IFAD
Guidelines on Project Audits
Approval

Audit Committee – One Hundred Twenty-First Meeting
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Guidelines on Project Audits

Approved by the Executive Board – One Hundred-Fourth Meeting
Rome, 12 December 2011
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<td>DA</td>
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<td>GAAS</td>
<td>Government Generally Accepted Auditing Standards</td>
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<td>IESBA</td>
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Proper oversight and management of financial resources are key to IFAD’s success, as well as to its reputation. In accordance with Article 7, Section 1 (c) of the Agreement Establishing IFAD, and Article IX (Financial reporting and information), Section 9.03 (a) (Audit of accounts) of the General Conditions for Agricultural Development Financing, it is essential to ensure that proceeds of any financing are used solely for the purpose intended under the loan or grant, and that all projects are audited and certified regularly.

"IFAD’s Guidelines on Project Audits“ were first issued in 2003 to document IFAD’s procedures in relation to the project audit cycle and to improve the quality of project audits. Changes in the project cycle, the revisions to the General Conditions for Agricultural Development and IFAD’s shift to direct supervision have necessitated a revision of the guidelines. The borrowers’ community needs a modern tool and resource reflecting these changes, as well as best practices reflecting the lessons learnt over time.

This revision to the Audit Guidelines also responds to the Governing Bodies’ request for improvement in the Fund’s financial management systems.

The Audit Guidelines shall be followed by all projects directly supervised by IFAD, as well as those administered by cooperating institutions that do not have their own audit guidelines.

In line with these directives, and as part of the continuing effort to improve the management of IFAD’s portfolio, greater emphasis has been placed on minimum requirements of annual project audit reports, the submission of the reports to the Fund and their effective monitoring, and review by IFAD staff. These requirements have also assumed greater importance in the light of current calls for international financial institutions to more vigorously support the development of good governance and transparency, and the reduction of corruption.

The implementation of these revised guidelines will not only enhance audit submissions and reviews, but also embed the concept of risk management in the project audit cycle. They are immediately applicable to all on-going agreements for IFAD-funded agricultural development projects and programmes.

Kanayo F. Nwanze
President
I. Introduction

1. Article 7, section 1(c) of the Agreement Establishing IFAD requires the Fund to ensure that the proceeds of any financing are used only for the purpose for which a loan or grant was provided, with due attention to economy, efficiency and social equity. IFAD's General Conditions for Agricultural Development Financing (hereafter “General Conditions”)1 require the borrower (or project party) to have the accounts relating to a project or programme (hereafter “project”) audited each fiscal year by independent auditors acceptable to the Fund, in accordance with auditing standards acceptable to the Fund and with these Guidelines.

2. The project design report will describe the assessment made of the borrower’s capacity for proper financial management, including the ability to produce periodic financial reports (generally every six months), and submit them annually for audit. Correct and timely execution by the borrower and/or recipient (hereafter “borrower/recipient”) of this fiduciary responsibility is critical to ensuring that projects achieve their intended objectives within the allocated resources. The external auditor’s report should provide an auditor’s opinion, point out any problems and irregularities identified during the audit, and make recommendations for improvement.

II. Audits

3. An audit is an ex post review of the financial activity within the project. The auditor's examination should therefore cover relevant books of accounts, records of transactions and financial systems maintained by the lead project agency (LPA) for the purpose of executing a project, and the financial statements prepared by an LPA reflecting project operations during a given period. Annex I describes the general principles governing project audits.

The audit is carried out by appropriately qualified and experienced accountants/auditors and aims to:

i. Provide an independent assurance of accountability;

ii. Give credibility to the financial statements and other management reports;

iii. Identify weaknesses in internal controls and financial systems;

iv. Verify compliance with financing agreement provisions relating to financial matters; and

v. Make recommendations for improvement.

1 References herein are to the General Conditions for Agricultural Development Financing adopted by the Executive Board on 29 April 2009, as subsequently amended. Projects subject to the earlier versions of the General Conditions should interpret these Guidelines in accordance with the applicable provisions of the earlier General Conditions.
III. Establishment of Audit Arrangements

**ASSESSMENT OF THE AUDITOR’S CAPACITY**

4. The groundwork for the selection of the external auditor, including, where appropriate, determination of the availability and quality of auditors in the borrower’s country, should be completed during the project design phase. Particular attention should be given to the:

   i. Overall status of the accounting and auditing profession;

   ii. Competence and independence of the national supreme audit institution (SAI); and

   iii. The selected auditor’s adherence to acceptable auditing standards.

5. Agreement as to whether the project audit is to be carried out by the SAI (or under its responsibility) or by a private audit firm should be reached prior to financing negotiation. The basis for discussion is outlined in IFAD’s assessment of audit capacity within the country, or in the assessments of other international financing institutions (IFIs). A checklist for assessing an auditor’s capacity, selection and appointment is given in annex II.

**APPOINTMENT OF THE AUDITOR**

6. Article IX (Financial reporting and information), section 9.03 (Audit of accounts) of the General Conditions stipulates the borrower’s obligations vis-à-vis project audits.

   Article X (Cooperation), section 10.04 (Audits initiated by the Fund) governs audits initiated by the Fund.

   Usually audits are annual, but where risks are assessed to be particularly high, audits may, at the Fund’s discretion, be requested more frequently.

