Board of Executive Directors
For information

GN-2811-1
23 August 2019
Original: English
Spanish
Public

To:	The Executive Directors
From:	The Secretary
Subject:	Financial Management Guidelines for IDB-financed Projects (OP-273-12)

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Remarks: The Operations Financial Management and Procurement Services Office (VPC/FMP) translated the document and submitted both language versions to the Office of the Secretary for distribution.

Supersedes: GN-2811(4/15)

Reference: GN-2538(10/09), GN-1831-28(5/10)

VPC/FMP

Original: Spanish

Financial Management Guidelines for IDB-financed Projects (OP-273-12)

June 17, 2019

PUBLIC

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Note: This document applies to all projects without a completed Analysis Mission as of March 1, 2015, and also to operations in execution at the borrower's and/or EA's request, subject to the Bank's approval. All previous versions are replaced by this document.

ACRONYMS AND ABBREVIATIONS

IDB	Inter-American Development Bank (the Bank)
TC	Technical Cooperation
COSO	Committee of Sponsoring Organizations of the Treadway Commission
AFS	Audited Financial Statements
SAI	Supreme Audit Institutions
EVP	Executive Vice President
FM	Financial Management
FMP	Operations Financial Management and Procurement Services Office
MIF	Multilateral Investment Fund
IASB	International Accounting Standards Board
IFAC	International Federation of Accountants
INTOSAI	International Organization of Supreme Audit Institutions
IAS	International Accounting Standards issued by IASB
IPSAS	International Public Sector Accounting Standards
IFRS	International Financial Reporting Standards
OA	Operations Administration Manual
EA	Executing Agency(ies)
OF	Procurement and Financial Management for Operations Manual
OMJ	Opportunities for the Majority
OPC	Operations Policy Committee
PEFA	Public Expenditure and Financial Accountability
SEP	Social Entrepreneurship Program
SCF	Structured and Corporate Finance Department
VPC	Vice Presidency for Countries

I. INTRODUCTION, OBJECTIVE AND APPLICABILITY

1.1 The Agreement Establishing the Inter-American Development Bank (IDB) states, among other things, that the Bank *"shall take the necessary measures to ensure that the proceeds of any loan made, guaranteed, or participated in by the Bank are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency*[1]*".*

1.2 The objective of this document is to define the financial management principles and requirements to be applied in all operations financed or executed by the IDB, throughout the project[2] cycle, to ensure compliance with the provisions in paragraph 1.1 above.

1.3 To this end, it is recognized that borrowing member countries and Executing Agencies (EA) develop and maintain financial management systems, and that the Bank promotes the use and strengthening of such systems in project design, execution and evaluation, provided that they:

i) reasonably ensure the efficient, comprehensive and effective management of the resources of the financing; and
ii) comply with international financial management standards and good practices that are consistent with the Bank's policies and requirements.

1.4 This document replaces, in its entirety, the Financial Management Policy for IDB-financed Projects (OP-273-2) and applies to Bank-financed projects[3], with the exception of those operations financed by the Multilateral Investment Fund (IDB Lab) and the Social Entrepreneurship Program (SEP)[4]. This document shall be applied in accordance with the Bank's policies, including those relating to retroactive financing and macroeconomic safeguards, among others.

1.5 This document is structured as follows: *Section I* includes the introduction, objectives and applicability; *Section II* sets out the scope and principles of Financial Management for IDB-financed projects; *Section III* presents the Bank's project Financial Management requirements; and Annex 1 contains the application of Financial Management principles and requirements.

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[1] Agreement Establishing the Inter-American Development Bank*,* Article 3, Section 9, paragraph b: Use of Loans Made or Guaranteed by the Bank*.*
[2] The term "project" is used in this document to refer to any Bank-financed loan, technical cooperation or operation.
[3] It includes funds under administration and operations executed by the Bank. If there are discrepancies between the funds under administration agreements and this document, the former shall prevail.
[4] This private sector unit complies with the policies and procedures designed for non-sovereign guaranteed operations.

II. Scope and Principles of Project Financial Management

2.1 For the Bank, the term "project financial management" comprises a number of systems, including budget, treasury, accounting and financial reporting, and internal and external controls.

2.2 The guiding principles of financial management are legality, integrity, economy, efficiency, effectiveness, and transparency.

2.3 The Bank understands that an adequate financial management system, among other things:

i) ensures that the funds are used for their intended purpose, under the principles of economy and efficiency;

ii) ensures accountability of individuals and institutions in charge of their administration;

iii) produces reliable and timely information for decision-making purposes; and

iv) is subject to the independent review and supervision of internal and external control entities.

2.4 Within the public sector, the Bank will assess public financial management systems to determine whether they satisfactorily comply with the principles and characteristics mentioned above and, thus, recommend[5] their full or partial use in project design, execution and evaluation. In non-public sector contexts (e.g., non-governmental organizations, foundations, etc.), the borrower's and/or EA's financial management system will also be assessed in order to make the appropriate recommendation.

