.wto.org">http://www.wto.org</a></td>
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</table>

# Donor Organizations

<table>
<thead>
<tr>
<th>Organization</th>
<th>Website</th>
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<tbody>
<tr>
<td>Asian Development Bank (AsDB)</td>
<td><a href="http://www.adb.org">http://www.adb.org</a></td>
</tr>
<tr>
<td>European Bank for Reconstruction and Development (EBRD)</td>
<td><a href="http://www.ebrd.org">http://www.ebrd.org</a></td>
</tr>
<tr>
<td>European Union – Technical Assistance to the</td>
<td><a href="http://europa.eu.int/">http://europa.eu.int/</a></td>
</tr>
<tr>
<td>Commonwealth of Independent States (EU-TACIS)</td>
<td>comm/dg1a/tacis/index.htm</td>
</tr>
<tr>
<td>Food and Agriculture Organization of the United Nations</td>
<td><a href="http://www.fao.org">http://www.fao.org</a></td>
</tr>
<tr>
<td>International Fund for Agricultural Development</td>
<td><a href="http://www.ifad.org">http://www.ifad.org</a></td>
</tr>
<tr>
<td>International Monetary Fund (IMF)</td>
<td><a href="http://www.imf.org">http://www.imf.org</a></td>
</tr>
<tr>
<td>Islamic Development Bank (ISDB)</td>
<td><a href="http://www.isdb.org">http://www.isdb.org</a></td>
</tr>
<tr>
<td>United Nations Development Program (UNDP)</td>
<td><a href="http://www.undp.org">http://www.undp.org</a></td>
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</tbody>
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# Selected Bilateral Organizations

<table>
<thead>
<tr>
<th>Organization</th>
<th>Website</th>
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<tbody>
<tr>
<td>Canadian International Development Agency (CIDA)</td>
<td><a href="http://www.acdi-cida.gc.ca">http://www.acdi-cida.gc.ca</a></td>
</tr>
<tr>
<td>Danish International Development Agency (DANIDA)</td>
<td><a href="http://www.um.dk/danida">http://www.um.dk/danida</a></td>
</tr>
<tr>
<td>Department for International Development (DFID)</td>
<td><a href="http://www.dfid.gov.uk">http://www.dfid.gov.uk</a></td>
</tr>
<tr>
<td>Gesellschaft für Technische Zusammenarbeit (GTZ) (German</td>
<td><a href="http://www.gtz.de">http://www.gtz.de</a></td>
</tr>
<tr>
<td>Technical Cooperation)</td>
<td></td>
</tr>
<tr>
<td>Japan Bank for International Cooperation (JBIC)</td>
<td><a href="http://www.jbic.go.jp">http://www.jbic.go.jp</a></td>
</tr>
<tr>
<td>Japan International Cooperation Agency (JICA)</td>
<td><a href="http://www.jica.go.jp">http://www.jica.go.jp</a></td>
</tr>
<tr>
<td>Swedish International Development Agency (SIDA)</td>
<td><a href="http://www.sida.se">http://www.sida.se</a></td>
</tr>
<tr>
<td>United States Agency for International Development (USAID)</td>
<td><a href="http://www.usaid.gov">http://www.usaid.gov</a></td>
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</tbody>
</table>

# Sectoral References

<table>
<thead>
<tr>
<th>Organization</th>
<th>Website</th>
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<tbody>
<tr>
<td>Consultative Group to Assist the Poorest (CGAP)</td>
<td><a href="http://www.cgap.org">www.cgap.org</a></td>
</tr>
<tr>
<td>The Microfinance Gateway</td>
<td><a href="http://www.microfinancegateway.org">http://www.microfinancegateway.org</a></td>
</tr>
<tr>
<td>World Council of Credit Unions (WCCU)</td>
<td><a href="http://www.woccu.org">www.woccu.org</a></td>
</tr>
</tbody>
</table>
Other

Africa Governance Institute, UNDP
Aid Harmonization and Alignment
Council for the Development of Social Science Research in Africa (CODESRIA)
COSTAB
Decentralization, UNDP
E-governance
Governance Research Indicator Country Snapshot (GRICS), World Bank
Governance Resource Centre (GRC) of the UK Department for International Development (DFID) Institute of Development Studies
International Corporate Governance Network
PEFA - Public Expenditure & Financial Accountability
Promoting Good Governance, GTZ
Public Sector Governance
The Civil Society and Governance Programme
The Encyclopedia about Corporate Governance
Transparency International
Working Group on Internet Governance (WGIG)

7.3 ROME & PARIS DECLARATIONS

Rome Declaration

In February 2003, leaders of the major multilateral development banks and international and bilateral organizations, and donor and recipient country representatives gathered in Rome for the High-Level Forum on Harmonization (HLF-Rome). They committed to take action to improve the management and effectiveness of aid and to take stock of concrete progress. Information regarding the HLF and follow up to the Forum is found at: www.aidharmonization.org.

7.3.1 The HLF concluding statement, The Rome Declaration on Harmonization, sets out an ambitious program of activities:
- Ensure that harmonization efforts are adapted to the country context, and that donor assistance is aligned with the development recipient’s priorities.
- Expand country-led efforts to streamline donor procedures and practices.
- Review and identify ways to adapt institutions’ and countries’ policies, procedures, and practices to facilitate harmonization.
Implement the good practices principles and standards formulated by the development community as the foundation for harmonization.

7.3.2 The attached is the Rome Declaration on Harmonization:

Rome Declaration

Paris Declaration

7.3.3 The Paris Declaration represents the culmination of the High Level Forum on Aid Effectiveness (HLF) held in Paris 28 February to 2 March 2005. The HLF was hosted by the French Government and attended by development officials and ministers from ninety one countries, twenty six donor organizations and partner countries, representatives of civil society organizations and the private sector. The participants took stock of progress in the wide range of activities that have taken place since the Rome High-Level Forum (2003). They also identified the areas in which further, or more intense, work is needed. The Bank participated in and contributed to the funding of the HLF. For further details regarding the HLF and follow up to the Forum please refer to www.aidharmonization.org

7.3.4 The Paris Declaration is as follows:

Paris Declaration

7.3.5 The Paris Declaration on Aid Effectiveness (see above) reflects the commitment of external funding agencies to “avoid, to the maximum extent possible, creating dedicated structures for day-to-day management and implementation of aid-financed projects and programmes.” The Bank has committed in the Paris Declaration to harmonize project implementation arrangements, minimize the use of parallel structures for project implementation, and to use joint PIUs with other development partners where possible.

7.3.6 As a follow up to the Paris Declaration, OECD-DAC has prepared the attached document: ‘Paris Declaration on Aid Effectiveness - Indicators of Progress: (i) List of Indicators; (ii) Letter from the DAC Chair; and (iii) Methodology for Quantitative Indicators’

7.3.7 The following World Bank paper: ‘Guidance Note for Project Management - Strengthening Institutional Capacity during Project Implementation, October 2005’ aims to encourage operations managers and staff not only to give priority to project implementation performance but also to balance it with sustainable institutional capacity development beyond the project. To that end, existing country institutions should be the “default” mode, and PIUs—especially parallel “stand-alone” PIUs—should be phased out.

7.3.8 The World Bank ‘Guidance Note for Project Management - Strengthening Institutional Capacity during Project Implementation, October 2005’ is attached:
7.4 COUNTRY GOVERNANCE PROFILE

7.4.1 The Bank issued a Staff Guideline covering Country Governance Profile Assessments (CGP) in October 2003. It documents the Bank’s approach to the review of Governance processes in a country. It includes a check list of matters to be covered and indicates how issues are to be disclosed and reported. It also relates Governance issues to the Project Lending and Technical Assistance operations of the Bank.

7.4.2 The CGP Guidelines are attached:

7.5 POLICY ON GOOD GOVERNANCE

7.5.1 The Bank issued its Group Policy on Good Governance in November 1999. The policy mandates that in operationalizing its agenda in the area of good governance the Bank will focus on accountability, transparency, combating corruption, participatory governance and legal and judicial reforms.

7.5.2 Attached is the Bank Group Policy on Good Governance:

7.6 PREVENTING & COMBATING CORRUPTION & FRAUD

7.6.1 In February 2004 the Bank approved the Guidelines for Preventing & Combating Corruption and Fraud in Bank Group Operations. The paper contains the following Chapters:

- Introduction & Objective
- Taxonomy of Corruption
- Rationale for Combating Corruption
- Basic Principles, Bank Rules & Procedures for Preventing & Combating Corruption
- The Experience of Other MDBs
- Policy Framework for Preventing & Combating Corruption
- Where and How Corruption may occur in Bank Operations
- Procedures for Addressing Corruption & Fraud in Bank Operations
- The way forward and Implications for the Bank
- Conclusions

7.6.2 The Guidelines for Preventing & Combating Corruption and Fraud in Bank Group Operations are as follows:
7.7 HARMONIZING DONOR PRACTICES

7.7.1 To promote good practices for enhanced aid effectiveness, OECD-DAC published, in 2003, the following booklet: ‘Harmonising Donor Practices for Effective Aid Delivery, Good Practice Papers, A DAC Reference Document’. The Booklet covers the following six specific papers that have been agreed as setting out good practices:

- Framework for Donor Co-operation.
- Reporting and Monitoring.
- Financial Reporting and Auditing.
- Delegated Co-operation (i.e. when one donor acts on behalf of another).

7.7.2 The booklet ‘Harmonising Donor Practices for Effective Aid Delivery, Good Practice Papers, A DAC Reference Document’.

7.7.3 Additionally, OECD-DAC has published a paper that describes good practices donors can apply to support capacity development in the area of public financial management. Case studies illustrate how effective support of capacity development is beginning to take shape in a few countries and it provides guidance to donor organisations looking to improve the effectiveness of aid delivery aimed at capacity development in public financial management.

7.7.4 The paper ‘Capacity Development in Public Financial Management’ is attached

7.7.5 OECD papers ‘DAC Guidelines and Reference Series: Harmonising Donor Practices for Effective Aid Delivery’ can be accessed from the following website: www.oecd.org/dac/harmonisingpractices

7.8 SECTOR-WIDE APPROACHES

7.8.1 Sector-Wide Approaches (SWAps), emerged in the 1990s out of a growing dissatisfaction with the traditional project approach which has often been viewed as “fragmented, donor-driven” and entailing high transaction costs for aid recipient countries. SWAps emphasize greater reliance on government institutions, common implementation procedures and stronger and closer country partnership with its development partners.

7.8.2 In this regard, the Bank issued its Guidelines for Using Sector-Wide Approaches in April 2004. The paper defines the key imperatives for an effective SWAp process as: the existence of a government-led and coordinated comprehensive sector development programme; the existence of a conducive policy environment or policy reform agenda leading to it; and, the commitment and availability of donor resources in the form of sector investment loans and grants for institutional capacity building and studies to
underpin sector development issues. SWApS also require the existence of a strong and coordinated donors approach to the relevant sector’s problems as well as the presence of an effective consultation mechanism between the aid recipient member country and its development partners. The approach generally envisages the pooling of donor financial resources in support of government budget, the use of a common government-led implementation and coordination mechanism and a streamlined/harmonized disbursement and procurement procedures.

7.8.3 The paper notes that SWApS have emerged as important instruments for operationalizing country-led development frameworks. Several recent reviews of aid effectiveness have underlined the importance of wide stakeholder ownership of the development process, country-led coordination of donor interventions, greater country accountability, fewer donor conditionalities on the use of aid resources, and streamlined donor procedures that place fewer strains on the limited national capacities. An increasing number of donors are adopting SWApS as a process for facilitating sustainable development and enhancing the development impact of aid resources.

7.8.4 The Guidelines for Bank Group Operations Using Sector-Wide Approaches are as follows:

7.9 OPERATIONS MANUALS 500 & 600

Operations Manual 500

7.9.1 Operations Manual 500 covers the topic of Project Preparation and includes the following main topics:
  • Introduction
  • Borrower Has Done Own Preparation Without Bank Involvement
  • Bank Assists in Project Preparation
  • Bank Carries Out Project Preparation

7.9.2 The Operations Manual 500 is attached:

Operations Manual 600

7.9.3 Operations Manual 600 with its various Annexes, covers the topic of Project Appraisal and includes the following main topics:
  • Definitions and Objectives
  • Conducting the Field Appraisal
  • Preparing the Project Appraisal Report

7.9.4 The Operations Manual 600 is as follows:
7.9.5 Operations Manual 600 has the following Annexes:

- Annex 1 – Format and Content of an Appraisal Report:
  OM 600 Annex 1

- Annex 1A – Content of an Executive Summary:
  OM 600 Annex 1A

- Annex 1B – Provisional List of Goods and Services:
  OM 600 Annex 1B

- Annex 2 – The Project Logical Framework:
  OM 600 Annex 2

- Annex 3 – Financial and Economic Analysis in Appraisal Reports:
  OM 600 Annex 3

- Annex 4 – Project Implementation Document:
  OM 600 Annex 4

- Annex 4A – Supervision Plan:
  OM 600 Annex 4A

- Annex 5 – Content of the Procurement Section in Appraisal Reports:
  OM 600 Annex 5

- Annex 6 – Appraisal Quality Assessment Check List:
  OM 600 Annex 6

7.10 PUBLIC EXPENDITURE AND FINANCIAL ACCOUNTABILITY REVIEW

7.10.1 The Public Expenditure and Financial Accountability Review (PEFAR) is a World Bank led assessment of the Public Financial Management (PFM) arrangements in client countries. It has two main components – the Financial Accountability Assessment and the Public Expenditure Review (PER). The Bank participates, within its RMCs, in the preparation of the PEFAR.

7.10.2 The PEFAR is designed to enhance the Bank’s, the World Bank’s, and other Development Partners’ and the borrowers’ knowledge of Public Financial Management (PFM) and financial accountability arrangements in client countries.
Financial Accountability Assessment

7.10.3 The main focus of the Financial Accountability Assessment is to assess the following key functions and systems of central government: (i) Financial Management System: Revenue Management, Debt Management, External Resource Management and Aid Coordination, Cash Management, Public Procurement Management, and Payroll and Pension Management; (ii) Accounting, Reporting, Monitoring and Control: Internal Controls, Data Integrity, Security and IT Contingency Plans, Management and Annual Financial Reporting, Internal Audit; and (iii) External Accountability and Oversight: External Audit, Legislative Scrutiny, Ethics and Integrity Bodies, Public Access and Demand for Information. In addition, the assessment also focuses on cross-cutting issues, namely: (a) human resource, (b) legislative and institutional framework, and (c) the use of Information Technology (IT) that are assessed as components of the main focus areas. Furthermore, the assessment reviews areas of high-level concern that may be identified separately to ensure that they form part of the annual review of Budget Performance and Accountability Issues.

7.10.4 Financial Accountability is the obligation to demonstrate and take responsibility for the results of financial decisions against agreed expectations. Financial accountability is meaningful only if actual practice is in accordance with the framework as designed. Therefore, an exercise to assess the strength of a country’s financial accountability framework needs to include empirical evidence on actual practice (compliance with established rules and regulations in the country).

7.10.5 The Financial Accountability component of the PEFAR does not constitute an audit of country systems, nor does it provide a “pass/fail” assessment of a country’s PFM system in terms of its adequacy for managing government, Bank or other donor-provided resources. This component supports the Bank’s development objectives by identifying strengths and weaknesses in country PFM systems. It facilitates a common understanding among the government, the Bank, and development partners on the performance of the institutions responsible for managing the country’s public finances. This common understanding helps to identify priorities for action and informs the design and implementation of capacity-building programs. Information also helps the Bank and Development Partners to meet its fiduciary objectives by identifying risks to the use of loan and grant proceeds posed by weaknesses in borrower PFM arrangements. The Financial Accountability component provides a well-informed and objective assessment, a diagnosis of problems, advice on their resolution and an indication of the level of fiduciary risk. However, it is not intended to, and does not, provide assurance on the specific uses to which funds have been or may be applied.

7.10.6 The Financial Accountability assessment component of the PEFAR replaces the World Bank led Country Financial Accountability Assessment (CFAA). The scope of the CFAA comprised a review of public finance including budgeting, accounting and financial reporting, internal control systems and records management, auditing, legislative scrutiny, private sector financial accounting and auditing practices and corporate financial accountability.
7.10.7 The World Bank’s CFAA guidelines are attached:

Public Expenditure Review

7.10.8 The Public Expenditure Review (PER) analyses whether the government's strategic priorities as outlined in the Poverty Reduction Strategy Papers (PRSP) are in line with the country's overall macroeconomic and fiscal situation. Importantly, PERs focus on the efficiency and efficacy of public sector resource allocation.

7.10.9 PERs normally make an independent and objective assessment of country’s fiscal performance and review progress and lessons learnt from recent government efforts to improve upon the budget strategy that translates the national strategy for growth and poverty reduction in budget terms. The exercise also reviews progress in implementation of previous PER recommendations and takes stock of ongoing budgetary reforms aimed at improving public expenditure management at local government level.

7.10.10 Apart from the standard independent (to government) assessment of government operations and public expenditure policies, the other main objectives of the PER reviews are to support the government’s effort to improve the link between the national strategy for growth and poverty reduction and the budget framework, and review progress in implementation of the previous PER recommendations. Mostly, the results from the PER's work are aimed at feeding into the preparation of government budget for subsequent years, inform the annual PER consultations with stakeholders, and provide advice towards further improvement in public expenditure management in the country concerned. PERs analyse and estimates government revenues, evaluates government spending, inter- and intra-sectoral spending, and the efficacy of public enterprises.

7.11 PERFORMANCE MEASUREMENT

7.11.1 There is wide agreement that effective institutions and systems of public financial management (PFM) have a critical role to play in supporting implementation of policies of national development and poverty reduction. The Public Expenditure and Financial Accountability (PEFA) PFM Performance Measurement Framework, included as an attachment, below, has been developed as a contribution to the collective efforts of many stakeholders to assess and develop essential PFM systems, by providing a common pool of information for measurement and monitoring of PFM performance progress, and a common platform for dialogue. The development of the Framework has been undertaken by the Public Expenditure Working Group, which involves World Bank, IMF and PEFA staff, with direction provided by the PEFA Steering Committee.

7.11.2 The PEFA PFM Performance Measurement Framework incorporates a PFM performance report, and a set of high level indicators which draw on the HIPC expenditure tracking benchmarks, the IMF Fiscal Transparency Code and other international standards. It forms part of the Strengthened Approach to supporting PFM reform, which emphasizes country-led reform, donor harmonization and alignment around the country strategy, and a focus on monitoring and results. This approach seeks to mainstream the better practices that are already being applied in some countries.
7.11.3 Further information on the Framework and the Strengthened Approach can be found at the PEFA website – www.pefa.org.

7.11.4 The PFM Performance Measurement Framework (English & French versions) are attached:

7.12 LOCAL GOVERNMENT FINANCIAL MANAGEMENT

7.12.1 Enhancing local government management capacity is a key to the success of any decentralization strategy. Effective and efficient local government budgeting and financial management is the cornerstone of any effective decentralization strategy. The task of improving local government financial management systems is enormous. The legal framework varies across countries. Local governments vary in size, financial and economic resources. As a result, there is no singular financial management system that can be applied across the board to all local governments and countries. What is similar across countries and local governments is the conceptual framework of modern budgeting and financial management. The application of these budgeting and financial management practices may however vary across countries.

7.12.2 These issues are discussed in the following paper - Framework for Effective Local Government Finance - that provides a framework for central elements of local government budgeting and financial management practices. The paper covers five primary sections including: i.) Essential Components of Effective Local Government Finance; ii.) A Shift in the Nature of Local Government Budgeting; iii.) The Capital Budget; iv.) The Role of Financial Reporting and Accounting; and, v.) The Treasury System. Additionally, the presentation that is provided below summarizes the broad issues discussed in the paper. Further information in this area is found at: http://www1.worldbank.org/publicsector/coursedetails.cfm?ID=69.

7.12.3 Framework for Effective Local Government Finance:

7.13 ASSESSMENT OF FINANCIAL MANAGEMENT

7.13.1 This section provides the Annexes (A to E) that support the Assessment of Financial Management topic that is discussed in Section Error! Reference source not found. (Executing Agencies), of these Guidelines.

7.13.2 Annex A-2 provides details of the FMQ, which is a series of questions, organized by topics. The topics duplicate the headings in the outline of the Financial Management Assessment Report (Annex C-2). It is designed as a single form so that it can be used for both self-assessment by borrower, executing agency or implementation agency and by the Bank's review team. If the financial management system is not yet in place, the FMQ can be used as a checklist of issues that will need to be considered in the development of the system.
7.13.3 **Annex A-1** summarises the risk ratings at two levels. Macro fiduciary risks inherent in the borrower country, entity, and project environment are summarized in the ‘Inherent Risks’ section. The risks identified through the FMQ are then summarised, per topic, in the ‘Control Risk’ section.

7.13.4 Annex B provides examples of documentation required to support the assessment. In Annex C highlights the key contents of the Financial Management Assessment Report as well as an outline of the report.

7.13.5 A structured framework to assist Financial Analysts in carrying out the review of the financial management systems is given in Annex D. The approach used is largely based on IFAC Standard 400 “Risk Assessment and Internal Control” framework.

7.13.6 Management recognises that financial governance of projects is posing new challenges for the Bank in terms of its capacity by way of staff strengths and skills-mix of specialists with financial management skills. Where capacity to operationalize the financial management assessments required by these Guidelines is inadequate, Task Managers should ensure consultants with adequate financial management skills are recruited to assist in the assessment process. To this end, a sample Terms of Reference for use when recruiting consultants is provided as Annex E.
7.13.7 Annex A: Financial Management Questionnaire

Annex A-1: Summary Risk Assessment

Project: ____________________________

Date: ____________________________

<table>
<thead>
<tr>
<th>Risk Assessment</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>Comments</th>
</tr>
</thead>
</table>

Inherent Risk
[list specific country, entity, and project inherent risks]

Overall Inherent Risk

Control Risk
1. Implementing Entity
2. Funds Flow
3. Staffing
4. Accounting Policies and Procedures
5. Internal Audit
6. External Audit
7. Reporting and Monitoring
8. Information Systems

Overall Control Risk

Risk Assessment Legend:
1 - **High** (no accountability mechanisms for resources. Bank and Borrower to take urgent action)
2 - **Substantial** (limited accountability mechanisms for resources. Bank and Borrower should be on guard)
3 - **Moderate** (good accountability systems in place that require improvement. Bank and Borrower should monitor progress)
4 - **Negligible or Low** (solid accountability systems in place. Bank and Borrower can rely on systems)
Annex A: Financial Management Questionnaire (continued)

Annex A-2: Questionnaire and Detailed Risk Assessments

Project: ____________________________________________

Self-Assessment completed by: _________________________ Date: ________________

Bank Review/Assessment completed by: _________________ Date: ________________

Note: If there is more than one implementing entity, a Questionnaire should be completed for each entity

<table>
<thead>
<tr>
<th>Topic</th>
<th>Remarks/Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. IMPLEMENTING ENTITY</strong></td>
<td></td>
</tr>
<tr>
<td>1.1 What is the legal status/registration of the entity?</td>
<td></td>
</tr>
<tr>
<td>1.2 Has the entity implemented a Bank-financed project in the past?</td>
<td></td>
</tr>
<tr>
<td>1.3 What are the statutory reporting requirements for the entity?</td>
<td></td>
</tr>
<tr>
<td>1.4 Is the governing body for the project independent?</td>
<td></td>
</tr>
<tr>
<td>1.5 Is the organizational structure appropriate for the needs of the project?</td>
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</tr>
</tbody>
</table>

**CONCLUSIONS AND RECOMMENDATIONS**

(a) Please outline, principal areas where controls regarding ‘Implementing Entity’ assessment area might be improved.

(b) Please outline, any other aspects of ‘Implementing Entity’ financial management system that merit specific mentioning.

(c) Risk Assessment (Implementing Entity): 1 2 3 4

<table>
<thead>
<tr>
<th>Topic</th>
<th>Remarks/Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2. FUNDS FLOW</strong></td>
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</tr>
<tr>
<td>2.1 Describe the funds flow arrangements, including a chart and explanation of the flow of funds from the African Development Bank Group, government and other financiers.</td>
<td></td>
</tr>
<tr>
<td>2.2 Are the arrangements to transfer the proceeds of the loan/grant (from the government / ministry of finance) to the entity satisfactory?</td>
<td></td>
</tr>
<tr>
<td>2.3 Were there any major problems in the past in receipt of funds by the entity?</td>
<td></td>
</tr>
<tr>
<td>2.4 In which Bank will the Special Account be opened? Is it acceptable?</td>
<td></td>
</tr>
<tr>
<td>2.5 Does the PIU(^1) have experience in the management of disbursements from the African Development Bank Group?</td>
<td></td>
</tr>
<tr>
<td>2.6 Does the entity have/need a capacity to manage exposure to foreign exchange risks?</td>
<td></td>
</tr>
<tr>
<td>2.7 How are the counterpart funds accessed?</td>
<td></td>
</tr>
<tr>
<td>2.8 Are controls over payments made from the counterpart funds adequate?</td>
<td></td>
</tr>
<tr>
<td>2.9 If part of the project is implemented by communities or by NGOs, does PIU have necessary reporting and monitoring features built into its systems to track the use of project proceeds by such agencies.</td>
<td></td>
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</tbody>
</table>

\(^1\) The project financial management system depends on the nature of the project and of its implementing entity, which could be a self-standing Project Implementing Unit (PIU), Project Co-ordination Unit (PCU), Project Management Unit (PMU), Project Liaison Unit (PLU), a government ministry, department, or agency, or a commercial entity. These guidelines use ‘PIU’ to refer to all of the above.
2.10 Are the beneficiaries required to contribute to the project costs? If beneficiaries have an option to contribute in kind (in the form of labour) are proper guidelines formulated to record and value the labour contribution?

**CONCLUSIONS AND RECOMMENDATIONS**

(a) Please outline, principal areas where controls regarding ‘Funds Flow’ assessment area might be improved.

(b) Please outline, any other aspects of ‘Funds Flow’ financial management system that merit specific mentioning.

(c) Risk Assessment (Funds Flow):

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### 3. STAFFING

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3.1 What is the organizational structure of the accounting department? Attach an organization chart.

3.2 Identify the account staff, including job title, responsibilities, educational background and professional experience. Attach job descriptions and CVs of key accounting staff.

3.3 Is the project finance and accounts function staffed adequately?

3.4 Is the finance and accounts staff adequately qualified and experienced?

3.5 Is the project accounts and finance staff trained in the Bank procedures?

3.6 What is the duration of the contract with the finance and accounts staff?

3.7 Indicate key positions not contracted yet, and the estimated date of appointment.

3.8 Does the project have written position description for all of the officers, managers and staff that clearly define duties, responsibilities, lines of supervision, and limits of authority?

3.9 At what frequency is the staff transferred?

3.10 What is training policy for the finance and accounting staff?

**CONCLUSIONS AND RECOMMENDATIONS**

(a) Please outline, principal areas where controls regarding ‘Staffing’ assessment area might be improved.

(b) Please outline, any other aspects of ‘Staffing’ financial management system that merit specific mentioning.

(c) Risk Assessment (Staffing):

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### 4.1 ACCOUNTING POLICIES AND PROCEDURES

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4.1.1 Does the entity have an accounting system that allows for the proper recording of project financial transactions, including the allocation of expenditures in accordance with the respective components, disbursement categories and sources of funds? Will the project use the entity accounting system?

4.1.2 Are controls in place concerning the preparation and approval of journal entries, ensuring that journal entries are correctly made and adequately explained?

4.1.3 Is the chart of accounts adequate to properly account for and report on project

---

2 The role of the accountant in the public sector is far wider than the production of the annual financial statements. Financial management is usually a more important task. This may include: development of a Medium-Term Expenditure Framework; annual budget planning development, monitoring and reporting; reviewing, maintaining and enhancing internal financial control; efficient procurement of goods and services; cash-flow planning and treasury management; planning, developing, managing and auditing financial management information systems (computerised financial systems); and activity based costing (ACCA: http://www.accaglobal.com/transparency/publicsector/financialmanagement/).
4.1.4 Are cost allocations to the various funding sources made accurately and in accordance with established agreements?

4.1.5 Are the General Ledger and subsidiary ledgers reconciled and in balance?

4.1.6 Are all accounting and supporting documents retained on a permanent basis in a defined system that allows authorized users easy access?

### 4.2 Segregation of Duties

<table>
<thead>
<tr>
<th>Remarks/Comments</th>
<th>4.2.1 Are the following functioning responsibilities performed by different units or persons: (i) authorization to execute a transaction; (ii) recording of the transaction; and (iii) custody of assets involved in the transaction?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>4.2.2 Are the functions of ordering, receiving, accounting for and paying for goods and services appropriately segregated?</td>
</tr>
<tr>
<td></td>
<td>4.2.3 Are bank reconciliations prepared by someone other than those who make or approve payments?</td>
</tr>
</tbody>
</table>

### 4.3 Budgeting System

<table>
<thead>
<tr>
<th>Remarks/Comments</th>
<th>4.3.1 Do the budgets lay down physical and financial targets?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>4.3.2 Are budgets prepared for all significant activities in sufficient detail to provide a meaningful tool with which to monitor subsequent performance?</td>
</tr>
<tr>
<td></td>
<td>4.3.3 Are actual expenditures compared to budget with reasonable frequency and explanations required for significant variations from the budget?</td>
</tr>
<tr>
<td></td>
<td>4.3.4 Are approvals required in advance or post-facto for variations from the budget?</td>
</tr>
<tr>
<td></td>
<td>4.3.5 Who is responsible for preparation and approval of budgets?</td>
</tr>
<tr>
<td></td>
<td>4.3.6 Are procedures in place to plan project activities, collect information from the units in charge of the different components, and prepare the budgets?</td>
</tr>
<tr>
<td></td>
<td>4.3.7 Are the project plans and budgets of the project activities realistic, based on valid assumptions and developed by knowledgeable individuals?</td>
</tr>
</tbody>
</table>

### 4.4 Payments

<table>
<thead>
<tr>
<th>Remarks/Comments</th>
<th>4.4.1 Do invoice processing procedures provide for:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Copies of purchase orders and receiving reports to be obtained directly from issuing departments?</td>
</tr>
<tr>
<td></td>
<td>• Comparison of invoice quantities, prices and terms, with those indicated on the purchase order and with records of goods actually received?</td>
</tr>
<tr>
<td></td>
<td>• Comparison of invoice quantities with those indicated on the receiving reports?</td>
</tr>
<tr>
<td></td>
<td>• Checking the accuracy of calculations?</td>
</tr>
<tr>
<td></td>
<td>4.4.2 Are all invoices stamped PAID, dated, reviewed and approved, and clearly marked for account code assignment?</td>
</tr>
<tr>
<td></td>
<td>4.4.3 Do controls exist for the preparation of the payroll and are changes to the payroll properly authorized?</td>
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</tbody>
</table>

### 4.5 Policies And Procedures

<table>
<thead>
<tr>
<th>Remarks/Comments</th>
<th>4.5.1 What is the basis of accounting (e.g., cash, accrual)</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>4.5.2 What accounting standards are followed?</td>
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<tr>
<td></td>
<td>4.5.3 Does the project have an adequate policies and procedures manual used to control activities and to ensure staff accountability?</td>
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<td></td>
<td>4.5.4 Are the accounting policies and procedure manuals updated for the project activities?</td>
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<td></td>
<td>4.5.5 Do procedures exist to ensure that only authorized persons can alter or establish a new accounting principle, policy, or procedure to be used by the entity?</td>
</tr>
<tr>
<td></td>
<td>4.5.6 Are there written policies and procedures covering all routine financial management?</td>
</tr>
</tbody>
</table>
4.5.7 Do policies and procedures clearly define *conflict of interest* and *related party transactions* (real and apparent) and provide safeguards to protect the organization from them?

4.5.8 Are manuals distributed to appropriate personnel?

<table>
<thead>
<tr>
<th>4.6 Cash and Bank</th>
<th>Remarks/Comments</th>
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</thead>
<tbody>
<tr>
<td>4.6.1 Are there any project bank accounts opened yet?</td>
<td></td>
</tr>
<tr>
<td>4.6.2 Indicate names and positions of authorized signatories in the bank accounts.</td>
<td></td>
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<tr>
<td>4.6.3 Does the project maintain an adequate, up to date cashbook, recording receipts and payments?</td>
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<tr>
<td>4.6.4 Do controls exist for the collection, timely deposit, and recording of receipts at each collection location</td>
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<tr>
<td>4.6.5 Are bank and cash reconciled on a monthly basis?</td>
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<tr>
<td>4.6.6 Are all unusual items on the bank reconciliation reviewed and approved by a responsible official?</td>
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<tr>
<td>4.6.7 Are all receipts deposited on a timely basis?</td>
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<tr>
<th>4.7 Safeguard over Assets</th>
<th>Remarks/Comments</th>
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<tbody>
<tr>
<td>4.7.1 Is there a system of adequate safeguards to protect assets from fraud, waste, and abuse?</td>
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<tr>
<td>4.7.2 Are subsidiary records of fixed assets and stocks kept up to date?</td>
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<tr>
<td>4.7.3 Are there periodic physical inventories of fixed assets and stocks?</td>
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<td>4.7.4 Are assets sufficiently covered by insurance policies?</td>
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<tr>
<th>4.8 Other offices and implementing entities</th>
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<tbody>
<tr>
<td>4.8.1 Are there any other regional offices or executing entities participating in implementation?</td>
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<tr>
<td>4.8.2 Has the project established controls and procedures for flow of funds, financial information, accountability and audits in relation to the other offices or entities?</td>
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<tr>
<td>4.8.3 Does information among the different offices/implementing agencies flow in an accurate and timely fashion?</td>
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<tr>
<td>4.8.4 Are periodic reconciliations performed among the different offices/implementing agencies?</td>
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4.9 Other

4.9.1 Has the project advised employees, beneficiaries and other recipients whom to report to if they suspect fraud, waste or misuse of project resources or property?

**CONCLUSIONS AND RECOMMENDATIONS**

(a) Please outline, principal areas where controls regarding ‘Accounting Policies and Procedures’ assessment area might be improved.

(b) Please outline, any other aspects of ‘Accounting Policies and Procedures’ financial management system that merit specific mentioning.

(c) Risk Assessment (accounting Policies and Procedures):

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5. INTERNAL AUDIT

5.1 Is there an internal audit department in the entity?

5.2 What are the qualifications and experience of the persons working in the department?
**5.3** To whom does the internal auditor report?

**5.4** Will the internal audit department include the project in its work program?

**CONCLUSIONS AND RECOMMENDATIONS**

(a) Please outline, principal areas where controls regarding ‘Internal Audit’ assessment area might be improved.

(b) Please outline, any other aspects of ‘Internal Audit’ financial management system that merit specific mentioning.

(c) Risk Assessment (Internal Audit):

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**6. EXTERNAL AUDIT**

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6.1 Is the entity’s financial statement audited regularly by an independent auditor? Who is the auditor?