7. Prior to the financing negotiation, there will be discussion with the borrower concerning the auditor’s terms of reference (TORs) and the audit arrangements, including special audit requirements (if any). IFAD may make the appointment of the auditor a condition of withdrawal (section 4.02). Annex III contains IFAD’s minimum requirements for a project audit. IFAD’s audit requirements and TORs for the auditor are essential to ensure that auditors receive clear guidelines as to their task and that the scope and format of their report are established. Annex IV provides a model set of guidelines for auditors.

8. In accordance with international best practice and as recommended by the International Ethics Standards Board for Accountants (IESBA), contracted audit firms cannot provide consultancy services to the project (including the preparation of financial statements and the corresponding accounting activities) or have done so in the previous two years.
9. TORs for the auditor to be engaged by the borrower/recipient are subject to no-objection by IFAD. IFAD staff may provide advice to borrowers based on these Guidelines, but they should not normally be involved in drafting the TORs.

As project implementation proceeds, the resulting responsibilities for the various steps involved in the appointment of the auditor are as follows:

i. Borrower prepares TORs for the auditor in conformity with these Audit Guidelines, and sends it to IFAD for review and no-objection. Annex VI gives sample TORs for the audit of project financial statements, including statements of expenditure (SOEs) and special accounts (SAs)/designated accounts (DAs).

ii. IFAD communicates “no objection” to borrower.

iii. Borrower initiates the procurement process using the agreed TORs.

iv. Borrower informs IFAD of the name of proposed auditor and the procurement process followed for the selection.

v. IFAD communicates “no objection” to borrower on the selection of proposed auditor upon performance of the necessary due diligence.

vi. Borrower appoints the auditor.

vii. The auditor appointed normally issues a formal engagement letter confirming their acceptance of the appointment and outlining the methodology, scope and responsibilities under the audit. The borrower’s representative will sign and return a copy of the letter to the auditor. A sample audit engagement letter is given in annex V. In the case of SAs, national procedures will be followed, provided they are acceptable to the Fund.

10. By the due date as stipulated in section 9.03(b) of the General Conditions (six months after the end of the borrower’s fiscal year), the original audit report is submitted by the borrower to IFAD. IFAD may agree to accept an electronic advance copy, provided that adequate safeguards are in place to ensure that the Fund subsequently confirms, within a reasonable time period, that the electronic copy conforms to the original.

IFAD’s and the borrower’s obligations with regard to audit report submission are as follows:

i. At least 30 days (one month) before the end of the fiscal year, the borrower confirms to IFAD that an auditor has been appointed.

ii. Project accounts and financial statements are audited at the end of each fiscal year, and the audit report and management letter are delivered to the borrower, generally within five months after the end of the fiscal year.

iii. Borrower sends the original audit report to IFAD and may upload a scanned copy of it in the IFAD corporate audit system software within six months from the end of the fiscal year (or by any other date specified in the financing agreement).
iv. If IFAD does not receive an audit report by the due date, or if the report received is unsatisfactory, it will notify the borrower and the LPA of this fact. Where appropriate, IFAD, in consultation with the borrower, may consider engaging an independent auditor of its choice to carry out the project audit.

v. If IFAD determines that the borrower’s documentation submission is not complete and/or satisfactory, IFAD will communicate with the borrower and follow up until all documentation is received in the required format.

vi. If the audit report is overdue for 90 days from the stipulated due date, IFAD will confirm the report’s non-receipt and will prepare and send a “legal notice” informing the borrower that non-receipt of the audit report within 60 days will trigger the process of suspension of disbursements under the financing.

vii. If the audit report is overdue for 180 days from the original due date and the borrower has not satisfactorily responded to the previous communications, IFAD will prepare a notice for suspension, which is automatic in accordance with section 12.01(b) of the General Conditions.

11. The Fund may suspend, in whole or in part, the right of the borrower/recipient to request withdrawals from the loan and/or grant accounts if the Fund has not received any audit report or other document referred to in article VIII (Implementation reporting and information) or article IX (Financial reporting and information) of the General Conditions within the time prescribed in the agreements, or the audit report is not fully satisfactory to the Fund, or the borrower/recipient or any other project party has otherwise failed to perform its obligations under article VIII or IX.

12. The audit report package should normally include the audited financial statements, three separate audit opinions (on the financial statements, on the SOEs and/or financial monitoring reports, and on the SAs/DAs), a management letter, and any additional reports required by IFAD. While the auditor’s opinion will describe the acceptability or otherwise of the project financial statements, the management letter will detail the shortcomings, if any, in the project’s internal controls, procedures and practices, together with appropriate recommendations for improvement. Annex VII gives an example of an auditor’s opinion. Annex VIII provides an outline of a management letter.

13. Where arrangements are in place with a cooperating institution (CI), the CI will ensure that the audit has been carried out in accordance with the TORs.

14. IFAD/Ci will carry out a comprehensive review of the audit report upon its receipt in order to establish the integrity of the audit process and the reliability of the financial statements. It will then prepare a communication to the borrower on the main findings arising from this review. If the review is satisfactory (i.e. there are no identified irregularities that give rise to financial concerns over IFAD financing and no substantial recommendations for improvement), IFAD will advise the borrower of completion of a satisfactory review. Such advice will be sent to the borrower not later than 60 days from receipt of the audit report. No further action will be necessary.
15. If the review of the audit report reveals problems or irregularities of a financial nature regarding IFAD financing, IFAD will advise the borrower of the concerns. Such advice will be sent to the borrower not later than 60 days from receipt of the audit report. IFAD may require that a time-bound remedial action plan be set up. The borrower should implement the remedial plan as agreed and keep IFAD informed of the action taken.