III. Bank's Project Financial Management Requirements

3.1 In the operations that are fully or partially financed by the Bank, the project team agrees with the borrower and/or EA on a number of financial management arrangements and requirements, which generally include the following: i) financial planning and cash flow needs, ii) records and reports on the use of the project's resources; iii) effective internal controls; iv) statement of accounts audited by independent entities; and v) comprehensive supervision by the Bank.

3.2 The Bank considers that the requirements listed below should be specifically met and **be read, interpreted and applied in conjunction with the guide in Annex 1,** which forms an integral part of these Guidelines:

3.2.1 **Requirement 1: Eligibility of expenditures.** The expenditures financed with the operation's resources (Bank or counterpart funds) are eligible as long as they: i) are necessary for the project and in line with its objectives; ii) comply with the applicable Bank policies and legal agreement(s); and iii) are properly recorded and adequately supported in the borrower's and/or EA's systems.

[5] The assessment and recommendation on the full or partial use of public financial management systems will be based on the Strategy for Strengthening and Use of Country Systems (GN-2538).

3.2.2 **Requirement 2: Disbursement management**. The Bank will accept disbursement requests made by the borrower, EA and/or co-executing agencies in accordance with the project's financial plan, based on an operating plan that is consistent with the necessary activities, timing and costs to achieve the targets and outputs that will ensure that the project's objectives are met. The required need for financial resources will be determined for a maximum period to be agreed between the parties[6].

3.2.3 **Requirement 3: Rendering of accounts**. The Bank will periodically require a justification of the use of the project's resources, which, in the specific case of the advance of funds, involves a high percentage[7] of the cumulative resources pending justification. The Bank will not grant further advance of funds until such justification is submitted.

3.2.4 **Requirement 4: Project financial supervision**. IDB-financed operations are subject to supervision by the Bank, using different monitoring and evaluation mechanisms, at any stage of execution, either by its own staff or through third parties acceptable to the Bank.

3.2.5 **Requirement 5: Project financial reporting system**. The borrower and/or EA will maintain a financial reporting system acceptable to the Bank, which permits accounting and financial recording, budget management, and the issuance of financial and other reports relating to the use of the resources financed by the Bank and other sources of project financing.

3.2.6 **Requirement 6: Internal control**. The borrower and/or EA will identify, assess and manage the risks associated with the project. Accordingly, the borrower and/or EA undertake that the project funds will be managed in an adequate internal control environment acceptable to the Bank, including: i) the effective use of the project's resources; ii) reliability of financial reporting; and iii) compliance with the legal agreement(s) entered into with the Bank, and applicable laws and regulations. In addition, as part of internal control, the borrower and/or EA will retain all documents and records of the project in accordance with the Bank's policies and the applicable legal agreement(s), and will allow its internal auditors (i.e., the entity that performs the internal audit function), the Bank, its consultants, and the appointed external auditors to access its staff, records and financial management systems.

3.2.7 **Requirement 7: Independent external auditors.** The Bank will identify eligible external auditors to conduct the audits of IDB-financed projects, and the borrower and/or EA will select and contract the auditors, as appropriate, in accordance with the terms of reference previously agreed upon between the borrower and/or EA and the Bank, which establish the type of review, its timing and scope. The Bank may also select and/or contract the external auditors when: i) the benefits of this decision outweigh the costs to the borrower and/or EA in carrying out this process and in managing the relevant service;

[6] As a general rule, the maximum period will be 6 months. However, at certain times during project execution, the period may be up to 12 months, based on the risk and operational needs of the project, as established in Annex 1.

[7] As a general rule, the level of justification of advances of funds is 80%. However, depending on the execution mechanism and the liquidity needs of the project, other percentages may be accepted, as established in Annex 1.

ii) there is limited access to external audit services within the country; or iii) special circumstances[8] warrant the selection and contracting of the auditors by the Bank.

3.2.8 **Requirement 8: External financial audit of the project.** The external financial audit report must be submitted to the Bank within the agreed-upon time period[9] between the parties, counting from the agreed-upon date of the project's fiscal year end[10]. The non-submission of the required external audit reports leads to the suspension of disbursements for the corresponding operation, in accordance with the Bank's procedures.

3.2.9 **Requirement 9: Prohibited practices**. Prohibited practices include corrupt, fraudulent, coercive, collusive and obstructive practices, as defined in the Bank's Sanctions Procedures.

3.2.10 **Requirement 10: Transparency**. The Bank is committed to transparency in all aspects of its operations and discloses documents and information that it produces or is in its possession that is not on the list of exceptions of the Access to Information Policy.

3.3 The Bank may consider allowing the borrower and/or EA to comply with parts of the financial management requirements in these Guidelines, provided that the principles listed in Chapter II of this document are applied, e.g., in **policy-based loans** and similar operations, and in those operations in which the **Bank is the executing agency.**

8 "Special circumstances" may include, among others: i) an investigation, conducted by OII, or a sanction for the occurrence of a prohibited practice –corrupt, fraudulent, collusive, coercive or obstructive practice– that poses an integrity risk to the project; or ii) the project is assessed by the Bank as being high risk.

