



IFAD

**Operational
Procedures for
Project Audits**

(for use by IFAD and Cooperating Institutions)



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Approved by the President of IFAD on 31 July 2003

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Abbreviations and Acronyms

CI	Cooperating Institution
CPM	Country Portfolio Manager
FC/Loans	Loans and Grants Unit of the Controller's Office
General Conditions	General Conditions for Agricultural Development Financing
ISA	International Standards on Auditing
MDB	Multilateral Development Banks
OECD	Organisation for Economic Co-operation and Development
PCU	Project Coordination Unit
PFS	Project Financial Statement
SA	Special Account
SAI	Supreme Audit Institution
SOE	Statements of Expenditure
TOR	Terms of Reference

I. Introduction

1. These *Operational Procedures for Project Audits* outline the procedures relating to the audit of IFAD-funded projects. However, it should be noted that a large number of IFAD-funded projects are administered by Cooperating Institutions (CIs), some of which have published their own guidelines relating to project audits. In cases where the CI has published its own guidelines and these have been formally accepted by IFAD, the audit guidelines of the CI will be followed. In these cases, the CI will inform IFAD of any issues that may arise on specific audits. At the same time, there are other CIs that have not published guidelines on project accounts and audits. In the latter case, these *Operational Procedures* and the *Guidelines on Project Audits* (for borrowers' use) issued by IFAD will be followed. These *Operational Procedures* and the *Guidelines* are also applicable to all projects directly supervised by IFAD.
2. For each IFAD-funded project, the loan or grant agreement will specify which guidelines are to be followed, i.e. whether those of the CI or of IFAD.
3. These *Operational Procedures* are therefore issued for the use of CIs appointed by IFAD to handle loan and grant administration on its behalf, when such CIs do not have their own published procedures or guidelines on project audits.

II. Cooperating Institutions (CIs)

4. CIs appointed by IFAD have overall responsibility for project supervision and loan administration, including the monitoring of compliance with audit covenants contained in the legal (loan or grant¹) agreements. All major multilateral development banks (MDBs) that act as CIs for IFAD provide financial management and auditing guidelines and sample forms for use by their borrowers. Other CIs may or may not provide borrowers with auditing guidelines and sample forms, and rely on IFAD to do so. As part of their project supervision responsibility on behalf of IFAD, all CIs are expected to work closely with borrowers on accounting, financial management and audit matters throughout the project cycle.
5. As set out in the cooperation agreement between IFAD and the CI, and as stipulated in IFAD's letter of appointment to the CI, with each loan or grant agreement and general condition, the CI in general is responsible for:
 - ▶ ensuring timely appointment of the independent auditor by the borrower;
 - ▶ ensuring timely receipt and review of audit reports;
 - ▶ following up with borrowers as necessary to ensure that they take any remedial actions recommended in the audit reports;
 - ▶ recommending sanctions in case of non-receipt of audit reports or when serious irregularities have been reported by the auditors; and
 - ▶ keeping IFAD informed of all important audit issues, especially cases of non-compliance with audit provisions.

The CIs will not normally consult with IFAD on routine audit matters.

1 All references to "loans" in these *Operational Procedures* are also valid for IFAD's grants as covered by the General Conditions.

III. Regional Divisions within the Programme Management Department (PMD)

6. Within the regional divisions, the country portfolio manager (CPM) is responsible for project appraisal and coordination with the CI for supervision of project implementation, including accounting, financial management and audit arrangements. The CPM also takes note of important audit recommendations, particularly issues relating to improved project management, for discussion and follow-up with the CI and the borrower, as necessary. CPMs should therefore work closely with the CI staff to ensure timely appointment of the auditor, receipt and review of audit reports, and appropriate follow-up action on the auditor's findings and recommendations, including adoption of any remedial actions or, in extreme cases, imposition of sanctions on the borrower. Within IFAD, the CPM will interact closely with the Loan Officer, as the latter's active role and input, based on professional knowledge and expertise, are critical to resolving project accounting, financial management and audit-related issues.

IV. Loans and Grants Unit, Controller's Office (FC/Loans)

7. Within IFAD, the loans officer is responsible for monitoring of project audit submission, including review of financial aspects of audit reports. While the primary responsibility for the review of financial accountability based on audit reports and the use of loan or grant proceeds rests with the CI, IFAD also has an important fiduciary role in this aspect. The role of the loans officer is critical in audit monitoring.² Where irregularities are noted in the audit report, the loans officer, in consultation with the CPM, will provide the CI with an opinion on the severity and impact of such irregularities. IFAD Senior Management will consider the recommendation of the CI, together with the opinions of the CPM, loans officer and the legal officer, in deciding on corrective action, including application of sanctions.