16. Audit reports containing a qualified opinion, an adverse opinion or a disclaimer of opinion indicate prima facie the existence of problems and irregularities in project implementation. Upon completion of the audit review, IFAD will advise the borrower in writing of the concerns, communicating the main findings of the audit review and the necessary remedial actions to be taken. Such advice will be sent to the borrower not later than 60 days from receipt of the audit report.

17. IFAD monitors the submission of audit reports on a regular basis.

18. If a borrower does not comply with the audit requirements contained in article IX (Financial reporting and information), and in particular section 9.03 (Audit of accounts) of the General Conditions, the Fund will apply remedies as provided for in the General Conditions.

19. As part of its remedial action, IFAD may engage independent auditors of its choice (section 9.03(c) of the General Conditions) and may finance the cost of such audit by withdrawal from the financing account. For such purpose, the borrower and the project parties shall make their financial and other records available to such auditors promptly.
Annex I

GENERAL PRINCIPLES GOVERNING PROJECT AUDITS

1. Audits can vary considerably, depending on the objectives, project activities and expected reports or outcome. They can be classified into three categories:
   i. Financial statement audits;
   ii. Compliance audits; and
   iii. Operational audits.

2. The objective of the audit of project financial statements is to determine whether the statements are presented in conformity with acceptable accounting standards, such as the International Financial Reporting Standards (IFRS), the International Public Sector Accounting Standards (IPSAS), or national standards where these are converging towards internationally recognized best practice and/or are deemed to provide minimum disclosures. Each audit covers a specific period, usually the project fiscal year. A financial statement audit assesses whether reported disbursements were made in accordance with the relevant financing agreement. Attention is also given to disbursements based on SOEs and SAs/DAs. The audit ascertains whether individual expenditures, which comprise the SOE totals, are properly authorized, eligible under the financing provisions, appropriately accounted for and fully supported by documentation retained in the borrower’s files.

3. The findings of the audit, in conjunction with any comments on SOEs in project reports and historic experience in processing withdrawal applications, will be used by IFAD to determine whether the borrower should continue to use the SOE procedure. If SOEs are found to include ineligible expenditures, the borrower will be required to refund the amounts in question.

4. Where SAs/DAs have been established, the annual audit and checks during missions will verify whether withdrawals from SAs/DAs are properly authorized and eligible in accordance with the financing agreement. The audit will ensure that the year-end balance in the SA/DA is reconciled with IFAD’s records.

5. The auditor is expected, as specified in the TORs, to examine the project’s system of accounting and other internal controls, including internal audit, as part of an audit of financial statements in order to express an opinion on the reliability of the project financial statements produced by the borrower.

6. A compliance audit involves reviewing, testing and appraising an organization’s controls and operating procedures, including compliance with regulations, contracts and laws to which the organization is subject.
7. An operational audit is a more thorough examination of an organization’s management techniques and performance. It may help to identify implementation issues for the purpose of prompt remedial actions at the project level. The primary product of an operational audit is a report recommending improvements in the efficiency and effectiveness of operations, encompassing, to the extent possible, all the major functions of the organization.

8. Audit reports should be accompanied by a management letter, which is a report on an organization’s internal controls and operating procedures and their effectiveness. It is based on the auditor’s reviews during the normal course of an audit. A management letter also provides information on the status of implementation of recommendations issued in previous years.

9. The audit report should contain a clear expression of opinion on the financial statements. The auditor’s opinion may be unqualified, qualified, adverse, or a disclaimer of opinion.

10. An unqualified opinion indicates the auditor’s satisfaction in all material respects with the preparation of the financial statements, and with their consistency, adequacy, and compliance with regulations, statutory requirements and any additional requirements stated in the corresponding audit TORs (e.g. review of SOEs and SA/DA-based disbursements). An unqualified opinion is normally fully acceptable to IFAD except when it is not in line with results of implementation support missions and/or other corroborating evidence.

A qualified opinion is issued when an auditor has reservations on specific areas and concludes that an unqualified opinion cannot be issued, but deems that the effect of any disagreement, uncertainty or limitation of scope of the audit does not require an adverse opinion or a disclaimer of opinion. The subject of the qualification and its financial effect must be clearly stated in the auditor’s report. In case of a qualified opinion, IFAD will consider the impact on its fiduciary responsibilities, if any.

An adverse opinion is issued when the effect of the disagreement is so pervasive and material to the reliability of the financial statements that the auditor concludes that a qualification of the report will be insufficient to disclose the misleading or incomplete nature of the financial statements. This is normally not acceptable to IFAD.

A disclaimer of opinion is issued when the possible effect of an uncertainty or of a limitation on the scope of the auditor is so significant that the auditor is unable to express an opinion on the financial statements. This is normally not acceptable to IFAD.

1 Auditors may provide an internal control memorandum instead of a management letter. A sample outline of a management letter is provided in Annex VIII to these Guidelines.
Annex II

CHECKLIST FOR CAPACITY ASSESSMENT, SELECTION AND APPOINTMENT OF AN AUDITOR

1. When the proposed auditor is the country’s SAI, IFAD will check the following general information about the SAI:
   i. Does the SAI belong to the International Organization of Supreme Audit Institutions (INTOSAI)?
   ii. Is the SAI independent of the lead project agency (LPA) and the responsible government ministry, for example, in terms of control over its budget and personnel?
   iii. Does the SAI report to the management of the project or to the LPA?
   iv. Is the SAI involved in approval of the project’s transactions?
   v. Is the SAI involved in the internal control or financial management systems of the project or LPA?
   vi. Has the SAI consented to the appointment?

