**ETHIOPIA PRODUCTIVE SAFETY NET APL IV PROJECT**

**TERMS OF REFERENCE FOR FINANCIAL AUDIT**

1. **BACKGROUND**
2. The aim of the overall PSNP APL series is to contribute to improving the productivity and efficiency of transfers to chronically food insecure households, reducing household vulnerability, improving resilience to shock, and promoting sustainable community development. The proposed Project Development Objective (PDO) for APL IV is: Increased access to safety net and disaster risk management systems, and complementary livelihood and nutrition services for food insecure households in rural Ethiopia.
3. This will be achieved through 1) support for building core instruments and tools of social protection and DRM systems, 2) delivery of safety net and enhanced access to livelihoods services for vulnerable rural households, and 3) improved program management and institutional coordination.
4. PSNP 4 builds on the significant lessons learned in previous PSNP phases, documented through bi-annual impact evaluations and a large number of studies, assessments and missions. PSNP 4 will be integrated within a broader system and policy framework for social protection and DRM. This move to a systems approach, supporting investments to build administrative and management systems, marks a natural progression of the program to date, as it has developed from transitioning Ethiopia's emergency system to a more predictable safety nets program, which will now be aligned under a national system. PSNP 4 will also aim to enhance clients’ access to livelihoods services as a sub-component within the PSNP. PSNP 4 will provide to clients an integrated set of safety net services and technical assistance to enhance livelihoods strengthening. The program will continue to be implemented through government systems, in partnership with Non-Governmental Organizations (NGOs) and service providers. Three components will contribute to the achievement of the overall PSNP development objective. These are:

* Component 1: Systems Development (USD 144 million total; USD 27 million IDA). Support to the social protection and DRM systems will include targeting, registry, capacity development, management information systems (MIS), early warning triggers and response mechanisms.
* Component 2: Productive safety nets and links to livelihoods services (USD 3.031 billion total; USD 451 million IDA): this will be done through 3 sub-components delivering key services to the targeted households: (a) safety nets transfers to chronically food insecure households, and support to a scalable response mechanism for transitory needs; (b) sustainable community assets and human capital investments; and c) enhanced access to complementary livelihoods services for client households through crop and livestock production, off-farm income generating activities, and labor/employment linkages.
* Component 3: Institutional and Management Development (USD 219 million total; USD 22 million IDA). This component will support sustainable capacity development and institutional strengthening to implement PSNP 4.

1. This government program is proposed to have the following program structure.

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| --- | --- |
| **Program Component** | **Total**  **(in USD million)** |
| 1. Systems Development | 144 |
| 1. Productive safety nets and links to livelihoods services | 3,003 |
| 1. Institutional management development | 219 |
| 1. Total Program Cost | **3,366** |

1. The Development partners in addition to IDA that are involved in financing this project known at appraisal include DFID, Irish Aid, UDAID, WFP and the multi donor trust fund involving the donors: EC,SIDA,DFATD - Canada and RNE.
2. The institutional arrangements for the APL IV will build on existing structures and will largely be the same as in the previous phases. Although Ministry of Agriculture (MOA) is responsible for the overall project, the Ministry of Finance and Economic Development (MoFED) will be responsible for the financial management aspects of the project. At Regions or Woredas the Regional or Woreda bureaus or offices of both Ministries will be involved in respective areas in managing the project. Other implementing agencies in of the program include MoLSA, FCA, agricultural extension directorates, natural resource directorates, etc at all levels of government.
3. Detailed information on the project including implementation arrangements is provided in the World Bank’s Project Appraisal Document (PAD) dated XXXX (to be completed later) as well as the program Implementation Manual.
4. The accounting period covered for the audit is 12 months following the government fiscal year ending on July 7. The Audit will be completed on an annual basis following the normal government fiscal/accounting year.
5. **OBJECTIVE OF THE PROJECT AUDIT**
6. The objectives of the audit of the Project Financial Statements (PFSs) is to enable the auditor to express a professional opinion(s) on the financial position of the project at the end of each fiscal year, and on funds received and expenditure incurred for the relevant accounting period in conformity with the applicable contractual conditions, ISAs and relevant programme manuals. The accounting system, books and records provide the basis for preparation of the PFSs by the project implementing agency and are established to reflect the financial transactions in respect of the project, MOFED and the rest of the implementing agencies maintain adequate internal controls and supporting documentation for transactions.
7. **FINANCIAL AUDIT**