6.2 Are there any delays in audit of the entity? When are the audit reports issued?

6.3 Is the audit of the entity and/or the project conducted according to the International Standards of Auditing?

6.4 Were there any major accountability issues brought out in the audit report of past three years?

6.5 Will the entity auditor audit the project accounts or will a separate auditor be appointed to audit the project financial statements?

6.6 Are there any recommendations made by the auditors in prior audit reports or management letters, which have not yet been implemented?

6.7 Is the project subject to any kind of audit from an independent governmental entity (e.g., the Supreme Audit Institution) in addition to the external audit?

6.8 Has the project prepared acceptable Terms of Reference for an annual Project audit?

**CONCLUSIONS AND RECOMMENDATIONS**

(a) Please outline, principal areas where controls regarding ‘External Audit’ assessment area might be improved.

(b) Please outline, any other aspects of ‘External Audit’ financial management system that merit specific mentioning.

(c) Risk Assessment (External Audit):

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**7. REPORTING AND MONITORING**

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7.1 Are financial statements prepared for the entity? In accordance with which accounting standards?

7.2 Are financial statements prepared for the implementing unit?

7.3 What is the frequency of preparation of financial statements? Are the reports prepared timely to be useful to management for decision-making?

7.4 Does the reporting system need to be adapted to report on the project components?

7.5 Does the reporting system have the capacity to link the financial information with the project physical progress? If separate systems are used to gather and compile physical data, what controls are in place to reduce the risk that the physical data may not synchronize with the financial data.

7.6 Does the Project have established financial management reporting responsibilities that specify what reports are to be prepared, what they are to contain and how they are to be used?

7.7 Are financial management reports used by management?
7.8 Do the financial reports compare actual expenditures with budgeted and programmed allocations?

7.9 Are financial reports prepared directly by the automated accounting system or are they prepared by spreadsheets or some other means?

CONCLUSIONS AND RECOMMENDATIONS
(a) Please outline, principal areas where controls regarding ‘Monitoring and Reporting’ assessment area might be improved.

(b) Please outline, any other aspects of ‘Monitoring and Reporting’ financial management system that merit specific mentioning.

(c) Risk Assessment (Monitoring and Reporting):

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8. INFORMATION SYSTEMS

8.1 Is the financial management system computerized?

8.2 Can the system produce the necessary project financial reports?

8.3 Is the staff adequately trained to maintain the system?

8.4 Does the management organization and processing system safeguard the confidentiality, integrity and availability of the data?

CONCLUSIONS AND RECOMMENDATIONS
(a) Please outline, principal areas where controls regarding ‘Information System’ assessment area might be improved.

(b) Please outline, any other aspects of ‘Information Systems’ financial management system that merit specific mentioning.

(c) Risk Assessment (Information Systems):

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7.13.8 Annex B: Supporting Documents

The supporting documents will normally include the following items, if applicable to the project financial management system and necessary for the assessment. General country information need only be included if it is not otherwise available.

- Assessment Report
- Financial Management Questionnaire
- Financial regulations, standards or pronouncements used by the project/entity
- Information concerning the legal and organizational structure of the entity
- Extracts or copies of important legal documents, agreements, or minutes
- Information concerning the sector, economic environment, and legislative environment within which the entity operates
- Evidence of the assessment planning process
- Evidence of the Financial Analyst’s consideration of the work of the Internal Auditor (if applicable) and conclusions reached
- Analyses of significant ratios and trends (revenue generating projects)
- Draft format of the financial statements produced by the project/entity
- Evidence that work performed by consultants was supervised and reviewed
7.13.9 **Annex C: Financial Management Assessment Report**

**Annex C-1: Content of the Financial Management Assessment Report**

**Executive Summary:** The executive summary fulfils two purposes: (a) to summarize the findings of the assessment and (b) to be the input to the project Appraisal Report, including an overall assessment as to the adequacy of the financial management system. The executive summary should be brief and cover the following points:

1. **(a)** record an assessment of the adequacy of the financial management system and of the financial performance of any revenue-earning entities, and describe and give a timetable for any measures proposed to improve capabilities;

2. **(b)** describe the status of the borrower’s and the project implementing entities’ compliance with audit covenants in existing Bank Group-financed projects, and explain any actions being taken to address noncompliance; and

3. **(c)** record agreements with the borrower on standards and formats for audited financial statements and the timetable for their submission.

In addition, country level issues arising from the Country Governance Profile (CGP) and other country analytic work (e.g. the World Bank led Financial Accountability assessment component of PEFAR) should be identified, including the impact on the project financial management system.

In addition, the following issues should be covered, if significant:

- The flow of funds between donors, the project, and its beneficiaries.
- If project implementation capacity in financial management is assessed as weak, the supervision and other actions to mitigate the possible unfavorable results.
- The adequacy of banking arrangements.

**Summary Project Description:** Provide a brief summary of the project, focusing on the issues that impact the Assessment.

**Country Issues:** Identify any country issues that are relevant to the project. The source of the issues should be current analytical work (e.g., CGP, PEFAR, PEFA-PFM, CPAR, etc.). Insofar as possible, analysis of the country issues should not be repeated as part of the assessment. The bulk of the content for this section could be common to all assessments in the country.

**Risk Analysis:** The risk analysis from the Financial Management Questionnaire should be copied into this section. In addition, the appropriate contribution to project’s Appraisal Report should be presented in the same format as is required in the Appraisal Reports:
<table>
<thead>
<tr>
<th>Risk</th>
<th>Risk Rating</th>
<th>Risk Mitigation Measures</th>
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**Strengths and Weaknesses:** Identify the significant strengths that provide a basis for reliance on the project financial management system.

In the following chart, identify the significant weakness of the project financial management system and the way in which each weakness will be addressed. Methods of addressing the weakness include an agreed action to rectify the weakness (the resolution will link to the action plan) or to accept it as a risk that will be mitigated (the resolution will link to the risk table, above).

<table>
<thead>
<tr>
<th>Significant Weaknesses</th>
<th>Resolution</th>
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**Implementing Entity:** Provide a description of the implementing entity and any unique features that impact the financial management issues.

**Funds Flow:** Describe the funds flow, preferably in the format of flow chart.

**Staffing:** Identify the key staff positions and the capability of this staff to fulfil the accounting and reporting needs of the project.

**Accounting Policies and Procedures:** Describe key policies and procedures that demonstrate the adequacy of the project financial management system.

**Internal Audit:** Describe the internal audit function and its oversight responsibilities over the project financial management system.

**External Audit:**
- Describe issues that have arisen in the audit of previous Bank Group-financed projects implemented by the project and/or entity, including the status of overdue audit reports or outstanding issues; if the issues are significant, they should be included in the action plan and conditions.
- Describe audit arrangements for the current project, including appointment of auditor and the audit terms of reference.
- Complete the following chart to clearly identify the audit reports that will be required to be submitted by each project implementation agency and the due date for submission.

<table>
<thead>
<tr>
<th>Audit Report</th>
<th>Due Date</th>
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<tbody>
<tr>
<td>Entity</td>
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<tr>
<td>Project</td>
<td></td>
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<tr>
<td>Other (specify)</td>
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</tbody>
</table>
**Reporting and Monitoring:** Describe the financial reporting systems and the ability to report on the project expenditures.

Attach a draft of the format of the financial statements that will be prepared by the project. This financial statements format will be used as the annual audited financial statements.

**Information Systems:** Describe information systems that will be used for the financial management of the project.

**Impact of Procurement Arrangements:** Describe the impact of the procurement assessment on the assessment of the financial management system.

**Disbursement Arrangements:** The assessment should document the following details of the disbursement arrangements:
- Method;
- Special Account allocation and procedures;
- Disbursement Mechanisms (e.g., direct payment);
- Any unique circumstances or requirements.

**Action Plan, If Required (Agreed with Borrower):** If weaknesses have been identified that need to be rectified before the project has acceptable financial management, an action plan should be documented in the assessment. Actions that are conditions should be noted as such; all action plans must be agreed with the borrower.

<table>
<thead>
<tr>
<th>Action</th>
<th>Responsible Person</th>
<th>Completion Date</th>
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**Conditions:** List all conditions (e.g., negotiation, Board presentation, effectiveness, disbursement), fully describing actions that must be taken to meet the condition.

**Financial Covenants:** List all financial covenants that will be in the project Loan/Grant Agreement.

**Supervision Plan:** Identify the supervision strategy and required resources for the financial management aspects of the project.

**Annex C: Financial Management Assessment Report** *(continued)*

**Annex C-2: Financial Management Assessment Report (Template Format)*

[Name of Country]  
[Name of Project (Project Ref. Number)]  
[Date of Review Completion]  

1. **Background**

1. Scope/Objective of Review of Financial Management System. This report is the result of a financial management review and analysis as conducted by [Name and Title of Consultant]
and/or Bank staff conducting Review]. The scope of the work has been set out in the Terms of Reference for “Conducting and Preparing a African Development Bank Group Financial Management Assessment” dated X/X/XX. The objective of the review is to determine whether the project has in place a financial management system as required by the Bank Group under Operations Manual 600, Paragraphs 15 & 16.

2. **Project Objective.** The proposed Project’s main development objectives are:

3. **Project Status/Schedule.** The Project is currently at [...] stage. Dates for the project cycle are: (a) Decision Meeting: [date]; (b) Appraisal: [date]; (c) Negotiations: [date]; (d) Board [date]; (e) Signing: [date]; (f) Effectiveness: [date]; (g) Completion: [date]; and (h) Closing: [date]. (Please separate ‘actual dates’ from ‘estimated dates for the remaining project cycle’)

II. **Organizational Structure/Institutional Arrangements**

4. **Organization Chart (Annex 4).** Identify ministries, committees, Project Implementation Units involved, how they relate to one another, responsibilities, staffing and status of set up.

5. **Institutional Experience with Bank Group-Financed Projects.** Identify prior Bank Group financed programs that have had experience with PIUs and entities involved.

III. **Project Structure and Costing**

6. **Financing and Cost Sharing.** Identify project financing sources, amounts and details on funding for each loan/grant category and/or project component.

7. **Loan/Grant Agreement Categories.** Identify loan/grant agreement categories and amounts and percentages of Bank financing for each.

8. **Project Component and Sub-Components.** Identify project components, sub-components and amounts of financing for each funding source.

9. **Procurement Budget.** Identify procurement categories and projected volume to determine risk areas (e.g. breakdown by amounts).

IV. **Internal and Other Controls**


11. **Laws/Regulations.** Identify local laws and regulations affecting the project on financial management related issues.

12. **Cash Management and Documentation Flow.**

V. **Accounting Standards, Financial and Management Reporting**

13. **Accounting Standards.** Identify the accounting standards applied by the project in preparing and presenting Project Management Reports.
14. **Project Reports.** Identify which project reports (examples: Quarterly Progress Report, Annual Progress Report, Audit Report, Audit Management Letter, etc.) are used, attach agreed formats (Annex 5); identify parties responsible for preparing and submitting; identify project Chart of Accounts (COA) (Annex 8). Check actual project reports against reporting timetable and identify shortfalls. Reconcile project report’s figures to COA. Ensure project reports are fairly presented.

15. **Automation Assessment.** Assess automation capacity and needs (both hardware and software) in preparing and presenting project reports.

**VI. Special Accounts, Disbursements and Supporting Documentation**

16. **Special Accounts.** Identify how many accounts are utilized, the entities and individuals who are responsible for processing and reconciling transactions, where bank accounts are held and in what currency and how transactions are authorized. Assess appropriateness of segregation of duties. Prepare a flowchart of project receipt procedures and entities/individuals involved (Annex 6). Assess adequacy of the bank reconciliation procedures.

17. **Disbursement Processing and Supporting Documentation.** Prepare a flowchart of project disbursement procedures and entities/individuals involved (Annex 7).

**VII. Staffing and Training**

18. **Project Financial Management Staffing, Qualifications and Job Descriptions.** Assessment and evaluation of financial management staff backgrounds, experience, qualifications and job descriptions.

19. **Training.** Identify training needed, for whom and who would conduct training programs.

**VIII. Audit Arrangements**

20. **Project Audits.** Describe audit TOR details (when prepared, by whom, content), accounting and auditing standards applied, types of audits submitted or to be submitted (Project, Special Account, etc.) timing of audit submission, selection process and timing for auditor and identify auditor used. Assess independent and objectivity of auditor.

21. **Entity Audits.** Same as above.

22. **Compliance with Audit Covenants.** Describe PIUs and country overall’s audit compliance with existing Bank financed programs, quality of past audit submissions, auditors used, outstanding follow-up issues.

**IX. Budgeting and Monitoring**

23. Describe and evaluate project budgeting process, cycle. Identify issues in obtaining and monitoring local funding.
X. **Risks**

24. **Country Risks.** Describe relevant: (a) Country Governance Profiles; and (b) World Bank led PEFAR details analyzing the general financial management environment and risks in the country. Identify Country Corruption Index (Transparency International statistic).

25. **Project Risks.** Identify, discuss and evaluate project risks. Complete and attach: (a) Financial Management Questionnaire (Annex 1) and Summary of Risk Assessment (Annex 2) identifying elements of material risk, strategies used to evaluate and recommendations.

XI. **Issues/Next Steps**

26. (a) **Other Findings.** Summarize other internal control finding and recommendations not covered elsewhere in this report; and
   (b) **Action Plan.** Discuss time-based Action Plan items. The Action Plan is included in report as Annex 3.

XII. **Conclusion**

27. Based on assessment, specify whether project does or does not satisfy minimum Bank financial requirements as stipulated in OP 600 Paragraphs 15 & 16.

**Attachments:**
- Annex 1: Financial Management Questionnaire
- Annex 2: Summary of Risk Assessment
- Annex 3: Action Plan
- Annex 4: Project Organization Chart
- Annex 6: Flow chart of receipts, including funds from external donors
- Annex 7: Flow chart of disbursements
- Annex 8: Chart of accounts
- Annex 10: Meeting Schedule of Project Contacts

7.13.10 **Annex D: Assessing Risk**

This annex provides a structured framework to assist the Financial Analyst in carrying out the review of the financial management systems. The approach is largely based on IFAC Statement 400 “Risk Assessment and Internal Control.” Consistent with the fact that the assessment is not an audit, the Financial Analyst is not required to carry out compliance or substantive testing of the system reviewed.

**Definitions**

*Inherent risk* -- Inherent risk is the susceptibility of the project financial management system to factors arising from the environment in which it operates, such as country rules and regulations and entity working environment (assuming absence of any counter checks or internal controls).
Control risk -- Control risk is the risk that the project’s accounting and internal control framework are inadequate to ensure project funds are used economically and efficiently and for the purpose intended, and that the use of funds is properly reported.

Financial management system -- The project financial management system is the series of tasks and records of the project entity by which transactions are processed as a means of maintaining financial records. Such systems identify, assemble, analyze, calculate, classify, record, and report transactions and other events periodically presented in the financial statements.

Internal control framework -- The internal control framework is defined as all the policies and procedures adopted by the management of the project entity to assist in achieving management's objective of ensuring, as far as practicable, the orderly and efficient conduct of the project, including adherence to management policies, the safeguarding of assets, the prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information. The internal control framework extends beyond those matters that relate directly to the functions of the financial management system, and comprises:

The control environment, which means the overall attitude, awareness and actions of the project management and staff regarding the internal control framework and its importance in the entity. The control environment has a bearing on the effectiveness of the specific control procedures. A strong control environment--for example, one with tight budgetary controls--can significantly complement specific control procedures. However, a strong environment does not, by itself, ensure the effectiveness of the internal control framework. Factors affecting the control environment include:

- Composition of the Project Management Unit,
- Philosophy and operating style of the project management,
- Project entity’s methods of assigning authority and responsibility,
- Arrangements for external audit of the project, and
- Management’s personnel and incentive policies.

The control procedures are those policies and procedures, in addition to the control environment, which management has established to achieve the specific project objectives. Specific control procedures include:

- Reporting, reviewing and approving reconciliation,
- Controlling applications and environment of computer information systems,
- Maintaining and reviewing control accounts and trial balances,
- Reviewing and reconciling disbursement summaries with the project accounting records,
- Limiting physical access to assets and records, and
- Comparing and analyzing the financial results with budgeted amounts.

Assessing Inherent Risks

To assess inherent risks that the project may face, the Financial Analyst should evaluate factors at three different levels--country specific, entity specific, and project.
(a) Country specific

In assessing the country specific inherent risks, the Financial Analyst is expected to draw upon the existing work (such as CGP, PEFAR, PEFA-PFM, CPAR, etc) and is not expected to carry out the risk assessment every time financial management systems are assessed for an individual project. Areas to be reviewed include:

- Significant weaknesses in the budgetary process (transparency, basis of preparing the budget, budget monitoring process, sanctity of budget approvals, medium/short term expenditure framework);
- Significant weaknesses in the public sector accounting and reporting (standards, timeliness, capacity of the public sector accounting professionals);
- Significant weaknesses in the public and private sector auditing (standards, capacity, independence, timeliness);
- Significant weaknesses in the legislative scrutiny process particularly in respect of review and follow up over the audit findings (composition of the Public Accounts Committee, frequency of Public Accounts Committee PAC meetings, independence, effectiveness);
- Significant weaknesses in the funds flow mechanism (bureaucratic delays, cumbersome procedures, weak banking system);
- Salary structure within the public sector as compared to the private sector;
- Degree of management independence from the politics; and
- Status of the accounting profession in the country.

(b) Entity specific

The inherent risks in relation to the project implementing entity are primarily in three areas: (a) institutional and organizational aspects, (b) funds flow, and (c) audit arrangements. In some projects the distinction between the entity and project may be nonexistent as the project implementing unit (PIU) is created exclusively to implement the Bank Group-financed project, and the PIU is independent of any existing agency.

(i) Institutional and Organizational Aspects. The Financial Analyst should review the institutional and organizational structure, considering the following:

- Capacity to handle the budgeting, accounting, internal controls, and reporting functions;
- Complexity of the project, volume of transactions, number of implementing agencies, and geographical spread of the project activities (for a complex project that is implemented by a large number of agencies, the project will require a strong project financial management team to monitor the release of funds, their use, and reporting of expenditures);
- Number of accounting staff required to manage the financial management function, staff qualifications, staff training requirements, the level of the accounting staff vis-à-vis other departments, and reporting relationships;
- Staff retention and turnover rate, and the adequacy of the performance review process (frequent staff changes may have an adverse impact on the project implementation); and
- Risks that the project will not have appropriate staff who are sufficiently qualified and trained, or that the staff will be transferred frequently leading to disruptions or that the reporting relationships are conducive to efficient functioning.

(ii) Fund Flow Arrangements. The Financial Analyst should review the funds flow arrangements from the Bank to the special account, the implementing agency, contractors and suppliers, and in
some cases, to the ultimate beneficiary to assess the risks that the proceeds of the loan/grant will be used for their intended purposes. The same issues need to be examined for flow of counterpart funds.

*(iii) Audit Arrangements.* The Financial Analyst should assess the risks that audited project financial statements will not be furnished to the Bank on time or that the quality of audit will not be acceptable to the Bank.

*(c) Project specific*

The Financial Analyst should pay particular attention to the following factors when assessing the project-specific inherent risks:

- Complexity of the project,
- Number of project implementing agencies involved and their prior experience,
- Involvement of NGOs and community groups in project implementation,
- Ability of the PIU to attract and retain qualified staff,
- The integrity of project management, and
- Susceptibility of assets to loss or misappropriation.

**Assessing Control Risk**

To assess the weaknesses of the internal control system, the Financial Analyst will need to understand its objectives, framework, environment, and control procedures.

*(a) Objectives of internal control framework*

Internal controls relating to the financial management system are concerned, among other things, with ensuring that:

- Transactions are executed in accordance with management’s authorization.
- All transactions and other events are promptly recorded in the correct amount, in the appropriate accounts, and in the proper accounting period to permit the preparation of financial statements in accordance with an identified financial reporting framework.
- Access to assets is permitted only in accordance with management’s authorization.
- Recorded assets are compared with the existing assets at reasonable intervals and appropriate action is taken regarding any differences.

*(b) Understanding the internal control framework*

To understand the internal control framework, the Financial Analyst should obtain knowledge of its design and operation through completion of the Financial Management Questionnaire. Where the system is already in place, it may be appropriate to perform a “walk-through” test (i.e., trace a few transactions through the financial management system). When the transactions selected typify those that pass through the system, this procedure may also form part of the assessment of the degree of control risk.

The nature, timing, and extent of the review of the internal control framework will vary with, among other things, the
• Size and complexity of the entity and its computer systems,
• Type of internal controls involved,
• Nature of the project entity’s documentation of specific internal controls, and
• Extent to which the financial management system and internal control framework are in place and functioning at the time of the assessment.

An understanding of the main elements of the financial management system and internal control framework is obtained through previous experience with the PIU (where applicable), and is supplemented by:

• Inquiries with management and personnel at various levels within the PIU, together with reference to documentation such as procedure manuals, job descriptions, and flow charts;
• Inspection of documents and records produced by the financial management system and internal control framework; and
• Observation of the project entity’s activities and operations, including computer operations

Observation of the project entity’s activities and operations, including computer operations

(c) Understanding the financial management system

The Financial Analyst should obtain an understanding of the financial management system that the project has established by completing the Financial Management Questionnaire.

(d) Understanding the control environment

The Financial Analyst should obtain an understanding of the control environment sufficient to assess project management’s attitude, awareness, and actions regarding internal controls and their importance to the entity. The control environment will include the budgeting, costing, management reporting, and auditing systems. The Financial Analyst will have to gain an understanding of various aspects of these systems; the Financial Management Questionnaire provides a format for gathering this understanding.

(e) Understanding the control procedures

Because control procedures are integrated with the control environment and the financial management system, some knowledge about control procedures is likely to be gained while obtaining an understanding of the financial management system. For example, in assessing the control procedures pertaining to cash and bank balances, it would be usual to ascertain whether bank accounts are reconciled.

(f) Tests of control

When reviewing the effective operation of internal controls, the Financial Analyst should consider how and by whom they are applied. The concept of effective operation recognizes that some deviations may occur. Deviations from prescribed controls may be caused by such factors as changes in key personnel, significant seasonal fluctuations in volume of transactions, and human error. When deviations are observed, specific inquiries should be made regarding these
matters, particularly the timing of staff changes in key internal control functions. However, the Financial Analyst will not normally carry out tests of the internal controls system.

**g) Assessing the control risk**

After obtaining an understanding of the financial management system and internal control framework, an assessment of control risk should be made and documented in the Financial Management Questionnaire. The assessment of control risk is the process of evaluating the effectiveness of the project entity’s financial management system and internal control framework in ensuring that project funds are used economically and efficiently and for the purpose intended and are properly reported.

Many internal controls which would be relevant to large project entities are not practical for small entities. For example, in small projects, accounting procedures may be performed by a few persons, who may have both operating and custodial responsibilities, and therefore segregation of duties may be missing or severely limited. Inadequate segregation of duties may, in some cases, be offset by a strong management control system in which managerial supervisory controls exist because of direct personal knowledge of the entity and involvement in transactions. In circumstances where segregation of duties is limited and evidence of supervisory controls lacking, the evidence necessary to support the assessment may have to be obtained entirely through the performance of substantive procedures.

7.13.11 **Annex E: Terms of Reference**

Conducting and Preparing an African Development Bank Group Project Financial Management Assessment

[Name of Country, Name of Project and Project Reference Number]

I. **Objective and Background**

(Cut and paste a brief description of the project’s objectives, size and what appraisal activity has already been performed. Reference any documents you would like the consultant to review about the project. It is usually also important to include any country risks noted in our country’s analyses concerning corruption or lack of financial management capacity in the environment the project will operate in. Mention all funding sources and whether you would like the consultant to review project procedures designed to meet the requirements imposed by other donors, in addition to the Bank Group’s.)

(Add information concerning the implementing entities, including where they are located, the Bank Group’s experience with them on previous projects and other activities.)

- The objective of the proposed Financial Management Assessment for the proposed XXX Project is to assess the extent to which the Project has in place an adequate financial

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3 This TOR is for use when recruiting consultants to assess the financial management arrangements in Bank Group-financed projects.
management system, as required by the African Development Bank Group’s Operations Manual 600, Paragraphs 15 & 16.

- (Add other objectives as appropriate.)

II. Scope of Testing

The Financial Management Assessment of the financial management system should be carried out in accordance with the ‘Assessment of Financial Management Arrangements In African Development Bank Group-financed Projects: Guidelines To Staff’ and ‘The African Development Bank Group Guidelines for Financial Management and Financial Analysis of projects’ and should address the following important aspects:

1. Understanding the Project

The reviewer should pay particular attention to:

- reports issued by the African Development Bank and other donors that provide insights on general financial management environment prevailing in the country;
- project appraisal reports to become familiar with the project’s objectives, components and sub components;
- cost sharing arrangements including categories of expenditures, location, and sources of financing;
- the experience, lessons learned and recommendations noted from prior projects, or from the previous activities of the implementing agencies;
- the structure and experience of the implementing agencies used in implementing the project, including the relationships between any lead agencies and participating agencies;
- the paths for project funds flow and the timing of those flows and the implications where decentralization is involved (e.g. whether direct to the project or through government ministries; direct financing or reimbursements); laws, rules, regulations and agreements that govern or may affect any aspect of the project;
- reports issued by project auditors (if any audit has been conducted) or by the Bank Group in respect of the projects’ operations;
- the scope and purposes of the local decentralized levels’ formats and procedures; and
- identifying the key risk areas of the specific project.

2. Review of Records Management System

The reviewer should assess whether the following aspects of the Records Management System are in place:

- there are clearly defined procedures for creating, maintaining and safeguarding records;
- the records management procedures address the location and maintenance of records relating to project participating agencies;
- there are clearly defined procedures for safeguarding the records from fire, water, other environmental risks, and from unauthorized access;
- there are adequate back-up procedures, particularly with respect to computerized records; and
- there is adequate access to records by authorized persons including auditors and external donor supervision staff.
3. Review of Internal Controls

The reviewer of internal controls should pay specific attention to:

- assessment of both country and project risks to include, inter alia, the overall environment for internal controls (e.g. support for an accountability culture at a high level of government) and organizational risks - presence of honest and capable employees (usually influenced by compensation, education and experience levels);
- ascertaining the strength and identifying weaknesses in the management structure or function;
- determining whether there is accountability to an outside implementation agency or committee;
- ascertaining if there are adequate (a) administrative, accounting and operational procedures for various levels of authority, (b) segregations of duties, (c) controls over assets, and (d) cash management procedures and they are clearly defined; and
- evaluating the general and procedural controls surrounding (a) budget preparation and execution; (b) the operation of the accounting and reporting system; (c) the receipt and disbursement of cash; (d) the maintenance and recording of capital and other assets; (e) procurement and payables; and (f) employee compensation and payroll processing, when applicable to the project.

4. Project Accounting

The reviewer should assess the adequacy of the design of the project accounting system. The system should be capable of providing financial information as required by all donors and relevant parties and of fulfilling all the legal and regulatory requirements of the Borrower country. The accounting standards to be used should be clearly identified and reported to the Bank. Special attention should be given to:

- describing the basis of accounting and ascertaining its appropriateness for the controls and reporting requirements of the project;
- identifying or assisting in the preparation of a chart of accounts that is tailored to the specifics of the project and make it possible to aggregate sources of financing and expenditures under project components, sub components and locations, taking into consideration the requirements of the Borrower, co-financiers, the Bank, and other interested parties;
- reviewing the cost components and sub components to see if they are adequate to measure physical and other monitorable achievements; and
- ensuring that there are arrangements to record contract commitments, expenditures and other information required to track the procurement process.

5. Staffing

The reviewer should assess if an adequate number of staff and management have been identified or hired for the project. The Financial Management Assessment should include an assessment of credentials and experience in accounting to make good judgments on the maintenance of the books of accounts and on the production of financial information. The reviewer should also:

- assess management and staff proposed for the project for having appropriate professional skills and performance, and strong accountability over operations; and
- review policies and experience of the implementing agencies in staff retention, turnover rates and the recruitment process with respect to appropriate qualifications, training opportunities and examine the adequacy of performance review process.

6. Accounting Software

The reviewer should assess the proposed financial software’s capabilities to ensure that it:

- can provide data for periodic reporting (monthly, quarterly, annual etc.); by unit or activity; by funding source and expenditure categories; by actual and budget for the period and accumulated to date; to show variance between actual and for the period, accumulated for year, and to date;
- has the ability to work in the currency of the Bank (UA), the Borrower and that of the Special Account;
- has good internal controls, is auditable and will provide transparency; and
- has a good track record for reliability, will be installed on time, will be within budget, and is well supported technically.

7. Audit Arrangements

The reviewer should assess whether the auditor has been identified and plans have been made to appoint the auditor before the commencement of project activities, and to re-appoint the auditor well before the beginning of each fiscal year. The auditing standards to be used should be clearly identified and reported to the Bank. Special attention should be given to:

- reviewing whether the proposed auditor is independent of the entity/project to be audited;
- reviewing whether that the proposed auditor is capable and experienced with respect to this type of project;
- reviewing whether the proposed auditor is appropriately qualified, competent and follows acceptable standards on auditing; and
- reviewing whether an appropriate terms of reference has been drafted, drawing special attention to areas of concern that may not be emphasized under a normal audit (compliance with donor financial covenants and procurement guidelines), and that the auditor is provided with appropriate information on the project (Appraisal Report, Loan/Grant Agreements, etc.).

8. Financial Management Reporting

The review should be comprehensive enough to ascertain whether the project would satisfy African Development Bank requirements for disbursements (e.g. Inadequate Financial and/or Procurement Management). Special attention should be given to:

- documenting the agreed upon formats for project reporting, as well as their frequency and distribution, and for the financial statements as tailored to the specifics of the project); and
- determining whether the project is capable of producing reliable [quarterly] project management reports.

9. Procedures Related to Funding Sources

The reviewer should ascertain and document the mechanisms envisioned for the project to obtain periodic funding from the host government and external donors, including the method planned to draw down funds pledged in legal agreements, as well as arrangements proposed to establish and
maintain Special Accounts. Limits and approval procedures should be clearly established, along with procedures to conduct periodic reconciliations.

III. Financial Management Documentation

In conducting the assignment, the reviewer should become familiar with the following project documentation: Project Appraisal Report; Loan/Grant Agreement; Project Financial Management Systems Manual; and Other Bank policies and procedures regarding disbursement, procurement (e.g. Disbursement Manual, etc.)

IV. Deliverables

The reviewer shall prepare a report from their Financial Management Assessment fully documenting and evaluating the project financial management results noted from the work performed in Section II: above. The report (a template format is attached), should include the following information:

- a general report, in accordance with the attached template, which should include a detailed summary of each topic in II, above, as well as an opinion on the financial management system in place and its adequacy to meet Borrower’s, external donor’s and project management’s needs; and
- a listing of findings and recommendations proposed, as well as a realistic time-bound action plan detailing specific steps considered necessary to address inadequacies noted in the project's financial management capacity.

7.14 SHOWCASE PROJECT INITIATIVE

Introduction

7.14.1 Under the stewardship of CHRM, and the coordination of FFMA, the Bank initiated the Showcase Project Initiative (SPI) as part of its ongoing efforts to improve project quality at entry by providing staff with the necessary tools to perform state-of-the art project appraisal through both pedagogical and hands-on training. Specifically, a team of consultants from Queen’s University was retained to assist staff conduct enhanced project appraisal on live projects that will be turned into benchmark case studies for the Bank Group.

Integrated Project Appraisal

7.14.2 The analysis of the selected projects is carried out through an integrated approach, covering the evaluation of the financial, economic, stakeholder and risk aspects of each project in a single consistent model. This model also integrates the financial results from the analysis of the project within the overall financial position of the parent Executing Agency (EA).

7.14.3 The central tool of the integrated project appraisal approach is the pro forma cash flow and net economic benefit statement. From these annual inflows and outflows, over the life of the project, are estimated. There are several goals of the appraisal. First, the appraisal seeks to determine if the project will be financially sustainable. The EA, as owner of the proposed project, should expect to recover the initial outlays on the project and to earn a fair rate of return. The debt service coverage ratios are very important.
indicators of financial sustainability. Secondly, the lenders to the project should feel comfortable with the ability of the project to generate the cash to the EA in order to meet the scheduled debt obligation, as well as, with the ability of the borrower to make timely payments not only on the project in question but also on its overall debt service. Other measures of financial performance such as the unit cost of products produced also provide useful benchmarks for comparing the proposed investment with alternative options.

7.14.4 The pro forma net economic benefit statement constructed from financial appraisal serves as the basis for determining the project’s economic feasibility. Within the integrated appraisal framework, the economic analysis is built directly on the financial cashflows of the project and the economic treatment of project benefits is measured by the cost savings expressed in economic terms, consistent with the financial valuation of system cost savings by the EA. The issues that analysis aims to address in the economic analysis are mainly focused on the contribution of the project to the economy of country concerned and economic cost of producing the public goods or services.

7.14.5 In the stakeholder module of the integrated appraisal, the quest is to identify the primary stakeholders affected by the project. What the decision-makers should know is the present value of economic externalities created by this project, and what is the amount of the gain/loss realized by each stakeholder because of the project.

7.14.6 The objective of the sensitivity and risk analysis is to identify the risks the project faces. Project managers, to a certain extent, can control some risk factors while others can only be addressed at the level of the EA and the government of country concerned. There are also some factors that are totally exogenous forces that none of the country institutions can address.

**SPI Benchmark Projects**

7.14.7 Four Showcase Projects were selected by the SPI working group in cooperation with the consultants from Queen’s University and approved by the SPI steering committee. Project selection was based on objective criteria, including: (i) suitability to highlight key project appraisal issues; (ii) geographic and sector mix; (iii) borrower diversity (AfDB/ADF, sovereign/non-sovereign); and (iv) project timing (to fit the six-month SPI window). The four selected projects are: (1) El Kureimat Power Plant (Egypt); (2) Rural Water and Sanitation Initiative (Senegal); (3) Rascom Satellite Telecommunications (Multinational); and (4) Smallholder Agriculture Development (Zambia).

7.14.8 In accordance with the objectives of the SPI, the consultants assisted the Bank’s operations departments and other support departments to perform the following three primary tasks: (i) the preparation of full-fledged financial, economic and risk analysis models for four Bank Group Showcase Projects; (ii) the transformation of the four Showcase Projects into AfDB-specific case studies to serve as examples of ‘best practices’ and provide reference material for future Bank Group appraisal work; and (iii) the development of the AfDB case studies into well-documented teaching materials for use in future training courses both inside the Bank and at external development training centers.

7.14.9 Below, the Appraisal Reports that are an outcome of the SPI can be accessed through the link provided. However, the related case study and teaching materials and the appraisal
models are available separately in the Bank as they are too voluminous to link then to these Guidelines.