² In the case of IFAD directly supervised projects, there is no CI, so the responsibility for all audit-related matters is undertaken by the FC/loans officer, working in close consultation with the CPM.

V. Responsibilities in the Audit Monitoring Cycle

8. Given the importance of annual audit of project accounts, specific responsibilities are identified below with regard to: (i) the borrower's timely submission of audit reports to IFAD (and the CI), and (ii) IFAD's and the CI's actions relating to the review of audit reports received, as well as follow-up on those not received by the deadlines established in the legal (loan or grant) agreements.
9. At project appraisal, the IFAD mission should assess the borrower's accounting, financial management and audit capacity. The project documents, including the loan agreement, establishing the appropriate audit arrangements and timeframe are then negotiated and agreed upon between IFAD and the borrower. As project implementation proceeds, the resulting responsibilities for the various steps involved in the audit report monitoring cycle are listed below.
 - (i) Borrower prepares terms of reference (TOR) for the auditor in conformity with audit *Guidelines*, and sends it to the CI for review and approval.
 - (ii) Borrower informs the CI of the name of proposed auditor and the selection process followed.
 - (iii) If satisfied, the CI sends 'no objection' to borrower (copy to IFAD) on selection of proposed auditor.
 - (iv) Borrower appoints the auditor, in accordance with the timeframe established in the loan agreement,³ and provides the auditor with the TOR.
 - (v) The auditor appointed issues formal engagement letter.
 - (vi) Project accounts and financial statements are audited as 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.

3 Where reservations exist on the ability of the borrower to carry out timely audits, the appointment of the auditor may be made a condition of effectiveness or disbursement as deemed necessary.

- (vii) Borrower sends the audit report to the CI (with two copies to IFAD) within six months from end of the fiscal year (or by any other date specified in the loan agreement).
- (viii) CI receives the audit report and sends prompt acknowledgement (within two weeks of receipt) to the borrower (copy to IFAD).
- (ix) CI carries out a comprehensive review of the audit report in order to establish the integrity of the audit process and reliability of financial statements (within 30 days from receipt).
- (x) On completion of review, the CI sends out an appropriate communication (within 45 days from receipt) to the borrower (copy to IFAD) detailing any issues of concern and required remedial action,⁴ based on its review of the audit report.
- (xi) CI recommends to the regional division in IFAD, under copy to the Loans and Grant Unit of the Controller's Office (FC/Loans) and the Office of the General Counsel (for the purpose of all accounting, auditing and financial management related matters) appropriate remedial measure or sanction, if irregularity or non-compliance with loan covenants is considered serious.
- (xii) Borrower implements remedial action as needed and informs CI.
- (xiii) CI follows up with borrower on implementation of agreed remedial action, keeping IFAD informed.

Throughout this procedure, IFAD monitors progress or otherwise and steps in as necessary.

10. All project supervision reports prepared by the CI (and IFAD staff, where applicable) will include a section on the most recent audit and issues arising therefrom. In the event of the borrower's non-compliance with audit provisions, the CI (in consultation with IFAD as necessary) will recommend remedial action or that sanction to be imposed, if deemed necessary, and advise IFAD accordingly. The review of audit findings and recommendations, as well as the adoption of remedial measures, is an essential part of project supervision.

⁴ The CI (or IFAD) may ask the borrower to produce a timebound action plan for correcting the areas of concern identified in the audit report, if the borrower has not done so when the audit report is submitted.

VI. Establishment of Audit Arrangements

ASSESSMENT OF AUDIT CAPACITY AT APPRAISAL

11. The groundwork for a timely and comprehensive audit should be laid during project appraisal. The availability and quality of auditors should be ascertained by the appraisal mission in light of the CI's and IFAD's experience in the borrower's country, and based on the nature of the project audit. The appraisal mission should utilize the information available in the relevant Country Financial Management Capacity Assessment carried out by MDBs.⁵ The appraisal mission should pay particular attention to the following aspects, as part of its assessment of the financial management, procurement, disbursement and auditing capacity of the borrower and the Project Coordination Unit (PCU):
- ▶ overall status of the accounting and auditing profession in the country;
 - ▶ competence and independence of the national supreme audit institution (SAI); and
 - ▶ adherence to acceptable standards of accounting and auditing, preferably the adoption of International Accounting Standards (IAS) and International Standards on Auditing (ISA) by the selected auditors.
12. Assessment of the audit capacity should be described in the financial management, reporting and auditing section of the project design document/appraisal phase report. The appraisal mission will also ascertain whether the project audit would be carried out by the SAI or by other independent auditors, such as a private firm, either directly or through a subcontract arrangement with the SAI. Financial provision for the audit should be included in the project costing.
13. As part of the assessment of the borrower's capacity to implement and manage the project effectively, the appraisal mission will evaluate any internal audit mechanism foreseen for the project or the PCU.