**A. PREPARAION OF ANNUAL FINANCIAL STATEMENTS**

1. The responsibility for the preparation of financial statements of the Project including adequate disclosure is that of MOFED. MOFED is also responsible for the selection and application of accounting policies. MOFED would prepare the PFSs in accordance with IPSAS (International Public Sector Accounting Standards) or equivalent national accounting standards as promulgated by the International Federation of Accountants (IFAC). The government’s accounting system outlined in the Manual of the Federal Accounting System which is based on modified cash basis of accounting can be used.
2. The auditor is responsible for forming and expressing opinions on the financial statements. The auditor would carry out the audit of the project in accordance with the International Standards on Auditing (ISA), and to relevant guidelines operating in the program. As part of the audit process, the auditor may request from MoFED written confirmation concerning representations made in connection with the audit.

**B, SCOPE OF THE AUDIT**

1. **Audit Planning**: The auditor will prepare a work plan to ensure adequate coverage of the various institutions that receive project funds and cover all the major risk areas. The auditor should exercise due professional care, judgment, apply integrity, objectivity, and skepticism and determine the nature, timing and extent of audit procedures to fit the objectives, scope and context of the audit. The auditor is expected to obtain evidence regarding the design of controls and performing tests of controls if considered appropriate by the Auditor and also perform substantive (including analyitical) procedures.
2. **Understanding of the engagement context**: The Auditor should obtain a sufficient understanding of the engagement context including the Project, the Entities, the laws and regulations which apply to the Project and the Contractual Conditions for the Project which are set out in Section V below. The understanding should be sufficient to identify and assess the risks of material errors or misstatements in the expenditure and source stated in the Financial Report, whether caused by error or fraud, and sufficient to design and perform further audit procedures.
3. As stated in III above, the audit of the project will be carried out in accordance with International Standards on Auditing (ISA) promulgated by the International Federation of Accountants (IFAC), and to relevant guidelines operating in the program, and will include such tests and auditing procedures as the auditor will consider necessary under the circumstances. Special attention should be paid by the auditor as to whether:
4. All external financing has been used in accordance with the conditions of the relevant financing agreements, with due attention to economy and efficiency, and only for the purposes for which the financing was provided. The relevant financing agreements are: [to be listed later when these are signed];
5. Counterpart funds have been provided and used in accordance with the relevant financing agreements, with due attention to economy and efficiency and only for the purposes for which they are provided;
6. Goods, works and services financed have been procured in accordance with the relevant financing agreements including specific provisions of the World bank and Govenment Procurement Policies and Procedures[[1]](#footnote-1) in compliance with the provisions of the Project implementation manual;Procurement rules insofar these conditions are relevant to determine the eligibility of Project expenditure
7. All necessary supporting documents, record, and accounts have been maintained in respect of all project activates, including expenditures/transfers reported on Interim Unaudited Financial Statement (IFR) methods of reporting. The auditor is expected to verify that respective reports issued during the period were in agreement with the underlying books of accounts;
8. Designated Accounts have been maintained in accordance with the provision of the relevant financing agreements and funds disbursed out of the Accounts were used only for the purpose intended in the financing agreement;
9. National laws and regulations have been complied with and that the financing and accounting procedures approved for the project (e.g. Project Implementation manual, including financial management manuals and government financial rules/ regulations as applicable to the project, etc.) were followed and used;
10. Financial performance of the project is satisfactory;
11. Assets procured from project funds exist and there is verifiable ownership by the implementing agency or beneficiaries in line with the financing agreement; and
12. Ineligible expenditures included in withdrawal applications are identified and reimbursed to the Designated Accounts. These should be separately noted in the audit report.
13. In complying with International Standards on Auditing, the auditor is expected to apply the following audit procedures:
14. **Fraud and Corruption**: Consider the risks of material misstatements in the financial statements due to fraud as required by ISA 240: The Auditor’s Responsibility to Consider Fraud in an Audit of Financial Statements. The auditor is required to identify and assess these risks ( of material misstatement of the financial statements) due to fraud, obtain sufficient appropriate audit evidence about the assessed risks; and respond appropriately to identified or suspected fraud;
15. **Laws and Regulations:** In designing and performing audit procedures, evaluating and reporting the results, consider that noncompliance by the implementing agency with laws and regulations may materially affect the financial statements as required by ISA 250: Consideration of Laws and Regulations in an Audit of Financial Statements;
16. **Governance:** Communicate audit matters of governance interest arising from the audit of financial statements with those charged with governance of an entity as required by International Standards on Auditing 260: Communication of Audit Matters with those Charged with Governance; and
17. **Risks**: In order to reduce audit risk to an acceptable low level, determine the overall responses to assessed risks at the financial statement level, and design and perform further audit procedures to respond to assessed risks at the assertion level as required by Internal Standard on Auditing 330: the Auditor’s Procedures in Response to Assessed Risks.
18. **Using the work of Internal Auditors (if deemed necessary)**: When the Auditor determines that an internal audit function is likely to be relevant for the audit he/she (a) determines whether, and to what extent specific work of the internal auditors can be used, and (b) if using the specific work of the internal auditors, whether that work is adequate for the purposes of the audit. The Auditor should comply with ISA 610 'Using the Work of Internal Auditors' insofar as this ISA is relevant to the audit.
19. **Audit documentation and evidence**: the auditor uses professional judgement to determine whether audit evidence is sufficient and appropriate taking into account the terms and conditions of the Project. For all findings that can be quantified in monetary terms and material in value, the auditor shall give a monetary value, with sufficient description and shall also include document references and date of the transaction and other relevant information which facilitates for easy location of the finding.

