

TERMS OF REFERENCE FOR EXTERNAL AUDITORS OF THE AFRICAN DEVELOPMENT BANK GROUP FINANCED PROJECTS

1. BACKGROUND

- 1.1 The African Development Bank Group (the Bank) has been supporting the Government of (*name the Country*) in its development efforts since *19XX/20XX (to be determined)*. A Loan/Grant of UA **XX** million (*to be determined*) was approved in *19XX/20XX (to be determined)* to finance the (*name the Project*).
- 1.2 *Provide other information such as Development objectives of the project; Institutional and project financial management arrangements; Other co-financiers if any; Financial year/period to be audited; Level of disbursements; and any other pertinent information that should be brought to the attention of the auditors.*

2. OBJECTIVE OF THE AUDIT

- 2.1 The objective of the audit of the Project financial statements (PFSs) is to enable the auditors to express an independent¹ professional opinion on the financial position of the Project as at (*date to be determined*); and to ensure that the funds granted to the Project have been used for their intended purposes.
- 2.2 The project books of accounts provide the basis for preparation of the PFSs by the project implementing unit and are established to reflect the financial transactions in respect of the project. The PIU maintains adequate internal controls and supporting documentation for transactions.

3. RESPONSIBILITY FOR PREPARATION OF FINANCIAL STATEMENTS

- 3.1 The responsibility for the preparation of PFSs lies with the Project Implementation Unit (PIU). The PIU is also responsible for :
- (a) the selection and application of accounting policies. The PIU will prepare the PFSs in accordance with applicable accounting standards-either the International Public Sector Accounting Standards (IPSASs), International Financial Reporting Standards (IFRs), or National Accounting Standards that comply with IPSASs or IFRs in all material respects; and
 - (b) Implementing accounting, administrative and financial procedures documented in manuals.
- 3.2 The auditors are responsible for the formulation of an opinion on the PFSs based on their audit conducted in accordance with ISAs (International Standards on

¹ The auditors will not provide any other services that may result to a conflict of interest.

Auditing) issued by the IFAC (International Federation of Accountants) or ISSAIs (International Standards of Supreme Audit Institutions) issued by the INTOSAI. National Auditing Standards that comply with ISAs or ISSAIs in all material respects will also be accepted. In accordance with these standards, the auditors will request the PIU for an Engagement/Confirmation Letter committing the PIU's management to the preparation of the PFSs and maintenance of proper internal control systems as well as acceptable documentation for all financial transactions.

4. SCOPE OF THE AUDIT

4.1 The audit will be carried out in accordance with the Standards specified in 3.2 above and will include such tests and verification procedures as the auditors consider necessary under the circumstances. In conducting the audit, special attention should be paid to the following:

- (a) All Bank funds have been used in accordance with the conditions of the loan agreement, with due attention to economy and efficiency and only for the purposes for which the funds were provided;
- (b) Counterpart funds (government budget) and external funds (in case of co-financing) have been provided and used in accordance with the conditions of the loan agreement, with due attention to economy and efficiency and only for the purposes for which they were provided;
- (c) Goods, works and services financed have been procured in accordance with the loan agreement and in accordance with the Bank's rules and procedures²; and have been properly accounted for ;
- (d) Appropriate supporting documents, records and books of accounts relating to all project activities have been kept. Clear linkages should exist between the books of accounts and the financial statements presented to the Bank;
- (e) Special accounts have been maintained in accordance with the provisions of the loan agreement and in accordance with the Bank's disbursement rules and procedures (refer to sections 6 and 7 below for further guidance);
- (f) The financial statements have been prepared by project management in accordance with applicable accounting standards mentioned (ref. section 3 above) and give a true and fair view of the financial position of the Project as at the year end and of its receipts and expenditures for the period ended on that date;
- (g) Comprehensive assessment of the adequacy and effectiveness of the accounting and overall internal control system to monitor expenditures and

² Depending on the complexity of certain procurement activities, the Auditors may integrate, in the audit team, technical experts during the period of the contract. In such a case, the Auditors will conform to **ISA 620: (Using the Work of an Auditor's Expert)**. The necessity for the use of an expert's works should be brought to the attention of the Borrower and the Bank for a mutual agreement and appropriate decisions.

other financial transactions and ensure safe custody of project-financed assets and that they are being used for the intended purposes;

- (h) Project's fixed assets are real and properly evaluated and project property rights or related beneficiaries' rights are established in accordance with loan conditions; and
- (i) Ineligible expenditures identified during the audit will be reflected in a separate paragraph of the audit report and if material, the point should be reflected in the auditors' opinion.

4.2 In accordance with International Standards on Auditing, the auditors shall pay attention to the following:

- (a) ***Fraud and Corruption*** : In accordance with **ISA 240 (The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements)** the auditors shall identify and evaluate risks related to fraud, obtain or provide sufficient evidence of analysis of these risks and assess properly the risks identified or suspected;
- (b) ***Laws and Regulations*** : In preparing the audit approach and in executing the audit procedures, the auditors shall evaluate the PIU's compliance with the provisions of laws and regulations that might impact significantly the PFSs as required by **ISA 250 (Considerations of Laws and Regulations in an Audit of Financial Statements)**;
- (c) ***Governance*** : Communicate with the PIU's Management responsible for Governance regarding significant audit issues related to governance in accordance with **ISA 260: (Communication with those charged with Governance)**; and
- (d) ***Risks*** : With a view to reducing audit risks to a relatively low level, the auditors will apply appropriate audit procedures and handle anomalies/risks identified during their evaluation. This is in accordance with **ISA 330 (The Auditor's Responses to Assessed Risks)**.