### El Kureimat Power Plant

<table>
<thead>
<tr>
<th>Sector</th>
<th>Power</th>
</tr>
</thead>
<tbody>
<tr>
<td>Country</td>
<td>Egypt</td>
</tr>
<tr>
<td>Widow</td>
<td>AfDB</td>
</tr>
</tbody>
</table>

Appraisal Report is as follows:

![El-Kureimat.pdf]

### Rural Water and Sanitation Initiative

<table>
<thead>
<tr>
<th>Sector</th>
<th>Water</th>
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<tbody>
<tr>
<td>Country</td>
<td>Senegal</td>
</tr>
<tr>
<td>Widow</td>
<td>ADF</td>
</tr>
</tbody>
</table>

Appraisal Report is as follows:

![Rural Water and Sanitation Initiative.pdf]

### Smallholder Production Project

<table>
<thead>
<tr>
<th>Sector</th>
<th>Agriculture</th>
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<tbody>
<tr>
<td>Country</td>
<td>Zambia</td>
</tr>
<tr>
<td>Widow</td>
<td>ADF</td>
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Appraisal Report is as follows: Not Yet Finalized

### Rascom Satellite Telecommunications

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<tr>
<th>Sector</th>
<th>Telecom</th>
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<tbody>
<tr>
<td>Country</td>
<td>Multinational</td>
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<tr>
<td>Widow</td>
<td>AfDB</td>
</tr>
</tbody>
</table>

Appraisal Report is as follows: Not Yet Finalized

### 7.15 RESULTS-BASED COUNTRY STRATEGY PAPER

7.15.1 In June 2005 the Board considered the Results-Based County Strategy Paper (RBCSP) that among other important innovations requires countries and the Bank country teams to be more explicit about the outcomes that the Bank supported assistance interventions will influence. It also entails better monitoring and evaluation of performances in terms of outcome and allows for a better harmonization and alignment of donors procedures with country monitoring and evaluation system. **The main features of the RBCSP are:**

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• **Results Framework**: a planning and management tool that defines the links between strategic development goals and outcomes that are directly influenced by the Bank’s programs; thus emphasis is on measurement and management.

• **Monitoring and Evaluation System**: This is part of results framework, which aims at minimizing the burden on country capacity by trying to reduce multiplicity of donors systems. Monitoring is a continuing function that uses systematic collection of data on specified indicators to provide management and the main stakeholders of an ongoing development intervention with indications of the extent of progress and achievement of objectives and progress in the use of allocated funds. Evaluation involves a systematic and objective assessment of an on-going or completed project, program or policy, its design, implementation and results.

• **The RBCSP should be analytic** in its content and orientation: The document should analyze issues and derives logical conclusions.

• **A more systematic stocktaking** self-evaluation using mid-term reviews and CSP completion report.

7.15.2 The RBCSP paper is attached:

### 7.16 APPRAISAL CHECKLISTS

7.16.1 This section provides generic checklist for the financial appraisal of: a non-revenue earning project; revenue-earning project; and financial intermediary institution. It also provides a checklist to review financial aspects of Appraisal Reports.

**Appraisal Checklist for a Non-Revenue-Earning Project**

<table>
<thead>
<tr>
<th>Activity</th>
<th>Remarks/comments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Preparation at Headquarters</strong></td>
<td></td>
</tr>
<tr>
<td>A.1</td>
<td>Meet with Division Manager and Task Manager to receive briefing on the Bank's approach to defining a non-revenue-earning project with respect to the country, borrower, co-financier(s), project and appraisal mission (OM 600).</td>
</tr>
<tr>
<td>A.2</td>
<td>Study the Country Strategy Paper (OM 330) to understand the role that the project to be designed will fulfil.</td>
</tr>
<tr>
<td>A.3</td>
<td>Study relevant reports on the country profile, institutions to be involved and responsible for the project, and where available, the proposed EA.</td>
</tr>
<tr>
<td>A.4</td>
<td>Study all reports on project identification and preparation including the Country Economist’s forecast of local and foreign inflation for the country concerned (OMS 600 Annex 3, paragraph 17).</td>
</tr>
<tr>
<td>A.5</td>
<td>Study relevant reports on country project performance.</td>
</tr>
<tr>
<td>A.6</td>
<td>Study all recent reports on ongoing projects in the sector in the country.</td>
</tr>
<tr>
<td>A.7</td>
<td>Based on steps A.1 to A.6, above, summarize all positive and negative attributes ascribed to country, sector and similar projects.</td>
</tr>
<tr>
<td><strong>B. Initial Steps</strong></td>
<td></td>
</tr>
<tr>
<td>B.1</td>
<td>Participate in, or where necessary, arrange initial meetings with government counterparts in all organizations likely to be concerned with...</td>
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<td>--------------------------------------------------------------------------------------------</td>
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<tr>
<td>B.2</td>
<td>Ensure all managers and staff to be involved in project planning and implementation have copies of the Bank’s Handbook for Borrowers on Financial Management and Financial Analysis of Projects, the Bank’s handbooks on Disbursement and Procurement.</td>
</tr>
<tr>
<td>C.</td>
<td>The Institutional Environment</td>
</tr>
<tr>
<td>C.1</td>
<td>Confirm/modify information obtained through readings in section A, above.</td>
</tr>
<tr>
<td>C.2</td>
<td>Determine current organizational and management linkages of central government, state government (where applicable) and sector institutions to be involved in financial aspects of project design, development, implementation and operation.</td>
</tr>
<tr>
<td>C.3</td>
<td>Determine current and/or proposed organizational and financial aspects of the management structure of the existing or proposed EA to be involved in project design, development, implementation and operation.</td>
</tr>
<tr>
<td>C.4</td>
<td>Understand the country’s financial sector, the role of the central bank and the banking system, and their potential application to/impact on, the project.</td>
</tr>
<tr>
<td>C.5</td>
<td>Determine the capability, capacity and current performance of the accounting and auditing profession in the country, particularly as they will impact on the project.</td>
</tr>
<tr>
<td>C.6</td>
<td>Determine the capability, capacity and current performance of the government audit service, particularly as they will impact on the project.</td>
</tr>
<tr>
<td>C.7</td>
<td>Determine the quality of accounting and book-keeping capability and training in the existing or proposed executing agency.</td>
</tr>
<tr>
<td>C.8</td>
<td>Determine the capability of the financial manager(s) designated to be responsible for the project.</td>
</tr>
<tr>
<td>C.9</td>
<td>Make recommendations for modifications to organizational structures, managements, staffs and training necessary to support the project and, where necessary, prepare an institutional appraisal of the EA to support upgrading of institutional performance. Share recommendations with the Task Manager.</td>
</tr>
<tr>
<td>D</td>
<td>Financial Management Systems</td>
</tr>
<tr>
<td>D.1</td>
<td>Taking into account the conclusions arrived at under C.5 to C.9 above, where there exists an ongoing financial management system, accounting and book-keeping systems, computer/data processing systems, and an internal control environment and systems to support the project, form a judgment on the acceptability, or otherwise, of these systems. Examine the following systems to the extent that they are likely to be necessary to support the project:</td>
</tr>
<tr>
<td></td>
<td>a). Planning and budgeting records</td>
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<tr>
<td></td>
<td>b). Payroll including HR records</td>
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<tr>
<td></td>
<td>c). Accounts payable</td>
</tr>
<tr>
<td></td>
<td>d). Accounts receivable</td>
</tr>
<tr>
<td></td>
<td>e). Taxes and duties</td>
</tr>
<tr>
<td></td>
<td>f). Inventories</td>
</tr>
<tr>
<td></td>
<td>g). Project accounting records</td>
</tr>
<tr>
<td></td>
<td>h). Ledgers and journal systems</td>
</tr>
<tr>
<td></td>
<td>i). Bank accounts and reconciliations</td>
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<td></td>
<td>j). Equity records</td>
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<td></td>
<td>k). Subsidies received</td>
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</tr>
<tr>
<td>l). Grants/Donations records</td>
<td>m). Loans received and repayments</td>
</tr>
<tr>
<td>o). Cash management</td>
<td>p). Asset records</td>
</tr>
<tr>
<td>r). Periodic and annual financial statements</td>
<td>s). External auditors’ reports and opinions</td>
</tr>
</tbody>
</table>

**D.2** On the basis of examination in D.1, determine the nature and form of the accounting standards in use and their likely acceptability to the Bank. In the event that they would not be acceptable, define the Bank’s requirements to counterparts of the EA and the borrower.

**D.3** On the basis of examination in D.1, determine the nature and form of the auditing standards in use and their likely acceptability to the Bank. In the event that they would not be acceptable, define the Bank’s requirements to counterparts of the EA and the borrower.

**D.4** In the absence of any of the system elements set out in D.1 above, define new or additional system requirements necessary to support the project and advise a timetable to counterparts for their introduction and full operation, including necessary staff additions and training.

**E. Definition of Project Cost Requirements**

**E.1** Review with counterparts and consultants responsible for project design/preparation the project description and specifications documents in order to understand the likely project components and their related cost elements.

**E.2** Although this project is proposed as non-revenue-earning, review with the Task Manager the possibility of introducing a tariff and charges as part of project design, for meeting all or any critical part of the costs of producing products/outputs/sales, etc., ensuring that such a tariff and charges would encourage cost savings that could be proposed as part of the project and meet forecast inflationary factors.

**E.3** Use appropriate MS Excel models or where available, “COSTAB” software to compile all project costs and procurement documentation.

**E.4** Review with counterparts and consultants responsible for project design/preparation the Project Cost Estimates Table for comprehensiveness, adequacy of structure/descriptions of base cost line items, including annual foreign and local costs, and annual/periodic expenditures including interest during construction, where applicable. Ensure that taxes and duties are clearly defined and capable of being measured for exclusion from Bank financing.

**E.5** Prepare or obtain a country/sector disbursement profile to judge the likely accuracy of the forecasts of proposed expenditures and Bank disbursements.

**E.6** Examine the price contingencies for accuracy with respect to local and foreign costs, including application of appropriate rates of local and foreign inflation in accordance with Country Economist’s advice (OM 600, Annex 3 paragraph 17).

**E.7** Examine the physical contingencies for accuracy with respect to appropriate allowances (OM 600 Annex 3 paragraph 9 et seq).

**E.8** Discuss with Task Manager and, where appropriate, with counterparts, the Financing Plan and disbursement profile to determine the total financing requirements, the amount and timing of receipt of each input of funds requirements, the amount of the Bank’s proposed total loan/credit proceeds, of receipts from co-financier(s), and from counterpart funds.
**Preparation of Financial Projections and Draft Appraisal Report**

<table>
<thead>
<tr>
<th>F.</th>
<th>Activity</th>
<th>Remarks/comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>F.1</td>
<td>Determine forecast annual operating costs of the EA that relate to the implementation of the project only, and incorporate inflation as forecast in A.4 above</td>
<td></td>
</tr>
<tr>
<td>F.2</td>
<td>Using information gathered in E.3 to E.9, above prepare a projected combined annual income statement/funds flow/balance sheet for the project period.</td>
<td></td>
</tr>
<tr>
<td>F.3</td>
<td>On the basis of the data gathered in E.3 to E.9 above, compile the FIRR, with appropriate financial performance indicators for the project and, where appropriate, the EA. Discuss proposed indicators with Task Manager and counterparts, explaining logic of selection and methods of calculation</td>
<td></td>
</tr>
<tr>
<td>F.4</td>
<td>With Task Manager, explain in detail to counterparts the method of compilation and the forecast results of all financial statements at all appropriate levels of concerned institutions and managements with the objective of reaching agreement on the Project Cost Estimates Table, the Financing Plan, the financial projections, the financial performance indicators and any tariffs and charges proposed.</td>
<td></td>
</tr>
<tr>
<td>F.5</td>
<td>With the Task Manager, meet with co-financiers at mutually agreed locations (whenever possible, in the presence of counterparts) to explain the method of compilation and the forecast results of all financial statements at all appropriate levels of concerned institutions and managements with the objective of reaching agreement on the Project Cost Estimates Table, the financing plan, the financial projections, performance indicators and any tariffs and charges proposed.</td>
<td></td>
</tr>
<tr>
<td>F.6</td>
<td>Draft the section of the Aide Memoire (OM 600, paragraph 39) relating to all financial aspects of the project and discuss with Task Manager. Make any agreed amendments for presentation of complete Aide Memoire to counterparts at appropriate levels.</td>
<td></td>
</tr>
<tr>
<td>F.7</td>
<td>Draft paragraphs for inclusion in the financial section of the Appraisal Report, and prepare financial annexes to attach to the Appraisal Report. Review with the Task Manager.</td>
<td></td>
</tr>
</tbody>
</table>

**Appraisal Checklist for a Revenue-Earning Project**

<table>
<thead>
<tr>
<th>Activity</th>
<th>Remarks/comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.1</td>
<td>Meet with Division Manager and Task Manager to receive briefing on the Bank's approach to defining a revenue-earning project with respect to the country, the sector, the project and objectives of the appraisal mission (OM600).</td>
</tr>
<tr>
<td>A.2</td>
<td>Study the Country Strategy Paper (OM 330) to understand the role that the project to be designed will fulfil.</td>
</tr>
<tr>
<td>A.3</td>
<td>Study relevant reports on the country profile, institutions to be involved in design, authorization, implementation, and operation of the project, particularly where available, the proposed EA.</td>
</tr>
<tr>
<td>A.4</td>
<td>Study all reports on project identification and preparation. Obtain forecasts of inflation for the country concerned from the Country Economist (OMS 600 Annex 3 paragraph 17).</td>
</tr>
<tr>
<td>A.5</td>
<td>Study all reports on country and sector project performance.</td>
</tr>
<tr>
<td>A.6</td>
<td>Study all reports issued within the past five years on similar projects in the sector in the country.</td>
</tr>
</tbody>
</table>
| A.7      | Based on steps A.1 to A.6, above, summarize all positive and negative
attributes ascribed to country, sector and similar projects.

**B. Initial Steps**

B.1 Participate in, or where necessary, arrange meetings with key managers and any counterparts representing managers in the EA to confirm appraisal arrangements/requirements. Make a judgment on the likely efficiency of the managers and the counterpart(s).

B.2 Participate in, or where necessary, arrange initial meetings with government counterparts in all organizations likely to be concerned with the project, to confirm appraisal arrangements/requirements.

B.3 Ensure all managers and staff to be involved in project planning and implementation have copies of the Bank’s Handbook for Borrowers on Financial Management and Financial Analysis of Projects, the Bank’s Disbursement Handbook and the Bank’s Procurement Handbook.


**C. The Institutional Environment**

C.1 Confirm evidence provided through readings in section A. above

C.2 Determine current organizational structure and responsibilities with respect to the project of central government, state government(s) and sector agencies that will be involved in project design, development, implementation and operation, for example, Ministries of Finance and Economy, Industrial Production, Planning and Development, Agriculture, Export Guarantee Agency, etc.

C.3 Determine the likely acceptability to the Bank of current and/or proposed organizational and management structure of the EA and/or consultants involved in preparing the project’s planning, programming, design, development, implementation and operation.

C.4 Understand the country’s financial sector, the role of the central bank and the banking system, and their probable application to/impact on the project.

C.5 Explore current status of positive and negative attributes in paragraph A.7, above

C.6 Determine the capability, capacity and current performance of the country’s accounting and auditing profession as it impacts, or will impact, on the EA and on the project

C.7 Determine the capability, capacity and current performance of the government auditing profession, particularly the Auditor-General’s Office or equivalent, as it impacts, or will impact, on the EA and on the project.

C.8 Determine the actual, or forecast anticipated, quality of accounting and book-keeping capability and training in the EA to service the project and EA.

C.9 Determine the capability of the financial manager(s) designated to be responsible for the project, against the background of paragraphs C.6 to C.8, above.

C.10 Make recommendations for modifications to organizational structures, financial management(s), accounting /bookkeeping /inventory management staffs and training necessary to support the project and where necessary, prepare an institutional appraisal of the EA to support upgrading of institutional performance. Share findings with the Task Manager.

**D. Financial Management Systems**
D.1 Taking into account the outcome of paragraphs C.7 – C.10 above, where there exists an ongoing financial management system, accounting and book-keeping systems, computer/data processing systems, and an internal control environment and systems to support the project, form a judgment on the acceptability, or otherwise, of these systems and documentation. Examine the following systems and documentation to the extent that they are likely to be necessary to support the project:

- Planning and budgeting records
- Payroll including HR records
- Accounts payable
- Accounts receivable
- Taxes and duties
- Inventories
- Cost of Manufactured goods
- Project accounting records
- Management and Overhead
- Ledgers and journal systems
- Bank accounts and reconciliations
- Records of stock issues and re-purchase
- Investors/Shareholders Records
- Equity records
- Grants/Donations records
- Subsidies received
- Loans received and repayments
- Loans advanced
- Cash management
- Dividends records
- Asset and depreciation records
- Internal controls and internal audit
- Periodic and annual financial statements
- Recent external auditors’ reports and opinions

In cases where the EA is a public company owned wholly or in part, by the government, the following two additional matters should be reviewed: i) financial clauses of the Articles of Incorporation (or Association) of the Company; and (ii) minutes of company meetings for the past three years (or such other period as may be reasonable) in which financial policy, strategy, decisions and issues were recorded.

D.2 On the basis of examination in paragraphs C.6, C.8 and D.1, determine the nature and form of the accounting standards in use and their likely acceptability to the Bank. In the event that they would not be acceptable, define the Bank’s requirements to counterparts of the EA and the borrower (where applicable).

D.3 On the basis of examination in paragraphs C.6, C.7, and D.1, determine the nature and form of the auditing standards in use and their likely acceptability to the Bank. In the event that they would not be acceptable, define the Bank’s requirements to counterparts of the EA, the existing auditing firm (if it is to be retained for the project) and the borrower (where applicable).

D.4 In the absence of any, or all, of the system elements set out in D.1 above, define new or additional system requirements and documentation necessary to support the project and advise a timetable to counterparts for their introduction and full operation, including necessary staff additions and training.

E. Definition of Project Cost Requirements
### E. Review with counterparts and consultants responsible for project design/preparation the project description and specifications documents in order to understand the cost of each project component (new assets) and their likely foreign and local costs for each year of implementation, the total cost of each asset for depreciation purposes (including interest during construction) and the forecast date(s) of their commissioning.

#### E.1 Review with the Task Manager the likely adequacy and suitability of the existing tariff and charges, or any new tariff and charges developed as part of project design, for products /outputs /sales, etc. ensuring, where necessary, that the tariffs and charges reflect cost savings proposed as part of the project and take account of forecast inflationary factors.

#### E.2 Use appropriate MS Excel models or where available, “COSTAB” software to compile all project costs and procurement documentation.

#### E.3 Review with counterparts and consultants responsible for project design/preparation the Project Cost Estimates Table for comprehensiveness, adequacy of structure/descriptions of base cost line items, and annual/periodic expenditures including interest during construction, where applicable. Ensure that taxes and duties are clearly defined and capable of being easily defined for exclusion from Bank financing.

#### E.4 Examine the physical contingencies and their legitimacy (OM 600 Annex 3).

#### E.5 Examine the price contingencies for accuracy with respect to local and foreign costs, including application of appropriate rates of local and foreign inflation in accordance with Country Economist’s advice.

#### E.6 Discuss with Task Manager and, where appropriate, with counterparts, the Financing Plan and disbursement profile to determine the total financing requirements, the amount and timing of receipt of each input of funds requirements, the proposed amount of the Bank’s total loan proceeds, of receipts from co-financier(s), from internal funds, and from government counterpart funds (where applicable).

### F. Preparation of Financial Projections for an Ongoing Production Operation

#### F.1 Determine actual and forecast physical output statistics and losses (industrial /agricultural products /electricity /water/ telecom, etc.) for at least two completed fiscal years prior to the start of project implementation, for the period of project implementation, and for at least three years of operation.

#### F.2 In consultation with the Task Manager and counterparts, as appropriate, apply the tariff and charges gathered in paragraph E.2, above to provide a revenue stream during implementation and thereafter.

#### F.3 In consultation with the Task Manager and counterparts, as appropriate, determine a commissioning schedule for the components of the project with related costs, and prepare a depreciation schedule for the assets to be provided by the project.

#### F.4 In consultation with the Task Manager and counterparts, as appropriate, if it will be necessary to revalue assets periodically through the implementation period and thereafter to reflect the impact of severe inflation, prepare a forecast depreciation schedule with and without the assets referred to in paragraph F.3, above.

#### F.5 In consultation with the Task Manager and counterparts, as appropriate, prepare the EA’s operating costs with and without the project for at least
<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>F.6</td>
<td>Prepare schedules of interest payments due to lenders.</td>
</tr>
<tr>
<td>F.7</td>
<td>Prepare schedules of loan repayments to lenders.</td>
</tr>
<tr>
<td>F.8</td>
<td>Using the results of paragraphs F.1 – F.6, above compile an Income Statement for at least two completed fiscal years prior to the start of project implementation, for the period of project implementation, and for at least three years of operation.</td>
</tr>
<tr>
<td>F.9</td>
<td>For an ongoing operation - using the following information determined in paragraphs, above: projected annual investments (paragraph E.1), disbursements (paragraph E.8), interest payments (paragraph F.6), loan repayments (paragraph F.7), and the results from the Income Statements (paragraph F.8), prepare a Cash Flow Statement for at least two completed fiscal years prior to the start of project implementation, for the period of project implementation, and for at least three years of operation.</td>
</tr>
<tr>
<td>F.10</td>
<td>For an ongoing operation - on the basis of audited annual financial statements for two fiscal years prior to implementation and the results of the Income Statement (paragraph F.8, above) and the Cash Flow Statements (paragraph F.9, above), prepare Balance Sheets for the period of implementation and three years of operation.</td>
</tr>
<tr>
<td>G.1</td>
<td>Determine forecast physical output statistics and losses (industrial/agricultural products/electricity/water/telecom, etc.) for the period of project implementation (if any), and for at least five years of operation.</td>
</tr>
<tr>
<td>G.2</td>
<td>In consultation with the Task Manager and counterparts, as appropriate, apply the tariff and charges determined in paragraph E.2, above to provide a revenue stream during implementation and thereafter.</td>
</tr>
<tr>
<td>G.3</td>
<td>In consultation with the Task Manager and counterparts, as appropriate, determine a commissioning schedule for the components of the project with related costs, and prepare a depreciation schedule for the assets to be provided by the project.</td>
</tr>
<tr>
<td>G.4</td>
<td>In consultation with the Task Manager and counterparts, as appropriate, if it will be necessary to revalue assets periodically through the implementation period and thereafter to reflect the impact of severe inflation, prepare a forecast depreciation schedule.</td>
</tr>
<tr>
<td>G.5</td>
<td>In consultation with the Task Manager and counterparts, as appropriate, prepare the EA’s operating costs for the period of project implementation, and for at least five years of operation and incorporate inflation as forecast in paragraph E.7, above.</td>
</tr>
<tr>
<td>G.6</td>
<td>Prepare schedules of interest payments due to lenders.</td>
</tr>
<tr>
<td>G.7</td>
<td>Prepare schedules of loan repayments to lenders.</td>
</tr>
<tr>
<td>G.8</td>
<td>Using the results of G.1 – G.6, above compile an Income Statement for the period of project implementation, and for at least five years of operation.</td>
</tr>
<tr>
<td>G.9</td>
<td>Using the following information determined in paragraphs, above: projected annual investments (paragraph E.1), disbursements (paragraph E.8), interest payments (paragraph G.6), loan repayments (paragraph G.7), and the results from the Income Statements (paragraph G.8), prepare a Cash Flow Statement for the period of project implementation, and for at least five years of operation.</td>
</tr>
<tr>
<td>G.10</td>
<td>On the basis of the results of the Income Statements (paragraph G.8), and the Cash Flow Statements (paragraph 59), prepare Balance Sheets for the period of implementation and five years of operation.</td>
</tr>
</tbody>
</table>
H. For All Projects

H.1 On the basis of data generated in paragraphs F.1 to G.10, above compile appropriate financial performance indicators including the FIRR for the project and, where appropriate, the EA. Discuss proposed indicators with Task Manager and counterparts, explaining logic of selection and methods of calculation.

H.2 With the Task Manager, explain to counterparts, in detail, the method of compilation and the forecast results of all financial statements at all appropriate levels of concerned institutions and managements with the objective of reaching agreement on the Project Cost Estimates Table, the financing plan, the financial projections and tariffs and charges proposed.

H.3 With the Task Manager, meet with co-financiers at mutually agreed locations (if possible in the presence of counterparts) to explain the method of compilation and the forecast results of all financial statements at all appropriate levels of concerned institutions and managements with the objective of reaching agreement on the project cost table, the financing plan, the financial projections and tariffs and charges proposed.

H.4 Draft the section of the Aide Memoire (OM 600 paragraph 39) relating to all financial aspects of the project and discuss with the Task Manager. Make any agreed amendments for presentation of complete Aide Memoire to counterparts at appropriate levels.

H.5 Draft paragraphs for inclusion in the financial section of the Appraisal Report, and prepare financial annexes to attach to the Appraisal Report. Review with the Task Manager.

Appraisal Checklist for a Financial Intermediary Institution

7.16.2 Financial Intermediaries (FIs) comprise a wide range of institutions, including Apex institutions that service one or more FIs in a country. FIs may provide services to one or more sectors in a country (agriculture, various categories of industry, etc.), including support to microfinance organizations. The latter may also receive support from the banking sector in a country, with or without FI support. The generic checklist that follows, therefore, should be used with caution and appropriately modified to address the nature and form of the FI that is under appraisal.

<table>
<thead>
<tr>
<th>Activity</th>
<th>Preparation at Headquarters</th>
<th>Remarks/comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.1</td>
<td>Meet with Division Manager and Task Manager to receive briefing on the Bank's approach to funding FIs in the country, the sector (e.g. agriculture, industry, etc), the objectives of the project and of the appraisal mission.</td>
<td></td>
</tr>
<tr>
<td>A.2</td>
<td>Study the Country Strategy Paper (OM 330) to understand the role that the project to be designed will fulfil.</td>
<td></td>
</tr>
<tr>
<td>A.3</td>
<td>Study relevant reports on the country profile, institutions to be involved in design, authorization, implementation, and operation of the project, particularly where available, the proposed FI.</td>
<td></td>
</tr>
<tr>
<td>A.4</td>
<td>Study all reports on project identification and preparation.</td>
<td></td>
</tr>
<tr>
<td>A.5</td>
<td>Study all relevant reports on country and sector project performance.</td>
<td></td>
</tr>
<tr>
<td>A.6</td>
<td>Study all reports issued within the past five years on similar FI projects in the country.</td>
<td></td>
</tr>
<tr>
<td>A.7</td>
<td>Based on steps A.1 to A.6, above, summarize all positive and negative attributes ascribed to country, sector and similar projects</td>
<td></td>
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</table>
### B. Initial Steps

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<tbody>
<tr>
<td>B.1</td>
<td>Participate in, or where necessary, arrange meetings with key managers and any counterparts representing managers in the FI to confirm appraisal arrangements/requirements. Make a judgment on the likely efficiency of the managers and the counterpart(s).</td>
</tr>
<tr>
<td>B.2</td>
<td>Participate in, or where necessary, arrange initial meetings with government counterparts in all organizations likely to be concerned with project development, to confirm appraisal arrangements/requirements. Organizations may include the Central Bank, Ministry of Economy, Ministry of Finance, sector ministries (Agriculture, Industry), Ministry of Trade and Industries, etc.</td>
</tr>
<tr>
<td>B.3</td>
<td>Ensure all managers and staff to be involved in project planning and implementation have copies of the Bank’s Handbook for Borrowers on Financial Management and Financial Analysis of Projects, the Bank’s Disbursement Handbook and the Bank’s Procurement Handbook.</td>
</tr>
</tbody>
</table>

### C. The Institutional Environment

<p>| | |</p>
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<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>C.1</td>
<td>Confirm evidence provided through information gathered from paragraphs A.1 to A.6, above.</td>
</tr>
<tr>
<td>C.2</td>
<td>Determine current organizational structure and management position responsibilities, with respect to the FI and the project, of central government, state government(s) and sector agencies that will be involved in project design, development, implementation and operation, for example, Central Bank, Ministries of Finance and Economy, Industrial Production, Planning and Development, Agriculture, Export Guarantee Agency, etc.</td>
</tr>
<tr>
<td>C.3</td>
<td>Determine the likely acceptability to the Bank of current and/or proposed organizational and management structure of the FI and/or consultants involved in preparing the project’s planning, programming, design, development, implementation and operation.</td>
</tr>
<tr>
<td>C.4</td>
<td>Understand the country’s financial sector, the role of the central bank and the banking system, and their probable application to/impact on the FI and the project.</td>
</tr>
<tr>
<td>C.5</td>
<td>Understand the role that the FI plays within the financial sector, for example, is it an apex institution serving one or more FIs? Is it a microfinance institution serving a specific small sectoral or regional/local group of clients? Is it a narrowly focused operation for a sub-sector such as textiles?</td>
</tr>
<tr>
<td>C.6</td>
<td>Determine the capability, capacity and current performance of the country’s accounting and auditing profession as it impacts, or will impact, on the FI and on the project.</td>
</tr>
<tr>
<td>C.7</td>
<td>In countries where the government audit service is required to audit the activities and financial statements of a FI, determine the capability, capacity and current performance of the government auditing profession, particularly the Auditor-General’s Office or equivalent, as it impacts, or will impact, on the FI and on the project.</td>
</tr>
<tr>
<td>C.8</td>
<td>Determine the actual, or forecast anticipated, quality of accounting and book-keeping capability and training in the FI to service the FI and the project.</td>
</tr>
<tr>
<td>C.9</td>
<td>Determine the capability of the financial manager(s) designated to be responsible for the project, against the background of paragraphs C.6 through C.8 above.</td>
</tr>
</tbody>
</table>
C.10 Make judgments as to required modifications to the FI’s organizational structures, lending operations, cash management, risk management, financial accounting/bookkeeping/management and staffing, and training necessary to support the project and where appropriate recommend for inclusion as a component in the project for appraisal. Share findings with the Task Manager.

D. Management Policies and Systems

D.1 Examine the following policies, systems and documentation to the extent that they are likely to be necessary to support the FI and the project:

### 1. Soundness and Clarity of Management Policy

a). Soundness, rationality, and integrity of management policy: Has management established a sound and rational policy (short- and long-term strategies) with full consideration given to current and future management conditions?

Sample supporting questions:

- When drawing up management policy, does the management take into consideration soundness, rationality, and feasibility?
- Is the management policy integrated?

b). Clarity and permeability of management policy: Is management policy clear and well understood, and does it function well?

Sample supporting questions:

- Is the management policy clear with respect to criteria for action by each department?
- Is the policy well understood throughout the entire organization, and does it function well?
- Does the FI compile a medium- and long-term business plan (e.g., every 3-5 years)?
- Does the FI compile a business plan (annually or semi-annually)?
- Does the department in charge of management planning regularly monitor the level of accomplishment and make necessary adjustments?

### 2. Permeability of Risk Management Policy

a). Understanding of risk management: Does the management accurately recognize the types of risk and risk exposure inherent in the bank’s portfolio and understand the method of risk management, and has it encouraged the FI to establish full awareness of the importance of risk control throughout the FI?

Sample supporting questions:

- Does the management have high professional moral standards and make efforts to establish awareness of the importance of internal controls among employees?
- Does the management recognize internal and external factors constituting potential risks to the FI, and is the management aware of the different types and degrees of risk and risk exposure inherent in these factors?
- Does the management recognize different risk management
methods according to the types of risk and risk exposure?

- Does the management set limits to the acceptable amount or degree of risks inherent in the FI and adequately instruct relevant sections?

b). Basic strategy for risk management: *Is the management actively involved in drawing up strategies and establishing the framework for risk management giving due consideration to the balance between various risks to FI’s capital and also the strategic importance of its risk-taking?*

Sample supporting questions:

- Is the management clearly aware of its responsibility for drawing up appropriate and adequate risk management policy?
- Does the board of directors decide basic policy vis-à-vis risk-taking and risk control giving due consideration to the balance between various risks to the FI’s capital as well as each business operation?
- Does the management regularly check the effectiveness of its risk management system?
- Does the management possess the necessary framework, system, and procedures for identifying, monitoring, and controlling various risks?
- Does the management aim to build a comprehensive risk management system on an institution-wide basis?

c). Diversification of risks: *Does the FI diversify risks in the operation of its various businesses?*

Sample supporting questions:

- Is the FI aware of the necessity of diversifying fund-raising sources and investment vehicles?
- Does the FI have in place an organization and operational framework that further emphasizes the importance of risk management rules and regulations such as limit on exposure to a single borrower?
- Does the FI avoid excessive dependency on a specific counter-party in its business operation?
- Is it possible to monitor risks so as to detect any mal-distribution?

d). Countermeasures against payment failure of other FIs: *Does the management understand the effects of payment failure by other FIs and resulting instability of the financial system, and have in place appropriate countermeasures?*

Sample supporting question:

- Does the FI have in place countermeasures against payment failure by other FIs or resulting financial system instability?

### 3. Internal Controls: Organization, Delegation of Authority, and Reporting System

a). Organization: *Is the FI adapting its organization so as to strengthen the risk management system and to implement flexible
**countermeasures to meet changes in the financial environment?**

Sample supporting questions:

- Is the FI adapting its organization and staff allocation so as to strengthen the risk management system?
- Is the burden of responsibility regarding business operations and risk management clearly defined?
- Does the FI have in place a system that can control risk exposure while responding to economic change by utilizing research department data?
- Does the FI have in place an internal control system capable of swiftly and adequately dealing with newly recognized risks arising from changes in the environment, etc.?
- Is the FI aware of the necessity for organizational reform in line with changes in the environment, etc., and is there a department responsible for planning and implementing measures in response to such changes?
- Does the institution-wide risk management section regularly assess the effectiveness of the FI’s overall risk control system?

b). Separation of responsibilities: *Are the framework and procedures for decision-making clarified? Are delegation of authority and allocation of responsibilities conducted appropriately from the standpoint of securing a double-checking system and avoiding conflict of interest? Are these procedures clearly stipulated in the internal rules for delegation of authority?*

Sample supporting questions:

- Are internal rules for the delegation of authority rational from the standpoint of securing double-checking of operations and risk control in line with business expansion?
- Has the FI confirmed that there is no excessive concentration of authority nor extreme delegation of authority to subordinates?
- Does the FI have in place a framework where monitoring and evaluation of major risks are conducted by a specializing section independent from the business promotion department?
- Are risk management responsibilities clearly defined among the board of directors, ALM committee, directors in charge, and department heads?
- Does the department head keep to the unavoidable minimum the range of duties where a sufficient double-checking system cannot be applied, and does the FI have in place a system for close monitoring?

c). Reporting of business information: *Does the FI have in place an appropriate reporting by which the management can receive valuable information on business operations and risk management? Are decisions made by the management clearly understood by the entire organization?*

Sample supporting questions:

- Does the FI have in place an appropriate reporting system by which directors in charge and the board of directors receive information on business operations and risk management?
without undue delay?