   If the national SAI has previously performed the audit of an IFAD-funded project, IFAD will consider past record results:
   i. Has the SAI fulfilled satisfactorily its responsibilities in previous projects?
   ii. Did the SAI submit all the audit reports due?
   iii. Were the reports submitted on time?
   iv. Was the overall quality of the audit reports acceptable?
   v. Was there any evidence, from the findings of IFAD supervision missions, that the audit reports failed to identify irregularities and weaknesses?
   vi. Were the SAI’s recommendations appropriate to the problems and irregularities in the project?
   vii. Did the SAI follow up on previous audit findings during subsequent audits?

2. When the proposed auditor is a private audit firm, IFAD will check if the borrower’s proposal is sufficiently transparent and thorough, and will, prior to consenting to the selection, seek answers to the following questions:
   i. Is there evidence of a competitive selection process for the auditor, say from a list of three to six qualified firms?
   ii. Was the selection based on a technical evaluation together with the financial evaluation?
   iii. Is there evidence of the auditor’s past experience and acceptable performance in similar audits?
   iv. Did the proposed auditor submit satisfactory references and descriptive material about the firm?
3. In making a proposal for appointment of a private auditor, the borrower should provide IFAD with relevant supporting documentation and should address the following questions:

   i. Does the firm adhere to internationally accepted auditing standards? The firm’s audit procedures and methods should ensure compliance with such standards.

   ii. Is the firm independent of the project entity to be audited and of the people appointing the auditor?

   iii. What is the legal status of the firm? This includes such aspects as partners’ status and any limited liability provision in the firm’s articles.

   iv. Are any of the assigned audit staff employed by or closely linked to the project entity to be audited, or to any government body or public agency?

   v. Can the auditor confirm that there is no conflict of interest or lack of independence implicit in accepting the appointment?

   vi. Is the auditor committed to providing qualified and experienced staff that can ensure timely submission of audit reports?

   In particular:

   vii. What is the staffing plan for the audit?

   viii. What are the qualifications of the assigned staff?

   ix. Do the assigned staff belong to professional audit or accounting bodies such as the Institute of Chartered Accountants or the Institute of Certified Public Accountants?

4. Auditors should not be appointed as consultants responsible for designing accounting and control systems on which they would be required to comment. Such appointments would create a conflict of interest and increase the risk that auditors might not report shortcomings in the project.

   In general, and in accordance with international best practice and as recommended by IESBA, contracted audit firms cannot provide consultancy services to the project or have done so in the previous two years.

5. The borrower should ensure that the auditor’s fee is not established in any way that compromises independence.
1. The minimum requirements for audit of IFAD-funded projects are explained to borrowers prior to financing negotiations, with the understanding that they be conveyed to project auditors prior to audit in order to ensure satisfactory fulfilment of the requirements.

2. The borrower and the LPA must ensure that the independent auditor acceptable to IFAD is appointed in sufficient time to carry out the audit. This includes review of the financial management arrangements at the beginning of project implementation and periodically thereafter.

3. The LPA will have the annual financial statements audited in accordance with internationally accepted auditing standards. The auditor's report should indicate the standards used, and the extent, if any, to which the examination did not conform to those standards.

4. The audit report should contain a clear expression of the auditor’s opinion regarding the financial statements. It should include a financial statements audit and a compliance audit, and should be accompanied by a management letter. It should also include a section on the project’s compliance with the financing agreement, particularly those provisions dealing with financial matters. A full operational audit may be carried out if IFAD considers it necessary.

5. The auditor will review the project accounts, including annual financial statements, SOEs and SA(s)/DA(s), and present an opinion covering the three elements. In addition, the audit report will address:
   i. The adequacy of accounting and internal controls, including the internal audit mechanism (where present), for monitoring expenditures and other financial transactions and ensuring safe custody of project assets;
   ii. The adequacy of documentation maintained by the LPA for all transactions; and
   iii. Any other matters IFAD may reasonably request.

6. “Project accounts” refers to the financial statements of the project, usually for a fiscal year. They must show the financial status of the project and must be prepared in accordance with internationally accepted standards (IFRS, IPSAS) or government generally accepted auditing standards (GAAS) when converging towards international best practice. The content of the financial statements can vary depending on the standards used and the project circumstances. In any case, the minimum content is detailed as follows:
   i. Yearly and prior-year statements of sources and application of funds, which should disclose separately IFAD’s funds, counterpart funds (government), other donors’ funds and beneficiaries’ funds;
   ii. The balance sheet (when required), which should disclose bank and cash balances that agree with the statement of sources and application of funds, fixed assets and liabilities;
iii. Withdrawal application schedule – SOEs (annual/cumulative);

iv. SA (DA) statement/reconciliation;

v. Cumulative status of funds by category (preferably in special drawing rights);

and

vi. Notes to the financial statements.

A separate management letter is part of the audit package.

Where the project consists of several entities, financial statements should be consolidated. Where the project is implemented in different areas by different LPAs, proper arrangements should be made to allow consolidation.

7. The auditor’s opinion should deal with the adequacy of the procedures used by the project for preparing SOEs and should include a statement to the effect that amounts withdrawn from the financing account on the basis of such SOEs were used for the purposes intended under the financing agreement.