⁵ FC/Loans will liaise with the MDBs and obtain the country financial management assessment reports and provide them to the CPM for use by the appraisal team.

**AUDITOR GENERAL
OR SUPREME AUDIT
INSTITUTION (SAI)**

14. When the proposed project auditor is the country's auditor general or the national supreme audit institution (SAI), the appraisal mission should ensure that the SAI has satisfactorily fulfilled its audit responsibilities in previous IFAD-funded projects, by reference to comments made by the CI and FC/Loans on the audit reports of past IFAD projects in the country for timeliness of submissions, quality of reports, adequacy of findings, and the country's record of compliance in general with IFAD's audit provisions.⁶
15. If the conclusion of the appraisal mission's review is not positive, or if there is insufficient data to make a proper assessment, the appraisal mission should ascertain whether the SAI belongs to the International Organization of Supreme Audit Institutions (INTOSAI) and if it is considered reasonably 'independent,' i.e. with regard to appointment and management of its staff and other resources, and in carrying out audit operations. In case of doubt, the appraisal team should recommend that the borrower consider appointment of other independent national or international auditors.
16. If the past record of an SAI (or any other auditor, private or public) in auditing IFAD-funded projects is found to be unsatisfactory, the CI should communicate clearly to the borrower (with copy to IFAD) its objection or reservation to the appointment of the SAI as project auditor for future projects. Where the appraisal mission finds the SAI's capacity to be limited, it may suggest appropriate remedial measures for improving its capacity, and also recommend provision of funding from the project loan or grant for the purpose of capacity building.⁷ In such cases, it is common for the SAI to subcontract project audits to private independent audit firms functioning in the country until the SAI is staffed adequately and otherwise ready to undertake the audits directly.
17. The project appraisal mission will review any such subcontracting arrangement that may exist and ensure that the project audit will be carried out in a timely manner and in compliance with IFAD's audit requirements. Where doubt persists, the IFAD Project Development Team (PDT), consisting of the CPM, loans officer and legal officer, may advise that the appointment of the independent project auditor should be made a condition of loan or grant effectiveness or disbursement.

6 Within IFAD, FC/Loans will develop, in consultation with MDBs, an in-house database that will contain country-specific information on development and capacity of the accounting and auditing profession, quality and availability of auditors, potential audit risks, etc. Appraisal teams should avail themselves of such in-house information in performing their task.

7 The provision of such funding for capacity building within the PCU or the borrowing country would be in IFAD's interest and consistent with the Organisation for Economic Co-operation and Development (OECD)/MDB initiative on Harmonization of Project Financial Reporting and Auditing.

**PRIVATE
INDEPENDENT
AUDIT FIRMS**

18. When a private audit firm is selected, the auditor should be appointed based on a transparent and competitive selection process with an agreed TOR for the project audit assignment, which should be cleared with the CI in advance. The selection of the project auditor should be from a list of three to six firms, and based on a technical evaluation, considered together with a financial evaluation.⁸ In addition, the selected auditor should:

- ▶ adhere to the International Standards on Auditing (ISAs) or Generally Accepted Auditing Standards (GAAS);
- ▶ be a member of a professional body affiliated with the International Federation of Accountants (IFAC);
- ▶ provide evidence of relevant past experience and references; and
- ▶ provide an adequate level of staff expertise and resources, and ensure timeliness of submission of audit reports.

**AGREEMENT
ON AUDIT
ARRANGEMENTS**

19. Article IX (Financial Reporting and Information), Section 9.03 (Audit of Accounts) of the IFAD *General Conditions for Agricultural Development Financing* stipulates the borrower's obligations vis-à-vis project audits. Timing for the appointment of the auditor, as well as deadlines for submission of audit reports, is generally found in article V of the loan agreement.