5. FINANCIAL STATEMENTS

5.1 The auditors will ensure that the PFSs are prepared in accordance with the standards mentioned above (ref. section 3 above) and give a true and fair view of the financial position of the project as at the fiscal year end and its receipts and expenditures for the financial year ended on that date.

5.2 The project financial statements prepared by project management shall include:

- (a) **Non-Revenue Earning Projects**

- i) Statement of Receipts³ (funds received from the Bank, counterpart funding and where applicable, co-financiers' funding) and Expenditures (expenditures incurred for both the current year and accumulated to-date) showing separately Bank's funding, those of counterparty and co-financiers if applicable and cash balances;
- ii) Statement of Special Account;
- iii) Statements of Expenditures
- iv) Notes to the Financial Statements describing the applicable accounting principles in place and a detailed analysis of the main accounts.

(b) **Revenue-Earning Projects**

- i) Balance Sheet showing accumulated funds of the project, bank balances and other assets and liabilities of the project as at the close of each fiscal year;
- ii) Income Statement (or Operating, or Income and Expenditure, or Profit and Loss);
- iii) Cash Flow Statement that should disclose the cash flows during each fiscal year;
- iv) Statement of special account;
- v) Statements of expenditures; and
- vi) Notes to the Financial Statements describing the applicable accounting principles in place and a detailed analysis of the main accounts.

5.3 As an annex to the financial statements mentioned above, the audit report should include:

- (a) A reconciliation between the amount shown as "received from the Bank" and that shown as having been disbursed by the Bank. The reconciliation should indicate the methods used for disbursement, i.e. special account, direct payment or reimbursement guarantee, reimbursement methods with those recommended in the appraisal report and the disbursement letter; and
- (b) A comprehensive list of all fixed assets purchased, with given dates, values and condition of the assets.

³ Any revenue generated by the Project e.g. sale of bid documents, disposal of project assets, bank credit interests earned in the special account and fees earned should be accounted for and disclosed.

6. STATEMENT OF EXPENDITURES

In conjunction with the audit of the PFSs, the auditors should:

- (a) Audit all Statements of Expenditures (SOEs) used as a basis for the submission of withdrawal applications to the Bank by the project;
- (b) Determine the eligibility of expenditures in accordance with the loan agreement and appraisal report. Where ineligible expenditures are identified as having been included in the withdrawal applications and replenished, these should be noted separately by the auditors; and
- (c) Annex to the PFSs a schedule listing withdrawal applications submitted on the basis of SOEs with their reference number and the amount involved.

7. SPECIAL ACCOUNT

7.1 In conjunction with the audit of the PFSs, the auditors are also required to review the activities of the special account associated with the project. The auditors should examine the :

- (a) Eligibility and correctness of financial transactions during the period under review and account balance at the end of such period;
- (b) Operations and use of the special account in accordance with Loan/Grant Agreement/Disbursement Letter; and
- (c) Adequacy of internal controls for this type of disbursement mechanism.

7.2 The Special Account usually comprises:

- (a) Initial deposit and subsequent replenishments received from the Bank;
- (b) Withdrawals related to project expenditures;
- (c) Interest that may be earned on the account balance; and
- (d) The remaining balance at the end of the period.

8. AUDIT REPORT

8.1 The audit report will comprise (i) the auditors' opinion on the project financial statements and (ii) a complete set of project's financial statements and other relevant statements as mentioned in section 5.2 above.

8.2 All ineligible expenditures will be disclosed in an annex to the audit report.

9. MANAGEMENT LETTER

- 9.1 In addition to the audit report, the auditors will prepare a “management letter” in which they will:
- (a) Give comments and observations on the accounting records, procedures, systems and controls that were examined during the course of the audit;
 - (b) Identify specific deficiencies and areas of weakness in systems and controls and make recommendations for improvement;
 - (c) Report on the degree of compliance with each of the financial covenants on the Loan/Grant agreement and give comments, if any, on internal and external matters affecting such compliance;
 - (d) Report on the implementation status of recommendations pertaining to previous period audit reports;
 - (e) Communicate matters that have come to their attention during the audit which might have a significant impact on the implementation and sustainability of the project; and
 - (f) Bring to the borrower’s attention any other matters that the auditors consider pertinent.
- 9.2 Ideally, the management letter will include reactions/comments from PIUs on the weaknesses noted by the auditors.

10. GENERAL INFORMATION

- 10.1 The audit report including the financial statements, the management letter including the PIU’s responses should be received by the Bank within six (6) months after the end of the fiscal year under review.
- 10.2 The auditors should be given access to all legal documents, correspondence and any other information associated with the project and deemed necessary by them. Confirmation of amounts disbursed and outstanding at the Bank should also be obtained. The project task manager at the Bank can assist in obtaining these confirmations.
- 10.3 It is recommended that the auditors become familiar with the following documents that may have been prepared by the Bank:
- (a) General Conditions Applicable to Loan, Guarantee and Grant Agreements;
 - (b) Loan/Grant Agreement;
 - (c) Project Appraisal Report;

- (d) Guidelines for Financial Management and Financial Analysis of projects;
- (e) Disbursement Handbook;
- (f) Aide Memoires and official communications with the Bank; and
- (g) Procurement rules and procedures for works, goods and services.

11 AUDITORS EXPERIENCE AND QUALIFICATIONS

11.1 The audit firm should be registered and have a license from a national or regional professional Accountancy Body. The firm should have relevant experience in accounting and auditing of development projects, especially donor-funded operations.

11.2 The key audit team will comprise, at least:

- (a) An audit manager with at least 10 years experience in auditing and with a sound knowledge of donor-financed projects. In addition he/she should be a member of a recognized accountancy professional body;
 - (b) A team leader with at least a Masters degree in auditing/accounting or equivalent with a minimum of 5 years experience in auditing; and
 - (c) An assistant auditor with adequate experience and professional qualifications.
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