AUDIT METHODOLOGY 8. In reviewing the project accounts and financial statements, the auditor will:

i. Verify that acceptable accounting standards have been consistently applied and indicate any material deviation from these standards, and the effect of such deviation on the annual financial statements;

ii. Assess the adequacy of accounting and internal control systems (procedures and responsibilities) for monitoring expenditures and other financial transactions (commitment, review, approval, payment and accounting) and ensuring safe custody of project-financed assets, and document any instances where controls are lacking or need strengthening;

iii. Determine whether the LPA has maintained adequate documentation for all transactions, e.g. procurement documents, contracts, suppliers’ invoices, letters of credit and evidence of payment, and ascertain that expenditures were properly authorized and in compliance with legal requirements;

iv. Verify the numerical accuracy of statements and accounts;

v. Verify that disbursement requests for expenditures submitted to IFAD are eligible for financing under the financing agreement, and identify clearly any ineligible expenditures; and

vi. Carry out a physical verification of any significant assets purchased and confirm their existence and use for project purposes.

9. From the second audit onwards, the auditor will follow up on the remedial actions taken by the borrower/recipient in response to previous audit findings and recommendations, and report on progress or otherwise. In this regard, IFAD-funded projects are required to set up a proper audit log for implementation monitoring purposes.
TERMS OF REFERENCE (TOR) AND ENGAGEMENT LETTER

1. IFAD approves, or provides a “no objection” to, the TORs for the auditor to be engaged by a borrower. IFAD staff should not normally be involved in drafting audit TORs, though there is no objection to their giving advice to borrowers based on these Guidelines. A borrower may wish to include in the TORs additional auditing tasks necessary to satisfy requirements of other financiers, including those of the borrower itself. These should in no way cause late delivery of the audit report.

2. These Guidelines should not be regarded as universally applicable to audits of all IFAD-financed projects or project entities. Borrowers should select the components they consider appropriate for an audit and should add to the TORs relevant aspects that may not be included in these Guidelines. The Guidelines are applicable only to the appointment of auditors for the audit of the financial statements of a project, an implementing agency, or a financial intermediary or credit institution. They are not intended for special audits, reviews, investigations or consultancy assignments.

3. The auditor is responsible for expressing an opinion on the financial statements; responsibility for preparing the statements and presenting them to the auditor lies with project management. The form of annual financial statements and supporting documentation to be supplied to the auditor, together with the estimated time for providing them, should therefore be specified.

4. The scope of the audit should be explained by the borrower so that the auditor may determine if there are requirements beyond those of a routine audit. It is essential that the auditor become familiar with the project financing agreement and the IFAD Guidelines on Project Audits.

The following are examples of routine audit requirements:

i. The audit should be carried out in accordance with internationally accepted auditing standards; the auditor should indicate any ways in which the examination would not conform to those standards.

ii. The auditor should comment on and confirm the extent to which acceptable accounting standards have been and are being consistently applied; the auditor should indicate any material deviation from those standards and the effect on a project’s annual financial statements.

5. The form and content of the auditor’s TORs may vary for each project; only the relevant aspects should be included in the engagement letter. The TORs and the engagement letter should include the elements set out below.
6. The summary should include:
   i. Description of the employing project authority or entity;
   ii. Term of the auditor’s engagement, namely whether it is for a fiscal year or some other period;
   iii. Description and the timing of the financial statements and other material to be provided by project management for the audit;
   iv. Terms for delivery of the audit report;
   v. Specification that the audit be carried out in accordance with internationally accepted auditing standards;
   vi. Provision of a management letter;
   vii. Statement of access to project records, documents and personnel available to the auditor; and
   viii. Details regarding submission of a proposal and workplan by the auditor.

7. The contents should include:
   i. A description in the TORs of the entity engaging the auditor and whether it is acting on behalf of or is a constituent part of a larger entity; and
   ii. Legal and general descriptions of the project and the LPA, in sufficient detail to enable the auditor to understand their nature, objectives and activities.

   The following additional information may be considered:
   iii. Organizational charts;
   iv. Names and titles of senior managers;
   v. Names and qualifications of officers responsible for financial management, accounting and internal audit;
   vi. Name and address of any existing external auditor, if a change is made;
   vii. Description of information technology facilities and computer systems in use; and

   viii. Copies of the latest financial statements, financing agreement, minutes of financing negotiations, project design document, and annual work programme and budget, if it is available.

8. Normally the auditor is required to provide an engagement letter, a sample of which is given in annex V to these Guidelines. In countries where an auditor’s obligations are provided for by law, this step may not be necessary; such a letter would still, however, be informative for the borrower and IFAD. It is in the interests of auditors and borrowers that the auditor send the engagement letter before the audit commences in order to avoid misunderstandings.
9. In the case of recurring audits, the auditor need not be asked to issue a new engagement letter each year. The following factors may, however, call for a new engagement letter:
   i. Any indication that the client misunderstands the objective and scope of the audit;
   ii. Any revised or special terms of the engagement;
   iii. Change in project management;
   iv. Significant change in the nature or size of the client project’s activities; and
   v. Legal requirements.