**C. INTERIM AUDIT**

1. Given the involvement of large number of institutions, the auditor will carry out interim audits at the end of the first six month up to January 7 of each year following the audit plan that is designed at planning stage of the audit (please refer to B above for planning). The auditor would select representative samples of implementing agencies in different geographical regions to conduct the audit. In selecting sample woredas, the auditor should take into account the diversity of the sample woredas in terms of budget size, remoteness, type of beneficiaries and perceived risks. The sample should also take into account repeater woredas in order to follow up on status of previously made recommendations.
2. Purpose of this interim audit is primarily to ensure that the funds allocated for the Project are used for the purposes for which they are intended. The audits are **not separate exercises and thus are not only an end on their own, but are intended to facilitate the process of the annual financial audit**, and also provide early information to project management to enable them to timely take corrective actions and to assure all parties (including donors) that funds are utilised for the purpose intended.
3. When the PFS are submitted to the auditor, in addition to other relevant audit activates /works, the auditor would draw on the results of the interim audit to form an opinion of the PFS.
4. Since the Interim audit is part and parcel of the final year- end audit, the overall scope of the work (of the interim audit) is within the “Scope of the Audit” described in B above. However, the following are some of the items that the auditors should pay particular attention to in the interim audit:
5. Review of sample transactions at Woreda and Regions to ensure that project expenditures are incurred for the purposes intended and are thus eligible. Ensure that transactions are duly authorized and approved by respective officials;
6. Ensure that the accounting and internal controls polices and regulations are adhered with;
7. Ensure that adequate documentation, records, and accounts have been maintained in respect of all project activities;
8. Ensure compliance with National laws and regulations; Contractual conditions and relevant programme manuals
9. Ensure that there is a proper approved payroll for amounts paid to beneficiaries, who are engaged in various safety net activities. The payroll should include the name of the beneficiary, the number of worked days, the daily payment rate, the total amount paid, and the signatures of the beneficiary. Ensure that the payroll is approved by the responsible woreda officials;
10. Sample verification that the payments to beneficiaries, as documented in payrolls, were actually made to the beneficiaries;
11. Reconciliation between the beneficiaries data as per the payroll system and the accounting system;
12. Check that regular and consistent and proper financial reports are submitted to Regions from woredas and check whether the reports are prepared from underlying accounting records and financial management manual/guidelines;
13. Report all findings together with recommendations; and
14. Review issues raised in the previous audit reports on repeated visits and report on progresses/follow up covering: Recommendations not implemented, and Recommendations implemented.