9 As a general rule, the due date is not more than 120 days subsequent to the end of the project fiscal year, the date of last disbursement or any other date agreed with the Bank. However, the Bank may agree with the borrower and/or EA other due dates for the submission of financial audit reports. See Annex 1.

10 In the case of non-reimbursable technical cooperation, the project team may determine that the project external audit will not be required, based on the amount, level of risk, nature and complexity of the operation. However, the project team will require the borrower and/or EA to prepare unaudited financial reports and submit them to the Bank.

ANNEX 1 APPLICATION OF FINANCIAL MANAGEMENT PRINCIPLES AND REQUIREMENTS

This Annex is structured as follows: A) Project Financial Management Systems; B) Bank's Project Financial Management Requirements; C) Financial Management Requirements for Policy-based Loans and operations executed by the Bank; and finally, a glossary of terms.

A. Project Financial Management Systems

A.1. **Use of Financial Management Systems[1].** Where assessed by the Bank as being adequate and viable, the project should use:

i) the borrower's and/or EA's financial management systems to budget, process, record, make payments, account for, and report on the transactions of the IDB-financed project;

ii) the borrower's and/or EA's internal control systems (including the applicable internal audit functions); and

iii) the country's Supreme Audit Institutions (SAI) to audit the activities of the project.

A.2. **Assessments of Financial Management Systems.** These assessments will be conducted as follows:

i) During the programming cycle and/or in the preparation and update of the country strategy, the Bank will assess the relevant country's financial management and control systems, at the national or other applicable level, at the borrower's request[2]**.**

ii) During project preparation, and if a prior systems assessment has been conducted, the Bank will confirm, based on the results of the assessments referred to in paragraph (i), whether the financial management and control systems identified as part of such assessments continue to be working properly, as they relate to the specific EA and co-executing agencies. This analysis will help determine the applicable project execution mechanism.

B. Bank's Project Financial Management Requirements

B.1. **General requirement:** The Bank will determine the Financial Management Arrangements and Requirements for each project and document them during project preparation and negotiation of the project legal agreement(s), taking into account:

i) the country strategy and other relevant information and diagnostics[3] at the appropriate level (country, state, municipal or sector-level);

ii) the fiduciary risks associated with the country; and

iii) the level of use accepted by the Bank of the borrower's and/or EA's (and co-executing agencies, as appropriate) financial management systems.

B.2. **Updating of the Financial Management Arrangements and Requirements.** The financial management arrangements and requirements may be updated or adjusted during project execution, if warranted, however any changes in such arrangements or requirements shall be

[1] A country's financial management systems may include national, sub-national or sectorial systems.

[2] The Bank may form its opinion based on its own evaluation of the country's and EA's systems or based on an evaluation performed by an external third party (e.g., another donor).

[3] For example, PEFA (Public Expenditures and Financial Accountability), the tool used to determine the level of development and use of Public Financial Management Systems.

documented and authorized by the Bank. During project evaluation, any lessons learned should be identified and documented, as they relate to the Financial Management Arrangements and Requirements and their updates.

B.3. **Specific requirements**

1. **Requirement 1: Eligibility of expenditures**. If the Bank at any time determines that ineligible expenditures have been financed with the project's resources, the Bank may, at its discretion, require the borrower and/or EA to: i) refund the amount paid for any ineligible expenditures; ii) provide substitute documentation evidencing payment for other eligible project expenditures; or iii) a combination of both. If the borrower and/or EA does not comply with the Bank's request, the Bank may take action to resolve the situation, such as the suspension of disbursements, in accordance with the Bank's procedures.

2. **Requirement 2: Disbursement management**

2.1 **Financial planning.** For an efficient and effective project execution, the borrower and/or EA will prepare and periodically update the project financial plan. It includes the timing and amount of the project's resources (Bank and local counterpart funding or other financing, as applicable), as well as the anticipated expenditures for the life of the project, including the borrower's and/or EA's current and anticipated commitments and obligations, in coordination with other planning tools[4], and taking into account theirs budget cycles, as applicable.

2.2 **Disbursements**. The Bank shall disburse the project resources according to the true liquidity needs of the project, as evidenced by the current and anticipated commitments and obligations of the project. The borrower's, EA's and/or co-executing agency's requests for disbursement will be made in accordance with the project's financial plan and its updates, its annual budget, and the corresponding annual operating plan, including the procurement plan, as appropriate.

2.3 **Disbursement authority**. The Representative or his/her designate will be responsible for final approval (authorization) in the Bank's operating system, provided that the principles of independence and segregation of duties are followed.

2.4 **Project disbursement limits**. Project disbursement limits[5] may be established by the Bank, based on the assessed level of risk and the capacity of the borrower and/or EA. The timing and amount of each disbursement will not exceed the needs of the borrower and/or EA for:

i) a reference period of six months; or

ii) another reasonable period, as approved by the Project Team Leader, when the following criteria, among others, are met and properly documented:

a) the benefits of an annual financial plan outweigh those of a six-month plan; e.g., the date of last disbursement of the operation will occur within a period of more than 6 months but less than 12 months;

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[4] For example, Multi-year Execution Plan (MEP), Annual Operating Plan (POA), and Procurement Plan (PP), as appropriate.