10. The auditor should be expected to:
   i. Submit a proposal including the audit fees, depending on the audit assignment, for the audit of financial statements of the project, the LPA if applicable, the financial intermediary or credit institution, or a combination of these, including SOEs and SAs/DAs;
   ii. Provide an opinion based on the scope and detail of the audit of financial statements, including a separate opinion on the SOEs, SAs/DAs, and other areas covered in the TORs, and follow up audit recommendations from previous years;
   iii. Provide a management letter describing any weaknesses identified in the project accounting and internal control systems, including any internal audit function (if existing), and recommend improvements; and
   iv. Provide a translation of the reports in English, French, Spanish or Arabic (as per the official language of the borrower).

11. The auditor should be required to verify SOEs, accounting records and supporting documentation, and undertake a physical inspection of work done or goods and services acquired. The auditor should also establish that expenditures claimed for reimbursement under this procedure are eligible for financing in accordance with the provisions of the financing agreement.

12. The auditor should be required to verify the correctness of transactions – withdrawals and replenishments including the exchange rates used – in the SA/DA and the use of SA/DA funds in accordance with the financing agreement. This should include examination of the reconciliation of the SA/DA bank balance at year-end with project records and IFAD’s disbursement records.
13. Rotation of auditors after a number of years may be proposed, but frequent changes are not desirable in view of factors such as cost, the need for continuity and institutional memory, and shortage of qualified independent auditors in the borrower’s country. IFAD should ascertain the reasons for changing auditors. An evaluation of the auditor’s performance should be done annually. To avoid long-term relationships between the project and the external auditors, which may compromise perceived independence, and to adhere to best practice, a full procurement process should normally be performed at a minimum every four years.

14. The auditor may be asked to conduct a special review of one or more of the following:

i. Economy, efficiency and effectiveness in the use of project resources;

ii. Achievement of planned project results;

iii. Legal and financial obligations and commitments of the project and the extent of compliance or non-compliance thereof;

iv. Systems and procedures such as improvements in accounting, information technology or computer systems, and operations that may be under development, on which the auditor’s comments are necessary to ensure effective controls; and

v. Other activities on which an auditor may consider it appropriate to report.\(^1\)

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\(^1\) The foregoing list is not exhaustive, nor should all matters be addressed in every project. The scope and extent of an audit are likely to be unique to each project or project entity.
To the Project Management (or appropriate Project Manager):

1. You have requested that we audit [insert names of financial statements – e.g. sources and uses of funds for the year ending [dd/mm/yyyy] and balance sheet as of [dd/mm/yyyy]. We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter. Our audit will be carried out in accordance with International Standards on Auditing (ISAs) or other internationally accepted standards, with the objective of our expressing an opinion on the financial statements, including the use of the statements of expenditure and special account.

2. In forming our opinion on the financial statements, we will perform sufficient tests and reviews to obtain reasonable assurance as to whether the information contained in the underlying accounting records and other source data are reliable and sufficient as the basis for the preparation of the financial statements. We will also determine whether the information is properly communicated in the financial statements.

3. Because of the nature of the tests and other inherent limitations of an audit, and the inherent limitations of any system of internal control, there is an unavoidable risk that some material misstatements may remain undiscovered. However, we expect to provide you with a separate management letter concerning any material weaknesses in internal control that come to our notice.

4. May we remind you that project management is responsible for the preparation of financial statements, including adequate disclosure of relevant information. This includes maintenance of adequate accounting records and internal controls, selection and application of accounting policies, and safeguarding of assets. As part of our audit process, we will request from management written confirmation of representations made to us in connection with the audit.

5. We should be given access to all legal documents, correspondence, and any other information associated with the project and deemed necessary by us for the purpose of our audit.

6. We look forward to receiving the full cooperation of your staff. We trust that they will make available to us whatever records, documentation and other information we may request in connection with our audit.

7. Our fees, which will be billed as the audit work progresses, are based on the time required by the staff and other resources assigned to the audit, plus direct out-of-pocket expenses. Individual hourly rates may vary according to the degree of responsibility involved and the experience and skills that staff require for the audit.
8. Please sign and return the attached copy of this letter as confirmation that it is in agreement with your understanding of the arrangements for our audit of the financial statements.

Name of firm or company
(Chartered accountants, certified public accountants or other recognized professionals)
Terms of reference for an audit of the IFAD funded [project name]

The following are the terms of reference (TORs) on the basis of which the lead project agency (LPA) agrees to engage the audit firm ("the auditor") to perform an audit and to report in connection with the agreement with the International Fund for Agricultural Development (IFAD) concerning [title of the project and loan/grant number].

1.1 Responsibilities of the parties to the engagement

The LPA refers to the entity that executes the project on behalf of the borrower/recipient and that has signed the agreement with IFAD.

- The LPA is responsible for providing financial statements for the activities financed by the financing agreement and for ensuring that these financial statements can be properly reconciled to the LPA records and accounts in respect of these services.

- The LPA accepts that the ability of the auditor to perform the procedures required by this engagement effectively depends on the LPA’s providing full and free access to its staff and records and accounts.

- The LPA shall provide the auditor with all necessary documentation to perform the assignment properly; in particular, the following information shall be provided to the auditor before the beginning of the assignment:

  - Financing agreement;
  - Annual progress report;
  - Project implementation manual;
  - Financial management manual;
  - Organizational charts along with names and titles of senior managers;
  - Names and qualifications of officers responsible for financial management, accounting and internal audit;
  - Description of information technology facilities and computer systems in use; and
  - Copies of the minutes of negotiations, the project design document, the annual work programme and budget, and the Letter to the Borrower, if available.
"The auditor" refers to the auditor who is responsible for performing the agreed procedures as specified in these TORs, and for submitting a report of factual findings to the LPA.