- Does the FI have a consistent reporting format, giving due consideration to easy comprehension and coherency of contents?
- Are decisions made by directors in charge and the board of directors adequately communicated to, and understood by, concerned sections (including domestic and overseas branches)?
- Does the FI have in place a regular reporting system to senior officers and management regarding risk management?

4. Staff Recruitment and Training

a). Staff recruitment: Does the FI recruit staff with appropriate experience, skill levels, and degree of expertise to undertake, specialized business operations?
Sample supporting questions:

- Does the FI recruit staff with appropriate experience, skill levels, and degree of expertise to undertake specialized business operations, in particular, those risk management?
- Do staff members actively take part in business operations in line with their position and responsibilities?
- Does the FI recruit staff based on an employment plan?
Sample supporting questions:

b). Training: Does management have a clear staff-training policy?

- Does the on-the-job training (OJT) program function adequately?
- Does the FI have training programs according to qualifications and job description?
- Does the FI revise training programs in accordance with changes in business operation and sophistication of risk management?

5. Internal Audit

a). Audit system: Does the FI conduct effective internal audits (headquarters audit and in-house audit) to enhance its risk management system and check the thoroughness of internal rules?
Sample supporting questions:

- Are the frequency, checkpoints, and scope of internal audits adequate?
- Does the internal audit section/department have auditors with expertise in each business area, and are they able to effectively audit the FI’s overall operation?
- Does the internal audit section/department have access to all relevant documents and vouchers?
- Does the FI conduct regular internal audits of all departments including headquarters and of all operations excluding those that are considered customarily exempted from auditing?
- Is the internal audit section/department completely independent from other sections/departments, and does it directly report to the management?
b). Follow-up of audit: Does the management give prompt and adequate attention to audit results, and take appropriate measures if problems are detected?
Sample supporting questions:

- Are internal audit results reported to the management promptly and accurately?
- Is information useful for improvement of operations regularly passed on to concerned departments such as the operations planning department?
- Does the internal audit section/department take the initiative in directing improvement measures such as the revision of internal rules in order to prevent the reoccurrence of problems?
- Does the management appropriately monitor whether improvement measures directed to sections/departments are carried out?

6. Profit and Loss Management

a). Monitoring of profit/loss: Do the management and individual departments within the organization monitor profit/loss while considering the balance between risk and return?
Sample supporting questions:

- Does a specialized department (e.g., the financial department) monitor profit/loss from various viewpoints such as profit by customer and branch, and on a consolidated basis?
- Does each department manage profit/loss bearing in mind the allocation of indirect costs?
- Is due consideration given to risk profiles when assessing and determining profit/loss conditions?
- Is there a computerized support system for profit/loss management (e.g., cost accounting of deposits and lending)?

b). Distribution of management resources taking into account risk and return: Is due consideration given to the balance between risk and return, and between risk and the FI’s capital when distributing management resources to each department?
Sample supporting questions:

- Does the FI thoroughly assess capital and other resources before embarking on a new business?
- Does the management appropriately decide the resources distribution policy based on regular profit/loss reports?
- Are limits on risk exposure set for each department taking into consideration the FI’s capital?

c). Rational pricing: Is pricing of deposit and lending rates rational in view of operational/profit planning, market conditions, and risks?
Sample supporting questions:

- Is the differential between actual market rates and pricing of deposit, lending, and derivatives rates within a rational range?
- Is delegation of authority relating to pricing clearly defined?
- In pricing, is consideration given not only to operations, profit, and market conditions, but also operating cost, credit
spread, and embedded option premium for premature cancellation?

7. Risk Management of Affiliated Companies

a). Monitoring of profit/loss on a consolidated basis including affiliated companies: Is financial performance monitored appropriately on a consolidated basis or on the basis of including affiliated companies (but not consolidating)?

Sample supporting questions:

- Is financial performance monitored on a consolidated basis with full understanding of the business performance of companies subject to consolidated accounting?
- Is financial performance monitored appropriately on the basis of including affiliated companies not subject to consolidated accounting taking into consideration degree of business affiliation?
- Is there a section responsible for monitoring the business operations of affiliated companies (including non-bank financial institutions)?
- Is the FI capable of checking unusual activities such as large fund transfers among affiliated companies?
- Does the head office fully recognize the risk profiles inherent in overseas affiliated companies?
- Does the FI regularly monitor risks to which domestic and overseas affiliated companies are exposed to ensure that they are within a rational range in relation to their financial strength such as capital?

8. Establishment of Compliance Framework

a). Management understanding of legal compliance and action to achieve it: Does the management fully recognize the importance of complying with laws and regulations, market rules, and internal rules? Are they taking the initiative in raising compliance awareness?

Sample supporting questions:

- Does the management fully understand that insufficient compliance can impair the management base?
- Is the top management making efforts to ensure that recognition of the importance of compliance penetrates throughout the FI?
- Is the management fully aware which FI operations are most likely to cause problems in terms of compliance?
- When starting a new operation, does the management take into consideration of newly arising risks in the area of compliance?

b). Establishment and implementation of a framework for compliance: Has the FI established a framework and concrete procedures (a compliance program) to ensure consistent compliance? Are they appropriately implemented?

Sample supporting questions:

- Are responsibilities with respect to compliance clarified by
appointing an executive director and setting up a responsible coordination department?

- Are matters regarding compliance such as planning and monitoring under centralized control?
- Does the FI have in place concrete procedures (i.e., planning of education and training programs, compiling codes of conduct and compliance manuals, drawing up internal rules, etc.) that effectively initiate compliance?
- Do FIs with overseas branches have a compliance officer for each country who regularly monitors local legal changes?
- Has the FI appropriately placed a person in charge of compliance in relevant departments and clearly stipulated their job descriptions in the allocation of duties?
- Have these positions been effectively put into practice (i.e., implementation of training programs and educational activities, consultation, and inspection in the event of any doubtful contradictions to rules, swift reporting to the coordinating department)?
- In the development and sales of new products, does the coordinating department confirm the legal compliance of its content and policy of customer explanation in advance?
- Does the FI maintain close contact with its lawyers with a view to forestalling trouble and dealing with any incident appropriately and swiftly?

c). Monitoring and reporting to management: In addition to monitoring, does a department independent of operations sections conduct checks on compliance? Are lawsuits and problems that could harm the FI’s reputation appropriately reported to the management?

Sample supporting questions:

- Is the compliance consistency in each type of FI business monitored by compliance officers and in-house audits on a daily basis?
- Does the compliance officer promptly and appropriately report the compliance consistency and problems in each operation section to the coordinating department?
- Does a department (i.e., internal audit department) independent from operation sections and a coordinating department regularly examine the compliance consistency?
- Does the coordinating or internal audit department promptly and appropriately report the compliance consistency and problems to the management and auditors (or auditors committee)?
- Are incidents and accidents swiftly reported to the supervisory authorities?
- Is the credibility of the content of reports sent to other authorities assured?
- Are summaries of customer complaints or lawsuits sent to branches in order to forestall problems?

9. Disclosure and Accounting Process

a). Active disclosure of financial information and restraints on
management: From the standpoint of fulfilling accountability to customers and shareholders, does the management actively and fairly disclose financial information? Is the management sufficiently monitored internally and externally in order to secure business operations?

Sample supporting questions:

- Are the FI’s management policy and strategies made widely known through disclosure magazines and other management means?
- Are major indicators of the FI’s performance accurately disclosed?
- Do the board of directors and auditors (or auditors committee) function appropriately to secure proper execution of business by the management? When required, does the FI appoint external board members and set up a compliance committee?
- Does the management take due notice of the opinions of external auditors (letters of advice on improvement of internal control, i.e., management letters)? Does the management examine and implement appropriate improvement measures?
- Does the FI actively initiate relations with investors, by for example, conducting briefings about its business performance for investors?

b). Appropriate accounting procedures: Is the FI’s processing of daily accounts and annual financial statements sound?

Sample supporting questions:

- Is the processing of daily accounts carried out properly?
- Are annual financial statements produced in accordance with International Accounting Standards (IAS)?
- Is there any unsound accounting manipulation of statements (i.e., figures subject to financial statements and disclosure) such as carrying over of losses that should be realized?
- Are the required amounts of write-offs and provisioning determined by self-assessment appropriated in the financial statements?
- Are soundness of accounting principles and reliability of financial statements secured through adequate auditing?

10. Compilation and Understanding of Contingency Plan

a). Compilation of a contingency plan: Has the FI drawn up a countermeasure (contingency plan) against disasters and accidents?

Sample supporting questions:

- Has the FI drawn up a comprehensive plan for the head office and all branches, and is there a manual for it?
- Is there a section responsible for drawing up and coordinating the plan?

b). Understanding of the plan: Are the management and the staff fully aware of the contingency plan, and do they fully understand it?

Sample supporting questions:

- Is the management aware of the plan, and do they fully understand it?
c). Content of the plan: *Does the contingency plan enable the FI to continue its operations in case of an emergency?*

Sample supporting questions:

(i) Managerial factors:
- Does the plan give due consideration to the safety of customers and employees in case of an emergency?
- Does the plan clearly designate an emergency headquarters to be in charge of dealing with a crisis?
- Does the plan assess the degree of impact an emergency will have on operations?
- Does the plan clearly designate the priority level of each operation, delegation of authority, and arrangements for obtaining the necessary staff in case of an emergency?
- Does the plan clearly state the order and method of contacting management and staff in case of an emergency?
- Does the FI have a means of communication with entities operating payment systems and supervisory authorities, etc., in case of an emergency?
- Does the FI have in place a public relations network (including the use of mass communications) directed at customers in case of an emergency?

(ii) Material factors:
- Does the plan take into consideration electricity, water, and food supply?
- Does the plan clearly designate the necessary action to protect assets such as securing a warehouse to store things and deciding the evaluation procedure for damaged property?
- Has the FI secured backup data in a vault and/or distant location?
- Does the FI have in place a backup center or a backup contract with trustworthy subcontractors or other FIs?
- Has the FI secured multiple communications methods using private lines between the head office and branches, and between the computer center and branches?
- Has the FI secured countermeasures (i.e., alternative office space, etc.) in the event of an emergency (in particular, for overseas branches)?

d). Review and on-site drilling of the plan: *Does the FI have a system for reviewing the contingency plan when appropriate, and are on-site drills conducted regularly?*

Sample supporting questions:
- Does the FI have a system to review the plan when necessary?
- Are on-site drills conducted regularly at the head office against possible shutdown of the system?
- Are on-site drills conducted regularly at both the head office and branches?
- Are results of on-site drills reported to management after appropriate assessment, and utilized in reviewing the plan?
<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>D.2</td>
<td>On the basis of examination in paragraphs C.6, C.8, and D.1 above, determine the nature and form of the accounting standards in use and their likely acceptability to the Bank. In the event that they would not be acceptable, define the Bank’s requirements to counterparts of the FI and the borrower (where applicable).</td>
</tr>
<tr>
<td>D.3</td>
<td>On the basis of examination in paragraphs C.6, C.7, and D.1, determine the nature and form of the auditing standards in use and their likely acceptability to the Bank. In the event that they would not be acceptable, define the Bank’s requirements to counterparts of the FI, the existing auditing firm (if it is to be retained for the project) and the borrower (where applicable).</td>
</tr>
<tr>
<td>D.4</td>
<td>In the absence of any, or all, of the management policies and systems set out in D.1 above, define new or additional management policies and systems requirements and documentation necessary to support the FI and the project and advise a timetable to counterparts for their introduction and full operation, including necessary staff additions and training.</td>
</tr>
<tr>
<td>E.</td>
<td><strong>Definition of Project Cost Requirements</strong></td>
</tr>
<tr>
<td>E.1</td>
<td>Review with counterparts and consultants responsible for project design/preparation the project description and specifications documents in order to understand the cost of proposed sub-projects and similar components (new sub-loans) and the likely foreign and local costs for each year of new advances.</td>
</tr>
<tr>
<td>E.2</td>
<td>Review with the Task Manager the likely adequacy and suitability of the existing interest rate spread, or any new spread that needs to be instituted as part of project design, for on-lending of Bank loan proceeds, etc. ensuring, where necessary, that the charges reflect any operating cost savings proposed as part of the project and take account of forecast inflationary factors.</td>
</tr>
<tr>
<td>E.3</td>
<td>Review with counterparts and consultants responsible for project design/preparation the Project Cost Estimates Table for comprehensiveness, adequacy of structure/descriptions of base cost line items, and annual/periodic funds flows. Ensure that any taxes and duties to be funded by sub-loans are clearly defined and capable of being easily defined for exclusion from Bank financing.</td>
</tr>
<tr>
<td>E.4</td>
<td>Examine any proposed physical contingencies and their legitimacy.</td>
</tr>
<tr>
<td>E.5</td>
<td>Discuss with Task Manager and, where appropriate, with counterparts, the Financing Plan to determine the total financing requirements, the amount and timing of receipt of each input of funds requirements, the proposed amount of the Bank’s proposed total loan proceeds, of receipts from co-financier(s), from internal funds, and from government’s counterpart funds (where applicable).</td>
</tr>
<tr>
<td>F.</td>
<td><strong>Preparation of Financial Projections for an Ongoing FI Operation</strong></td>
</tr>
<tr>
<td>F.1</td>
<td>Determine the FI’s operating objectives for at least two completed fiscal years prior to the start of project implementation and the extent of their fulfilment, and reasons for any shortcomings.</td>
</tr>
<tr>
<td>F.2</td>
<td>Examine and determine the feasibility of, and acceptability to the Bank of, the FI’s operating objectives for the period of project implementation and its forecast for the next two following years.</td>
</tr>
<tr>
<td>F.3</td>
<td>Review the portfolio of performing and non-performing loans, paying specific attention to adverse commentaries (if any) by the external auditor.</td>
</tr>
<tr>
<td>F.4</td>
<td>Review the actual ongoing performance and past statistics relating to recoveries, bad debts, and provisions, particularly the adequacy of the</td>
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<tr>
<td>F.5</td>
<td>Review the status and performance of equity participations and the realism (realisability, earning capacity) of the related entries in the FI’s financial statements.</td>
</tr>
<tr>
<td>F.6</td>
<td>Review the adequacy of the FI’s interest rate spreads to meet all obligations.</td>
</tr>
<tr>
<td>F.7</td>
<td>Examine for reasonableness and profitability the FI’s proposed term lending program using the Bank loan proceeds and other resources.</td>
</tr>
<tr>
<td>F.8</td>
<td>Examine the FI’s proposed equity participation program using the Bank loan proceeds and other resources.</td>
</tr>
<tr>
<td>F.9</td>
<td>Measure the resilience, earning capacity, and security of the FI’s past, ongoing and proposed short-term lending program and its actual and proposed sources of funding.</td>
</tr>
<tr>
<td>F.10</td>
<td>Examine the continuing feasibility/profitability of the FI’s current and proposed leasing program and its actual and proposed sources of funds.</td>
</tr>
<tr>
<td>F.11</td>
<td>In consultation with the Task Manager and counterparts, as appropriate, if it will be necessary to revalue assets periodically through the Bank loan period and thereafter to reflect the impact of severe inflation, prepare a forecast of the impact on lending operations.</td>
</tr>
<tr>
<td>F.12</td>
<td>In consultation with the Task Manager and counterparts, as appropriate, prepare the FI’s operating costs with and without the project for at least two completed fiscal years prior to the start of project implementation, for the period of Bank loan disbursement, and for at least two years of operation and incorporate impacts of inflation forecasts.</td>
</tr>
<tr>
<td>F.13</td>
<td>Review the FI’s status and performance of schedules of interest payments due to lenders.</td>
</tr>
<tr>
<td>F.14</td>
<td>Review the FI’s status and performance of loan repayments to lenders.</td>
</tr>
<tr>
<td>F.15</td>
<td>Examine the reliability of the system of liquidity (cash) management and determine the number of occasions when cash reserves were depleted to dangerous levels in the most recent two years without available recourse.</td>
</tr>
<tr>
<td>F.16</td>
<td>Compile the following financial statements for at least two completed fiscal years prior to the start of loan signing, forecasts for the period of loan disbursement, and forecasts for at least three years thereafter.</td>
</tr>
<tr>
<td></td>
<td>a). Income Statement</td>
</tr>
<tr>
<td></td>
<td>b). Cash Flow Statement (or Sources and Uses of Funds)</td>
</tr>
<tr>
<td></td>
<td>c). Balance Sheet</td>
</tr>
<tr>
<td></td>
<td>d). Capital Adequacy Analysis</td>
</tr>
<tr>
<td></td>
<td>e). Portfolio of Investments at year-end</td>
</tr>
<tr>
<td></td>
<td>f). Schedule of non-performing assets showing: (i) non-performing not rescheduled; (ii) non-performing rescheduled but not performing; (iii) non-performing equity investments; and (iv) non-performing leases.</td>
</tr>
<tr>
<td></td>
<td>g). Analysis of Income and Earnings showing % of average assets by categories</td>
</tr>
<tr>
<td></td>
<td>h). Losses experience by sector/activities</td>
</tr>
<tr>
<td></td>
<td>i). Credit Risk Management</td>
</tr>
<tr>
<td></td>
<td>j). Liquidity and Interest Rate Sensitivity Management</td>
</tr>
<tr>
<td></td>
<td>k). Statement of Changes in Shareholders’ Equity</td>
</tr>
<tr>
<td></td>
<td>l). Provisions for Losses, Write-offs and Recoveries</td>
</tr>
<tr>
<td></td>
<td>m). Schedule of Collateral and Securities</td>
</tr>
<tr>
<td>F.17</td>
<td>Review the records of VaR and prepare a chart showing significant at-risk dates and amounts at risk in the two years prior to appraisal.</td>
</tr>
<tr>
<td>F.18</td>
<td>On the basis of generated data in paragraphs F.1 through F.16 above, compile appropriate financial performance indicators for the FI. Discuss proposed indicators with the Task Manager and counterparts, explaining logic of selection and methods of calculation.</td>
</tr>
<tr>
<td>F.19</td>
<td>With Task Manager, explain in detail to counterparts the method of compilation and the forecast results of all financial statements at all appropriate levels of concerned institutions and managements with the objective of reaching agreement on the Project Cost Estimates Table, the financing plan, the financial projections, interest spreads, and lending conditions proposed.</td>
</tr>
<tr>
<td>F.20</td>
<td>With the Task Manager, meet with co-financiers at mutually agreed locations (if possible in the presence of counterparts) to explain the method of compilation and the forecast results of all financial statements at all appropriate levels of concerned institutions and managements with the objective of reaching agreement on the Project Cost Estimates Table, financing plan, the financial projections and interest spreads, and lending conditions proposed.</td>
</tr>
<tr>
<td>F.21</td>
<td>Draft the section of the Aide Memoire (OM600 para 39) relating to all financial aspects of the project and discuss with the Task Manager. Make any agreed amendments for presentation of complete Aide Memoire to counterparts at appropriate levels of authority.</td>
</tr>
<tr>
<td>F.22</td>
<td>Draft paragraphs for inclusion in the financial section of the Appraisal Report, and prepare financial annexes to attach to the Appraisal Report. Review draft with the Task Manager.</td>
</tr>
</tbody>
</table>

Financial Review Checklist for Appraisal Report (AR)

7.16.3 The following checklist is for reviewing ARs. Items resulting in ‘NO’ answers should be resolved to the financial analyst’s satisfaction. When reviewing projects, it is important to review the lessons learned from the past. In this respect, the first section of the checklist (lessons from past projects) provides guidance on the issues that should be examined. The remaining sections apply to the project under appraisal.

<table>
<thead>
<tr>
<th>A. Lessons from Past Projects</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Were finance-related covenants met (for instance, revenue-generating targets, following up on agreed financial restructuring, adhering to expected financial ratios etc)?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>2. Were counterpart funds made available on a timely basis?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>3. Were adequate funds made available for operations and maintenance (O&amp;M)?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>4. Were financial statements and auditor reports submitted in a timely manner?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>5. Were auditors’ reports unqualified?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>6. Was there an absence of weaknesses in handling finances or in procurement?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>7. Were on-lending and relending activities free of problems?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>8. Were capacity-building programs effective in relation to financial management?</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>B. Project Cost Estimates</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Has the Project Cost Estimates Table summary been prepared in accordance with these Guidelines?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>2. Are detailed project cost estimates available and have they been prepared in accordance with these Guidelines?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>3. Are the assumptions that support the estimates available and do they appear reasonable?</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>
4. Have Local and Foreign costs been properly identified?  
5. Are the physical and price contingency provisions adequate?  

<table>
<thead>
<tr>
<th>C. Financing Plan (FP)</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Has the FP summary table been prepared in accordance with these Guidelines?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>2. Do relending and onlending arrangements appear to be reasonable?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>3. Does the FP indicate that adequate counterpart funds will be available in a timely manner?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>4. Are local cost financing arrangements in line with Bank policy?</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>D. Executing Agencies (EA) and Implementing Agencies (IA)</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Has the past financial performance of the EA/IA been analyzed?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>2. Has a ratio analysis of the EA/IA financial statements been conducted?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>3. Are the financial management capabilities of EA and IA adequate?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>4. Are properly trained and qualified staff in place to manage finances?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>5. If there are other ongoing operations, have financial details been provided and are these reasonable?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>6. Have EA/IA budgets and forecasts (excluding the project) been provided?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>7. Does the EA/IA have processes in place to prepare or update budgets and forecasts on a regular basis?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>8. Where the EA/IA is not a government department, state government body or local government body; is its capital adequate to support operations and to execute or implement the project?</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>E. Financial Projections</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Have the assumptions and bases that underlie the financial projections (e.g., cash flows, income, expenses and other financial projections) been provided?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>2. Are the assumptions that underlie the financial projections reasonable?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>3. Are provisions adequate (for instance, bad debts, non-revenue water and power supplies, and technical losses)?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>4. If the projections were prepared by the financial analyst or by consultants, does the borrower “own” the projections?</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>F. Financial Analysis</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Have the detailed FIRR calculations been undertaken in accordance with these Guidelines?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>2. Are the detailed FIRR calculations reasonable?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>3. Have the detailed WACC calculations been undertaken in accordance with these Guidelines?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>4. Are the detailed WACC calculations and assumptions reasonable?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>5. Does FIRR exceed WACC and, if not, are there reasonable justifications for proceeding with the project?</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>6. Have sensitivity analyses been conducted in accordance with these Guidelines?</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>G. Project Justifications</th>
<th>Yes</th>
<th>No</th>
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</thead>
<tbody>
<tr>
<td>1. Is the project financially sustainable?</td>
<td>☐</td>
<td>☐</td>
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<tr>
<td>2. Have cost-recovery mechanisms and pricing issues been adequately considered?</td>
<td>☐</td>
<td>☐</td>
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<tr>
<td>3. Has an affordability study been conducted on proposed prices (tariffs)?</td>
<td>☐</td>
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<tr>
<th>H. Accounting and Auditing</th>
<th>Yes</th>
<th>No</th>
</tr>
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<tbody>
<tr>
<td>1. Have arrangements been made to ensure the timely submission of quarterly reports?</td>
<td>☐</td>
<td>☐</td>
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</tbody>
</table>
2. Have actions been taken to select and engage auditors in accordance with these Guidelines? □ □
3. Have arrangements been made to support the timely submission of audited annual reports (within six to nine months) including audit reports on special agreements? □ □
4. If in the past government audits were either not satisfactory or not available, has the appointment of private auditors and funding to cover cost of such appointments been considered? □ □

I. Procurements and Disbursement Arrangements
1. Has adequate attention been given to anticorruption measures? □ □
2. Are adequate fund reimbursement procedures in place (in accordance with Bank requirements)? □ □

J. Finance-Related Risks
1. Have risks regarding the timely availability of adequate counterpart funds been minimized? □ □
2. Have risks regarding the timely availability of adequate funds for operations and maintenance been minimized? □ □
3. Have risks regarding the availability of staff to manage financial management activities been minimized? □ □

K. Assurances
1. Have adequate assurances been obtained in relation to measures to counter finance-related risks (see above)? □ □
2. Have adequate assurances been obtained that proposed pricing formulas will be implemented? □ □
3. Have adequate assurances been obtained that efficiency improvements and capacity building in relation to financial management will be undertaken? □ □
4. Have adequate assurances been obtained that financial covenants will be implemented and monitored as agreed? □ □

7.17 AUDIT

The Terms of Reference for Auditors

7.17.1 The following sample Terms of Reference for Auditors (TOR) is an extract from Chapter 5: Financial Reporting and Auditing (pages 81 – 84) of the following OECD publication: Harmonising Donor Practices for Effective Aid Delivery, Good Practice Papers, A DAC Reference Document, OECD 2003 (see section 7.7, of this Chapter of these Guidelines).

Specimen Terms of Reference for External Auditors of Donor-supported Projects and Sector Programmes

Audit responsibilities

This “Specimen Terms of Reference (TOR) for Donor-Supported Projects and Sector Programmes” is intended to provide guidance to the staff of governments and donors in agreeing terms of reference for donor-supported activities. It should not be seen as universally applicable to all donor-supported projects. Those components that are considered appropriate for a particular
project should be selected, inappropriate items omitted, and additional matters included, where considered necessary.

**Background**

The background section of the TOR should include a brief summary of government accounting and financial management practices. It should include a general description of the supervising agency (often a Ministry of the Government or Department within a Ministry) and the executing agency (often a department or division within a Ministry) and should include a statement of their economic goals. There should be a broad description of the project in the context of its contribution to achieving the goals of the executing agency. The auditor should understand the “purpose for which the funds are intended” in the context of project objectives as well as in terms of the specific budget for the project.

Financial statements of the executing agency that provide sufficient disclosure of the receipts and disbursements of the project and of relevant information in the notes to the financial statements should normally meet the needs of donors. Where financial statements do not provide this information, a separate special purpose financial statement with a special purpose audit report would be expected. This would normally take the form of a Cash Flow Statement, prepared on the cash basis of accounting. This TOR is directed to the audit of special purpose financial statements.

**The executing agency**

This section should contain a description of the executing agency including the physical address, phone numbers, fax numbers, web sites and general e-mail addresses. A summary of the financial management assessment of the project executing agency should be included, together with a reference that the full financial management assessment would be available to the auditor. Other details would include:

- An organisation chart.
- A list of senior officers together with their contact details.
- A list of the contact persons responsible for accounting, financial management and internal audit together with phone numbers and email addresses.
- A description of the project including the project budget by major expenditure categories and the sources of all funding for the project.
- A statement that the project appraisal report (if applicable) would be available to the auditor should be included.

**Accounting standards**

This section should include a description of the accounting standards followed for the project and whether they are consistent with the government’s accounting standards. Any deviations from standard government accounting practices should be specified. Any deviations between the actual accounting standards applied and international practice as embodied in either International Accounting Standards (IAS) published by the International Accounting Standards Board or the draft International Public Sector Accounting Standards (IPSAS) on Cash Accounting published by the Public Sector Committee (PSC) of the International Federation of Accountants may also be described.
**Reporting standards**

The usual format of reporting for a non-revenue project is a Cash Flow Statement. The format of the accounting report should be provided. The format should include a list of funding sources to be reported separately as well as a list, agreed during the funding agreement negotiations, of the expenditure categories for reporting purposes.

The Cash Flow Statement format should normally include the current reporting period compared with the annual budget and accumulative figures from the commencement of the project compared with the total project budget.

The date by which the project accountants will prepare a draft Cash Flow Statement together with the agreed supporting schedules should be specified. Audited special purpose financial statements should be issued within about four to six months after the end of the fiscal period.

**Available facilities**

There should be a description of the nature and the location of all records belonging to the project. This list should specify those records kept at the executing agency’s headquarters and those that are located at other offices. If computers are used to record transactions relating to the project a description of the computer specifications needs to be provided together with a description of the operating software.

The TOR should state that the auditor would have full and complete access at any time to all records and documents (including books of account, legal agreements, minutes of committee meetings, bank records, invoices and contracts etc.) and all employees of the entity. The auditor should be advised that he/she has a right of access to banks and depositories, consultants, contractors and other persons or firms engaged by the programme/project management. If an auditor may not have unrestricted access to any records, person or location during the course of the audit, this restriction should be clearly defined, with reasons, in the TOR.

**Audit scope**

**Scope of work**

The scope of the audit should be sufficiently clear to properly define what is expected of the auditor but not in any way restrict the audit procedures or techniques the auditor may wish to use to form an opinion. It should specify at least the following:

- A definition of the entity or the portion of an entity that is subject to audit.
- The audit will be carried out in accordance with either ISA\(^4\) or INTOSAI\(^5\) auditing standards.
- The audit period covered will include the current reporting period. Issues relevant for the accumulative reporting period (from inception of the project) will rely upon the audit work of previous auditors, if necessary through communication with them.
- Sufficient audit evidence will be gathered to substantiate in all material respects the accuracy of the information contained in supporting schedules attached to the Cash Flow Statement.

\(^4\) International Standards of Auditing (ISA) published by the International Auditing Practices Committee of the International Federation of Accountants.

\(^5\) International Organization of Supreme Audit Institutions.
• If Statements of Expenditures (SOEs) were used to fund disbursements, the scope of the audit will include a sufficient sample of such disbursements to determine whether funds disbursed through SOEs were used for the purposes defined by the funding agreement.
• If a special/imprest bank account is used in conjunction with the SOEs, the scope of the audit will include gathering sufficient evidence to determine that the balance indicated as being on hand in the records is represented by unencumbered cash in a bank account.

The TOR should require the auditor to state in the audit report if the audit was not in conformity with any of the above and indicate the alternative standards or procedures followed.

*The audit report*

The TOR should clearly indicate expected content of the auditor’s opinion. This would include at least the following:
• That it is a special purpose report and its intended use.
• Accounting standards that have been applied and indicate the effect of any deviations from those standards.
• The audit standards that were applied (either INTOSAI standards, ISAs, or national standards that comply with one of these in all material respects.
• The period covered by the opinion.
• Whether the specified Cash Flow Statement and supporting schedules present fairly the cash receipts and disbursements for the project and that the funds were used for the purposes defined by the funding agreement(s).

This section should also indicate the due date for submission of a draft audit report and the signed audit report to the management of the project, as well as the due date for the submission of the signed audit report to the donors for compliance with the funding agreement.

*Compliance with funding agreement covenants*

Traditionally compliance with covenants referred to meeting technically defined financial targets, such as debt service coverage in revenue producing projects. Increasingly funding agreements of programme/projects which are not revenue earning contain specific performance targets. These are sometimes specified by a time bound action plan such as the date of the introduction of a double entry accounting system or implementation of a system of internal controls. In other cases there may be a broader action plan with specific dates to achieve a specific set of actions. In some cases funds releases are tied to meeting these targets. In other cases specific quantifiable targets such as the construction of specified numbers of rural health clinics or the provision of specific or “at least” numbers of inoculations against infectious diseases are covenanted. Some grant and loan covenants are too nebulous to be subject to audit.

The scope section of the TOR should clearly indicate whether the auditor is expected to issue an opinion on the implementing agency’s compliance with any specific covenants. This section should specifically state:
• The auditor is not an arbitrator in any disagreements between the borrower and lender(s).
• The covenant(s) for which an opinion will be issued, by a very specific reference to the funding agreement section(s) and paragraph number(s).
• A copy of the funding agreement will be provided to the auditor.
Copies of all correspondence between the government and the funding agency/agencies relating to compliance, calculation of compliance or interpretation of definitions used in the covenants will be provided.

**Management letter**

The TOR should specify that the auditor will submit a management letter at the completion of the audit. Guidance should be provided regarding the topics/issues to be covered in the management letter. At least the following topics/issues should be included:

- A general review of programme/project progress and timeliness in relation to progress milestones and the planned completion date, both of which should be stated in the programme/project document. This is not intended to address whether there has been compliance with specific covenants relating to specific performance criteria or outputs. However general compliance with broad covenants such as implementing the programme/project with economy and efficiency might be commented upon but not with the legal force of an audit opinion.
- An assessment of the programme/project’s internal control system with equal emphasis on i) the effectiveness of the system in providing the programme/project management with useful and timely information for the proper management of the programme/project and ii) the general effectiveness of the internal control system in protecting the assets and resources of the programme/project.
- A description of any specific internal control weaknesses noted in the financial management of the programme/project and the audit procedures followed to address or compensate for the weaknesses. Recommendations to resolve/eliminate the internal control weaknesses noted should be included.

**Model Audit Opinions**

*Model Audit Opinion for a Non-Revenue-Earning Project*<sup>6</sup>

To: Borrower (or designated agency)

We have audited the accompanying financial statements (pages____ to _____) of the _________ Project financed under the African Development Bank Loan #______ as of December 31, 20__, and for the year then ended.

These financial statements are the responsibility of the management of the _________ EA. Our responsibility is to express an opinion on the accompanying statements based on our audit.

We conducted our examination in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of misstatement. Our audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our audit also includes assessing the accounting principles and significant estimates made by management, as well as evaluating the overall statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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<sup>6</sup> ISA700 has been amended with effect from 31 December 2006. Financial Analysts should become familiar with the revisions and prepare borrowers of changes.
The ____ (EA’s) policy is to prepare the accompanying statements in the format agreed between the African Development Bank and the Government of _______ as noted in the Minutes of Negotiations for the Loan, [on a cash receipts and disbursements basis in which cash is recognized when received and expenses are recognized when paid, rather than when incurred] / [on an accruals basis in which expenses are recognized when incurred and revenue is reported when income is due.]

In our opinion, (A) the aforementioned financial statements and appended notes that were also the subject of the audit, fairly present in all material respects the financial position of the _______ project as at__________20__ and the results of its operations for the year ended ____________ 20__, in conformity with ____________ accounting standards, applied on a basis consistent in all material respects with that of the previous year; (B) the [Borrower] [EA] has utilized all proceeds of the loan withdrawn from the African Development Bank only for purposes of the Project as agreed between the African Development Bank and [the Borrower] in accordance with the Loan Agreement; and no proceeds of the loan have been utilized for other purposes; and (C) the [Borrower] [EA] was in compliance as at the date of the balance sheet of the year of audit with all financial covenants of the Loan Agreement.

In addition:

(a) (1) With respect to Statements of Expenditures, adequate supporting documentation has been maintained to support claims to the African Development Bank for reimbursements of expenditures incurred; and (2) which expenditures are eligible for financing under Loan Agreement No. ____.

(b) (1) The Imprest Accounts (page __) give a true and fair view of the receipts collected and payments made during the year ending ____; and (2) these receipts and payments support Imprest Account liquidations/replenishments during the year.

[(a) and (b), above, are to be provided where the Loan Agreement requires separate Imprest Account and Statement of Expenditures audits and audit opinions.]

Model Audit Opinion for a Revenue Earning Project

To: Borrower (or designated agency)

“We have examined the Balance Sheet of _______ as of _______ 20__, and the Income Statement, Cash Flow Statement and related statements and Notes (see pages____ to ____ of our Report) of the _______________ Project financed under the African Development Bank Loan #______________ as of December 31, 20__, and for the year then ended.