[5] See paragraph 1.4 in Section I.

b) high level of decentralization in the execution of the project;

c) adequacy of the timeframe required for management by results; and

d) compliance with national legislation.

2.5 **Designated accounts.** The Bank and the borrower and/or EA shall agree on a financial institution's bank account to be designated for the management of project resources, or alternatively, a sub-account in the country's Single Treasury Account, if this mechanism has been validated and is acceptable to the Bank.

2.6 **Disbursement methods.** The Bank may use the following methods to make disbursements:

i) *Advances*;

ii) *Direct Payments* made by the Bank to third parties on behalf and at the request of the borrower and/or EA;

iii) *Reimbursements* of expenditures incurred by the executing agency or borrower, with their own resources; and

iv) Reimbursements of Guarantee *Letters of Credit (only applicable to reimbursable operations).*

2.7 **Increase in the amount of advances.** The Bank may increase the amount of an advance of funds, based on the following criteria: i) the borrower and/or EA provides evidence that immediate unplanned cash flow needs have arisen; ii) the request is made during the period in effect of the corresponding advance of funds; iii) the amount of the advance is increased only once during such period; and iv) an adjusted financial plan is submitted for the remaining period of the corresponding advance of funds. The Project Team Leader will determine whether such an increase is appropriate.

2.8 **Final project disbursement.** The Bank will not make disbursements to the borrower and/or EA after the Date of Last Disbursement (original or extended).

2.9 **Closing period and final justification.** During the closing period[6], the borrower and/or EA can make final payments to third parties, reconcile its accounts, make any necessary adjustments, and submit any final justifications of expenditures incurred, prior to the closing date. In addition, the borrower and/or EA is responsible for ensuring that adequate funds corresponding to the audit fees and ex-post evaluations to be financed with Bank resources are retained, safeguarded and properly accounted for, as of the Closing Date.

2.10 **Maintenance of value.** The value of each disbursement made by the Bank to a borrower and/or EA shall be maintained at the equivalent value of the disbursement or project currency stated in the relevant legal agreement(s), and no adjustments to that equivalent value shall be made due to changes in exchange rates. The justification of expenditures made with resources advanced to the borrower and/or

[6] The reference term for the closing period is 90 days, for those projects where the submission due date of the Final Audit Report is 120 days. When the due date exceeds 120 days, the parties will agree on how to adjust the reference term for the closing period.

EA must be for the equivalent of the total advance in the disbursement or project currency, using the exchange rate agreed with the Bank.

2.11 **Exchange differences**. The Bank may accept adjustments to the justifications if there are exchange rate fluctuations that do not affect project execution[7]. However, if such fluctuations affect project execution, they will be closely monitored, and the Bank will determine the procedure to be followed, on a case-by-case basis. This procedure may include, among others:

i) reinvest any exchange gains in the project; or

ii) request the borrower and/or EA to return any unjustified funds; or

iii) provide the necessary local currency units to complete the execution of the project.

2.12 **Application of exchange rates**. If project expenditures have been incurred in local currency, the EA and the Bank will agree on the exchange rate to be used in justifications and reimbursements. For purposes of the justification of expenditures to the Bank (including reimbursements/recognition of expenditures, and local counterpart), the equivalent amount to be reported in the project or disbursement currency will be determined using the rate specified in the project legal agreement(s), which could be one of the following:

i) the effective exchange rate used to convert the funds denominated in the project's currency to the local currency; or

ii) the effective exchange rate of the payment date[8], without regard to the source of financing used.

3. **Requirement 3: Rendering of accounts**

3.1 **Justification of advances.** The borrower, EA or co-executing agencies will submit justifications of all the amounts advanced under their responsibility. These justifications will be submitted to and accepted by the Bank, in accordance with the established percentages, prior to receiving any subsequent advances of funds.

3.2 **Reference level for the rendering of accounts**. The justification of the advanced funds will be made for the total accumulated balance pending justification, involving a high level of justification of project expenditures. As a general rule, high level of justification means 80% of the total accumulated balance pending justification.

3.3 **Permanent adjustment**

i) **Level of authority in the design phase.** When in the design phase the project team identifies the need to require a percentage for the justification of accounts other than 80%, it will justify this situation as part of the execution mechanism

[7] This is deemed to affect project execution when the exchange difference prevents the fulfillment of the commitments undertaken with the Bank and third parties.