The auditor shall provide:

- **A separate opinion on the project financial statements (PFSs).**
  Minimum content of the PFSs to be provided by the project:
  - Yearly and cumulative statements of sources and application of funds, which should disclose separately IFAD's funds, other donors' funds and beneficiaries' funds;
  - Yearly and cumulative SOEs by withdrawal application and category of expenditures;
  - Reconciliation between the amounts shown as received by the project and those shown as being disbursed by IFAD should be attached as an annex to the PFSs. As part of that reconciliation, the auditor will indicate the procedure used for disbursement (SA funds, letters of credit, special commitments, reimbursement or direct payment) and indicate whether the expenditure is fully documented or uses the summary of expenditures format;
  - Cumulative status of funds by category;
  - Reconciliation of SA/DA account statement;
  - A statement of comparison between actual expenditures and budget estimates;
  - Notes accompanying the PFSs; fixed assets;
  - Full disclosure of cash balances; and
  - Other statements or disclosures relevant to the project, e.g. financial monitoring reports, credit lines, etc.

- **A separate opinion on the use of the SA/DA.** The auditor is also required to audit the activities of the SA/DA associated with the project, including the initial advance, replenishments, interest that may accrue on the outstanding balances, and the year-end balances. The auditor must form an opinion as to the degree of compliance with IFAD procedures and the balance of the SA/DA at year-end. The audit should examine: (i) the eligibility of withdrawals from the SA/DA during the period under review; (ii) the operation of the SA/DA in accordance with the financing agreement and other instructions provided to the borrower/recipient by IFAD; (iii) the adequacy of internal controls within the project appropriate for this disbursement mechanism; and (iv) the use of correct exchange rate(s) to convert local currency expenditures to the denominated currency of the SA.

- **A separate opinion on withdrawal applications/statements of expenditure/summary of expenditures (SOEs).** The audit will include a review of SOEs used as the basis for submitting withdrawal applications. The auditor will carry out tests and reviews as necessary and relevant to the circumstances. SOE expenditures will be carefully compared for eligibility with relevant financial agreements and the disbursement letter, with reference to the project design report for guidance when necessary. Where ineligible expenditures are identified as having been included in
withdrawal applications and reimbursed, auditors will note these separately. A
schedule listing individual SOEs withdrawal applications by reference number and
amount should be attached to the PFSs. The total withdrawals under the SOE
procedure should be part of the overall reconciliation of IFAD disbursements
described above. The auditor’s opinion should deal with the adequacy of the
procedures used by the project for preparing SOEs and should include a statement
that amounts withdrawn from the project account on the basis of such SOEs were
used for the purposes intended under the agreement.

- A separate management letter addressing the adequacy of the accounting and
  internal control systems of the programme, including compliance with the IFAD
  Procurement Guidelines and such other matters as IFAD may notify the LPA to
  include in the audit.

The auditor is requested to comment on:

- Economy, efficiency and effectiveness in the use of project resources;
- Achievement of planned project results;
- Legal and financial obligations and commitments of the project and the extent of
  compliance or non-compliance thereof;
- Systems and procedures such as improvements in accounting, information
  technology or computer systems, and operations that may be under development,
  on which the auditor’s comments are necessary to ensure effective controls; and
- Other activities on which the auditor may consider it appropriate to report.

- Auditors shall certify:

  - Whether the PFSs are drawn up in conformity with internationally accepted
    accounting standards;
  - Whether the PFSs are accurate and are drawn up from the books of accounts
    maintained by the project;
  - Whether the provisions of the financing agreement are adhered to;
  - Whether procurement has been undertaken by the project in accordance with
    applicable procurement procedures and the IFAD Procurement Guidelines;
  - The existence of any significant assets purchased and confirm their existence and
    use for project purposes;
  - Whether the project has an effective system of financial supervision or internal
    audit at all levels; and
  - Whether the expenditures claimed through SOEs are properly approved, classified
    and supported by adequate documentation.

- The auditor is a member of the Institute of Registered Auditors of [country], which
  in turn is a member of the International Federation of Accountants (IFAC). In the
  case of supreme audit institutions, these should be members of the International
  Organization of Supreme Audit Institutions (INTOSAI).
1.2 Subject of the engagement

The subjects of this engagement are the financial statements dated [dd/mm/yyyy] in connection with the agreement for the period covering [dd/mm/yyyy to dd/mm/yyyy]. The information, both financial and non-financial, that is subject to verification by the auditor is all information that makes it possible to verify that the expenditures claimed by the LPA in financial statements have occurred, and are accurate and eligible. Annex 1 to these TORs contains an overview of key information about the agreement and the services concerned.

1.3 Reason for the engagement

The LPA is required to submit to IFAD an audit report produced by an external auditor under article IX of the General Conditions for Agricultural Development Financing.

1.4 Engagement type and objective

This constitutes an engagement to perform specific agreed procedures following the IFAD Guidelines on Project Audits provided to the auditors by the LPA in annex 2 of these TORs. The objective of this audit is for the auditor:

- To verify that the expenditures claimed by the LPA in the financial statements for the activities covered by the agreement have occurred (“reality”), are accurate (“exact”) and are eligible (i.e. that expenditure has been incurred in accordance with the terms and conditions of the agreement); and
- To submit a report of factual findings with regard to the agreed procedures performed.