We conducted our examination in accordance with International Standards on Auditing [auditing standards of the country of ______]. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of misstatement. Our audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our audit also includes assessing the accounting principles and significant estimates made by management, as well as evaluating the overall statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, (A) the aforementioned financial statements and appended notes that were also the subject of the audit, fairly present separately (i) the financial position of the ____________ project
and (ii) the overall operations of the __________ [name of EA] as at ________ 20__, and the separate results of the project operations and the EA’s operations for the year ended __________ 20__, in conformity with international accounting standards [accounting standards of the country of __________], applied on a basis consistent in all material respects with that of the previous year; (B) the [Borrower] [EA] has utilized all proceeds of the loan withdrawn from the Bank only for purposes of the Project as agreed between the African Development Bank and [the Borrower] in accordance with the Loan Agreement; and no proceeds of the loan have been utilized for other purposes; and (C) the [Borrower] [EA] was in compliance as at the date of the balance sheet of the year of audit with all financial covenants of the Loan Agreement.

In addition:

(a) (1) With respect to Statements of Expenditures (SOE), adequate supporting documentation has been maintained to support claims to the African Development Bank for reimbursements of expenditures incurred; and (2) which expenditures are eligible for financing under Loan Agreement No. __________. (Required where an SOE audit is required under the Loan Agreement.)

(b) The Imprest Accounts (page____) gives a true and fair view of the receipts collected and payments made during the year ending ________________.

[(a) and (b) above to be provided where a separate Imprest Account audit is required under the Loan Agreement.]

Audit Report Questionnaire

7.17.2 This questionnaire is provided only as an example of the nature and type of questions that should be considered when reviewing the report of an auditor. Financial analysts should have regard to the nature of the organization under audit and frame their questions accordingly. Agencies operate in a wide range of sectors and activities, and therefore the form and nature of their financial statements will vary equally widely.

7.17.3 Further, approaches to, and the quality of auditing is variable. Therefore, the questions set out below should be regarded with some caution, because these may not have sufficient breadth or depth for some institutional statements and audits. Conversely, these may also be considered too extensive for some EAs, their activities and the audit services available.

7.17.4 Nevertheless, by using this checklist, or a suitably modified version thereof to reflect the nature and form of the EA concerned, a financial analyst should be able to obtain a reasonable view of the acceptability of the financial statements concerned and the audit thereof. To the extent possible each question should be answered by either “YES”, or “NO”, or N/A (Not applicable).

<table>
<thead>
<tr>
<th>Authenticity, Form, and Timeliness</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
<th>Ref</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Are the audited annual project financial statements and, where applicable, the EA’s audited annual financial statements signed by the entity’s management?</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td></td>
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<tr>
<td>(2) Is the audit report signed by the auditor?</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
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<tr>
<td>(3) Is the opinion on the auditor’s letterhead?</td>
<td>☐</td>
<td>☐</td>
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</tbody>
</table>
(4) Is the report bound and pages consecutively numbered? □ □ □
(5) Was the report received within a reasonable time after signing? □ □ □
(6) Was the report received within period covenanted (refer to the loan agreement)? □ □ □
(7) Is there a copy of a Management Letter? □ □ □
(8) Where appropriate, do the annual financial statements include reported data for the previous accounting period to enable comparisons to be made, particularly closing balances which should represent opening balances for the fiscal year under audit, and illustrate increases and decreases where applicable? □ □ □

<table>
<thead>
<tr>
<th>Audit Opinion</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
<th>Ref</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Was the examination asserted to be made in accordance with generally accepted auditing standards?</td>
<td>□</td>
<td>□</td>
<td>□</td>
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<tr>
<td>(2) Were generally accepted accounting principles applied on a basis consistent with that of the preceding year?</td>
<td>□</td>
<td>□</td>
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<tr>
<td>(3) Is a precise and “clear” opinion provided on: (i) Financial position, (ii) Results of operation, and (iii) Cash flows?</td>
<td>□</td>
<td>□</td>
<td>□</td>
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<tr>
<td>(4) Does the paragraph on the scope of the audit cover examination of the: (i) Balance Sheet (ii) Income Statement, and (iii) Cash Flow Statement?</td>
<td>□</td>
<td>□</td>
<td>□</td>
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<tr>
<td>(5) Are supplementary data stated fairly in all material respects, when considered in conjunction with the financial statements taken as a whole?</td>
<td>□</td>
<td>□</td>
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<tr>
<td>(6) Does the report address the auditor’s objectives under the loan agreement (i.e., utilization of loan funds, compliance with specific covenants, use of imprest funds, statement of expenditure procedures, conformity with the Bank’s Procurement Guidelines)?</td>
<td>□</td>
<td>□</td>
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<tr>
<td>(7) Does it appear that the supplementary statements form part of the accounts? Are they covered by the auditor’s certificate?</td>
<td>□</td>
<td>□</td>
<td>□</td>
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<tr>
<td>(8) Is the auditor’s opinion unqualified?</td>
<td>□</td>
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<table>
<thead>
<tr>
<th>Matters Addressed</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
<th>Ref</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Balance Sheet - Fixed Assets</td>
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</tr>
<tr>
<td>(a) Is the categorization and analysis of assets representative of the entity’s interests and activities (e.g., land, buildings, equipment, machinery, vehicles)?</td>
<td>□</td>
<td>□</td>
<td>□</td>
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<tr>
<td>(b) Are fixed assets under construction shown separately (Does the line item include the project)?</td>
<td>□</td>
<td>□</td>
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<tr>
<td>(c) Is there a schedule attached of gross fixed assets, accumulated depreciation provision and net fixed assets: (i) in operation; (ii) not in operation; (iii) with data on changes in asset holdings in year, including (a) sales, (b) revaluations, and basis for it, and (c) changes in depreciation provision?</td>
<td>□</td>
<td>□</td>
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<tr>
<td>(d) Is accumulated depreciation shown with depreciation rates and bases of calculation in supporting schedules?</td>
<td>□</td>
<td>□</td>
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<tr>
<td>(e) Are disclosures made of assets: (i) leased out, and (ii) pledged?</td>
<td>□</td>
<td>□</td>
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<tr>
<td>(f) In cases of revaluation of fixed assets and/or restatements of foreign long-term debt, is sufficient information provided to reconstruct both sides of the revaluation entries?</td>
<td>□</td>
<td>□</td>
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<tr>
<td>(2) Balance Sheet. Current Assets</td>
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<tr>
<td>(a) Is the total of current assets revealed?</td>
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<tr>
<td>(b) Is there an adequate analysis of current assets (e.g., prepaid expenses, deposits on contracts, receivables, inventories, marketable securities, short-term bank deposits, cash at bank, and cash on hand)?</td>
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<tr>
<td>(c) Are receivables adequately analyzed, aged and classified between key classes of debtors?</td>
<td></td>
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<tr>
<td>(d) Do marketable securities exclude medium-/long-term investments?</td>
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</tr>
<tr>
<td>(e) Is a bad and doubtful debt allowance indicated (Have actual bad debts been written off)? For financial intermediaries, is the provisioning policy in compliance with prudential guidelines)?</td>
<td></td>
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<tr>
<td>(f) Is there a suitable inventory analysis including: (i) manufacturers’ products for sale, (ii) materials and goods for incorporation, (iii) materials in manufacturing progress, (iii) materials and goods for maintenance, and (iv) work-in-process? Are the valuation bases described for each? Are the inventory policies and practices consistent from year to year?</td>
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<table>
<thead>
<tr>
<th>(3) Balance Sheet - Investments and other Assets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Are investments detailed in supporting schedules, with bases of valuation, revaluation, losses and yields?</td>
<td></td>
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<tr>
<td>(b) Are deferred charges and pre-operating expenses shown with amortization rates and accumulated amortization, where appropriate?</td>
<td></td>
</tr>
<tr>
<td>(c) For Other Assets, are goodwill or intangibles shown, with valuation bases? (Are “Other assets” substantial, and if so, is there an analysis in the Notes to the Financial Statements)</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>(4) Balance Sheet - Investments and other Assets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Is there an adequate analysis of equity (e.g., authorized capital; paid-in capital; share premiums; shares outstanding; government or other public authority contributions; surpluses from appropriated earnings, unappropriated earnings, and revaluations)?</td>
<td></td>
</tr>
<tr>
<td>(b) Is there a statement of shareholders equity?</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(5) Balance Sheet - Long-term Debt</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Are current maturities excluded and shown under current liabilities?</td>
<td></td>
</tr>
<tr>
<td>(b) Are all amounts due and payable but not repaid to lenders disclosed?</td>
<td></td>
</tr>
<tr>
<td>(c) Is there a comprehensive schedule of long-term debt, showing, among other things, for each outstanding loan: (i) original amount borrowed; (ii) interest rate, grace and repayment period and other relevant terms, (e.g., secured debt); (iii) currency in which debt is repayable and conversion rates, if applicable, at date of borrowing and current; (iv) gross amount outstanding and effective currency conversion, if applicable; (v) long-term debt transactions during year; (vi) current maturities; and (vii) maturities due and payable, but not paid?</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(6) Balance Sheet - Current Liabilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Is total of current liabilities shown and suitably analysed (e.g.,</td>
<td></td>
</tr>
</tbody>
</table>
current maturities of long-term debt, short-term borrowings, consumer deposits, taxes due, dividends due, accounts payable, accrued and other liabilities)

(7) Balance Sheet - Other Liabilities
(a) Are relevant other liabilities adequately described and analysed, including such matters as: pensions and other employee benefits, and deferred Taxation?
(b) Are the analysis of the foregoing and the format of the balance sheet items in accordance with sound accounting practices?
(c) Are contingent liabilities and pledges disclosed?
(d) Are reserve funds (e.g., pension funds) adequately classified, explained and legally utilized and provided for?
(e) Are suspense accounts fully explained?
(f) Is there an adequate description of verification procedures for fixed and movable assets and inventories?
(g) Is a statement of adequacy of insurance required?
(h) Is there an analysis in Notes to the Financial Statements of “Other Liabilities” where the amount is substantial?

(8) Income Statement
(a) Does the construction of the revenue, expenditure and other key items of this statement and supporting data provide satisfactory financial evidence of the results of activities conducted by the entity?
(b) Does the statement provide statistical data on (i) sales or other performance; (ii) manufacturing costs; (iii) sales costs; (iv) operating costs; (v) maintenance costs; (vi) administration costs; (vii) depreciation; (viii) non-operating income (analyzed); (ix) amortization of deferred charges?
(c) Are unusual items clearly shown (e.g., exchange gains or losses; profit or losses on sale of assets; and profits or losses from adjustments made to reflect changing prices and/or inflation)?
(d) Does the statement include any items relating to other fiscal years (e.g., prior-year adjustments), and are these separated from the current year?
(e) Is the net income relating to the fiscal year’s operations clearly demonstrated before inclusion of other items, as in (c) and (d) above?
(f) Does the allocation of Net Income clearly demonstrated?
(g) Does the opinion cover this statement?

(9) Cash Flow Statement
(a) Does the statement provide a clear description of operating, investing and financing cash flows?
(b) Do the transactions shown tie back to the Balance Sheet and Income Statement with the appropriate reconciliations?
(c) Does the opinion cover this statement?

Auditor’s Opinion and Report
(1) Where the audit opinion is qualified, is there sufficient information to quantify the effects of qualification on the: Balance Sheet Income Statement and Cash Flow Statement?
(2) Does the audit report contain an opinion on whether the entity/borrower is complying with/breaching any covenants or other legal agreements? For instance:

- Utilization of loan proceeds (e.g., diversion of funds, utilization for aspects where counterpart funds should have been used, etc).
- Project implementation (delays, bottlenecks, procedural procurement lapses).
- Statement of Expenditures (splitting of payments to avoid SOE ceiling, amount inadmissible).
- Imprest Fund (used for aspects meant for counterpart funds).
- Agreed upon matters between the Bank and Borrower that require special attention.
- For revenue-earning EAs/Borrower (significant changes in financial statement balances between financial years, significant bad debts, unrecorded liabilities, etc).

(3) Did the audit examine the efficiency of systems of Internal Control? If so, does the audit report disclose any material deficiencies or weaknesses in the accounting system or overall system of internal control?

(4) Does the audit report confirm, or otherwise, that financial management systems employed by the EA conformity with Bank requirements in the loan agreement?

Notes: In the case of revenue-earning EAs, the task manager will continue to make use of the financial statement in the manner currently used, which may include computations of ratios. The above questionnaire is meant to serve as a guide only and may be modified to suit specific needs.

7.18 DETAILED FINANCING PLAN

7.18.1 The following is an example of a typical Detailed Financing Plan for a revenue-earning project the purpose of which is to demonstrate that the funding to support all required aspects of the total estimated cost of the project including contingencies and items ineligible for Bank financing are identified and committed.
### DETAILED FINANCING PLAN

(x through xx)

#### COUNTRY

#### PROJECT

In (thousands) (millions) of UA/Bank Lending Currency

<table>
<thead>
<tr>
<th>Local Currency</th>
<th>Foreign Currency</th>
<th>Total</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funds Required</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proposed Project</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest during construction</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Other capital investments</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Required increase in working capital</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>- Project-related</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>- Non-project-related</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Increase (Decrease) in cash</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>TOTAL REQUIREMENTS</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
</tbody>
</table>

#### SOURCE OF FUNDS

<table>
<thead>
<tr>
<th>Source</th>
<th>Local Currency</th>
<th>Foreign Currency</th>
<th>Total</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income after taxes before interest and depreciation</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Less:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividends</td>
<td>(0.00)</td>
<td>(0.00)</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Debt service</td>
<td>(0.00)</td>
<td>(0.00)</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Taxes/other</td>
<td>(0.00)</td>
<td>(0.00)</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Net internal cash generation</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Proposed Bank loan</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Cofinancer loan(s)</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Other loans</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>- Project-related</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>- Non-project-related</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Total Borrowings</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Equity investments</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Consumer Contributions</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Subsidies for operations</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>TOTAL SOURCES</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
</tbody>
</table>
**7.19 SENSITIVITY AND RISK ANALYSES**

**Step 1: Identify the Key Variables**

7.19.1 The selection of variables which should be tested and the detail in which they are specified apply primarily to (i) critical cost and benefit items, (ii) critical items likely to cause non-performance of financial covenants, (iii) the effect of delays; and (iv) aggregate costs and benefits, which are the four principal areas of a project for which sensitivity analysis normally is considered.

7.19.2 **Critical Cost and Benefit Items:** The most effective tests are achieved by detailed disaggregation of costs and benefits and therefore these items should be subjected to specific analysis for each project. Analysis is more beneficial if individual items that are most critical to the project are subjected to individual review. These include on the costs side, prices of major inputs, productivity coefficients, currency risks and inflation rates, and on the benefits side, output prices (with the substitution of possible tariff structure variations), rate of growth in demand for output, and unit cost savings. While “revenues” can be regarded as a critical benefit, it is likely to be more useful to identify the element or elements of revenues that are most at risk, such as “revenues from installing new sewer connections”, along with the extent/scope of their contribution to benefits and the timing thereof.

7.19.3 **Non-performance of Financial Covenants:** The sensitivity of the principal elements of operations (critical operating costs e.g., wages, power and fuel, etc.), operating revenues, working capital requirements, etc., that will impact on the EA’s ability to achieve (i) rate of return ratio – a rate of return on net fixed assets in operation; (ii) self-financing ratio; (iii) debt service coverage, etc., should be measured.

7.19.4 **Effect of Delays:** Start-up delays, implementation delays, capacity utilization and full development delays, and parallel investment delays should be subjected to analysis. Delays come in different shapes and sizes and on different occasions (at start-up; at critical commissioning stages, e.g., river crossings; weather delays, e.g., regular “wet season”; resource shortages – shipping delays, personnel strikes and slow-downs; in commissioning; in completion; and in commencement of operation. It is important to identify the delay(s) most likely to be considered in terms of the maximum permissible delay(s) for inclusion as a Switching Value (SV). Delays may also be analysed in terms of the periodic effects on FNPV (annual, forecast percentage of completion).

7.19.5 **Aggregate Costs and Benefits:** Sensitivity analysis of the effects of variations in total costs and benefits of a project is useful to indicate the collective influence of underlying variables, and should be applied in all cases.

7.19.6 In addition to the foregoing, other critical areas which merit subjection to sensitivity analysis are potential cost overruns in project implementation and non-achievement of capacity utilization. In simple cases the variability in the project’s rate of return on net fixed assets in operation will largely reflect the influence of two or three variables. In such cases probability assessments regarding those variables might provide an adequate basis for judging the risk of the project’s failure, thus avoiding the need for more detailed
quantitative risk analysis. Even in more complex cases sensitivity analysis may sometimes facilitate risk analysis by identifying the variables for which probability distributions should be specified.

**Steps 2 and 3: Calculate Effects of Changing Variables**

7.19.7 The values of the basic indicators of project viability (FIRR and FNPV) should be recalculated for different values of key variables. This is preferably done by calculating sensitivity indicators (SIs) and switching values (SVs).

7.19.8 Switching Values (SVs) are sometimes used for conducting sensitivity analysis, but their application is not mandatory. It is the financial analyst’s responsibility to determine whether a demonstration of the impacts of switching values would support any decisions used in their selections. The SV of a variable is that value at which a project’s FNPV becomes zero (or the FIRR equals the discount rate). The SVs are normally given in terms of the percentage change in the value of the variable needed to turn a project’s FNPV equal to zero. SVs are useful to determine those variables that are most likely to affect project outcomes. SVs of the more important (or potent) variables should be presented in order of declining sensitivity.

7.19.9 The meaning of these concepts is presented below and a sample calculation immediately follows. Sensitivity indicators and switching values can be calculated for the FIRR and FNPV as shown below

**Using Sensitivity Indicators andSwitching Values**

<table>
<thead>
<tr>
<th>Sensitivity Indicator</th>
<th>Switiching Value</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Definition:</strong></td>
<td></td>
</tr>
<tr>
<td><strong>1. Towards the Net Present Value</strong></td>
<td>1. Towards the Net Present Value</td>
</tr>
<tr>
<td>Compares percentage change in FNPV with</td>
<td>The percentage change in a variable or combination of</td>
</tr>
<tr>
<td>percentage change in a variable or</td>
<td>variables to reduce the FNPV to zero (0).</td>
</tr>
<tr>
<td>combination of variables.</td>
<td></td>
</tr>
<tr>
<td><strong>2. Towards the Internal Rate of Return</strong></td>
<td>2. Towards the Internal Rate of Return</td>
</tr>
<tr>
<td>Compares percentage change in FIRR above</td>
<td>The percentage change in a variable or combination of</td>
</tr>
<tr>
<td>the cut-off rate with percentage change in a</td>
<td>variables to reduce the FIRR to the cut-off rate (=discount</td>
</tr>
<tr>
<td>variable or combination of variables.</td>
<td>rate).</td>
</tr>
<tr>
<td><strong>Expression:</strong></td>
<td></td>
</tr>
<tr>
<td><strong>1. Towards the Net Present Value</strong></td>
<td>1. Towards the Net Present Value</td>
</tr>
<tr>
<td>SI = ( \frac{(FNPV_b - FNPV_1)}{FNPV_b} \cdot \frac{X}{X_b} )</td>
<td>SV = ( \frac{(100 \times FNPV_b)}{X} \cdot \frac{X - X_1}{X_b} )</td>
</tr>
<tr>
<td>where: X_b – value of variable in the base case</td>
<td>where: X_b – value of variable in the base case</td>
</tr>
<tr>
<td>X_1 – value of the variable in the sensitivity test</td>
<td>X_1 – value of the variable in the sensitivity test</td>
</tr>
<tr>
<td>FNPV_b – value of FNPV in the base case</td>
<td>FNPV_b – value of FNPV in the base case</td>
</tr>
<tr>
<td>FNPV_1 – value of the variable in the sensitivity test</td>
<td>FNPV_1 – value of the variable in the sensitivity test</td>
</tr>
</tbody>
</table>
2. Towards the Internal Rate of Return

\[
SI = \frac{(FIRR_b - FIRR_1) / (FIRR_b - d)}{(X_b - X_1) / X_b}
\]

where:
- \(X_b\) – value of variable in the base case
- \(X_1\) – value of the variable in the sensitivity test
- \(FIRR_b\) – value of FIRR in the base case
- \(FIRR_1\) – value of the variable in the sensitivity test
- \(d\) – discount rate

1. Towards the Net Present Value

Base Case:
- \(P = P_b = 300\)
- \(FNPV_b = 20,912\)

Scenario 1:
- \(P_1 = 270\) (10% change)
- \(FNPV_1 = 6,895\)

\[
SI = \frac{(20,912 - 6,895) / 20,912}{(300 - 270) / 300} = 6.70
\]

Calculation example

1. Towards the Net Present Value

Base Case:
- \(P = P_b = 300\)
- \(FNPV_b = 20,912\)

Scenario 1:
- \(P_1 = 270\) (10% change)
- \(FNPV_1 = 6,895\)

\[
SV = \frac{(100 x 20,912)}{(FIRR_b \times FIRR_1)} \times \frac{(X_b - X_1)}{X_b} = \frac{(300 - 270)}{300} = 14.9%
\]

Sensitivity Indicator

2. Towards the Internal Rate of Return

Base Case:
- \(P = P_b = 300\)
- \(FIRR_b = 15.87\%\)

Scenario 1:
- \(P_1 = 270\) (% change)
- \(FIRR_1 = 13.31\%\)
- \(d = 12\%\)

\[
SI = \frac{(0.1587 - 0.1331) / (0.1587 - 0.12)}{(300 - 270) / 300} = 6.61
\]

Interpretation
- Percentage change in FIRR above the cut-off rate (12%) is larger than percentage change in variable: price is a key variable for the project

Characteristic
- Indicates to which variables the project result is or is not sensitive. Suggests further examination of change in variable.

Switching Value

2. Towards the Internal Rate of Return

Base Case:
- \(P = P_b = 300\)
- \(FIRR_b = 15.87\%\)

Scenario 1:
- \(P_1 = 270\) (% change)
- \(FIRR_1 = 13.31\%\)
- \(d = 12\%\)

\[
SV = \frac{(0.1587 - 0.1331)}{(300 - 270)} = 15.1%
\]

A change of approximately 15% in the price variable is necessary before the FNPV becomes zero or before the FIRR equals the cut-off rate.

Characteristic
- Indicates to which variables the project result is or is not sensitive. Suggests further examination of change in variable.

Measures extent of change for a variable that will leave the project decision unchanged.
7.19.10 The switching value is, by definition, the reciprocal of the sensitivity indicator. Sensitivity indicators and switching values calculated towards the FIRR yield slightly different results if compared to SIs and SVs calculated towards the FNPV. This is because the FIRR approach discounts all future net benefits at the FIRR value and the FNPV approach at the discount rate, d.

### Example of the Base Case for a Project

<table>
<thead>
<tr>
<th>PV @12%</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benefits</td>
<td>2,104</td>
<td>0</td>
<td>283</td>
<td>339</td>
<td>396</td>
<td>453</td>
<td>509</td>
<td>566</td>
<td>566</td>
<td>566</td>
</tr>
<tr>
<td>Costs:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment</td>
<td>1,687</td>
<td>1,889</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Operations &amp; maintenance</td>
<td>291</td>
<td>0</td>
<td>61</td>
<td>61</td>
<td>61</td>
<td>61</td>
<td>61</td>
<td>61</td>
<td>61</td>
<td>61</td>
</tr>
<tr>
<td>Total Costs</td>
<td>1,978</td>
<td>1,889</td>
<td>61</td>
<td>61</td>
<td>61</td>
<td>61</td>
<td>61</td>
<td>61</td>
<td>61</td>
<td>61</td>
</tr>
<tr>
<td>Net Cash Flow</td>
<td>126</td>
<td>-1,889</td>
<td>222</td>
<td>278</td>
<td>335</td>
<td>391</td>
<td>448</td>
<td>505</td>
<td>505</td>
<td>505</td>
</tr>
</tbody>
</table>

7.19.11 In the base case, the FNPV is 126 and the FIRR is 13.7 percent. The sensitivity of the base case FNPV has been analysed for (adverse) changes in several key variables, as follows:
- An increase in investment cost by 10 percent
- A decrease in economic benefits by 10 percent
- An increase in costs of operation and maintenance by 10 percent;
- An adverse foreign-exchange movement of 20 percent, and
- A delay in the period of construction, causing a delay in revenue generation by one year.

7.19.12 Proposed changes in key variables should be well explained. The sensitivity analysis should be based on the most likely changes. The effects of the above changes are summarized in the following table.

#### Sensitivity Analysis: A Numerical Example

<table>
<thead>
<tr>
<th>Item</th>
<th>Change</th>
<th>FNPV</th>
<th>FIRR %</th>
<th>SI (FNPV)</th>
<th>SV (FNPV)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base Case</td>
<td></td>
<td>126</td>
<td>13.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment</td>
<td>+ 10%</td>
<td>-211</td>
<td>9.6</td>
<td>13.3</td>
<td>7.5%</td>
</tr>
<tr>
<td>Benefits</td>
<td>- 10%</td>
<td>-294</td>
<td>7.8</td>
<td>16.6</td>
<td>6.0%</td>
</tr>
<tr>
<td>Operating and Maintenance Costs</td>
<td>+ 10%</td>
<td>68</td>
<td>12.9</td>
<td>2.3</td>
<td>43.4%</td>
</tr>
<tr>
<td>Foreign Exchange Movements</td>
<td>- 20%</td>
<td>-294</td>
<td>7.8</td>
<td>16.6</td>
<td>6.0%</td>
</tr>
<tr>
<td>Construction delays</td>
<td>One (1) year</td>
<td>-9</td>
<td>9.9</td>
<td>10.8</td>
<td>FNPV: 178% lower</td>
</tr>
</tbody>
</table>

SI = Sensitivity Indicator, SV = Switching Value

7.19.13 Combinations of variables can also be considered. For example, the effect on the FNPV or FIRR of a simultaneous decline in economic benefits and an increase in investment cost can be computed. In specifying the combinations to be included, the project analyst should state the rationale for any particular combination to ensure it is plausible.
Analyse Key Variable Changes

7.19.14 In the case of an increase in investment costs the sensitivity indicator is 13.33. This means that a change of 20% in the variable (investment cost) results in a change of 266% (13.3 x 20%) in the FNPV. It follows that the higher the SI, the more sensitive the FNPV is to the change in the concerned variable.

7.19.15 In the same example, the switching value is 7.5%, which is the reciprocal value of the SI x 100. This means that a change (increase) of 7.5% in the key variable (investment cost) will cause the FNPV to become zero. The lower the SV, the more sensitive the FNPV is to the change in the variable concerned and the higher the risk with the project.

7.19.16 At this point the results of the sensitivity analysis should be reviewed. It should be asked: (i) which are the variables with high sensitivity indicators; and (ii) how likely are the (adverse) changes (as indicated by the switching value) in the values of the variables that would alter the project decision?

Undertaking Risk Analysis

7.19.17 In cases where project results are expected to be particularly sensitive to certain variables, it has to be assessed how likely it is that such changes would occur. This likelihood can be assessed by studying experiences in earlier, comparable projects and by investigating the situation in the sector as a whole.

7.19.18 Steps should be taken to reduce the extent of uncertainty surrounding those variables where possible. The following remedial actions might be taken at the project level:

- The development of specific agreements to ensure that contractor performance and project quality during construction works reduces the likelihood of delays
- The development of agreements for long-term supply contracts at specified quality and prices to reduce the uncertainty of operating costs
- The formulation of capacity-building activities to ensure appropriate technical and financial management
- The implementation of pilot phases to test technical assumptions and to observe user’s reactions, in case there is considerable uncertainty in a large project or program, and
- The setting of certain criteria that have to be met by subprojects before approval. This is especially important in sector loans where most (small) subprojects will be prepared after loan approval.

7.19.19 The results of the sensitivity analysis should be stated along with the associated mitigating actions being recommended, and the remaining areas of uncertainty that they do not address. Sensitivity analysis is useful at all stages of project processing: at the design stage to incorporate appropriate changes; at the appraisal stage to establish a basis for monitoring; and, during project implementation to take corrective measures. The uncertainty surrounding the results of the economic and financial analysis is expected to decrease as the project moves into the operational phase.

7.19.20 For the key variables and combinations of such variables, a statement can be presented including: the source of variation for the key variables; the likelihood that variation will occur; the measures that could be taken to mitigate or reduce the likelihood of an adverse change; and the switching values and/or sensitivity indicators.
7.19.21 The purpose of quantitative risk analysis is to estimate the probability that the project FIRR will fall below the opportunity cost of capital; or that the FNPV, using the FIRR as the discount rate, will fall below zero. A statement of such an estimate means that decisions can be based not just on the single base-case FIRR but also on the probability that the project will prove unacceptable. Projects with smaller base-case FIRRs may involve less uncertainty and have a higher probability of being acceptable in implementation. Projects with higher base-case FIRRs may be less certain and involve greater risk. Risk analysis can be applied also to projects without measurable benefits, for example to assess the probability that unit costs will be greater than a standard figure.

7.19.22 Undertaking a risk analysis requires more information than for sensitivity analysis. It should be applied to selected projects that are large or marginal, or where a key variable is subject to a considerable range of uncertainty. A large project is one that takes a high proportion of government or the country’s investment resources, for example a project using more than 5 percent of the government’s investment budget in the peak project investment years. A marginal project is one where the base-case FIRR is only marginally higher than the opportunity cost of capital. A decision should be taken at an early stage of analysis whether to include a risk analysis in the appraisal or not.

7.20 PERFORMANCE INDICATORS

7.20.1 Few of the following ratios are appropriate for Financial Intermediaries (FIs). Appropriate indicators for assessing FI performance are described in Chapter 6 of these Guidelines and in section 7.20.32.

<table>
<thead>
<tr>
<th>Ratios or Other Measures</th>
<th>Computation Method</th>
<th>Significance and Notes</th>
</tr>
</thead>
</table>
| 1. Rate of Return on Net Fixed Assets in Service (%)  | Net Operating Income (a) x 100  
Average of Net Fixed Assets in Service (b) | Measures the productivity (yield) of Net (Depreciated) Fixed Assets in use: (a) excluding government grants and subsidies (b) these fixed assets may, or may not, be subject to revaluations. |
| 2. Self-Financing Ratio (%)                           | Cash from internal sources Ratio  
Average Annual Capital Expenditure (*) | Also called Cash Generation Capability and Contribution to Expansion. Measures the percentage of annual capital investments financed from available cash resources. (*) Average Annual capital expenditures may be derived from an average of multiple years (e.g. one past, the present year and one future year). |
| 3. Operating Ratio (%)                                | Total Operating Expenses (including Depreciation and Taxes x 100)  
Total Operating Revenues | Measures the coverage of operating expenses by operating revenues. |
| 4. Number of times interest earned (before income taxes) | Operating Income (before interest on long-term debt)  
Annual Interest Expense on Long-term Debt | Measures the coverage of interest charges particularly on long-term debt before taxes. |
<table>
<thead>
<tr>
<th>Knowledge Management</th>
<th>Chapter 7, Page 78 of 120</th>
</tr>
</thead>
</table>
| 5. Total Fixed Charge Coverage | Operating income, Interest, Lease Charge Payments (before taxes and charges)  
Annual Interest, Lease Charges and Other Fixed Charges | Similar to interest coverage ratio except that it is expanded to cover leases and other fixed charges. |
| 6. Return on Total Assets | Net Income + Interest Expense  
Average Investment in Assets | Measures the productivity of assets. |
| 7. Return on Common Stockholder Equity | Net Income - Preference Dividends  
Average Common Stockholders’ Equity | Indicates the earning power on common stockholder equity. |
| 8. Return on Capital Employed | Net Income after Taxes + Tax-adjusted Interest  
Equity + Long-term Debt | A measure of the efficient deployment of capital by the company. |
| 9. Percentage Growth in Revenues | Current Period Revenues - Previous Period Revenues x 100  
Previous Period Revenues | Measures the increase in revenues between two periods. |
| 10. Percentage of Revenues used to meet Operating (manufacturing) Expenses | Cost of Goods Sold x 100  
Revenues | Measures the gross margin for any period. |
Revenues | Measures gross profit before inclusion of selling, warehousing, management and administration costs. |
| 12. Non-operating (manufacturing) Cost compared to Sales | Selling, Warehousing, Management and Administration costs x 100  
Revenues | Overhead expense element of Revenues. |
| 13. Profit element of Revenues | Net Profit  
Total Revenues | Measures the profit element of sales. |
| 14. Fixed Assets Turnover Ratio | Revenues  
Net Fixed Assets | Measures the number of times fixed assets are turned over. |
| 15. Inventory Turnover | Cost of Goods Sold in period  
Average Inventory for Period | Measures the rate of movement in total inventory, that is, the number of times the inventory is turned over. |
| 16. Revenues to Total Assets | Revenues  
Total Assets | Measures efficiency of use of assets in generating sales. |
| 17. Return on Equity | Net Profit  
Equity | Measures the rate of return on the investment in business. |
### Capital Adequacy Indicators

The indicators in the table below are suitable for assessing capital adequacy.

<table>
<thead>
<tr>
<th>Ratios or Other Measures</th>
<th>Computation Method</th>
<th>Significance and Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>18. Debt Service Coverage Ratio (Version A)</td>
<td>Net Revenue [revenues – expenses (excluding non-cash and interest charges)] Annual Debt Service’ (b)</td>
<td>Measures the number of times that debt service requirements are covered by available revenues. Note: (a) revenues may be adjusted to take into account any change in tariffs/charges in the year of measurement; (b) aggregate debt repayments including principal and interest.</td>
</tr>
<tr>
<td>19. Debt Service Coverage Ratio (Version B: Forecast Cash Flows)</td>
<td>Estimated Net Revenues [estimated revenues - estimated expenses (excluding non-cash and interest charges)] Estimated Debt Service Requirements (Principal + Interest Payments)</td>
<td>Measures the extent to which forecast cash flows are able to cover forecast service requirements.</td>
</tr>
<tr>
<td>20. Debt: Equity Ratio</td>
<td>Total Debt Total Stockholders’ Equity + Total Liabilities</td>
<td>Measures the relationship between all borrowed funds and shareholders’ invested capital.</td>
</tr>
<tr>
<td>21. Long-Term Debt to Total Equity Ratio</td>
<td>Total Long-term Debt Total Shareholders’ Equity</td>
<td>A capital adequacy measure.</td>
</tr>
<tr>
<td>22. Long-Term Debt to Total Capitalization.</td>
<td>Long-term Debt Long-term Debt + Equity</td>
<td>A capital structure measure.</td>
</tr>
<tr>
<td>23. Equity Ratio</td>
<td>Total Stockholders’ Equity Total Shareholders’ Equity + Total Liabilities</td>
<td>Shows the protection to creditors and the extent of trading on the equity (leverage).</td>
</tr>
</tbody>
</table>

### Liquidity Indicators

The indicators in the table below are suitable for assessing liquidity.

<table>
<thead>
<tr>
<th>Ratios or Other Measures</th>
<th>Computation Method</th>
<th>Significance and Notes</th>
</tr>
</thead>
</table>

7 Based on the total of loan principal repayments and loan interest, including interest incurred on work in progress if this is to be financed from net income and not from capital receipts (loan/equity).
26. Days in Receivable

\[
\text{Average Accounts Receivable} \times \frac{360}{\text{Revenues}}
\]

Measures the average number of days required to recover accounts receivable.