[8] For practical reasons, the "effective exchange rate of the payment date" may be the exchange rate of the actual date of the transaction or an exchange rate that approximates the exchange rate of the date of the transaction, such as the exchange rate in effect on the last day of the prior month, or an average exchange rate for the month. The selection/option to be used as the "effective exchange rate of the payment date" shall be agreed between the Bank and the borrower and/or EA, and shall be documented in the relevant legal agreement(s).

in the document of approval of the operation at OPC level or its equivalent. This percentage will range between 50% and 80%.

ii) **Level of authority in the execution phase.** When the EA asks the Bank for a permanent adjustment of the percentage approved by the OPC or its equivalent, the Project Team Leader will submit an adequately documented justification, with the prior agreement of the Financial Management Specialist and the applicable Sector Division Chief, for consideration by the Representative, who will have the (non-delegable) authority to decide whether or not to grant such an adjustment. This decision will be based on the criteria described below, and the new percentage will range between 50% and 80%.

iii) **Criteria.** If the borrower's and/or EA's liquidity needs are justified, the following criteria will apply, among others, to approve on a permanent basis a level of justification other than the percentage approved by OPC or its equivalent:

a) The execution mechanism is complex and decentralized, and involves several co-executing agencies, different levels of authority (federal, state or other sub-national governments), or a combination of these factors.

b) The existence of co-financings, or funds under administration, where another donor/financier requires a percentage of justification that is different from the general rule, in order to maintain the pari-passu arrangement.

c) National budget regulations that require the availability of Bank financing to commit project resources before the borrower and/or EA can justify the established percentage.

d) The workflow and processes of the EA's financial and administrative systems require long periods of time for payments management, recording and accounts closing, or establish percentages that are different from the Bank's general rule.

3.4 **Specific adjustment**

i) **Level of authority in the execution phase.** When the EA asks the Bank for a specific adjustment of the percentage approved by the OPC or its equivalent, the team leader will submit a properly documented justification, with the prior agreement of the Financial Management Specialist, for consideration by the Representative, who will have the (non-delegable) authority to decide whether or not to grant such adjustment. This decision will be based on the criteria described below, and the adjustment will be granted on a one-time basis during the project execution period. The new percentage will range between 50% and 80%.

ii) **Criteria.** If the borrower's and/or EA's liquidity needs are adequately justified and documented, the following criteria will apply to approve, on a case by case basis, a level of justification other than the percentage in effect for the project:

a) The available bank balance does not allow the borrower and/or EA to cover the financial needs of the project in the short term; or

b) The percentage to be justified is up to five (5) points below the agreed level, and reaching this level would involve high transactional costs (e.g., return of funds to the Bank, renegotiation of consultancy contracts, etc.).

4. **Requirement 4: Project financial supervision**

4.1 **The nature, timing and extent of financial management interventions** for a project will be based on the assessed level of fiduciary risk, including the analysis of the borrower's and/or EA's financial management systems. The assessed level of fiduciary risk primarily considers (from the FM perspective): institutional financial management capacity, adequacy of financial management systems and internal and external controls, prior audit reports, prior experience, and known and perceived level of transparency associated with a country, a specific sector and the specific EA.

4.2 **Supervision plan.** For each project, as part of the overall project supervision plan, it is necessary to develop and implement the FM-related sections, based on the initial evaluations of the country's and EA's financial management systems, capacity, and risks, conducted during programming and project preparation. During the execution phase, this plan will be updated with the frequency established by the Bank.

4.3 **Preventive and ex-post reviews.** The Bank supervises the project's Financial Management Arrangements and Requirements via ex-post reviews and evaluations. Nevertheless, if the financial management specialists, together with the project team, determine that the borrower's and/or EA's financial management systems and internal controls are not adequate to obtain reasonable assurance that the project funds are being properly used, the Bank may require the prior approval of any decisions regarding project activities and transactions. These "preventive reviews of financial aspects" will be conducted on an exceptional basis, and should not be the norm for projects in execution.

5. **Requirement 5: Project financial reporting system**

5.1 **Financial reporting system**. The borrower and/or EA will maintain adequate and reliable financial management systems to budget (budget system), record and account for (accounting system), make payments (treasury system), and prepare reports and justifications of expenditures (accounting and reporting system) in a timely manner**.**

5.2 **Use of the borrower's and/or EA's accounting and reporting systems.** Where the Bank has assessed that the public financial management systems are flexible enough to allow for the aggregation of expenditures by project and sub-project or by components and sub-components, the Bank may accept the country's classification when designing the project budget. Based on the above, the Bank may accept the financial reports generated from the country's own accounting and reporting system(s), expressed in the currency specified in the legal agreement(s). Similarly, the borrower's and/or EA's accounting and reporting systems may be accepted in non-public sector contexts.

5.3 **Accounting standards.** The Bank requires that project transactions and activities be accounted for in a timely manner, in accordance with accounting standards acceptable to the Bank.

5.4 **Financial reports.** The Bank requires the borrower and/or EA to prepare and submit financial reports, which may include financial statements and other financial-related reports[9]. The characteristics of such reports (i.e., content, type, format, frequency, submission due dates, and applicable standards) will be agreed between the Bank and the borrower and/or EA, based on the nature and complexity of the project, its level of risk, and the fiduciary capacity of the borrower and/or EA, as well as the needs of the users of the reports.

5.5 **Supporting documentation.** The borrower and/or EA is responsible for maintaining all documentation to support project activities, decisions, and transactions, including all incurred expenditures, with adequate cross-references to the Bank-approved disbursement requests. This documentation must be timely and sufficient, in form[10] and substance, to satisfy the conditions related to the eligibility of expenditures. The borrower and/or EA shall make these original documents available to the independent auditors to conduct external audits of the project, and for Bank staff and consultants to perform the supervision and monitoring of the operation. The Bank requires the borrower and/or EA to retain all pertinent documents and records for a minimum of three years from the date of last disbursement, in accordance with the applicable Bank policies and legal agreement(s).