1.5 Scope of work

1.5.1 The auditor shall undertake this engagement in accordance with these TORs and with:

- International Standards on Auditing (ISAs) to perform agreed procedures regarding financial information as promulgated by IFAC;

- The Code of Ethics for Professional Accountants issued by IFAC. Although the International Standard on Related Services 4400 provides that independence is not a requirement for agreed procedures engagement, IFAD requires that the auditor also complies with the independence requirements of the Code of Ethics for Professional Accountants.

- IFAD Guidelines on Project Audits.

1.5.2 Terms and conditions of the agreement

The auditor verifies that the funds provided by the agreement were spent in accordance with the terms and conditions of the agreement.
1.5.3 Planning, procedures, documentation and evidence

The auditor should plan the work so that an effective audit can be performed. For this purpose, the auditor performs the procedures specified in the IFAD Guidelines on Project Audits and uses the evidence obtained from these procedures as the basis for the report of factual findings. The auditor should document matters that are important in providing evidence to support the report of factual findings, and evidence that the work was carried out in accordance with ISAs and these TORs.

1.6 Reporting

The report on this audit should describe the purpose and the agreed procedures of the engagement in sufficient detail to enable the LPA and IFAD to understand the nature and extent of the procedures performed by the auditor. Use of financial and audit reporting is governed by IFAD rules.

1.7 Other terms

[As necessary]

Annex 1: Information about the subject of the audit

[The table below should be completed by the project coordination unit and be attached as annex 1 to the TORs for use by the auditor.]

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ANNEX 2: IFAD Guidelines on Project Audits
[To attach]

NOTE: Additional items may be included in the TOR letter in accordance with the Guidelines for Auditors contained in Annex IV.
INDEPENDENT AUDITOR’S REPORT

[Addressee]

Report on the financial statements

We have audited the accompanying financial statements of________, which comprise the statement of financial position as at [dd/mm/yyyy], the statement of sources and uses of funds, statement of expenditures (SOEs) and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management’s responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards (or others), and for such internal control as Management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor’s responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (ISAs) and the International Fund for Agricultural Development Guidelines for Project Audits (“the IFAD Guidelines”).

Those standards (ISAs and IFAD Guidelines) require that we comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance that the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence that we have obtained is sufficient and appropriate to provide a basis for our audit opinion.
Opinion

In our opinion, the financial statements present fairly, in all material respects, [or give a true and fair view of] the financial position of [name of project] financed with the IFAD [mention financial product] as at [dd/mm/yyyy] and (of) its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards and the IFAD Guidelines.

In addition, (a) with respect to the SOE withdrawal application schedule, adequate supporting documentation has been maintained to support claims for reimbursements of expenditures incurred; and (b) such expenditures are eligible under the agreement referred to in [______].

In addition, in our opinion, the accompanying special/designated account statement presents fairly, in all material respects, the funds received and disbursements made from the special/designated account of the project for the year ended on [dd/mm/yyyy], in accordance with the accounting convention as described in the note above [______].

Restriction of use

This report is intended solely for the use of the Management of the project, IFAD, and the Government of [______], and should not be used for any other purpose.

Report on other legal and regulatory requirements

[Form and content of this section of the auditor’s report will vary depending on the nature of the auditor’s other reporting responsibilities.]

[Auditor’s signature]

[Date of the auditor’s report]

[Auditor’s address]
Annex VIII
SAMPLE OF OUTLINE OF A MANAGEMENT LETTER

MANAGEMENT REPORT FOR THE YEAR ENDED [dd/mm/yyyy]

We have recently completed our audit of [name of project] for the year ended [dd/mm/yyyy]. In accordance with our normal audit practice, the purpose of this letter is to comment on certain matters that we identified during the course of the audit. Our comments, together with our recommendations for improvements, are presented in the report that follows.

Our audit procedures are designed primarily to enable us to obtain sufficient assurance to express an opinion on the project’s financial position and the results of its operations. Consequently, a risk-based approach is used, which enables us to direct the major part of our audit effort to addressing general and specific identified risk areas within your organization.

AUDIT SCOPE

The scope of our audit included:

• Obtaining an understanding of the operations of the organization and the accounting systems in place;
• Identifying specific risks and potential misstatements relating to the major account balances and transactions;
• Identifying the computer processing environments existing within the organization;
• Substantive tests of detail of the material accounts; and
• Following up on issues identified in the prior year management report.

STATEMENT OF RESPONSIBILITY

It should be noted that the implementation and maintenance of systems of accounting and internal control are primarily the responsibility of Management. Our responsibility is to plan and perform audit work such that there is a reasonable expectation of detecting material irregularities and control weaknesses. As a result, the attached report should not be regarded as a complete list of internal control weaknesses.

STATUS OF INTERNAL CONTROL SYSTEM

In general, the control environment continues to be reliable, although we encourage Management to address the issues raised in the attached report.

The report has been discussed with Management and their comments have been included as Management comments. However, should you wish to discuss any of the points further, do not hesitate to contact us.
UPDATE ON THE IMPLEMENTATION STATUS OF RECOMMENDATIONS ISSUED DURING PREVIOUS AUDIT EXERCISES

[To list here an update on the status of implementation of previous years’ audit recommendations].

CONCLUSION

We would like to take this opportunity to express our appreciation for the courtesy and assistance afforded us by both Management and staff during the course of our audit.
## LOG OF AUDIT OBSERVATIONS

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