⁸ While the technical evaluation will include, inter alia, track record and professional reputation of the proposed firm, qualification and experience of the staff assigned to the project audit, the audit methodology and the scope of the audit, the financial evaluation will consist of a detailed quotation from the bidder of fees and other reimbursable costs of the audit.

20. During the project start up mission there will be a follow-up discussion with the borrower on audit arrangements, i.e. TOR, fiscal year, timing of audit, and deadline for submission of audit reports. The loan agreement specifies the date on which project audits are due, usually within six months from the end of the pre-determined project fiscal year. In addition, project audit arrangements should specifically provide for the following:
- ▶ where the first fiscal year covers a period of less than six months of project implementation, activities in such a period will be audited together with the second fiscal year;
 - ▶ when the project is cofinanced with a CI that has established audit guidelines, the loan agreement will specify which procedures shall apply;⁹
 - ▶ for IFAD directly supervised projects, IFAD *Guidelines on Project Audits* will be followed;
 - ▶ in the case of multi-agency implementation, a consolidated financial statement and audit report will be submitted by the “lead agency” nominated for this purpose by the borrower and indicated in the loan agreement;
 - ▶ where loan or grant funds are channeled through intermediary agencies, such as participating banks or credit institutions, to the ultimate beneficiaries of the project, the audit should include a review and opinion on the financial viability of some of these agencies;¹⁰ and
 - ▶ the source of financing for the cost of the audit.¹¹

9 Where the project is funded by more than one donor, it is important to agree on a single audit of acceptable standard to all donors, so that the borrower is not burdened with multiple audits and additional costs. A single audit in such cases is recommended by the OECD/MDB Good Practices Paper on Harmonization of Project Financial Reporting and Auditing.

10 For example, smallholder credit schemes implemented through participating commercial banks or development finance institutions (DFIs). Where there are many such intermediaries in a project, the audit should cover at least the major institutions, which will be identified at appraisal and stipulated in the loan agreement.

11 IFAD will generally agree to finance the cost of project audits out of its loan proceeds, based on the category of expenditure and percentage of financing provided for in the loan agreement.

**AUDIT GUIDELINES
AND TERMS
OF REFERENCE**

21. It is important to ensure that the auditors are provided with clear guidelines, including TOR, as to what is expected from them, what their report should cover, and the acceptable format of their report. The CI should draw the attention of the borrower and the auditors to certain aspects specific to donor-funded development projects that might not be covered under a routine audit, such as compliance with loan covenants, adherence to procurement procedures, eligibility of disbursements made under the statements of expenditure (SOE) procedure, maintenance of special accounts (SAs), and treatment of taxation.

**CHANGE OR
ROTATION OF
AUDITORS**

22. In the event of a change in auditors, the borrower should notify the CI and IFAD of the fact, providing acceptable reasons, and obtain CI consent prior to the change. While it may be desirable to rotate auditors after a number of years, it must be done carefully, taking into account the need for continuity and institutional memory concerning project information, the country-specific conditions, availability of qualified auditors, and any other relevant factor. The same procedures apply for selection and appointment of subsequent auditors as applied for the appointment of the original auditor.

VII. Monitoring and Review of Audit Report Submissions

COMMUNICATIONS TO (AND FROM) BORROWER

23. The CI (and the CPM, loans officer and legal officer within IFAD) should be fully aware of the following IFAD policy and procedural requirements in order to ensure that the various steps are followed diligently as part of their monitoring of audit report submission by borrowers. The borrower's obligations with regard to audit reports are normally described in articles V and VI of the IFAD loan agreement.

- ▶ At least 3 months before the end of each project fiscal year, the CI will send to the borrower (copy to IFAD) a reminder to ensure that auditors, if not appointed already, are appointed in time and before the end of the fiscal year. A standard letter to be used for this purpose is shown in Annex I.
- ▶ At least 30 days before the end of the fiscal year, the borrower confirms to the CI (copy to IFAD) that an auditor has been appointed.
- ▶ At least 90 days before audit report due date stipulated in the loan agreement, the CI will send a reminder to the borrower to ensure that financial statements have been prepared and the audit has begun so that the borrower will be able to comply with the timely submission of audit report, when due. See standard letter shown in Annex II.
- ▶ If the audit report is not received in the CI (with copies to IFAD) by the due date, then within 30 days from that date, the CI will notify the borrower and PCU (copy to IFAD FC/Loans) of the fact that the audit report has not been received. As provided for in Section VI of the loan agreement, where appropriate, FC/Loans, in consultation with the regional division, CI and the borrower, may consider engaging an independent auditor of its choice to carry out the project audit.
- ▶ If the CI determines that the borrower's documentation submission is not complete, the CI will communicate with the borrower (copy to IFAD) and follow-up until all documentation is received in the required format.
- ▶ If the audit report is 90 days overdue from the stipulated due date, FC/Loans, in consultation with the regional division and CI, will confirm non-receipt of the audit report, and will prepare a "legal notice" to be sent informing the borrower that non-receipt of the audit report within 60 days will trigger the process of suspension of disbursements under the loan.
- ▶ 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, FC/Loans, in consultation with the regional division and CI, will prepare a President's notice for suspension, which will set out the justification for the suspension. The President's notice for suspension must be cleared by the Office of the General Counsel.
- ▶ Procedural sanctions that apply in the case of suspension will be applicable for failure to comply with provisions on audit.