6. **Requirement 6: Internal control**

6.1 For all Bank projects, the borrower and/or EA is responsible for establishing and maintaining adequate financial management and internal control systems for the project, to provide reasonable assurance[11] that:

i) the project funds are used for the intended purpose and development objectives of the project, with special attention given to the principles of economy and efficiency;

ii) project transactions, decisions, and activities are properly authorized and documented;

iii) project transactions are executed in accordance with the policies and procedures established in the relevant legal agreement(s);

iv) these transactions are properly recorded to facilitate the preparation of reliable and timely financial and non-financial information; and

v) project assets are properly safeguarded.

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[9] These may include: interim financial statements of the project and/or entity, detailed reports on project assets, disbursement requests, budget versus actual expenditure reports, financial plans, FM and non-FM reports, etc.

[10] Supporting documentation may be submitted by electronic means or any other format agreed in the applicable legal agreement(s).

[11] "Reasonable assurance" is a concept that recognizes that the cost of an entity's internal control system should not exceed the expected benefits. Cost and inherent limitations within the internal control system result in it providing only reasonable, but not absolute, assurance that its objectives will be accomplished. Inherent limitations, such as mistakes in judgment, carelessness, fatigue, management override, and distraction, reduce the effectiveness of the internal control system.

7. **Requirement 7: Independent external auditors**. Independent auditor for the Bank refers to a private audit firm, individual public accountant, or Supreme Audit Institution which maintains the standard of quality required by the profession and complies with the International Standards on Auditing, the INTOSAI standards, or national auditing standards that are acceptable to the Bank.

   7.1 **Auditor eligibility.** Project audits will be conducted by Bank-eligible external auditors[12].

   7.2 **Use of Supreme Audit Institutions (SAI).** Where the Bank has assessed that the SAI of the country is acceptable to audit a project, and the SAI has expressed an interest to do so, the SAI may conduct the external audit. If the Bank is not able to use the SAI, an external auditor acceptable to the Bank will be contracted to conduct the required audit(s), as established in this document.

   7.3 **Financing the audit.** The project audit may be financed from:

   i) the resources of the Bank's financing;

   ii) the local counterpart funds; or

   iii) a combination of both.

   If the project is co-financed by the Bank and another multilateral financial institution or donor, then the budgeted audit fees may be shared with the applicable co-financiers. The audits may also be financed from sources other than project funds.

   7.4 **Auditor impairments.** Any private external auditor, whether contracted by the borrower and/or EA or the Bank, must be legally permitted to act as an independent auditor and sign audit opinions (if required for the specific audit), and must not have any existing or pending impairments to perform the work, including sanctions[13] or confirmed allegations of fraud or corruption against him/her, the firm, or any partners of the firm contracted to conduct the audit.

   7.5 **Subcontracting parts of the external audit.** No part of the external audit may be subcontracted to another auditor without the prior consent of the Bank.

8. **Requirement 8: External financial audit of the project**

   8.1 **Types of external financial audits**. The project team will agree with the borrower and/or EA on the preparation and submission to the Bank of one or more of the following reports. In all cases, the external auditor and the applicable auditing standards shall be acceptable to the Bank.

   i) Audited Financial Statements (AFS). AFS will be prepared in accordance with terms of reference acceptable to the Bank. The project team will determine the

[12] The selection and contracting of auditors will be made in accordance with the Financial Reports and External Audit manual (OF-200 Annex I) and the Standard Request for Proposals of External Audit Services (AF-200), and their updates.

[13] Sanctions may be imposed by the country's legal authorities, the country's SAI, the country's institute of public accountants and auditors, IFAC, the Bank, or other donors.

frequency, format, financial statement period[14], and the due date for submitting the AFS.

ii) Entity AFS, when they include financial information of the project. The Bank may accept the entity's financial audit reports if they fulfill the Bank's needs regarding financial reporting and rendering of accounts in respect of the project. In addition, the entity's financial reports must be prepared in accordance with accounting standards acceptable to the Bank.

iii) Other types of external audit work related to financial information (other than AFS)[15]. Based on the Bank's and the project's needs, in these cases the project team will determine the nature, timing, frequency, submission due dates, scope, methodology, types of reports, and terms of reference.

8.2 **Reporting cut-off date**. The cut-off date may be: i) the project fiscal year-end; ii) the date of last disbursement of the project's resources; or iii) another date agreed by the parties.

8.3 **Submission due date.** The submission due date will be not more than 120 days subsequent to the cut-off date agreed between the borrower and/or EA and the Bank. However, a longer due date of up to 180 days may be agreed, when the project is using financial management systems of the borrower and/or EA that:

i) have different reporting and audit cycles; and

ii) satisfy the information needs of the Bank and stakeholders.

8.4 **Waiver.** The borrower and/or EA may request a waiver of the requirement to submit the project's financial audit report —AFS or other financial audit reports—, and such waiver shall be granted by the Financial Management Specialist, if warranted and without undermining the objective of a timely rendering of accounts[16].