27. Accounts Receivable Turnover

\[
\frac{\text{Net Revenues}}{\text{Average Accounts Receivable}}
\]

Measures the number of times that receivables turn over in a year. The higher the turnover, the shorter the time between sales and collection cash.

28. Days in Inventory

\[
\frac{\text{Average Inventory}}{\frac{\text{Cost of Goods Sold}}{360}}
\]

Measures the average number of days it will take to sell an inventory.

29. Inventory Turnover

\[
\frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}
\]

Number of times the inventory is turned over in a period.

30. Days in Accounts Payable

\[
\frac{\text{Average Accounts Payable}}{\frac{\text{Cost of Goods Sold}}{360}}
\]

Measures the average time span of unpaid payables.

31. Accounts Payable Turnover

\[
\frac{\text{Cost of Goods Sold}}{\text{Average Accounts Payable}}
\]

Measures the number of times Accounts Payable turnover during a period.

7.20.2 Further discussions on the applicability of performance indicators follow.

**Operating Indicators**

**Operating Ratio**

7.20.3 The objective of an operating ratio is to measure operating efficiency. It should be used to address the efficient use of manpower, materials, transport, and other factors of production. It should not be used to measure cash flow requirements. The operating ratio indicator expresses operating expenses, including adequate maintenance and depreciation, as a percentage of revenues. It is easily understood and calculated from income statement data. The lower the ratio, the better is the borrower’s financial performance; a ratio up to 100 means that revenues are sufficient to meet operating expenses (a ratio of 80 means that operating expenses consume 80 percent of revenues).

7.20.4 It does not provide for financial obligations for debt repayment or contributions for expansion, except indirectly to the extent that revenues fund depreciation. In the event that the operating ratio at project preparation is inadequate, or is already low (below 100), the financial analyst should discuss with the project engineer and the enterprise the efforts which should be made to improve the ratio without increasing revenues by increases in charges.

7.20.5 There may be a need for supplemental monitoring that addresses physical performance or is related to an action plan linked with improving the operating ratio (e.g., water and/or sanitation employees per 1,000 house connections).

**Break-Even Ratio**

7.20.6 The breakeven indicator, which is infrequently used, compares the total revenues of an enterprise to operating expenses plus the amount by which debt service requirements exceed the provision for depreciation. The objective is to measure an enterprise’s efforts
to breakeven, without providing any surpluses for investment, dividends, etc. It is typically used by transportation enterprises (buses, trams) which are frequently heavily subsidized, where the indicator can be used by these institutions to measure their efforts to obtain sufficient revenues, exclusive of subsidies, to match operating expenses and debt service.

7.20.7 This indicator should not be introduced without a detailed justification at preparation, and in the appraisal. The justification should include a detailed breakeven analysis, displaying the effects of changes in volume on the breakeven point(s), and on profitability and cash flows. The discussion should include a forecast of when a self-financing ratio should be introduced, and if debt service is not being met completely, or at all, the steps which the government and the enterprise propose to take to recover debt service from consumers through the charging system(s) of the enterprise.

The Self-Financing Ratio (SFR)

7.20.8 The self-financing indicator, sometimes referred to as contribution to expansion, or contribution to investment, or cash generation, measures the net internal cash generated by an enterprise which is available for investment (expansion) purposes, usually to contribute to its investment program, particularly the proposed project. It is typically defined as a percentage of specified capital expenditures that are to be financed after meeting operating expenses, debt service, taxes, dividends, increases in working capital, and other significant cash outflows excluding capital expenditures. As such, a self-financing ratio indicator directly measures the adequacy of internal cash generation to finance consistently an agreed proportion of investment requirements. However, a self-financing ratio, as for all performance ratios, should be determined on the basis of discussions of financial policy with the enterprise, the sector and center/state economic and financial ministries/departments’ officials and other MDBs and Donors.

7.20.9 The target ratio should be carefully measured to directly support current and future policy objectives. The percentage of internal cash generation to be targeted is usually derived from the financing plan and financial projections for the period under consideration (which typically may be the project construction period plus three to five years beyond completion), after reflecting policy decisions on equity financing versus debt financing, and debt servicing principles. The principal method of determining this percentage is by comparing the net funds generated in a given year to the average capital expenditures for a representative period. This should consist of three years, including the year just past, the current year, and the next following year. The data for the current year and the next following year should be supported by a firm budget.

7.20.10 The often uncertain nature of future investment programs may make it necessary to provide for periodic reviews of the percentage(s) of internal cash generation. When a self-financing ratio indicator is used, the rate of return indicator for the enterprise should also be estimated and its adequacy should be judged on the basis of the considerations stated in that Section.

7.20.11 The financial analyst should encourage the policy-makers in an enterprise and the government concerned to address the issue of what should happen when investments decline, i.e., when the funds generated through the use of a self-financing ratio to drive or set the tariff level are greater than the yield targeted. For example, if a self-financing ratio target of 20 percent resulted in tariffs set in prior years that generated about $20 million
equivalent currently for an enterprise, and the investment program declined to about $40 million annually, or even to less than the $20 million yield of the ratio, what should the policy be vis-à-vis this “surplus” and further use of the self-financing ratio itself.

7.20.12 Two matters should be actively pursued. First, the enterprise should be encouraged to meet as much of its capital development requirements (asset financing) as possible, and therefore even if the ratio reached 100 percent, the benefit would accrue to the enterprise, its consumers and to the government, particularly if foreign loans were no longer needed. Second, either the government has undoubtedly provided equity in the past for the development of the enterprise (and therefore the sector concerned) and is entitled to receive payment for the use of that capital in the form of dividends – or even in the form of repayment of capital contributions to re-employ the resources in other less fortunate sectors, or enterprises within the same sector. Or, in cases where the self-financing ratio is a sector-specific policy, this repayment of capital, or the payment of dividends on the government’s equity, could commence once the balance of funds in excess of the yield of the specified self-financing ratio, even though the enterprise is still incurring debt, on the grounds that this “surplus” represented the funds available for distribution within the sector.

7.20.13 However, the self-financing ratio will continue to present the financial analyst with a paradox: (i) the higher the assessed risk, the higher the self-financing ratio required by prudent creditors; but (ii) weaker enterprises probably have higher risks and probably are unlikely to afford a high self-financing ratio - with the result that only limited investments are possible, thus contributing to (and not allaying) inherent weaknesses with the inevitable adverse impact on the community, the economy and government generally. This is a case where the indicator may be useful as an indicator only rather than as a driver of either tariff or a limiting factor on investment particularly if the national development plan depends on increased capacity from the EA. For example increased industrial development and resulting job creation may be important components of the national development strategy, which may depend on improved reliability in power supply.

Rate of Return (ROR)

7.20.14 The conventional concept of a rate of return is a measure of the efficiency of the use of operational assets, or alternatively, a measure of the return on invested capital compared to other opportunities to invest in the market place. This is particularly true at the margin (i.e., it is illogical to invest in assets if their yield is less than that obtainable for alternative uses of capital). The cost of capital is also proxy for when a utility should, or should not; put its money in the money market instead of buying an asset. The application and use of the rate of return concept has been broadened in its application to include being an indicator of performance of public sector enterprises.

7.20.15 The Rate of Return on Net Fixed Assets in Operation is a common financial performance indicator used in industry and commerce, and particularly by utility regulating agencies that seek to limit private sector profit maximization at the expense of unprotected consumers. Its application by MDBs in their performance monitoring has been the opposite of that adopted by regulatory agencies. The latter have always sought to keep rates and prices of utilities within fixed limits, whereas the MDBs have treated the indicator as a minimum (i.e., the borrower should either achieve or exceed the indicator specified in a covenant). This alternative use, particularly in cases where the indicator
target is set too low, may result in the achievement of less than the effect desired (as a measure of the efficiency of the use of invested capital) or justified on economic grounds, by encouraging politicians and managements to believe that as long as they achieve the specific “target”, the financial health of an enterprise will be assured.

7.20.16 In practice the rigid adoption of the prescribed target under inflationary conditions, in particular, or in times of financial stringency, may result in an adverse impact on long-term performance by providing insufficient resources for investment and reserves, with resultant damage to the quality of the service and/or product. The rate of return for the Bank’s purposes is the relationship between the net operating income and the net fixed assets in operation, and expressed as a percentage.

7.20.17 Expressed in other words, it is the net yield or return after tax achieved by the net assets in operation in an operating period. A rate of return indicates the return which should be achieved on invested productive capital of an enterprise in the country concerned; or the reasonable rate of return to the enterprise which it could obtain from average interest rates or returns for the similar amounts of capital invested in the market place (long-term borrowings and equity) which are usually higher than interest rates payable on long-term borrowings available to public sector enterprises and institutions. The definition of “reasonable” in these circumstances is a judgment call, and reference should be made to similar returns on investment elsewhere in the economy of the country concerned, or at the current interest rate structure, after making allowances for differences in the business risks and terms of comparable investments.

7.20.18 Net operating income after taxes is represented by operating income less operating expenses. Operating expenses include adequate maintenance and provision for depreciation, usually on a straight-line basis at a specified rate or rates; but interest and other financial charges are not included as part of operating expenses. Capital invested in fixed assets normally is the average for the year of the net value of an enterprise’s fixed assets. Invested capital may also include adequate working capital, particularly for enterprises that require a relatively high proportion of working capital to conduct operations.

7.20.19 With regards to the calculation of Rate of Return, this indicator should be based upon the value of assets at depreciated historical cost rather than the revalued amounts, unless the economy is hyperinflationary.

**Capital Adequacy Indicators**

**Debt Service Coverage**

7.20.20 The debt service coverage indicator measures the extent of the coverage of an enterprise’s debt service by its internal cash generation over a defined period. A performance of one means that there is precise coverage, while a performance in excess of one (e.g., 1.3) indicates a margin of safety in covering debt. This indicator recognizes that the repayment terms of debt are more significant than the total amount of debt in measuring repayment capacity which in turn determines borrowing capacity. Except for Financial Intermediaries, the debt service coverage indicator is appropriate for revenue-earning enterprises in all sectors, particularly for public utilities, transportation, and industry, including agro-industry. There are two versions of this indicator: (i) based on historical earnings; and (ii) on estimated future earnings.
7.20.21 The version based on historical earnings is based on either the latest completed fiscal year or a more recent 12-month period. It is more objective and certain than the future earnings version which includes uncertainty regarding future earnings. In calculating internal cash generation, the historic earnings version permits an adjustment for changes in sales prices introduced during the year as though they were in effect throughout the year. Nevertheless, this version may be constraining because it gives no credit for the earning power of the investments to be financed by the proposed loan, or any other expected increases in earning power. Conversely if an EA fails to implement a project within the grace period of the related loan, debt service payments cannot be met by the unfinished investment and the ability to meet debt service payments out of existing earnings is conservatively desirable.

7.20.22 The version that is based on future earnings recognizes the importance of designing a project that is capable of servicing its debt to avoid the case where the EA does not meet its existing poverty reduction goals because it has to service the project’s debt. It also recognizes the intention of the loan’s grace period which is to defer debt service until the project is capable of servicing its debt. It is a normal business risk to invest with the expectation that the investment will pay for itself within a reasonable time.

**Debt-Equity Ratio**

7.20.23 The debt-equity ratio represents the relative proportions of these two sources of funds in the capital structure of an entity. If a capitalization of $200 million is financed by long-term debt of $120 million and by equity of $80 million, the debt-equity ratio would be presented as 60:40. The debt-equity ratio indicator is normally used only for new enterprises, such as a “Greenfield” industrial plant, where for lack of an earnings record the debt service coverage indicator is not practicable. Except for FIs, the debt-equity ratio indicator helps to maintain a satisfactorily balanced financing plan in an enterprise’s early years, but a debt service coverage indicator should be used also, because this is likely to become a more meaningful measure as output commences. It should then supersede the debt-equity ratio indicator after the first year or two of operations.

7.20.24 The considerations determining the magnitude of the debt-equity ratio are the same as those discussed for debt service coverage. It is generally inappropriate to have a debt-equity ratio higher than 60:40, but flexibility is permissible, depending on the sector or industry concerned, on the degree of capital intensity, and on the level of debt service commitments entered into. Where the latter are not severe, a higher ratio may be admissible. For example, where the loan principal is repayable at the end of the term and inflationary conditions prevail; or the interest rate is fixed at a low level; or the prospects for continued intensive borrowing are negligible, giving prospects of declining debt-equity ratios. Lower ratios than this are preferable for enterprises whose earnings are subject to wide fluctuations. Higher ratios, normally not greater that 70:30 may be acceptable for enterprises with very dependable earning power. However, there are a number of public sector enterprises, which are funded almost entirely by government debt, where the debt-equity ratio is 90:10 and sometimes 100:0.

7.20.25 In terms of sound commercial and financial management practice, such ratios are meaningless, but because the enterprises concerned are, in effect, government “departments”, there may be no adverse performance effects, except that debt service could reach unmanageable proportions should the governments concerned ever seek to
recover real interest rates. However, in many of these cases, the “debt” is often non-repayable, and interest rates are usually kept low. The indicator in these circumstances has no credibility. It should be noted, however, that one of the Bank’s long-term objectives for enterprises of this type is, as a minimum to achieve self-financing status, and as an optimum, to achieve privatization. For either option, an unbalanced debt-equity structure of 90:10 or higher will mean that the enterprise will be regarded in the capital markets as not creditworthy, and until it can adopt a structure around 60:40, is unlikely to attract institutional lenders.

7.20.26 However, an important side issue arises from the highly leveraged enterprises referred to above. While it may be reasonable to accept their status in terms of an abnormally high debt-equity ratio, the financial analyst must recognize that these enterprises are operating on free or very “cheap” capital. The Bank considers, generally speaking, that enterprises should pay for the use of capital, and that a reasonable interest rate should be levied. If this capital is not transferred in the form of loans and is injected instead as equity, this too has a price – probably a higher price than loan funds if it were sought in the money market. Therefore, the analyst should actively encourage the payment to government for this form of capital injection.

7.20.27 Any issues should be discussed at Project Preparation, and the RRP should contain a clear statement on the treatment proposed, and justification therefore, particularly if the market price of funds is not to be levied by government.

**Liquidity Indicators**

*Current Ratio*

7.20.28 The current ratio is the ratio of current assets to current liabilities as of the date of the balance sheet. It is an indicator of the adequacy of working capital and short-term liquidity, since it indicates the extent to which current liabilities are covered by current assets that are capable of being converted to cash in a period roughly corresponding to the maturity of the obligations. Current assets normally include cash, marketable securities, and other assets, such as accounts receivable, inventories, and prepaid expenses, which in the ordinary course of business are expected to be converted into cash within a year or business cycle. Current liabilities are those which would or could become due and payable in the next year, including accounts payable, short-term notes payable, customer advances and deposits accrued taxes and expenses, dividends payable and current maturities of long-term debt.

7.20.29 The appropriateness of a current ratio depends on the nature of the operations and the characteristics of the market for the entity’s output. A ratio of less that 1.0 is generally inadequate and usually a ratio substantially above 1.0 is deemed appropriate. For example, an enterprise subject to seasonal or fluctuating demand for its output, or irregular timings of inventory acquisition/build-up, should have a current ratio high enough to carry the necessary inventories of goods in process and finished and saleable output pending actual sales – possibly as high as 4.0. An enterprise such as a public utility, with steady inflows of funds from monthly billings and a good record for prompt collection, may operate with a current ratio as low as 1.0, or even marginally lower. An enterprise which has to transport at its own time and expense large quantities of inputs and finished goods for long distances will likewise require a high ratio.
**Quick Ratio**

7.20.30 An alternative and better indicator of liquidity is the quick ratio. The basic difference between this and the current ratio lies in the treatment of inventories, which are the least liquid of current assets and are also those on which losses are most likely to occur if business conditions become adverse. The quick ratio is calculated by deducting inventories from current assets and dividing the remainder by current liabilities. In other respects this indicator possesses similar advantages and disadvantages as the current ratio. A quick ratio of at least 1.0 is usually considered appropriate.

7.20.31 The current and quick ratio indicators have a serious deficiency in that they present the status of an enterprise at a point in time, and not its regular performance. Distortions frequently occur, such as the case of enterprises relying on customers’ advance payments for large delivery contracts, which if they do not take place, cause major shortfalls in cash, or if they occur as contracted, may make the ratio far higher than the actual consumption of inputs warrant. It is feasible to use this indicator to “window-dress” the enterprises’ financial status for presentational purposes at the reporting date. Therefore the most useful application of this indicator is to request an enterprise to provide a graphic presentation of a series of status indicators at, say, monthly, or weekly intervals for each year. In this way, the effective liquidity position can be better determined.

7.20.32 The International Monetary Fund (IMF) has been called upon to assess financial system soundness in its member countries as part of its surveillance work, including through the preparation of Financial System Stability Assessments. To this end, a joint World Bank-IMF Financial Sector Assessment Program (FSAP), was introduced in May 1999. The following article on ‘New Tools for Assessing Financial System Soundness’ that appeared in the ‘Finance & Development: A quarterly magazine of the IMF’, September 2000, Volume 37, Number 3 explains how macroprudential indicators—defined broadly as indicators of the health and stability of the financial system—can help countries assess their banking systems' vulnerability to crisis.

7.20.33 The article, ‘New Tools for Assessing Financial System Soundness’ is attached:

7.21 FOREIGN EXCHANGE TRANSACTIONS

7.21.1 Foreign exchange (FX) settlement risk is the risk of loss when a bank in a foreign exchange transaction pays the currency it sold but does not receive the currency it bought. FX settlement failures can arise from counterparty default, operational problems, market liquidity constraints and other factors. The Bank of International Settlements (BIS) issued a statement: “Supervisory Guidance for Managing Settlement Risk in Foreign Exchange Transactions” whose purpose is to provide banking supervisors with information about FX settlement risk and its management that they should take into account when assessing a bank's policies and procedures.

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7.21.2 The following is the BIS statement.

7.22 PEARLS MONITORING SYSTEM

7.22.1 Since 1990, the World Council of Credit Unions, Inc. has been using a set of financial ratios known as “PEARLS” to measure both the individual components and the system risks of Credit Unions (CU) operations. Each letter of the word PEARLS measures key areas of CU operations: Protection, Effective financial structure, Asset quality, Rates of return and cost, Liquidity and Signs of growth. PEARLS is a management tool that helps managers find meaningful solutions to serious credit union institutional deficiencies.

7.22.2 The following is the World Council of Credit Unions paper on: PEARLS Monitoring System that was issued in October 2002.

7.23 FINANCING GOVERNMENT SERVICES THROUGH USER CHARGING

7.23.1 Countries are increasingly financing government services through user charging. The objective of user charging is not only to achieve cost recovery from users, but also to make government services more effective and efficient (Best Practice Guidelines for User Charging for Government Services, PUMA Policy Brief No. 3, Public Management Service, March 1998 by OECD: http://www.oecd.org/dataoecd/19/38/1901769.pdf).

7.23.2 The ‘Best Practice Guidelines for User Charging for Government Services, PUMA Policy Brief No. 3, Public Management Service, March 1998 by OECD’ is attached:

7.24 INTERNATIONAL ACCOUNTING STANDARDS

Public Sector Accounting Standards

7.24.1 The following Public sector Accounting Standards have been issued by the International Public Sector Accounting Standards (IPSAS) board or by its predecessor the Public Sector Committee. As new standards continue to be issued and old ones amended on an ongoing basis, Financial Analysts are advised to consult the following website, regularly, for the current list of IPSAS: http://www.ifac.org/PublicSector/

IPSAS 1 Presentation of Financial Statements
IPSAS 2 Cash Flow Statements
IPSAS 3 Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policy
IPSAS 4 The Effects of Changes in Foreign Exchange rates
IPSAS 5 Borrowing Costs
IPSAS 6 Consolidated financial Statements and Accounting for Controlled Entities
IPSAS 7 Accounting for Investments in Associates
IPSAS 8 Financial Reporting of Interests in Joint Ventures
IPSAS 9 Revenue from Exchange Transactions
IPSAS 10 Financial Reporting in Hyperinflationary Economies
IPSAS 11 Construction Contracts
IPSAS 12 Inventories
IPSAS 13 Leases
IPSAS 14 Events after the Reporting Date
IPSAS 15 Financial Instruments: Disclosure and Presentation
IPSAS 16 Investment Property
IPSAS 17 Property, Plant and Equipment
IPSAS 18 Segment reporting
IPSAS 19 Provisions, Contingent Liabilities and Contingent Assets
IPSAS 20 Related Party Transactions
IPSAS 21 Impairment of Non-Cash Generating Assets
CASH BASIS IPSAS: Financial Reporting Under The Cash Basis of Accounting (Attached)

Exposure Draft

The IPSASB issued, in February 2005, the following Exposure Draft No. 24: Financial Reporting under the Cash Basis of Accounting – Disclosure Requirements for Recipients of External Assistance:

International Financial Reporting Standards and International Accounting Standards

7.24.2 The following is a list of International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS) issued by the International Accounting Standards Board. Numbers missing in the sequence of IAS represent Standards that have been superseded. Again, Financial Analysts are advised to consult the following website, regularly, for the current list of IFRS and IAS: http://www.iasplus.com/standard/standard.htm

International Financial Reporting Standards

IFRS 1 First Time Adoption of International Financial Reporting Standards
IFRS 2 Share-based Payment
IFRS 3 Business Combinations
IFRS 4 Insurance Contracts
IFRS 5 Non-Current Assets held for Sale and Discontinued Operations
IFRS 6 Exploration for and Evaluation of Mineral Assets

International Accounting Standards

IAS 1 Presentation of Financial Statements
IAS 2 Inventories
IAS 7 Cash Flow Statements
IAS 8 Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies
IAS 10  Events after the Balance Sheet Date
IAS 11  Construction Contracts
IAS 12  Income Taxes
IAS 14  Segment Reporting
IAS 15  Information Reflecting the Effects of Changing Prices
IAS 16  Property, Plant, and Equipment
IAS 17  Leases
IAS 18  Revenue
IAS 19  Employee Benefits
IAS 20  Accounting for Government Grants and Disclosure of Government Assistance
IAS 21  The Effects of Changes in Foreign Exchange Rates
IAS 23  Borrowing Costs
IAS 24  Related Party Disclosures
IAS 26  Accounting and Reporting by Retirement Benefit Plans
IAS 27  Consolidated Financial Statements and Accounting for Investments in Subsidiaries
IAS 28  Accounting for Investments in Associates
IAS 29  Financial Reporting in Hyperinflationary Economies
IAS 30  Disclosures in the Financial Statements of Banks and Similar Financial Institutions
IAS 31  Financial Reporting of Interests In Joint Ventures
IAS 32  Financial Instruments: Disclosures and Presentation
IAS 33  Earnings Per Share
IAS 34  Interim Financial Reporting
IAS 36  Impairment of Assets
IAS 37  Provisions, Contingent Liabilities, and Contingent Assets
IAS 38  Intangible Assets
IAS 39  Financial Instruments: Recognition and Measurement
IAS 40  Investment Property
IAS 41  Agriculture

7.25 INTERNATIONAL AUDITING STANDARDS

International Standards on Auditing (ISAs)

100  Assurance Engagements (Withdrawn)
120  Framework of ISAs (Withdrawn)
200  Objective and General Principles Governing an Audit of Financial Statements
210  Terms of Audit Engagements
220  Quality Control for Audit Work
220R  Quality Control for Historical Financial Information
230  Documentation
240  Fraud and Error
250  Consideration of Laws and Regulations in an Audit of Financial Statements
260  Communication of Audit Matters to those Charged with Governance
300  Planning
310  Knowledge of the Business (Withdrawn)
315  Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement
320  Audit Materiality

The Auditor’s Procedures in Response to Perceived Risk
Risk Assessments and Internal Control (Withdrawn)
Auditing in a Computer Information Systems Environment (Withdrawn)
Audit Considerations Relating to Entities Using Service Organizations
Audit Evidence
Audit Evidence-Additional Considerations for Specific Items
External Confirmations
Initial Engagements – Opening Balances
Analytical Procedures
Audit Sampling and other Selective Testing Procedures
Audit of Accounting Estimates
Auditing Fair Value Measurements and Disclosures
Related Parties
Subsequent Events
Going Concerns
Management Representations
Using the Work of Another Auditor
Considering the Work of Internal Auditing
Using the Work of an Expert
The Auditor’s Report on Financial Statements
The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements
Modifications to the Independent Auditor’s Report
Comparatives
Other information in documents containing Audited Financial Statements
The Auditor’s Report on Special Purpose Audit Engagement

Glossary of Terms

Preface to ISAs and RSs

International Auditing Practice Statements (IAPs)

Inter-Bank Confirmation Procedures
CIS Environments-Stand-Alone Microcomputer Systems (Withdrawn)
CIS Environments-On-Line Computer Systems (Withdrawn)
CIS Environments-Database Systems (Withdrawn)
The Relationship Between Bank Supervisors and External Auditors
The Special Consideration in the Audit of Small Entities
The Audit of International Commercial Banks
Communications with Management (Withdrawn)
Risk Assessment and Internal Control (Withdrawn)
Computer-Assisted Audit Techniques (Withdrawn)
The Consideration of Environmental Matters in the Audit of Financial Statements
Implications for Management And Auditors Of The Year 2000 Issue (Withdrawn)
Auditing Derivative Financial Instruments
Electronic Commerce – Effect on the Audit of Financial Statements
Reporting by Auditors on Compliance with International Financial Reporting Standards

International Standards on Review Engagements

2400 Engagements to Review Financial Statements

Assurance Engagements other than Audits or Reviews of Historical Financial Information

3000R Assurance Engagements other than Audits or Reviews of Historical Financial Information
3400 The Examination of Prospective Financial Information

Related Services

4400 Engagements to Perform Agreed upon Procedures Regarding Financial Information
4410 Engagements to Compile Financial Information

7.26 MODEL FINANCIAL STATEMENTS

Service Organization

7.26.1 The following model set of summary financial statements is appropriate for use by a service-type organization. The format used for this particular model is appropriate for forecasting (projecting) financial statements, for instance, during project preparation. The Financial Analyst should determine the forecast period.

7.26.2 When using these financial statements, it is essential that:
• An appropriate Statement of Accounting Policies be developed and agreed between the Bank and the borrower.
• Appropriate Notes to the Financial Statements supplement the financial statements.
• Where appropriate, the Financial Statements should be tailored so that they adequately reflect the performance and position of the organization.
## Example Service Organization
### Forecast Income Statements [Format for Financial Projections]
For the years ended 31 December (US$ 000s)

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X2</th>
<th>20X3</th>
<th>20X4</th>
<th>20X5</th>
<th>20X6</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operating Revenues</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenues from services</td>
<td>35,052</td>
<td>36,748</td>
<td>39,288</td>
<td>41,202</td>
<td>41,202</td>
<td>41,202</td>
<td>41,202</td>
</tr>
<tr>
<td>Investment income</td>
<td>1,157</td>
<td>1,073</td>
<td>1,126</td>
<td>1,243</td>
<td>1,243</td>
<td>1,243</td>
<td>1,243</td>
</tr>
<tr>
<td>Other operating revenue</td>
<td>317</td>
<td>332</td>
<td>279</td>
<td>269</td>
<td>269</td>
<td>269</td>
<td>269</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>36,526</td>
<td>38,153</td>
<td>40,693</td>
<td>42,714</td>
<td>42,714</td>
<td>42,714</td>
<td>42,714</td>
</tr>
</tbody>
</table>

| **Operating Expenses**    |            |            |            |            |            |            |            |
| Wages, salaries and employee benefits | 12,960 | 13,363 | 13,975 | 14,504 | 14,504 | 14,504 | 14,504 |
| Supplies and consumables used | 4,022 | 4,285 | 4,582 | 4,687 | 4,687 | 4,687 | 4,687 |
| Repairs and maintenance | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 |
| Depreciation and amortization expenses | 791 | 872 | 918 | 926 | 926 | 926 | 926 |
| Other operating expenses | 18,677 | 20,395 | 20,601 | 21,280 | 21,280 | 21,280 | 21,280 |
| **Total**                 | 37,450     | 39,915     | 41,076     | 42,397     | 42,397     | 42,397     | 42,397     |

| **Surplus/(Deficit) from Operating Activities** | -924 | -1,762 | -383 | 317 | 317 | 317 | 317 |
| Project-related interest income / (costs) | 2,373 | 2,527 | 2,588 | 2,512 | 2,512 | 2,512 | 2,512 |
| Other interest costs | .. | .. | .. | .. | .. | .. | .. |
| Gains on sale of fixed assets | .. | .. | .. | .. | .. | .. | .. |
| **Total non-operating revenue / (expenses)** | 2,373 | 2,527 | 2,588 | 2,512 | 2,512 | 2,512 | 2,512 |

| **Surplus/(Deficit) from Ordinary Activities** | 1,449 | 765 | 2,205 | 2,829 | 2,829 | 2,829 | 2,829 |
| Minority interest share of surplus/(deficit) | .. | .. | .. | .. | .. | .. | .. |

| **Net surplus/(deficit) before extraordinary items** | 1,449 | 765 | 2,205 | 2,829 | 2,829 | 2,829 | 2,829 |
| Extraordinary items | .. | .. | .. | .. | .. | .. | .. |
| Income tax expense | .. | .. | .. | .. | .. | .. | .. |

| **Net Surplus/(Deficit) for the Year after Tax** | 1,449 | 765 | 2,205 | 2,829 | 2,829 | 2,829 | 2,829 |
### Example Service Organization

**Forecast Balance Sheets [Format for Financial Projections]**

As at 31 December (US$ 000s)

<table>
<thead>
<tr>
<th></th>
<th>20X1 Actual</th>
<th>20X2 Actual</th>
<th>20X3 Actual</th>
<th>20X4 Actual</th>
<th>20X5 Actual</th>
<th>20X6 Forecast</th>
<th>20X7 Forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>210</td>
<td>93</td>
<td>97</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Marketable securities</td>
<td>10,440</td>
<td>11,279</td>
<td>9,929</td>
<td>9,473</td>
<td>9,473</td>
<td>9,473</td>
<td>9,473</td>
</tr>
<tr>
<td>Receivables</td>
<td>5,520</td>
<td>5,490</td>
<td>5,559</td>
<td>5,593</td>
<td>5,593</td>
<td>5,593</td>
<td>5,593</td>
</tr>
<tr>
<td>Inventories</td>
<td>274</td>
<td>329</td>
<td>348</td>
<td>379</td>
<td>379</td>
<td>379</td>
<td>379</td>
</tr>
<tr>
<td>Work in progress</td>
<td>3,995</td>
<td>4,768</td>
<td>5,519</td>
<td>6,032</td>
<td>6,032</td>
<td>6,032</td>
<td>6,032</td>
</tr>
<tr>
<td>Investments</td>
<td>338</td>
<td>341</td>
<td>954</td>
<td>2,210</td>
<td>2,210</td>
<td>2,210</td>
<td>2,210</td>
</tr>
<tr>
<td></td>
<td><strong>20,777</strong></td>
<td><strong>22,300</strong></td>
<td><strong>22,406</strong></td>
<td><strong>23,787</strong></td>
<td><strong>23,787</strong></td>
<td><strong>23,787</strong></td>
<td><strong>23,787</strong></td>
</tr>
<tr>
<td><strong>Less: Current Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payables and provisions</td>
<td>4,716</td>
<td>4,588</td>
<td>4,428</td>
<td>4,401</td>
<td>4,401</td>
<td>4,401</td>
<td>4,401</td>
</tr>
<tr>
<td>Short-term borrowings</td>
<td>2,236</td>
<td>2,413</td>
<td>2,413</td>
<td>2,413</td>
<td>2,413</td>
<td>2,413</td>
<td>2,413</td>
</tr>
<tr>
<td>Current portion of borrowings</td>
<td>7,208</td>
<td>7,648</td>
<td>7,533</td>
<td>7,528</td>
<td>7,528</td>
<td>7,528</td>
<td>7,528</td>
</tr>
<tr>
<td>Employee benefits</td>
<td>832</td>
<td>857</td>
<td>857</td>
<td>856</td>
<td>856</td>
<td>856</td>
<td>856</td>
</tr>
<tr>
<td></td>
<td><strong>14,992</strong></td>
<td><strong>15,506</strong></td>
<td><strong>15,231</strong></td>
<td><strong>15,198</strong></td>
<td><strong>15,198</strong></td>
<td><strong>15,198</strong></td>
<td><strong>15,198</strong></td>
</tr>
<tr>
<td><strong>WORKING CAPITAL</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>5,785</strong></td>
<td><strong>6,794</strong></td>
<td><strong>7,175</strong></td>
<td><strong>8,589</strong></td>
<td><strong>8,589</strong></td>
<td><strong>8,589</strong></td>
<td><strong>8,589</strong></td>
</tr>
<tr>
<td><strong>Plus: Non-current Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments</td>
<td>14,392</td>
<td>15,204</td>
<td>16,102</td>
<td>16,930</td>
<td>16,930</td>
<td>16,930</td>
<td>16,930</td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td>25,252</td>
<td>25,861</td>
<td>25,787</td>
<td>25,851</td>
<td>25,851</td>
<td>25,851</td>
<td>25,851</td>
</tr>
<tr>
<td>Intangible assets</td>
<td>2</td>
<td>302</td>
<td>830</td>
<td>1,322</td>
<td>1,322</td>
<td>1,322</td>
<td>1,322</td>
</tr>
<tr>
<td></td>
<td><strong>39,646</strong></td>
<td><strong>41,367</strong></td>
<td><strong>42,719</strong></td>
<td><strong>44,103</strong></td>
<td><strong>44,103</strong></td>
<td><strong>44,103</strong></td>
<td><strong>44,103</strong></td>
</tr>
<tr>
<td><strong>Less: Non-current Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payables</td>
<td>524</td>
<td>510</td>
<td>492</td>
<td>489</td>
<td>489</td>
<td>489</td>
<td>489</td>
</tr>
<tr>
<td>Borrowings</td>
<td>28,833</td>
<td>30,591</td>
<td>30,131</td>
<td>30,113</td>
<td>30,113</td>
<td>30,113</td>
<td>30,113</td>
</tr>
<tr>
<td>Employee benefits</td>
<td>7,491</td>
<td>7,710</td>
<td>7,716</td>
<td>7,706</td>
<td>7,706</td>
<td>7,706</td>
<td>7,706</td>
</tr>
<tr>
<td></td>
<td><strong>36,848</strong></td>
<td><strong>38,811</strong></td>
<td><strong>38,339</strong></td>
<td><strong>38,308</strong></td>
<td><strong>38,308</strong></td>
<td><strong>38,308</strong></td>
<td><strong>38,308</strong></td>
</tr>
<tr>
<td><strong>Net Assets</strong></td>
<td><strong>8,583</strong></td>
<td><strong>9,350</strong></td>
<td><strong>11,555</strong></td>
<td><strong>14,384</strong></td>
<td><strong>14,384</strong></td>
<td><strong>14,384</strong></td>
<td><strong>14,384</strong></td>
</tr>
<tr>
<td><strong>EQUITY</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Issued and paid-up capital</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
</tr>
<tr>
<td>Reserves</td>
<td>7,201</td>
<td>7,190</td>
<td>7,190</td>
<td>7,190</td>
<td>7,190</td>
<td>7,190</td>
<td>7,190</td>
</tr>
<tr>
<td>Accumulated surpluses/(deficits)</td>
<td>382</td>
<td>1,160</td>
<td>3,365</td>
<td>6,194</td>
<td>6,194</td>
<td>6,194</td>
<td>6,194</td>
</tr>
<tr>
<td><strong>Total Equity</strong></td>
<td><strong>8,583</strong></td>
<td><strong>9,350</strong></td>
<td><strong>11,555</strong></td>
<td><strong>14,384</strong></td>
<td><strong>14,384</strong></td>
<td><strong>14,384</strong></td>
<td><strong>14,384</strong></td>
</tr>
</tbody>
</table>
### Example Service Organization