**RECEIPT AND
REVIEW OF THE
AUDIT REPORT**

24. The CI should confirm promptly (i.e., within 15 days) to the borrower (copy to IFAD) receipt of the audit report, notifying that any comments or issues will be communicated as soon as possible. As a first step, the CI should make sure that the audit has been carried out in accordance with IFAD's audit requirements, and then carry out a Desk Review of the Audit Report and the accompanying financial statements. Particular attention should be paid to the auditor's opinion, results of the compliance audit, and the contents of the management letter, which should all provide useful information concerning the use of loan funds and management of the project.¹² Guidelines for Desk Review of Audit Reports are set out in Annex III.
25. The CI should review the borrower's submission to ensure that the audit of financial statements included an examination of the expenditure documents retained by the borrower in support of SOEs and SAs, and that these have been covered in the auditor's report. On completion of the Desk Review, the CI should issue a letter to the borrower (copy to IFAD) outlining the results of the review and any problems or irregularities identified by the auditor that may require follow-up with the borrower. The letter should also indicate any additional information required from the borrower or the auditor, as well as identify any corrective measures to be taken by the borrower, and any recommended remedial action to be taken by IFAD and followed up by the CI.
26. The CI should complete the Desk Review of the Audit Report within 30 days from its receipt. If the audit report has not identified problems or irregularities, and does not contain any recommendations for improvement either in the use of project funds or management of the project, and if the CI staff are reasonably satisfied with the report based on the review and their knowledge of the project, no further action will be necessary. The CI will so inform the borrower and IFAD within 15 days.

12 In the case of IFAD directly supervised projects, the CPM and FC/Loans will jointly share this responsibility – i.e. the CPM will handle communication with the borrower, and FC/Loans will undertake the review of the audit report and provide comments and recommendations.

27. In general, the CI's (and IFAD's for directly supervised projects) Desk Review of the Audit Report would address the following aspects:
- ▶ fulfillment by the auditor of all audit requirements specified in the TOR;
 - ▶ qualifications or other significant points in the auditor's report;
 - ▶ whether all financial reporting requirements have been met;
 - ▶ comparison of the results shown in the project financial statements with required targets set in the financial covenants in the loan agreement;
 - ▶ overall project financial performance (i.e., actual versus budgeted);
 - ▶ adequacy of internal control mechanisms in the project;
 - ▶ presentation with respect to use of IFAD funds versus funds from other sources;
 - ▶ satisfactory use of SOE procedure for disbursements;
 - ▶ reconciliation and use of the project SA;
 - ▶ follow-up on actions noted in previous year's Desk Review; and
 - ▶ compliance with procurement procedures as stipulated in the loan agreement.
28. As soon as the Desk Review of the Audit Report is completed, and in any case no later than 45 days from the receipt of the audit report, the CI will send a letter to the borrower, copied to IFAD, notifying the borrower of any concerns emanating from the review of the audit report.

**PROBLEMS AND
IRREGULARITIES**

29. Audit reports containing a qualified opinion, an adverse opinion or a disclaimer of opinion are *prima facie* indication of the existence of problems and irregularities in implementation of the project (see description of Audit Opinions in Annex I to *Guidelines on Project Audits* (for borrower's use)). The CI's letter to the borrower should therefore make reference to the auditor's opinion, and seek clarification on the issues raised by the auditor. The borrower may also be asked to submit a timebound Action Plan for correcting the irregularities identified by the auditor, and the CI will monitor progress in implementing such a plan. Where the audit report reveals fundamental weaknesses in financial accountability and project management, the CI may propose a special investigative audit or suggest the need for technical assistance to the PCU, to be funded out of the loan, or both, as appropriate. In such cases, the CI, in consultation with IFAD, will send a communication to that effect to the borrower.