8.5 **Due date extensions for non-reimbursable technical cooperation and investment operations**. The Financial Management Specialist may grant a due date extension for the submission of project financial audit reports when extraordinary circumstances occur, of an unusual and infrequent nature (such as natural disasters). Such due date extensions may be consecutive and will not exceed 60 days per fiscal year.

8.6 **Non-submission of the external financial audit report**. For loan operations[17] in which the borrower and/or EA fail to submit the project's financial audit report on the agreed date, the Bank will start an automated process, which could result in the suspension of disbursements, in accordance with the timeframe and procedures established in Manual OF-200, Project Financial Management.

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[14] Generally, the borrower and/or EA will be required to submit annual AFS throughout the period of execution of the project. Nevertheless, depending on the circumstances of the specific operation, the project team may require the borrower and/or EA to submit more or less frequent AFS, for a period of more or less than one year.

[15] Other types of audit-related work include assurance engagements, such as statements of expenditure, "certifications" of disbursement requests, ex-post reviews of procurements and disbursements.

[16] See the Operations Administration Manual (OA): OA-420 IV-A and OA-421 IV-A, and their updates.

[17] Including those operations that, while not being loans, are managed as such, e.g., the Grant Facility for Haiti.

8.7 **Auditing standards.** The Bank requires that all external audits of projects and entities be conducted in accordance with auditing standards acceptable to the Bank, and the terms of reference previously approved by the Bank. For all other types of audit-related work, the auditor is required to perform the audit work in accordance with this document, the applicable auditing or consulting standards, and the terms of reference agreed upon between the borrower and/or EA and the Bank.

8.8 **Other audited reports**

i) **Entity audited financial statements.** In addition to the financial audit of the project, the Bank may require the borrower and/or EA to submit the entity's financial statements –prepared in accordance with the country's legal requirements– when such financial statements provide relevant information for other aspects related to the supervision of the project.

ii) **Other types of audits.** In addition to the financial audit reports, the Bank may require other types of audit reports, such as performance audits, value-for-money audits, special-purpose audits (i.e., audits of elements of a financial statement), audits of information technology systems, and audits of compliance with laws and regulations or operations regulations.

8.9 **Access to borrower and/or EA staff and records.** The borrower and/or EA shall allow its internal auditors (i.e., the entity that performs the internal audit function), the Bank, its consultants, and the appointed external auditors to access its staff, records, and financial management systems in all aspects that affect the project financed by the Bank.

9. **Requirement 9: Prohibited practices**

9.1 If, as a result of their work, the independent external auditors of the project identify any occurrence or suspected occurrence of a prohibited practice, they shall report the matter to the Bank. See the Bank's Sanctions at https://www.iadb.org/en/about-us/idb-sanctions-system,8619.html

10. **Requirement 10: Transparency**

10.1 **Access to Information Policy.** The disclosure of information and reports relating to project financial management shall be governed by the Bank's Access to Information Policy[18].

C. Financial Management Requirements to be considered for:

C.1. **Policy-based Loans and similar operations.** In this type of operations, in which an extensive use is made of a country's public financial management systems, the project team will pay particular attention to the associated fiduciary risks. The Financial Management Specialist may provide inputs relating to the following aspects, among others[19]:

i) *Bank account*: The Bank will deposit the proceeds of the loan into a specific bank account designated by the borrower and agreed upon by the parties.

[18] Document GN-1831-28 and future updates.

[19] See *Policy Based Loans: Guidelines for Preparation and Implementation* (CC-6005), March 31, 2005.

ii) *Disbursement management:* Disbursements will be made for the agreed amounts, and in accordance with the conditions specified in the relevant legal agreement(s). The borrower will prepare and submit a disbursement request, which will not need to be accompanied by a financial plan.

iii) *Eligibility of expenditures:* Eligible and ineligible expenditures will be treated in accordance with the Bank's policies and guidelines applicable to these operations, and the relevant legal agreement(s).

iv) *Audited financial report:* The Bank may require the borrower to submit an audited financial report in relation to any disbursement, in accordance with paragraphs 7, 8, 9 and 10, as applicable.

v) *Records and supporting documentation:* The Bank may require the borrower to maintain appropriate records and documentation regarding the disbursements of the loan.

In specific cases, and based on the nature of the project, the Bank may conduct an assessment of the government's financial management capacity, including budget preparation and execution, treasury processes, internal control, accounting and auditing (internal and external), to determine the use of public financial management systems, and the potential mitigation measures required for the implementation of the project.

C.2. Operations in which the Bank is the Executing Agency

These Guidelines will apply to the operations executed by the Bank, as appropriate. However, the following requirements will not apply to those projects in which the Bank is the Executing Agency:

i) *Disbursement management:* the advances method will not be used; and

ii) *Project financial audit*: the submission of a project financial audit report or report of expenditures incurred under the Bank's responsibility is not required.

D. Transitional measures

The authority to approve percentages ranging between 50% and 80%, in the case of justifications of funds advanced to the borrower and/or EA, is delegated to VPC/FMP until the Bank's systems are modified (expected for July 1, 2015).