**Forecast Cash Flow Statements [Format for Financial Projections]**

For the years ended 31 December (US$ 000s)

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X2</th>
<th>20X3</th>
<th>20X4</th>
<th>20X5</th>
<th>20X6</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Actual</td>
<td>Actual</td>
<td>Actual</td>
<td>Actual</td>
<td>Actual</td>
<td>Forecast</td>
<td>Forecast</td>
</tr>
</tbody>
</table>

#### OPERATING CASH FLOWS

**Receipts**

- Cash receipts from customers: 34,793
- Other Receipts: 341

**Payments**

- Employees: -12,615
- Suppliers: -19,750
- Other payments: -369

**Net Cash Flows from Operating Activities**

<table>
<thead>
<tr>
<th>Notes</th>
<th>20X1</th>
<th>20X2</th>
<th>20X3</th>
<th>20X4</th>
<th>20X5</th>
<th>20X6</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2,400</td>
<td>2,415</td>
<td>4,102</td>
<td>4,629</td>
<td>4,629</td>
<td>4,629</td>
<td>4,629</td>
</tr>
</tbody>
</table>

#### INVESTING CASH FLOWS

**Receipts**

- Interest received: 1,070
- Sales of fixed assets: 250
- Sales of investments: 1,983

**Payments**

- Interest paid: -2,507
- Purchases of fixed assets: -1,469
- Purchases of investments: -130

**Net Cash Flows from Investing Activities**

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X2</th>
<th>20X3</th>
<th>20X4</th>
<th>20X5</th>
<th>20X6</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-803</td>
<td>-4,013</td>
<td>-3,498</td>
<td>-4,577</td>
<td>-1,751</td>
<td>-1,751</td>
<td>-1,751</td>
</tr>
</tbody>
</table>

#### FINANCING CASH FLOWS

**Receipts**

- Proceeds from new borrowings: 275

**Payments**

- Capital withdrawals: ..
- Repayment of borrowings: -1,900
- Dividends paid: -2,829

**Net Cash Flows from Financing Activities**

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X2</th>
<th>20X3</th>
<th>20X4</th>
<th>20X5</th>
<th>20X6</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-1,625</td>
<td>1,477</td>
<td>-600</td>
<td>-49</td>
<td>-2,878</td>
<td>-2,878</td>
<td>-2,878</td>
</tr>
</tbody>
</table>

**Net increases/(decreases) for period**

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X2</th>
<th>20X3</th>
<th>20X4</th>
<th>20X5</th>
<th>20X6</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-28</td>
<td>-121</td>
<td>4</td>
<td>3</td>
<td>..</td>
<td>..</td>
<td>..</td>
</tr>
</tbody>
</table>

#### CASH AND CASH EQUIVALENTS

**Balances as at 1 January**

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X2</th>
<th>20X3</th>
<th>20X4</th>
<th>20X5</th>
<th>20X6</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>230</td>
<td>210</td>
<td>93</td>
<td>97</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

**Currency changes on opening balances**

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X2</th>
<th>20X3</th>
<th>20X4</th>
<th>20X5</th>
<th>20X6</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>8</td>
<td>4</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
</tr>
</tbody>
</table>

**Net increases/(decreases) for period**

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X2</th>
<th>20X3</th>
<th>20X4</th>
<th>20X5</th>
<th>20X6</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-28</td>
<td>-121</td>
<td>4</td>
<td>3</td>
<td>..</td>
<td>..</td>
<td>..</td>
</tr>
</tbody>
</table>

**Balances as at 31 December**

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X2</th>
<th>20X3</th>
<th>20X4</th>
<th>20X5</th>
<th>20X6</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>210</td>
<td>93</td>
<td>97</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>
Example Service Organization
Notes to the Financial Statements [Format for Financial Projections]
For the years ended 31 December (US$ 000s)

<table>
<thead>
<tr>
<th>Notes</th>
<th>20X1</th>
<th>20X2</th>
<th>20X3</th>
<th>20X4</th>
<th>20X5</th>
<th>20X6</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actual</td>
<td>Actual</td>
<td>Actual</td>
<td>Actual</td>
<td>Actual</td>
<td>Actual</td>
<td>Forecast</td>
<td>Forecast</td>
</tr>
</tbody>
</table>

Note 1: Revenues by Service Type

<table>
<thead>
<tr>
<th>Service Type</th>
<th>20X1</th>
<th>20X2</th>
<th>20X3</th>
<th>20X4</th>
<th>20X5</th>
<th>20X6</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>376</td>
<td>353</td>
<td>379</td>
<td>387</td>
<td>387</td>
<td>387</td>
<td>387</td>
</tr>
<tr>
<td>B</td>
<td>34,035</td>
<td>35,748</td>
<td>38,274</td>
<td>40,195</td>
<td>40,195</td>
<td>40,195</td>
<td>40,195</td>
</tr>
<tr>
<td>C</td>
<td>641</td>
<td>647</td>
<td>635</td>
<td>620</td>
<td>620</td>
<td>620</td>
<td>620</td>
</tr>
</tbody>
</table>

35,052 36,748 39,288 41,202 41,202 41,202 41,202

Note 2: Reconciliation of Income Statement to Operating Cash Flows

Net Surplus/(Deficit) per Income Statement

<table>
<thead>
<tr>
<th>Items included in net surpluses but not in net cash flows from operations:</th>
<th>20X1</th>
<th>20X2</th>
<th>20X3</th>
<th>20X4</th>
<th>20X5</th>
<th>20X6</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unrealised net foreign exchange gains</td>
<td>1,449</td>
<td>765</td>
<td>2,205</td>
<td>2,829</td>
<td>2,829</td>
<td>2,829</td>
<td>2,829</td>
</tr>
<tr>
<td>Interest received</td>
<td>-66</td>
<td>-87</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Interest paid</td>
<td>-1,070</td>
<td>-835</td>
<td>-834</td>
<td>-901</td>
<td>-901</td>
<td>-901</td>
<td>-901</td>
</tr>
<tr>
<td>Asset movements</td>
<td>2,507</td>
<td>2,516</td>
<td>2,561</td>
<td>2,502</td>
<td>2,502</td>
<td>2,502</td>
<td>2,502</td>
</tr>
<tr>
<td>Depreciation</td>
<td>791</td>
<td>872</td>
<td>918</td>
<td>926</td>
<td>926</td>
<td>926</td>
<td>926</td>
</tr>
<tr>
<td>Gains/(losses) on sales of assets</td>
<td>-7</td>
<td>3</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Other non-cash items</td>
<td>-918</td>
<td>110</td>
<td>864</td>
<td>1,134</td>
<td>1,134</td>
<td>1,134</td>
<td>1,134</td>
</tr>
<tr>
<td>Movements in employee benefit liabilities</td>
<td>-286</td>
<td>-929</td>
<td>-1,612</td>
<td>-1,861</td>
<td>-1,861</td>
<td>-1,861</td>
<td>-1,861</td>
</tr>
<tr>
<td>Movements in working capital</td>
<td>-2,400</td>
<td>2,415</td>
<td>4,102</td>
<td>4,629</td>
<td>4,629</td>
<td>4,629</td>
<td>4,629</td>
</tr>
<tr>
<td>Net Cash Flows from Operations</td>
<td>2,400</td>
<td>2,415</td>
<td>4,102</td>
<td>4,629</td>
<td>4,629</td>
<td>4,629</td>
<td>4,629</td>
</tr>
</tbody>
</table>

Manufacturing Organization

7.26.3 The following model set of summary financial statements is appropriate for use by a manufacturing organization for year-end reporting. When using these financial statements, it is essential that:

- An appropriate Statement of Accounting Policies be developed and agreed between the Bank and the borrower.
- Appropriate Notes to the Financial Statements supplement the financial statements.
- Where appropriate, the Financial Statements should be tailored so that they adequately reflect the performance and position of the organization.

7.26.4 The format used for this particular model set of summary financial statements is appropriate for year-end reporting.
Example Manufacturing Organization

Income Statement [Format for Year-end Reporting]

For the year ended 31 December 20X2

<table>
<thead>
<tr>
<th></th>
<th>For the Year Ended 31 December 20x2</th>
<th>Cumulative Since Project Start-Date</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Actual '000s</td>
<td>Forecast '000s</td>
</tr>
<tr>
<td>Notes</td>
<td>US$'000</td>
<td>US$'000s</td>
</tr>
<tr>
<td>SALES</td>
<td>893,121</td>
<td>1,431,093</td>
</tr>
<tr>
<td>Less cost of goods sold</td>
<td>813,673</td>
<td>1,296,081</td>
</tr>
<tr>
<td>GROSS PROFIT</td>
<td>79,448</td>
<td>135,012</td>
</tr>
<tr>
<td>Operating Costs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Administrative salaries</td>
<td>27,326</td>
<td>37,742</td>
</tr>
<tr>
<td>Depreciation</td>
<td>3,917</td>
<td>7,335</td>
</tr>
<tr>
<td>Amortization</td>
<td>12,357</td>
<td>12,357</td>
</tr>
<tr>
<td>Administration costs</td>
<td>56,037</td>
<td>88,259</td>
</tr>
<tr>
<td>Marketing expenses</td>
<td>3,109</td>
<td>4,985</td>
</tr>
<tr>
<td>OPERATING PROFIT</td>
<td>-23,298</td>
<td>-15,666</td>
</tr>
<tr>
<td>Other income</td>
<td>1,000</td>
<td>1,080</td>
</tr>
<tr>
<td>Foreign exchanges gains/(losses)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net income before interest and taxes</td>
<td>-22,298</td>
<td>-16,156</td>
</tr>
<tr>
<td>Project-related interest expenses</td>
<td>-42,672</td>
<td>-63,657</td>
</tr>
<tr>
<td>Other interest expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income tax expense</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Income after Interest and Taxes</td>
<td>-64,970</td>
<td>-79,813</td>
</tr>
</tbody>
</table>

Gross Margin (% of Sales) 8.9% 9.4% -0.5% ... 10.9% 11.1% -0.2% ...
Operating Margin (% of Sales) -2.6% -1.1% -1.5% ... 2.8% 3.4% -0.6% ...

Example Manufacturing Organization
Balance Sheet [Format for Year-end Reporting]
As at 31 December 20X2

<table>
<thead>
<tr>
<th>Notes</th>
<th>Current Assets</th>
<th>For the year ended 31 December 20x2</th>
<th>Cumulative Since Project Start-date</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Actual US$’000s</td>
<td>Forecast US$’000s</td>
</tr>
<tr>
<td></td>
<td></td>
<td>25,308</td>
<td>10,373</td>
</tr>
<tr>
<td></td>
<td>Bills receivable</td>
<td>56,114</td>
<td>59,943</td>
</tr>
<tr>
<td>3</td>
<td>Accounts receivable</td>
<td>365,150</td>
<td>402,058</td>
</tr>
<tr>
<td>4</td>
<td>Prepayments and other current assets</td>
<td>120,193</td>
<td>120,193</td>
</tr>
<tr>
<td></td>
<td></td>
<td>585,470</td>
<td>612,548</td>
</tr>
<tr>
<td>Less: Current Liabilities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Accounts payable</td>
<td>93,174</td>
<td>103,203</td>
</tr>
<tr>
<td></td>
<td>Short-term debt</td>
<td>207,610</td>
<td>207,610</td>
</tr>
<tr>
<td></td>
<td>Notes and bills payable</td>
<td>5,000</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>Advances from costumers</td>
<td>13,084</td>
<td>13,084</td>
</tr>
<tr>
<td></td>
<td>Accrued wages and salaries</td>
<td>184,427</td>
<td>184,427</td>
</tr>
<tr>
<td></td>
<td>Taxes payable</td>
<td>72,607</td>
<td>72,648</td>
</tr>
<tr>
<td></td>
<td>Accruals and other current liabilities</td>
<td>47,749</td>
<td>47,749</td>
</tr>
<tr>
<td></td>
<td>Current portion of term debt</td>
<td>3,000</td>
<td>13,578</td>
</tr>
<tr>
<td></td>
<td></td>
<td>626,651</td>
<td>647,299</td>
</tr>
<tr>
<td>WORKING CAPITAL</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>-41,181</td>
<td>-34,751</td>
</tr>
<tr>
<td>Plus: Non-current Assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Fixed assets</td>
<td>800,263</td>
<td>1,222,024</td>
</tr>
<tr>
<td></td>
<td>Capital work in progress (assets under construction)</td>
<td>445,108</td>
<td>169,390</td>
</tr>
<tr>
<td></td>
<td>Intangibles and deferrals</td>
<td>49,426</td>
<td>37,069</td>
</tr>
<tr>
<td></td>
<td>Other non-current assets</td>
<td>30,572</td>
<td>15,572</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1,325,369</td>
<td>1,444,055</td>
</tr>
<tr>
<td>Less: Non-current Liabilities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Term loans</td>
<td>443,700</td>
<td>621,349</td>
</tr>
<tr>
<td></td>
<td>Payables</td>
<td>7,646</td>
<td>7,646</td>
</tr>
<tr>
<td></td>
<td>Other non-current liabilities</td>
<td>49,250</td>
<td>49,250</td>
</tr>
<tr>
<td></td>
<td></td>
<td>500,596</td>
<td>678,245</td>
</tr>
<tr>
<td>NET ASSETS</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>783,592</td>
<td>731,059</td>
</tr>
<tr>
<td>EQUITY</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Issued paid capital</td>
<td>315,147</td>
<td>342,427</td>
</tr>
<tr>
<td></td>
<td>Accumulated surpluses/(deficits)</td>
<td>468,445</td>
<td>388,632</td>
</tr>
<tr>
<td></td>
<td></td>
<td>783,592</td>
<td>731,059</td>
</tr>
<tr>
<td>Current ratio</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>0.93</td>
<td>0.95</td>
</tr>
<tr>
<td>Quick ratio</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>0.16</td>
<td>0.14</td>
</tr>
<tr>
<td>Long-term debt: equity</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>0.64</td>
<td>0.93</td>
</tr>
</tbody>
</table>

Example Manufacturing Organization
Statement of Cash Flows [Format for Year-end Reporting]
For the year ended 31 December 20X2

<table>
<thead>
<tr>
<th>Notes</th>
<th>Actual US$’000s</th>
<th>Forecast US$’000s</th>
<th>Variance US$’000s</th>
<th>Actual US$’000s</th>
<th>Forecast US$’000s</th>
<th>Variance US$’000s</th>
<th>%</th>
<th>Actual US$’000s</th>
<th>Forecast US$’000s</th>
<th>Variance US$’000s</th>
<th>%</th>
</tr>
</thead>
</table>

### Operating Cash Flows

#### Receipts
- Cash receipts from costumers: 915,146 1,448,537 -533,391 -36.8%
- Tax rebates: 23,260 27,280 -4,020 -14.7%
- Other receipts: 1,000 1,080 -80 -7.4%

#### Payments
- Employees and suppliers: -896,292 -1,387,934 491,642 -35.4%
- Taxes paid: -5,942 -7,508 1,566 -20.9%

#### Net Cash Flows from Operations
- 37,172 81,455 -44,283 -54.4%

### INVESTING CASH FLOWS

#### Receipts
- Interest received: .. .. .. 0.0%
- Sales of fixed assets: .. .. .. 0.0%
- Sales of investments: .. .. .. 0.0%

#### Payments
- Interest paid: -28,482 -42,370 13,888 -32.8%
- Capital expenditures: .. -219,390 219,390 -100.0%

#### Net Cash Flows from Investing Activities
- -28,482 -261,760 233,278 -89.1%

### FINANCING CASH FLOWS

#### Capital contributions from owners: .. .. .. 0.0%

#### Proceeds from new borrowings: .. 168,370 -168,370 -100.0%

#### Payments
- Repayment of borrowings: -3,000 -3,000 .. 0.0%
- Dividends paid: .. .. .. 0.0%

#### Net Cash Flows from Financing Activities
- -3,000 165,370 -168,370 -101.8%

### CASH AND CASH EQUIVALENTS

#### Balances as at 1st January
- 19,618 25,308

#### Currency changes on opening balances: .. .. ..

#### Net increases/(decreases) for period
- 5,600 -14,935 -20,625 -138.1%

#### Balances as at 31 December
- 25,308 10,373

## Example Manufacturing Organization

### Notes to the Financial Statements [Format for Year-end Reporting]

For the year ended 31 December 20X2

<table>
<thead>
<tr>
<th></th>
<th>For the Year Ended 31 December 20x2</th>
<th>Cumulative Since Project Start-Date</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Actual US$'000s</td>
<td>Forecast US$'000s</td>
</tr>
<tr>
<td><strong>Note 1: Gross Margin by Product</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales by Product:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product A</td>
<td>240,318</td>
<td>284,659</td>
</tr>
<tr>
<td>Product B</td>
<td>230,868</td>
<td>258,132</td>
</tr>
<tr>
<td>Product C</td>
<td>262,416</td>
<td>586,880</td>
</tr>
<tr>
<td>Product D</td>
<td>149,919</td>
<td>287,022</td>
</tr>
<tr>
<td>Product E</td>
<td>9,600</td>
<td>14,400</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>893,121</td>
<td>1,431,093</td>
</tr>
<tr>
<td><strong>Cost of Sales by Product:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product A</td>
<td>203,418</td>
<td>311,059</td>
</tr>
<tr>
<td>Product B</td>
<td>203,418</td>
<td>336,981</td>
</tr>
<tr>
<td>Product C</td>
<td>260,375</td>
<td>414,746</td>
</tr>
<tr>
<td>Product D</td>
<td>138,324</td>
<td>220,334</td>
</tr>
<tr>
<td>Product E</td>
<td>8,138</td>
<td>12,961</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>813,673</td>
<td>1,296,081</td>
</tr>
<tr>
<td><strong>Gross Profit by Product ($’000s):</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product A</td>
<td>36,900</td>
<td>-26,400</td>
</tr>
<tr>
<td>Product B</td>
<td>27,450</td>
<td>-78,849</td>
</tr>
<tr>
<td>Product C</td>
<td>2,041</td>
<td>172,134</td>
</tr>
<tr>
<td>Product D</td>
<td>11,595</td>
<td>66,688</td>
</tr>
<tr>
<td>Product E</td>
<td>1,462</td>
<td>1,439</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>79,448</td>
<td>135,012</td>
</tr>
<tr>
<td><strong>Gross Margin by Product (%)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product A</td>
<td>15.4%</td>
<td>-9.3%</td>
</tr>
<tr>
<td>Product B</td>
<td>11.9%</td>
<td>-30.5%</td>
</tr>
<tr>
<td>Product C</td>
<td>0.8%</td>
<td>29.3%</td>
</tr>
<tr>
<td>Product D</td>
<td>7.7%</td>
<td>23.2%</td>
</tr>
<tr>
<td>Product E</td>
<td>15.2%</td>
<td>10.0%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>8.9%</td>
<td>9.4%</td>
</tr>
</tbody>
</table>

**Note 2: Cost of Goods Sold**

<table>
<thead>
<tr>
<th></th>
<th>US$'000s</th>
<th>US$'000s</th>
<th>Variance US$'000s</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raw Materials</td>
<td>424,751</td>
<td>690,624</td>
<td>265,873</td>
<td>38.5%</td>
</tr>
<tr>
<td>Utilities</td>
<td>238,734</td>
<td>416,461</td>
<td>177,727</td>
<td>42.7%</td>
</tr>
<tr>
<td>Direct Labor</td>
<td>79,639</td>
<td>121,775</td>
<td>42,136</td>
<td>34.0%</td>
</tr>
<tr>
<td>Direct Depreciation</td>
<td>35,257</td>
<td>66,012</td>
<td>30,755</td>
<td>46.6%</td>
</tr>
<tr>
<td>Other Variable Costs</td>
<td>22,750</td>
<td>38,117</td>
<td>15,367</td>
<td>40.3%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>801,131</td>
<td>1,332,989</td>
<td>531,858</td>
<td>39.9%</td>
</tr>
</tbody>
</table>

**Plus opening finished goods**

<table>
<thead>
<tr>
<th></th>
<th>US$'000s</th>
<th>US$'000s</th>
<th>Variance US$'000s</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>93,437</td>
<td>80,895</td>
<td>-12,542</td>
<td>-15.5%</td>
<td>...</td>
</tr>
<tr>
<td>Less closing finished goods</td>
<td>-80,895</td>
<td>-117,803</td>
<td>-26,908</td>
<td>31.3%</td>
</tr>
<tr>
<td><strong>Cost of Goods Sold</strong></td>
<td>813,673</td>
<td>1,296,081</td>
<td>482,408</td>
<td>37.2%</td>
</tr>
</tbody>
</table>

---

## Example Manufacturing Organization

### Notes to the Financial Statements [Format for Year-end Reporting]

**For the year ended 31 December 20X2**

<table>
<thead>
<tr>
<th>Note 3: Receivables</th>
<th>For the year ended 31 December 20x2</th>
<th>Cumulative since Project Start-Date</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Actual</td>
<td>Forecast</td>
</tr>
<tr>
<td></td>
<td>US$'000s</td>
<td>US$'000s</td>
</tr>
<tr>
<td>By Organization Type:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Related Parties</td>
<td>576</td>
<td>700</td>
</tr>
<tr>
<td>State-owned organizations</td>
<td>10,256</td>
<td>12,500</td>
</tr>
<tr>
<td>Other Organizations</td>
<td>9,744</td>
<td>9,000</td>
</tr>
<tr>
<td>Gross Receivables</td>
<td>20,576</td>
<td>22,200</td>
</tr>
<tr>
<td>By Age</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less than 30 days old</td>
<td>10,000</td>
<td>11,000</td>
</tr>
<tr>
<td>30 to 60 days old</td>
<td>5,000</td>
<td>5,500</td>
</tr>
<tr>
<td>60 to 90 days old</td>
<td>2,500</td>
<td>2,500</td>
</tr>
<tr>
<td>90 to 180 days old</td>
<td>2,000</td>
<td>2,000</td>
</tr>
<tr>
<td>More than 180 days old</td>
<td>1,076</td>
<td>1,200</td>
</tr>
<tr>
<td>Gross Receivables</td>
<td>20,576</td>
<td>22,200</td>
</tr>
<tr>
<td>Less: Provision for Doubtful Debts</td>
<td>-1,871</td>
<td>-2,219</td>
</tr>
<tr>
<td>Net Receivables per balance</td>
<td>18,705</td>
<td>19,981</td>
</tr>
</tbody>
</table>

### Note 4 Inventories

**By Age**

<table>
<thead>
<tr>
<th>By Age</th>
<th>Actual</th>
<th>Forecast</th>
<th>Variance</th>
<th>Actual</th>
<th>Forecast</th>
<th>Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 2 months old</td>
<td>100,000</td>
<td>120,000</td>
<td>125,000</td>
<td>160,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 to 4 months old</td>
<td>80,000</td>
<td>90,000</td>
<td>95,000</td>
<td>150,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 to 6 months old</td>
<td>100,000</td>
<td>95,000</td>
<td>95,000</td>
<td>90,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6 to 9 months old</td>
<td>60,000</td>
<td>60,000</td>
<td>70,000</td>
<td>40,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9 to 12 months old</td>
<td>20,000</td>
<td>30,000</td>
<td>35,000</td>
<td>20,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>More than 12 months old</td>
<td>15,150</td>
<td>17,058</td>
<td>17,488</td>
<td>5,796</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross Inventories</td>
<td>373,150</td>
<td>412,058</td>
<td>437,488</td>
<td>465,796</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Provisions for Obsolete Inventories</td>
<td>-10,000</td>
<td>-10,000</td>
<td>-10,000</td>
<td>-10,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Inventories per balance sheet</td>
<td>365,150</td>
<td>402,058</td>
<td>427,488</td>
<td>455,796</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Note 5: Reconciliation of Income Statement to Operating Cash Flows

#### Net Surplus/(Deficit) per Income Statement

Items included in net surpluses but not in net cash flows from operations:

- Unrealised net foreign exchange gains
- Interest revenues
- Interest expenses
- Asset movements
  - Depreciation
  - Gains/(losses) on sales of assets
- Other non-cash items
  - Movements in employee benefit liabilities
- Movements in working capital
  - Decrease/(increase) in receivables
  - Decrease/(increase) in inventories
  - Decrease/(increase) in work in progress
  - Increase/(decrease) in payables

Net Cash Flows from Operations
7.27 FINANCIAL LOAN COVENANTS

Preamble

This section presents a full discussion of the financial covenants. The Bank, however, unlike other lenders will not apply all these covenants. Importantly, financial loan covenants tend to vary from one project to another and are an outcome of loan negotiations with the borrower. Therefore, the discussion below is intended to only ensure that financial analysts are well informed and NOT as a prescription of what must be found across all projects that are financed by the Bank.

Operating Covenants

Rate of Return Covenant

7.27.1 Under the rate of return covenant, an enterprise affirms that it will take all actions necessary, including changes in its tariffs, rates and charges, for its revenues each year to cover operating expenses and taxes, if any, and to earn an agreed return on its investment. The rate of return covenant is appropriate under low inflationary conditions. When inflation is forecast to exceed 7 percent per annum over the five years from the date of loan effectiveness, the practice has been to require a periodic revaluation of assets.

7.27.2 This covenant is most frequently applied to public sector enterprises constructing and operating projects in the sectors, which embrace agribusiness, electric power, ports, telecommunications, gas or fuel pipelines, water supply and sanitation. The rate of return covenant is generally less frequently used for sanitation and sewerage projects, because they have considerable difficulty in generating surpluses for investment or reserves and therefore these projects are normally combined with those of water supply as part of a water supply utility enterprise operation. A model covenant is provided in section 7.27.32, below.

7.27.3 Competitive factors bear significantly on the financial performance of industry (including oil and gas), therefore a specific rate of return covenant is used infrequently in this sector; instead, a less precisely defined form of the rate of return covenant, the general price covenant (see following paragraphs), is usually used. For railways, the rate of return on invested capital may be used but a commonly used covenant is the operating ratio.

Self-Financing Ratio Covenant

7.27.4 A self-financing ratio covenant, directly addresses the need for sufficient internal cash generation to consistently finance an agreed proportion of investment requirements. This covenant is often used when a more direct approach to addressing cash generation requirements is considered desirable. Borrowers often favour the covenant because it: (i) is more readily understood, particularly by politicians and administrators; (ii) is less costly to put in place and maintain; and (iii) avoids setting aside funds which may occur with the rate of return covenant.

7.27.5 However it can be manipulated. This may arise if a borrower deliberately decides to match its annual investment plans to whatever level of net revenues becomes available, in order to comply with the covenant. As an example, a borrower required to contribute 20
percent per annum to its investment program from internally generated revenues, can comply by financing $100 million from $20 million internally generated revenues, but in reality it may need to make larger investments if it is to achieve its needed contribution to the National Development Strategy. More specifically, and even when using an extended review period (e.g. three years) as the base for determining investments, the objective of the covenant can be avoided by a borrower failing to implement acceptable levels of annual investments, with the result that the revenues required to be generated internally can be allowed to fall correspondingly. The significant and likely impact of this default is a failure by the borrower to expeditiously execute the project, directly due to the reduction of the level of investment agreed between the borrower and the Bank in the project implementation and financing plans. A model covenant is provided in section 7.27.32, below.

7.27.6 A further problem associated with using the self-financing ratio as a covenant is the reality of an often-uneven nature of investment programs (i.e., the pattern of investments can vary widely from year to year). A three-year investment pattern for a public sector enterprise could be $10 million, $77 million, and $12 million. Such a program with a three-year moving average would show for that period an average of $33 million. If the borrower was required to raise 30 percent from internally generated revenues annually, the result would be a surplus in year one of $23 million, a shortfall of $21 million in year two, with parity arriving only in year three.

7.27.7 This example makes the case for smoothing several years’ performances, but does not address the issue of achieving a political realistic justification for tariff and charges increases for an as yet unaccomplished investment program. Under these circumstances it may be difficult for a borrower to justify politically the raising of charges to yield a very large surplus in year one. While it may forecast to complete $77 million in year two, this may be a dubious estimate by a government that is hard-pressed for resources. Under these cases the Bank has to make its case convincingly in line with the macro-economic goals of the National Development Strategy.

**General Price Level Covenant**

7.27.8 The General Price Level Covenant should be carefully adapted to the circumstances of the particular project. The main purpose of the covenant is to set forth agreed criteria applicable in determining prices, and to provide for consultation with Bank. Because it is not feasible to be precise, the criteria should be expressed in general terms. A model covenant is provided in section 7.27.32, below.

**Operating Ratio Covenant**

7.27.9 An operating ratio covenant requires a public sector enterprise to set its tariffs and rates at levels that meet a specified operating ratio test. The covenant may also state a minimum reduction in the operating ratio to be achieved by a specified date, as part of an agreed effort to improve operating efficiency and, in some cases, eliminate uneconomic services. This covenant is normally used only where it is not feasible to use a rate of return or cash generation approach – for example, for an entity which has been incurring substantial operating losses and whose objective is to eliminate such losses. It may also be used for a revenue-earning entity that is likely to be restricted by government from generating appropriate amounts of capital for future expansion purposes. It is usually necessary to supplement an operating ratio covenant with agreements by the concerned government to
provide necessary funds to offset operating deficits until they are eliminated, to cover any deficiencies in meeting debt service obligations, and to assist in financing capital needs. A model covenant is provided in section 7.27.32, below.

**Breakeven Covenant**

7.27.10 A Breakeven Ratio covenant is designed to achieve financial viability in its most limited sense. There are two breakeven variations: revenue (accrual) breakeven; and cash breakeven. This section, and the model covenant, refers to the former variation. The covenant requires the entity to take all measures necessary, including adjustments in its rates, for revenues to cover operating expenses, adequate maintenance, taxes if any, and the greater of depreciation or debt service requirements. The objective of this covenant is to support a revenue-earning enterprise’s efforts to breakeven, without losses, but without providing any surpluses for investment, dividends, etc.

7.27.11 This approach is occasionally used for transportation and similar projects that follow the principle of funding their capital requirements predominantly through borrowings or grants, and also receive operating subsidies. It is infrequently used for the public sector, and is unlikely to be used for private sector projects. It compares the total revenues of an enterprise to the operating expenses plus the amount by which debt service requirements exceed the provision for depreciation.

7.27.12 The major risk in the use of this covenant is that the borrower/EA may become complacent if break-even is achieved, and will fail to pursue more aggressive revenue-earning policy to provide for the gradual removal of all subsidies. This covenant should not be introduced without a detailed justification at fact-finding, and in the AR. A detailed breakeven analysis, displaying the effects of changes in volume on the breakeven point and on profitability and cash flows should be developed.

**Capital Structure Covenants**

**Debt Service Coverage Covenant**

7.27.13 The two key issues to be decided in formulating the debt service ratio covenant are (i) whether to base it on historical or forecast earnings, and (ii) what particular ratio to require as the minimum acceptable coverage. A good rule to follow is to allow the enterprise reasonable flexibility in making financing arrangements without requiring the Bank’s frequent approval for new borrowings. This factor must be balanced against the need to maintain prudent limits on the enterprise’s debt service obligations. As a general rule, the covenant should be on the historical earnings basis if it is expected that the test could be met on this basis for the reasonably foreseeable future, or that the need to seek Bank approval for an exception would occur no more frequently than about once every several years.

7.27.14 The forecast basis should be used when it is likely that during a year there would be many occasions for incurring debt obligations, which would otherwise require prior Bank approval. This is particularly relevant for an enterprise that has a large investment program containing many projects, with long implementation periods and a need to arrange many borrowings to finance the program. It may also be advisable to use the
forecast basis in highly inflationary conditions to ensure that tariffs and rates are moved in concert with interest rates. A model covenant is provided in section 7.27.32, below.

7.27.15 A ratio typically recommended for this covenant is 1.5, but it can vary from as low as 1.2 to as high as 2.0 or more depending on industry averages, or how stable or cyclical the earnings of the EA are judged to be. Where business risks are similar the appropriate ratio would be lower when using historical earnings than with forecast earnings. However, it is essential that the financial analyst be prepared to justify the ratio recommended, particularly the excess requirement over 1.0. Any “mark-up” over 1.0 must be quantified in terms of the amount it is estimated to provide, and the proposed application of the funds, (working capital, reserves, investment purposes, dividends, etc). It is not sufficient to either select a “comfortable” or non-controversial figure, or to continue using a ratio already in a legal agreement for previous operations of the borrower.

7.27.16 Capital structure covenants have a limited use, in that they are not intended to perform as revenue-generating covenants. They serve only to restrict the borrowing capacity of EAs. The debt service coverage ratio covenant may be adapted to include a forecasting provision that would require an EA to institute mandatory adjustments to tariffs, or rates (if within its discretion, or to make the necessary applications for increases, if not). Bank staff should seek the advice of GECL before discussing with a borrower/EA the possible application of such a modified capital structure covenant.

Debt: Equity Ratio Covenant

7.27.17 The debt-equity ratio covenant is simple to understand and administer, and is consistent with the need to maintain a sound capital structure without unduly restricting the entity’s ability to make its own routine financing decisions. It is pertinent to note that for this form of covenant, debt need not be defined in the same way as for the debt service coverage covenant. For the latter, the definition applies to the entire amount of the long-term debt, and the applicable debt service obligations, as of the date of signing the contract for the debt. For the debt-equity ratio, the definition of debt may be framed in terms of debt outstanding. This provides the entity some flexibility in phasing additions to its equity capital to match the timing of expected drawdowns of debt. A model covenant is provided in section 7.27.32, below.

7.27.18 Defining debt in terms of the amount outstanding is appropriate for the debt-equity ratio covenant only when it is deemed feasible for an enterprise to apply the test each time it intends to draw down debt and, when necessary, call on its shareholders for additional equity capital before the increase in debt outstanding. This is most likely to be the case for financial intermediaries, which can generally limit their commitments to lend funds to the availability of resources in hand. Application of the drawdown concept is likely to be inappropriate in other sectors where use of borrowed funds cannot readily be interrupted if there is a failure to meet a debt limitation test for a particular drawdown of a loan. For similar reasons, application of the drawdown concept is generally not appropriate or feasible under the debt service coverage test.