**D, PROJECT FINANCIAL STATEMETNS (PFSs)**

1. The auditor should verify that the project PFSs have been prepared in accordance with the agreed accounting standards (see section 1 of Article III above) and give a true and fair view of the financial positions of the project at the relevant date and of resources and expenditures for the financial year ended on the date.
2. The Project Financial Statements (PFSs) should include:
3. A statement of Sources and Uses of Fund showing funds received (from the World Bank, DFID, Irish AID, the MDTF and other donors and counterpart funds all shown separately), the expenditures incurred and the balances there of;
4. A Balance sheet;
5. A summary of the activity in the Designated Accounts;
6. A summary of the principal accounting policies that have been adopted, and other explanatory notes; and
7. List of material assets (excluding food commodities) acquired or procured to date with project funds that are greater than USD 10,000.
8. As an Annex to the PFSs, the auditor should prepare a reconciliation of the amounts as “ received by” the Project from the World Bank and other development partners, with those shown as being “ disbursed by” the Bank and other development partners.

**E, UNAUDITED INTERIM FINANCIAL REPORTS (IFRs)**

1. In addition to the audit of the PFSs, the auditor is required to verify IFRs used as a basis for the submission of loan withdrawal applications to the World Bank. The auditor will apply such tests and auditing procedures as considered necessary under the circumstances. Annexed to the PFSs or as notes to the account should be a schedule listing IFR withdrawal applications by specific reference number and amount.
2. The total withdrawals under the IFR procedures should be part of the overall reconciliation of Bank disbursements described in section D above.

**F, DESIGNATED ACCOUNTS**

1. In conjunction with the audit of the Project PFSs, the auditor is also required to review the activities of the Designated Accounts associated with the project. The Designated account usually comprises;
2. Advance deposits received from World Bank and other development partners;
3. Replenishments substantiated by withdrawal applications;
4. Interest that may have been earned on the accounts, and which belong to the recipient; and
5. Withdrawals related to project expenditures.
6. The auditor should pay particular attention as to the compliance with the World Bank’s procedures as well as parallel financing donors and the balances of the Designated Accounts at the end of the fiscal year (or period). The auditor should examine the eligibility of financial transaction during the period under examination and fund balances at the end of such period, the operation and use of the DAs in accordance with the relevant general conditions, relevant financing agreements and disbursement letter, and the adequacy of internal controls for the type of disbursement mechanism.
7. For this Project, the Designated Accounts are referred to in the general conditions, the financing Agreement (subsection 5.3) and Disbursement Letter (para. I) which are annexed to this TOR.
8. The auditor should also examine eligibility and correctness of :
9. Financial transactions during the period under review;
10. Account balances at the end of such a period;
11. The operation and use of the Designated Account in accordance with the financing agreement; and
12. The adequacy of internal controls for the type of disbursement mechanism.

**G, AUDIT REPORTING**

1. **Audit Report on Annual Audit** -The audited financial statements, including the audit report along with the management letter should be received by the Bank and DPs no later than **six months** after the end of the accounting year to which the audit relates.
2. **Audit Report on the PFS** – The auditor will issue an opinion on the project financial statements (PFSs). The annual audit report of the project accounts should include a separate paragraph highlighting key internal control weaknesses and non-compliance with the financing agreement terms and project manuals.
3. **Management Letter** – In addition to the audit report, the auditor will prepare a management letter, in which the auditor will:
4. Give comments and observations on the accounting records, systems and controls that were examined during the course of the audit;
5. Indentify specific deficiencies of areas of weaknesses in systems and controls, and make detailed and comprehensive recommendations for their improvement;
6. Report on the degree of compliance of each of the financial covenants in the financing agreement and give comments, if any, on internal and external matters affecting such compliance;
7. Communicate matters that have come to his/her attention during the audit which might have a significant impact on the implementation of the project;
8. Determine the risk and potential negative consequences of the findings on the management and control system of the Project and make tangible recommendations for measures to be taken in order to remedy the situation. Based on this analysis, include a high, medium or low prioritisation on issues arising in the management letters. Ranks should be allocated according to the following criteria:

* A - a major weakness or a recurring issue that must be addressed soon
* B - an important matter that will significantly improve the control environment, the accounting system or the operations of the Project but is not so serious or prevalent as to be considered a major weakness
* C - a minor (or isolated) weakness that should nevertheless be addressed to improve the control environment, the accounting system or the operations of the Project;

1. Give comments on the extent to which outstanding issues/qualifications points have been addressed;
2. Review issues raised in the previous audit reports on repeated visits and report on progresses/follow up covering: Recommendations not implemented, and Recommendations implemented.
3. Undertake both kick-off and exit meetings with all the auditees/ implementing agencies. At the woreda level, these meetings should include as a minimum, representatives from WoFED and Woreda Food Security or equivalent offices.
4. Bring to the recipient’s attention any other matters that the auditor considers pertinent, including ineligible expenditures.
5. The management letter should also include responses from the implementing agency to the issues highlighted by the auditor.
6. **Audit Report on the Interim Audit** – The auditor shall submit interim audit reports (summary of Findings) to project management, MoFED and Development partners (DPs) with recommendations for improvements. It will be submitted to IDA and DPs within 90 days of the end of every January 7.
7. **Procedure for the consultation and submission of the final report:** The Auditor should submit a draft report to MOFED which takes into account of the entities (Regions and Woredas) comments. The Entities should submit comments to the Auditor during closing meetings and from receipt of the draft report. If the Entity's comments are not received within specified deadline, the Auditor reminds the Entity until a written reply from the Entity is received. In the exceptional case where the Entity does not reply or where the absence of a reply leads to excessive delays in the consultation and reporting process, the Auditor contacts MOFED to discuss a solution. The Auditor should record and document causes and reasons for delays in the consultation of reports for which the Auditor is not responsible.
8. **FINANCIAL AUDIT**
9. The auditor should have access to all legal documents, correspondences, and any other information associated with the project and deemed necessary by the auditor. The auditor will also obtain confirmation of amount disbursed and outstanding at the Bank and other DPs. Available information should include copies of the relevant: World Bank’s Project Appraisal Document (PAD); financing agreements including those of other DPs; Project Implementation Manual (PIM); PSNP Financial Management Manual, financial management assessment reports; implementation support and supervision status reports.
10. **GENERAL**
11. It is highly desirable that the auditor becomes familiar with the Bank’s Guidelines as well as the operating mode of the program on Annual Financial Reporting for World Bank- Financed Activities, June 30, 2003, which summarizes the Bank’s financial reporting and auditing requirements. The auditor should be familiar with World Bank and Government Procurement Guidelines, which can be obtained from the project implementing agency. The auditor should also be familiar with the Bank’s Disbursement Handbook for World Bank Clients, Disbursement Guidelines for Projects; May 2006. These documents are available on the Bank’s website and could be obtained from the Task Team Leader.

1. **Contradictory Procedure and Follow-Up**
2. After receipt of the final audit report MoFED will start a formal contradictory procedure with the Regional & Woreda Authorities. The purpose of this procedure is for MoFED to discuss and agree with these bodies the measures and action plan which emerge from the findings and recommendations in the final audit report. The Auditor may, where appropriate, be requested to provide clarifications or additional information with regard to the final audit report.

MoFED may request the Auditor for further assistance in the contradictory procedure and with the full follow-up of the final audit report. If this is required, MoFED will issue an addendum to the applicable contractual document for this engagement.

1. Depending on the complexity of procurement activities, the auditor may consider involving technical experts during the audit engagement. In cases where such experts are involved, the auditor is expected to comply with provisions of International Standards on Auditing 620 – Using the Work of an Expert. Consideration to use of the work of experts should be brought to the early attention of the borrower and the World Bank for mutual agreement and appropriate guidance. [↑](#footnote-ref-1)