Glossary of terms

Advance refers to the advancement of funds (from the Bank to the borrower, EA and/or co-executing agencies), based on the true liquidity needs of the project in the short term, to pay for project expenditures.

Assurance Engagement refers to an engagement in which an accounting and auditing practitioner expresses a "conclusion" based on the outcome of the practitioner's measurement or evaluation of the underlying subject-matter, against previously established criteria (e.g., policies, disbursement rules or operating regulations). The party responsible for expressing the "conclusion" must be independent of the party responsible for the subject-matter that is evaluated or measured.

External Audits refers to audits conducted by auditors (individuals, audit firms or Supreme Audit Institutions), who are not internal (i.e., employees) to the entity or project being audited and, therefore, should be independent of the project or entity subject to audit.

Eligible Auditor refers to the external auditor evaluated by the Bank, on a case-by-case basis, in accordance with the established criteria, which may include the level of development of the audit profession (public and private sector) in the country, as well as the following aspects relating to professional competence, particularly the auditor's: 1) independence and reputation, 2) capacity to conduct the audit in accordance with the terms of reference, 3) quality control procedures, 4) training, 5) peer review reports, 6) knowledge of the Bank's requirements, 7) prior experience in relation to the type of entity or project being audited, as well as experience in auditing Bank-financed projects, and 8) the auditor's interest in auditing IDB-financed projects, among others.

Internal Control according to the Committee of Sponsoring Organizations of the Treadway Commission (COSO) is defined as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: 1) effectiveness and efficiency of operations, 2) reliability of financial reporting, and 3) compliance with applicable laws and regulations.

Supreme Audit Institution for the Bank refers to the institution responsible, by law, for auditing government activities at the national and sub-national levels. It should be independent of the executive agencies (i.e., Ministries) that it audits. Generally, Supreme Audit Institutions report to the Legislative rather than the Executive branch in their countries.

Entity Financial Statements are the financial statements prepared by state-owned companies, autonomous or semi-autonomous institutions, trust funds established with resources of the Bank's financing, or other public sector entities that generate income.

Closing Date is defined as the last day of the closing period subsequent to the Date of Last Disbursement.

Date of Last Disbursement is the last date of the disbursement period, as defined in the project's legal agreement(s), and is considered to be the last date on which the Bank can make disbursements to the borrower and/or EA or to third parties.

Acceptable Auditing Standards include the International Standards on Auditing, issued by IFAC, as well as the auditing standards issued by the International Organization of Supreme Audit Institutions

(INTOSAI). The Bank may also accept national auditing standards that are consistent with the international standards mentioned above.

Acceptable Accounting Standards include the International Public Sector Accounting Standards (IPSAS), issued by the International Federation of Accountants (IFAC), and the International Financial Reporting Standards (IFRS), which incorporate the International Accounting Standards (IAS), issued by the International Accounting Standards Board (IASB). The Bank may also accept national accounting standards that are consistent with the international standards mentioned above.

Closing Period is the period between the Date of Last Disbursement and the Closing Date, when the borrower and/or EA can make final payments to third parties, and also must present any final justifications of expenditures to the Bank, with the exception of any final payments and justifications for the audit fees related to the external audit of the project.

Supervision Plan – The purpose of the supervision plan is to document the Bank's approach to the supervision and monitoring a project, throughout execution, to help ensure that a project is executed in an efficient and effective manner. The Project Team Leader is responsible for preparing and updating the supervision plan, based on inputs from the project team members. The supervision plan should describe any measures to be taken to mitigate any identified or potential risks associated with the project, including institutional strengthening.

Reimbursement refers to a disbursement made to the borrower and/or EA for eligible expenditures incurred and paid for from the borrower's and/or EA's own resources or resources from another co-financier.

Ex-post Review for the Bank refers to oversight (i.e., subsequent) actions or interventions taken by the Bank or its consultants with respect to project supervision, monitoring and verification of project management decisions, actions, and documentation. By doing so, it should not be assumed that the Bank has given its approval of any borrower and/or EA decisions made or actions taken in relation to the project.

Preventive Review for the Bank refers to preventive actions or interventions to be taken by the Bank, prior to any FM-related decisions and actions taken by and affected by the borrower and/or EA. This concept replaces the prior concept of "ex-ante" reviews.

Fiduciary Risk includes the financial management and procurement risks associated with a project. From the FM perspective, it can be defined as the risk that the financial management aspects in relation to a Bank-financed project are not working and/or being controlled adequately and, therefore, problems may arise in relation to project execution, which in turn may result in the project not being efficient, effective or adequately controlled. In addition, problems may not be prevented or detected in a timely manner by the Bank or the borrower and/or EA.

Public Financial Management Systems include the legal framework, organizational structure, procedures and information systems used by country entities and statutory bodies for managing public finances. Such systems primarily include budget planning and management, treasury and public debt, accounting and financial reporting, and internal and external controls. When appropriate, this term is applicable to other public sector entities, such as state-owned companies, public-private entities, etc.