7.27.19 The debt-equity ratio covenant is occasionally used for established entities when the borrower has overriding objections to the use of a debt service coverage covenant. Since the major shortcoming of the debt: equity ratio covenant is that it disregards the terms and conditions of the debt and their impact on the debt service burden, it may be advisable when using this form of covenant to add a limitation on medium-term debt;
e.g., limiting the amount of debt incurred with a term of issuance of less than ten years to some ten or fifteen percent of total capitalization.

Debt Limitation Covenant

7.27.20 An absolute debt limitation covenant limits the amount of debt that may be incurred annually to a stated amount (expressed in absolute terms or as a proportion of the total capitalization) and requires Bank concurrence before exceeding this limit. This covenant is used infrequently and only where debt service coverage or debt-equity covenants cannot be applied. Consequently no example is provided, as each covenant should be uniquely drawn.

7.27.21 The typical case when this covenant is used involves a public authority whose capital structure consists entirely or predominantly of debt, because of statutory requirements that all externally provided investment funds be advanced in the form of borrowing from government. The limit for new debt is fixed at a relatively small amount which together with the internally generated funds which are likely to be available, allows the borrower to carry out minor plant replacements or improvements, but which requires the borrower to consult with the Bank whenever it plans a major expansion.

7.27.22 Although this form of covenant is simple to administer, it has substantial disadvantages. It is related to a stated amount of debt without consideration of its terms and without taking into account changes in an enterprise’s financial requirements or debt servicing capacity; and it severely restricts an enterprise’s freedom of action. A preferable approach would be to agree that a substantial part of any loan by the government to the public sector enterprise would be subordinated and treated as quasi-equity capital, thus permitting the use of either the debt service coverage or debt equity ratio covenants. The project team should ensure that it is legally possible to create a subordinated debt. There may be restrictions or regulations of the government, which affect its ability to have its debt treated as quasi-equity.

Capital Adequacy Ratio Covenant

7.27.23 This covenant is normally applied to financial intermediaries (FIs). It is used to compare the adequacy of an institution’s available equity to meet losses that may be incurred by losses of financial assets. For this purpose, equity is defined in a similar manner as in the debt-equity ratio covenant, but with the addition of any provisions for bad and doubtful debts (loss provisions). However, the definition of assets will need to be defined on an institutional basis. A model covenant is provided in section 7.27.32, below.

7.27.24 Local market and lending conditions will materially affect the quality of assets and staff must reach agreement with the borrower on the risk factors applicable to each class of assets. This classification of risk by reference to groups of assets-at-risk may need to be varied over the life of a loan, and therefore it will be necessary to introduce regular reviews to determine any required revisions from time to time. In addition, judgment will be needed to determine a safe margin above the potential loss level of assets-at-risk prescribed in the covenant. Normally this is unlikely to be less than 1.00, when equity will at least absorb all potential losses, as calculated in accordance with methods specified in minutes to loan negotiations.
Liquidity Covenants

Current Ratio Covenant

7.27.25 The advantages of the current ratio covenant are that: (i) it is simple and easily understood by borrowers; (ii) it is based on an accurate and objective test; (iii) it can be based on readily defined accounting principles and calculated from standard financial statements; and (iv) in most cases it provides a fair representation of short-term solvency of the borrower. A model covenant is provided in section 7.27.32, below.

7.27.26 However, this covenant will only be an adequate test of liquidity if the covenant design provides for: (i) periods of falling sales and consequent declining internal cash generation, when the borrower may find it difficult to convert inventories to cash at reasonable prices; (ii) a suitable analysis of inventories, because some items may be non-saleable (for example, they may be spare parts or obsolete products not written off) and because a minimum level of inventories must be retained to continue operations; and (iii) a suitable analysis of accounts receivable; and seasonal variations in working capital requirements and interim peaks for debt maturities during the year. These problems, although serious in some projects, can be overcome either by making appropriate allowances when determining the acceptable ratio, or by using the quick ratio test. The borrower should be asked to calculate and confirm compliance with the current ratio at intervals throughout the fiscal year (e.g., in quarterly or semi-annual reports; or whenever requested by the Bank).

7.27.27 This covenant requires consistent and close monitoring to ensure that unacceptable management and accounting practices are not being followed to give the appearance of compliance. For example, accounts receivable may be overstated because of inadequate provisions for bad debts. In some instances, it may be necessary to introduce supporting covenants that specifically address such key issues as the size of short-term debt, or levels of inventories and receivables.

Quick Ratio Covenant

7.27.28 The quick ratio covenant is similar to the current ratio covenant, except that inventories are excluded, to focus on the most liquid items in the financial statements. It gives a much clearer view of the “cash” position of the enterprise. After taking that benefit into account, this covenant still has the shortcomings associated with the current ratio. A model covenant is provided in section 7.27.32, below.

7.27.29 While any selected covenant must be framed to reflect the objectives of the borrower and the project, it is probably desirable when a decision has to be made between the current and quick ratios, to select the latter and to require at least a three-monthly submission of information; and introduce a performance covenant to address control of inventories. In this way the cash position can be examined closely and regularly.

Dividend Limitation Covenant

7.27.30 The dividend limitation covenant with a dividend limitation test prohibits the borrower from declaring a dividend the payment of which would cause the current ratio (or quick ratio) to fall below a specified minimum. The minimum level of current ratio specified in this covenant may be higher than the minimum required under the current ratio covenant.
discussed in section 4.5.47 because decisions on whether to pay dividends are often discretionary, and a stricter standard of prudent financial management can thus be applied to this context. Therefore, the borrower is asked not to make voluntary payouts of cash to its stockholders until it has taken further measures to establish and maintain the liquidity essential for operations. A model covenant is provided in section 7.27.32, below.

**Model Financial Loan Covenants**

7.27.31 In the sections that follow, outlines of model financial covenants are provided for use in loan agreements. They are intended as a guide only. It is the responsibility of the GECL to determine, in consultation with the Task Manager and the financial analyst, the precise wording of loan covenants for inclusion in the legal agreements and their legal enforceability. In cases of borrowers conducting multiple operations, the text of the covenant should define which operations are to be subject to performance measurement. As an example, in an electric power project to be carried out by a borrower that operates electric power, water supply and telecommunications services, the covenant normally would be drafted to apply only to the electric power operations.

7.27.32 **Model Operating Covenants**

**Rate of Return Covenant**

Section ____.

(a) For the purposes of this Loan Agreement, all financial calculations, ratios and financial covenants shall be applied in respect of the Borrower’s Operations only.

(b) Except as the Bank shall otherwise agree, the Borrower shall earn, for each of its fiscal years after its fiscal year ending on [day/month/year], an annual return of not less than _____ percent of the average current net value of the Borrower’s fixed assets in operation.

(c) Before (date/month) in each of its fiscal years, the Borrower shall, on the basis of forecasts prepared by the Borrower and satisfactory to the Bank, review whether it would meet the requirements set forth in paragraph (a) in respect of such year and the next following fiscal year and shall furnish to the Bank the results of such review upon its completion.

*Paragraph (d): Option 1:* Where the borrower or government has discretion to adjust tariffs/rates:

(d) If any such review shows that the Borrower would not meet the requirements set forth in paragraph (b) for the Borrower’s fiscal years covered by such review, the Borrower shall promptly take all necessary measures (including without limitation, adjustments of the structure or levels of its rates (prices)) in order to meet such requirements.

*Paragraph (d): Option 2:* Where there is an independent regulator in place (or where it is anticipated that an independent regulator may be established during the project implementation period):

(d) If any such review shows that the Borrower would not meet the requirements set forth in paragraph (b) for the Borrower’s fiscal years covered by such review, the Borrower shall
promptly take all necessary measures (including without limitation, filing applications with the [name of regulator] seeking a tariff/rate increase) in order to meet such requirements.

(e) For the purposes of this Section:

(i) The annual return shall be calculated by dividing the Borrower’s net operating income for the fiscal year in question by one half of the sum of the current net value of the Borrower’s fixed assets in operation at the beginning and at the end of that fiscal year.

(ii) The term “net operating income” means total operating revenues less total operating expenses.

(iii) The term “total operating revenues” means revenues from all sources related to operations, after making adequate provisions for uncollectible debts, but excludes government grants, subsidies and transfers.

(iv) The term “total operating expenses” means all expenses related to operations, including administration, adequate maintenance, taxes and payments in lieu of taxes, and provision for depreciation on a straight-line basis at a rate of not less than ____ percent per annum of the average current gross value of the Borrower’s fixed assets in operation, or other basis acceptable to the Bank, but excluding interest and other charges on debt.

(v) The average current gross value of the Borrower’s fixed assets in operation shall be calculated as one half of the sum of the gross value of the Borrower’s fixed assets in operation at the beginning and at the end of the fiscal year [Where revalued: as valued from time to time in accordance with sound and consistently maintained methods of valuation satisfactory to the Bank].

(vi) The term “current net value of the Borrower’s fixed assets in operation” means the gross value of the Borrower’s fixed assets in operation less the amount of accumulated depreciation [Where revalued: as valued from time to time in accordance with sound and consistently maintained methods of valuation satisfactory to Bank].

(vii) The terms “operations” or operating” refer to the [identify relevant part of the operations] operations of the Borrower.

**Self-Financing Ratio Covenant**

Section ____

(a) For the purposes of this Loan Agreement, all financial calculations, ratios and financial covenants shall be applied in respect of the Borrower’s Operations only.

(b) Except as the Bank shall otherwise agree, the Borrower shall produce, for each of its fiscal years after its fiscal year ending on ________, cash from internal sources equivalent to not less than ___ percent of the annual average of the Borrower’s capital expenditures incurred, or expected to be incurred, for
Remainder of Paragraph (b), Option 1: that year, the previous fiscal year and the next ______ following fiscal years.

Remainder of Paragraph (b), Option 2: that year and the next ______ following fiscal years.

(c) Before (date/month) in each of its fiscal years, the Borrower shall, on the basis of forecasts prepared by the Borrower and satisfactory to the Bank, review whether it would meet the requirements set forth in paragraph (a) in respect of such year and the next following fiscal year and shall furnish to the Bank a copy of such review, upon its completion.

Paragraph (d): Option 1: Where the borrower or government has discretion to adjust tariffs/rates:

(d) If any such review shows that the Borrower would not meet the requirements set forth in paragraph (b) for the Borrower’s fiscal years covered by such review, the Borrower shall promptly take all necessary measures (including without limitation, adjustments of the structure or levels of its rates (prices)) in order to meet such requirements.

Paragraph (d): Option 2: Where there is an independent regulator in place (or where it is anticipated that an independent regulator may be established during the project implementation period):

(d) If any such review shows that the Borrower would not meet the requirements set forth in paragraph (b) for the Borrower’s fiscal years covered by such review, the Borrower shall promptly take all necessary measures (including without limitation, filing applications with the [name of regulator] seeking a tariff/rate increase) in order to meet such requirements.

(e) For the purposes of this Section:

(i) The term “cash from internal sources” means the difference between:

(A) the sum of cash flows from all sources related to operations, plus cash generated from consumer deposits and consumer advances of any kind, sale of assets, cash yield of interest on investments, and net non-operating income.; and

(B) the sum of all expenses related to operations, including administration, adequate maintenance and taxes and payments in lieu of taxes (excluding provision for depreciation and other non-cash operating charges), debt service requirements, all cash dividends paid and other cash distributions of surplus, increase in working capital other than cash and other cash outflows other than capital expenditures.

(ii) The term “net non-operating income” means the difference between:

(A) revenues from all sources other than those related to operations, after making adequate provisions for uncollectible debts; and

(B) expenses, including taxes and payments in lieu of taxes, incurred in the...
Generation of revenues in (a) above.

(iii) The term “working capital other than cash” means the difference between current assets excluding cash and current liabilities at the end of each fiscal year.

(iv) The term “current assets excluding cash” means all assets other than cash which could in the ordinary course of business be converted into cash within twelve months, including accounts receivable, marketable securities, inventories and prepaid expenses properly chargeable to operating expenses within the next fiscal year.

(v) The term “current liabilities” means all liabilities which will become due and payable or could under circumstances then existing be called for payment within twelve months, including accounts payable, customer advances, debt service requirements taxes and payments in lieu of taxes, and dividends.

(vi) The term “debt service requirements” means the aggregate amount of repayments (including sinking fund payments if any) of, and interest and other charges on, debt, excluding interest charged to construction and financed from loans.

(vii) The term “capital expenditures” means all expenditures incurred on account of fixed assets, including interest charged to construction, related to operations.

(viii) The terms “operations” or operating” refer to the [identify relevant part of the operations] operations of the Borrower.

(ix) Whenever for the purposes of this Section it shall be necessary to value, in terms, of the currency of the (Borrower/Guarantor), debt payable in another currency, such valuation shall be made on the basis of the prevailing lawful rate of exchange at which such other currency is, at the time of such valuation, obtainable for the purposes of servicing such debt, or, in the absence of such rate, on the basis of a rate of exchange acceptable to the Bank.

**General Price Level Covenant**

Section ______

(a) The (Borrower/Guarantor) and the Bank shall, from time to time, at the request of either party, exchange views with regard to the (Borrower’s/Guarantor’s) ________ pricing policies and its plans in respect of the overall development of the ________ sector.

(b) The (Borrower/Guarantor) agrees, as long as it exercises control over the setting of prices of the ________ companies, to establish prices for ________ sold by such companies which would: (i) allow the ________ companies, under conditions of efficient operation at reasonable levels of capacity utilization, to cover their operating costs including taxes, earn an adequate return on funds invested in them, meet their financial obligations and make a reasonable contribution to future investment for expansion of capacity; (ii) be reasonably competitive with prices for __________ in other major producing countries; and (iii) subject to the achievement of objectives (i) and (ii) above, pass on the benefit of declines in the real cost of production to __________ through reduction in prices in real terms.

Operating Ratio Covenant

This covenant may be converted to a working ratio covenant by substituting a definition of working expenses for operating expenses. This will normally require that depreciation be omitted from the definition of operating expenses recommended herein.

Section_____

(a) For the purposes of this Loan Agreement, all financial calculations, ratios and financial covenants shall be applied in respect of the Borrower’s Operations only.

(b) Except as the Bank shall otherwise agree, the Borrower shall maintain, for each of its fiscal years after its fiscal year ending on _______, a ratio of total operating expenses to total operating revenue not higher than _______ (percent).

(c) Before (date/month) in each of its fiscal years, the Borrower shall, on the basis of forecasts prepared by the Borrower and satisfactory to the Bank, review whether it would meet the requirements set forth in Paragraph (a) in respect of such year and the next following fiscal year, and shall furnish to the Bank the results of such review upon its completion.

Paragraph (d): Option 1: Where the borrower or government has discretion to adjust tariffs/rates:

(d) If any such review shows that the Borrower would not meet the requirements set forth in paragraph (b) for the Borrower’s fiscal years covered by such review, the Borrower shall promptly take all necessary measures (including without limitation, adjustments of the structure or levels of its rates (prices)) in order to meet such requirements.

Paragraph (d): Option 2: Where there is an independent regulator in place (or where it is anticipated that an independent regulator may be established during the project implementation period):

(d) If any such review shows that the Borrower would not meet the requirements set forth in paragraph (b) for the Borrower’s fiscal years covered by such review, the Borrower shall promptly take all necessary measures (including without limitation, filing applications with the [name of regulator] seeking a tariff/rate increase) in order to meet such requirements.

(e) For the purposes of this Section

(i) The term “total operating expenses” means all expenses related to operations, including administration, adequate maintenance, taxes and payments in lieu of taxes, and provision for depreciation on a straight-line basis at a rate of not less that _____ percent per annum of the average current gross value of the Borrower’s fixed assets in operation, or other basis acceptable to the Bank, but excluding interest and other charges on debt.

(ii) The term “total operating revenues” means revenues from all sources related to operations, after making adequate provisions for uncollectible debts.
(iii) The average current gross value of the Borrower’s fixed assets in operation shall be calculated as one half of the sum of the gross value of the Borrower’s fixed assets in operation at the beginning and at the end of the fiscal year, as valued from time to time in accordance with sound and consistently maintained methods of valuation satisfactory to the Bank.

(iv) The terms “operations” or operating” refer to the [identify relevant part of the operations] operations of the Borrower.

**Breakeven Ratio Covenant**

Section ______.

(a) For the purposes of this Loan Agreement, all financial calculations, ratios and financial covenants shall be applied in respect of the Borrower’s Operations only.

(b) Except as the Bank shall otherwise agree, the Borrower shall produce for each of its fiscal years after its fiscal year ending on____________, total revenues equivalent to /or not less that the sum of (i) its total operating expenses; and (ii) the amount by which debt service requirements exceed the provision for depreciation.  

(c) Before (date/month) in each of its fiscal years, the Borrower shall, on the basis of forecast prepared by the Borrower and satisfactory to the Bank, review whether it would meet the requirements set forth in paragraph (a) in respect of such year and the next following fiscal year and shall furnish to the Bank the results of such review upon its completion.

**Paragraph (d): Option 1:** Where the borrower or government has discretion to adjust tariffs/rates:

(d) If any such review shows that the Borrower would not meet the requirements set forth in paragraph (b) for the Borrower’s fiscal years covered by such review, the Borrower shall promptly take all necessary measures (including without limitation, adjustments of the structure or levels of its rates (prices)) in order to meet such requirements.

**Paragraph (d): Option 2:** Where there is an independent regulator in place (or where it is anticipated that an independent regulator may be established during the project implementation period):

(d) If any such review shows that the Borrower would not meet the requirements set forth in paragraph (b) for the Borrower’s fiscal years covered by such review, the Borrower shall promptly take all necessary measures (including without limitation, filing applications with the [name of regulator] seeking a tariff/rate increase) in order to meet such requirements.

(e) If any such review shows that the Borrower would not meet the requirements set forth in paragraph (b) for the Borrower’s fiscal years covered by such review, the Borrower shall promptly take all necessary measures (including without limitation, filing applications with the [name of regulator] seeking a tariff/rate increase) in order to meet such requirements.

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9 For some borrowers depreciation may not be applicable.
(f) For purposes of this Section:

(i) The term “total revenues” means the sum of total operating revenues and net non-operating income, but excludes all government grants, subsidies and transfers income.

(ii) The term “total operating revenues” means revenues from all sources related to operations, after making adequate provisions for uncollectible debts.

(iii) The term “net non-operating income” means the difference between:

(A) revenues from all sources other than those related to operations; and

(B) expenses, including taxes and payments in lieu of taxes, incurred in the generation of revenues in (iii)(a) above.

(iv) The term “total operating expenses” means all expenses related to operations, including administration, adequate maintenance, taxes and payments in lieu of taxes, and provision for depreciation on a straight-line basis at a rate of not less than ______ percent per annum of the average current gross value of the Borrower’s fixed assets in operation, or other basis acceptable to the Bank, but excluding interest and other charges on debt.

(v) The average current gross value of the Borrower’s fixed assets in operation shall be calculated as one half of the sum of the gross value of the Borrower’s fixed assets in operation at the beginning and at the end of the fiscal year, as valued from time to time in accordance with sound and consistently maintained methods of valuation satisfactory to the Bank.

(vi) The term “debt service requirements” means the aggregate amount of repayments (including sinking fund payments, if any) of, and interest and other charges on, debt.

(vii) The term “debt” means any indebtedness of the Borrower maturing by its terms more than one year after the date on which it is originally incurred.

(viii) Debt shall be deemed to be incurred: (a) under a loan contract or agreement or other instrument providing for such debt or for the modification of its terms of payment on the date of such contract, agreement or instrument; and (b) under a guarantee agreement, on the date the agreement providing for such guarantee has been entered into. Financial liabilities incurred by a borrower who is a lessee under finance leasing agreements may also be included as debt.

(ix) Whenever for the purposes of the Section it shall be necessary to value, in terms of the currency of the Guarantor, debt payable in another currency, such valuation shall be made on the basis of the prevailing lawful rate of exchange at which such other currency is, at the time of such valuation, obtainable for the purposes of servicing such debt, or, in the absence of such rate, on the basis of a rate of exchange acceptable to the Bank.

(x) The terms “operations” or operating” refer to the [identify relevant part of the operations] operations of the Borrower.
7.27.33 Model Capital Structure Covenants

Debt Service Coverage Covenant (Version A: Historical orientation)

Section ________.

(a) For the purposes of this Loan Agreement, all financial calculations, ratios and financial covenants shall be applied in respect of the Borrower’s Operations only.

(b) Except as the Bank shall otherwise agree, the Borrower shall not incur any debt, unless the net revenues of the Borrower for the twelve months prior to the date of such incurrence shall be at least ___ times the estimated maximum debt service requirements of the Borrower for any succeeding fiscal year on all debt of the Borrower, including the debt to be incurred.

(c) For the purposes of this Section:

(i) The term “debt” means any indebtedness of the Borrower maturing by its terms more than one year after the date on which it is originally incurred.

(ii) Debt shall be deemed to be incurred: (a) under a loan contract or agreement or other instrument providing for such debt or for the modification of its terms of payment on the date of such contract, agreement or instrument; and (b) under a guarantee agreement, on the date the agreement providing for such guarantee has been entered into. Financial liabilities incurred by a borrower who is a lessee under finance leasing agreements may also be included as debt. The alternative definition of incurrence of debt, as illustrated in the Debt-Equity Ratio Covenant should not be used for this form of debt limitation covenant.

(iii) The term “net revenues” means the difference between:

(A) the sum of revenues from all sources related to operations, after making adequate provisions for uncollectible debts, adjusted to take account of the Borrower’s (rates) (prices) in effect at the time of the incurrence of debt even though they were not in effect during the twelve-month period to which such revenues relate and net non-operating income; and

(B) the sum of all expenses related to operations including administration, adequate maintenance, taxes and payments in lieu of taxes, but excluding provision for depreciation, other non-cash operating charges and interest and other charges on debt.

(iv) The term “net non-operating income” means the difference between:

(A) revenues from all sources other than those related to operations; and
(B) expenses including taxes and payments in lieu of taxes, incurred in the generation of revenues in (iv)(A) above.

(v) The term “debt service requirements” means the aggregate amount of repayments (including sinking fund payments, if any) of, and interest and other charges on debt.
Interest charges which are incurred in financing capital expenditures during development should be excluded, if such charges are capitalized. However, if the borrower’s policy is to meet the cost from operating income, such interest charges should be included in “debt service requirements”. Lease payments under finance leases should also be included.

(vi) Whenever for the purposes of this Section it shall be necessary to value, in terms of the currency of the Guarantor, debt payable in another currency, such valuation shall be made on the basis of the prevailing lawful rate of exchange at which such other currency is, at the time of such valuation, obtainable for the purposes of servicing such debt, or, in the absence of such rate, on the basis of a rate of exchange acceptable to the Bank.

(vii) The terms “operations” or operating” refer to the [identify relevant part of the operations] operations of the Borrower.

Debt Service Coverage Covenant (Version B: Forecast orientation)

Section_____.

(a) For the purposes of this Loan Agreement, all financial calculations, ratios and financial covenants shall be applied in respect of the Borrower’s Operations only.

(b) Except as the Bank shall otherwise agree, the Borrower shall not incur any debt unless a reasonable forecast of the revenues and expenditures of the Borrower shows that the estimated net revenues of the Borrower for each fiscal year during the term of the debt to be incurred shall be at least _____times the estimated debt service requirements of the Borrower in such year on all debt of the Borrower including the debt to be incurred and no event has occurred since the date of the forecast which has, or may reasonably be expected in the future to have, a material adverse effect on the financial condition of future operating results of the Borrower.

(c) For the purposes of this Section:

(i) The term “debt” means any indebtedness of the Borrower maturing by its terms more than one year after the date on which it is originally incurred.

(ii) Debt shall be deemed to be incurred: (a) under a loan contract or agreement or other instrument providing for such debt or for the modification of its terms of payment on the date of such contract, agreement or instrument; and (b) under a guarantee agreement, on the date the agreement providing for such guarantee has been entered into10.

(iii) The term “net revenues” means the difference between:

(A) the sum of revenues from all sources related to operations and net non-operating income, after making adequate provisions for uncollectible debts; and

(B) the sum of all expenses related to operations including administration, adequate maintenance, taxes and payments in lieu of taxes, but excluding provision for

10 The alternative definition of incurrence of debt, as illustrated in the Debt-Equity Ratio Covenant should not be used for this form of debt limitation covenant.
depreciation, other non-cash operating charges and interest and other charges on debt. Lease payments under finance leases must also be included\textsuperscript{11}.

(iv) The term “net non-operating income” means the difference between:

(A) revenues from all sources other than those related to operations, and

(B) expenses, including taxes and payments in lieu of taxes, incurred in the generation of revenues in (iv)(a) above.

(v) The term “debt service requirements” means the aggregate amount of repayments (including sinking fund payments, if any) of, and interest and other charges on debt.

(vi) The term “reasonable forecast” means a forecast prepared by the Borrower not earlier than nine months prior to the incurrence of the debt in question, which both the Bank and the Borrower accept as reasonable and as to which the Bank has notified the Borrower of its acceptability.

(vii) The terms “operations” or operating” refer to the [identify relevant part of the operations] operations of the Borrower.

(viii) Whenever for the purposes of this Section it shall be necessary to value, in terms of the currency of the Guarantor, debt payable in another currency, such valuation shall be made on the basis of the prevailing lawful rate of exchange at which such other currency is at the time of such valuation obtainable for the purposes of servicing such debt, or, in the absence of such rate, on the basis of a rate of exchange acceptable to the Bank.

\textit{Debt-Equity Ratio Covenant}

Section _______.

(a) For the purposes of this Loan Agreement, all financial calculations, ratios and financial covenants shall be applied in respect of the Borrower’s Operations only.

(b) Except as the Bank shall otherwise agree, the Borrower shall not incur any debt, if after the incurrence of such debt the ratio of debt to equity shall be greater than _______ to _______.

(c) For purposes of this Section:

(i) The term “debt” means any indebtedness of the Borrower maturing by its terms more than one year after the date on which it is originally incurred.

\textit{Subparagraph (ii): Option 1:} General usage:

(ii) Debt shall be deemed to be incurred: (a) under a loan contract or agreement, or conditional sale or transfer or financing lease agreement or other instrument providing for such debt or for the modification of its terms of payment on the date of such contract,

\textsuperscript{11} Interest charges that are incurred in financing capital expenditures during development should be excluded, if such charges are capitalized. However, if the Borrower’s policy is to meet the cost from operating income, such interest charges should be included in “debt service requirements.”
agreement or instrument; and (b) under a guarantee agreement, on the date the agreement providing for such guarantee has been entered into. Financial liabilities incurred by a borrower who is a lessee under finance leasing agreements may also be included as debt.

**Subparagraph (ii): Option 2:** Primarily intended for use with financial intermediaries:

(ii) Debt shall be deemed to be incurred: (a) under a loan contract or agreement or other instrument providing for such debt or for the modification of its terms of payment, on the date, and to the extent, the amount of such debt has become outstanding pursuant to such contract, agreement or instrument; and (b) under a guarantee agreement, on the date the agreement providing for such guarantee has been entered into but only to the extent that the guaranteed debt is outstanding. Lease payments under finance leases should also be included.

(iii) The term “equity” means the sum of the total unimpaired paid-up capital, retained earnings and reserves of the Borrower not allocated to cover specific liabilities.

(iv) Whenever for purposes of this Section it shall be necessary to value, in terms of the currency of the Guarantor, debt payable in another currency, such valuation shall be made on the basis of the prevailing lawful rate of exchange at which such currency is, at the time of valuation, obtainable for the purposes of servicing such debt, or, in the absence of such rate, on the basis of a rate of exchange acceptable to the Bank.

**Capital Adequacy Ratio Covenant**

Section _____

(a) For the purposes of this Loan Agreement, all financial calculations, ratios and financial covenants shall be applied in respect of the Borrower’s Operations only.

(b) Except as the Bank shall otherwise agree, the Borrower shall not make an advance to a sub-borrower [including leasing of an asset], if after the making of any such advance [or lease], the ratio of its equity to its assets-at-risk shall be greater than ____to____.

(c) For purposes of this Section,

(i) The term “equity” means the sum of the total of unimpaired paid-up capital, retained earnings, and reserves of the borrower available to meet any losses which may be incurred by non-recovery of assets, including provisions for bad and doubtful debts and loan [and lease] losses at the date of making such advance [lease] in (a) above;

(ii) The term “assets-at-risk” means the sum of the total impaired value of assets at the date of making such advance [lease] in (b) above;

(iii) The term “impaired value of assets” in (ii) above means the value of each asset of the borrower valued in accordance with sound and consistently maintained methods of valuation satisfactory to the Bank.
7.27.34 Model Liquidity Covenants

Current Ratio Covenant

Section _____.

(a) For the purposes of this Loan Agreement, all financial calculations, ratios and financial covenants shall be applied in respect of the Borrower’s Operations only.

(b) Except as the Bank shall otherwise agree, the Borrower shall maintain a ratio of current assets to current liabilities of not less than______.

(c) Before (date/month) in each of its fiscal years, the Borrower shall, on the basis of forecasts prepared by the Borrower and satisfactory to the Bank, review whether it would meet the requirements set forth in paragraph (b) in respect of such year and the next following fiscal year and shall furnish to the Bank the results of such review upon its completion.

Paragraph (c): Option 1: Where the borrower or government has discretion to adjust tariffs/rates:

(d) If any such review shows that the Borrower would not meet the requirements set forth in paragraph (b) for the Borrower’s fiscal years covered by such review, the Borrower shall promptly take all necessary measures (including without limitation, adjustments of the structure or levels of its rates (prices)) in order to meet such requirements.

Paragraph (c): Option 2: Where there is an independent regulator in place (or where it is anticipated that an independent regulator may be established during the project implementation period):

(d) If any such review shows that the Borrower would not meet the requirements set forth in paragraph (b) for the Borrower’s fiscal years covered by such review, the Borrower shall promptly take all necessary measures (including without limitation, filing applications with the [name of regulator] seeking a tariff/rate increase) in order to meet such requirements.

(e) For the purposes of this Section:

(i) The term “current assets” means cash, all assets, which could in the ordinary course of business be converted into cash within twelve months, including accounts receivable, marketable securities, inventories and prepaid expenses properly chargeable to operating expenses within the next fiscal year.

(ii) The term “current liabilities” means all liabilities, which will become due and payable or could under circumstances then existing be called for payment within twelve months, including accounts payable, customer advances, debt service requirements, taxes and payments in lieu of taxes, and dividends.

(iii) The term “debt service requirements” means the aggregate amount of repayments (including sinking fund payments, if any) of, and interest and other charges on, debt.

(iv) Whenever for the purposes of this Section it shall be necessary to value, in terms of the
currency of the Guarantor, debt payable in another currency, such valuation shall be made on the basis of the prevailing lawful rate of exchange at which such other currency is, at the time of such valuation, obtainable for the purposes of servicing such debt, or, in the absence of such rate on the basis of a rate of exchange acceptable to the Bank.

(v) The terms “operations” or operating” refer to the [identify relevant part of the operations] operations of the Borrower.

**Quick Ratio Covenant**

Section ____.

(a) For the purposes of this Loan Agreement, all financial calculations, ratios and financial covenants shall be applied in respect of the Borrower’s Operations only.

(b) Except as the Bank shall otherwise agree, the Borrower shall maintain a ratio of liquid current assets to current liabilities of not less than_____

(c) Before (date/month) in each of its fiscal years, the Borrower shall, on the basis of forecasts prepared by the Borrower and satisfactory to the Bank, review whether it would meet the requirements set forth in paragraph (b) in respect of such year and the next following fiscal year and shall furnish to the Bank the results of such review upon its completion.

*Paragraph (d): Option 1:* Where the borrower or government has discretion to adjust tariffs/rates:

(d) If any such review shows that the Borrower would not meet the requirements set forth in paragraph (b) for the Borrower’s fiscal years covered by such review, the Borrower shall promptly take all necessary measures (including without limitation, adjustments of the structure or levels of its rates (prices)) in order to meet such requirements.

*Paragraph (d): Option 2:* Where there is an independent regulator in place (or where it is anticipated that an independent regulator may be established during the project implementation period):

(d) If any such review shows that the Borrower would not meet the requirements set forth in paragraph (b) for the Borrower’s fiscal years covered by such review, the Borrower shall promptly take all necessary measures (including without limitation, filing applications with the [name of regulator] seeking a tariff/rate increase) in order to meet such requirements.

(e) For the purposes of this Section:

(i) The term “liquid current assets” means cash, all assets, which could in the ordinary course of business be converted into cash within twelve months, including accounts receivable, marketable securities, and prepaid expenses properly chargeable to operating expenses within the next fiscal year, but excluding inventories.

(ii) The term “current liabilities” means all liabilities, which will become due and payable or could under circumstances then existing be called for payment within twelve months, including accounts payable, customer advances, debt service
requirements, taxes and payments in lieu of taxes, and dividends.

(iii) The term “debt service requirements” means the aggregate amount of repayments (including sinking fund payments, if any) of, and interest and other charges on debt.

(iv) Whenever for the purposes of this Section it shall be necessary to value, in terms of the currency of the Guarantor, debt payable in another currency, such valuation shall be made on the basis of the prevailing lawful rate of exchange at which such other currency is, at the time of such valuation, obtainable for the purposes of servicing such debt, or, in the absence of such rate on the basis of a rate of exchange acceptable to the Bank.

(v) The terms “operations” or operating” refer to the [identify relevant part of the operations] operations of the Borrower.

**Dividend Limitation Covenant**

Section______.

(a) For the purposes of this Loan Agreement, all financial calculations, ratios and financial covenants shall be applied in respect of the Borrower’s Operations only.

(b) Except as the Bank shall otherwise agree, the Borrower shall not declare any dividend or make any other distribution with respect to its share capital, unless after such dividend has been paid or other distribution has been made, the current assets of the Borrower would equal or exceed ___ times the current liabilities of the Borrower.

(c) For the purposes of this Section:

(i) The term “current assets” means cash, all assets, which could in the ordinary course of business be converted into cash within twelve months, including accounts receivable, marketable securities, inventories and prepaid expenses properly chargeable to operating expenses within the next fiscal year.

(ii) The term “current liabilities” means all liabilities, which will become due and payable or could under circumstances then existing be called for payment within twelve months, including accounts payable, customer advances, debt service requirements, taxes and payments in lieu of taxes and dividends.

(iii) The term “debt service requirements” means the aggregate amount of repayments (including sinking fund payments, if any) of, and interest and other charges on, debt.

(iv) Whenever for the purposes of this Section it shall be necessary to value, in terms of the currency of the Guarantor, debt payable in another currency, such valuation shall be made on the basis of the prevailing lawful rate of exchange at which such other currency is, at the time of such valuation, obtainable for the purposes of servicing such debt, or, in the absence of such rate on the basis of a rate of exchange acceptable to the Bank.