30. If the audit report has identified *ineligible expenditures*, the CI should inform the borrower (copy to IFAD) of the borrower's obligation to refund the amounts disbursed. Where there is a dispute on the eligibility of any expenditure, the CI may ask the borrower to provide satisfactory explanation and evidence supported by relevant documentation, within a reasonable timeframe (generally one month) in justification of the expenditures in question.

31. Where the issues identified during the Desk Review cannot be addressed with the borrower through correspondence, such issues should be followed up by the CI during the ensuing supervision mission to the project. Any plan of action to address the issues in such cases will be discussed at the meeting(s) with the borrower or PCU in the field, or both, and sent to IFAD for approval.

**BORROWER'S
FAILURE TO TAKE
REMEDIAL ACTION**

32. If, following the issuance of an audit report identifying serious irregularities and concerns, the borrower does not implement, by the agreed deadline, the remedial measures based on the agreed action plan, the CI should recommend that IFAD suspend disbursements until the borrower has taken the necessary action. Within IFAD, appropriate consultation and collective decision-making will take place with the regional division director concerned and the President before sending a communication to the borrower or PCU informing them of the suspension of disbursements under the relevant loan or grant.¹³

33. The action to be taken in such cases will be the same as for repeated failure of audit submission or receipt of unacceptable audit reports, as they would constitute violation of article V of the loan agreement. Based on article VI of the loan agreement, IFAD may also, if found appropriate to the circumstances, exercise its right to appoint an auditor of its choice.

34. In case of repeated non-compliance by the borrower with audit requirements covering previous projects, IFAD will make full use of the range of available recourse, such as condition of loan effectiveness, condition of loan disbursements, condition of future loan negotiations, or condition of Executive Board presentation of future loan(s), in order to ensure that the borrower takes the sanctions seriously and satisfies the audit requirements.

¹³ While suspension of disbursements is a critical recourse available to IFAD for enforcing the conditions under its loans and grants, it is also a sensitive matter that affects the relationship between IFAD and its borrowers. It is therefore essential that this recourse is used by the CIs and IFAD staff in a fair, yet effective, manner. The process described in these *Operational Procedures* for invoking suspension when a borrower is in violation of an audit related covenant is based on the collective recommendation from the CI and the CPM, loans officer and legal officer, followed by informed decisions by the division director and IFAD President.

**UNACCEPTABLE
AUDIT REPORTS**

35. If the audit report does not contain a clearly written expression of opinion on the financial information or the audited financial statements are unacceptable, the CI will immediately inform the borrower, on behalf of IFAD, explaining why the borrower's submission was considered unacceptable, and requesting the submission of acceptable audit report and audited financial statements by the set deadline as specified by IFAD. Where the borrower's non-compliance relates to SOE or SA procedure, the notice to the borrower on remedial actions needed will include a cautionary message that, unless compliance is achieved by the stipulated deadline, IFAD would discontinue the use of SOE procedure or withhold replenishment of the SA, or both. Once satisfactory compliance is achieved, SOE use and SA replenishment may be reinstated, following notice to the borrower sent from IFAD.

**STATUS DURING
SUSPENSION OF
DISBURSEMENTS**

36. Suspension of disbursements under any loan or grant shall provide for the same exemptions as those listed in the Loans and Grants Operational Manual, Section 6.2, for overdue loan charges (e.g. payments due under Special Commitments, payments against withdrawal applications that were submitted and received before the date of suspension, time-sensitive and critical aspects of civil works, and training and consultancy contracts may be exempted for an agreed period). The suspension notice shall detail all such exemptions clearly. While the borrower is permitted to withdraw funds from the SA for eligible project expenditures, SA replenishment will be made only after suspension is lifted.

37. When suspension of disbursements is in force for any reason, IFAD will not agree to any borrower's request for re-allocation of funds or extension of the project or loan closing date. IFAD may also make the submission of the audit report(s) in question a condition of negotiation or presentation to the Executive Board of any new loan(s) to the borrower.

VIII. Monitoring and Tracking of Audit Reports

38. Within IFAD, FC/Loans is the focal point for all information related to audit reports, and an audit report monitoring procedure is in use.

- ▶ A list of audit reports due for each year, the fiscal year of every project and the submission date is prepared yearly and distributed by electronic mail or by fax to all CIs for the projects under their supervision. The list should include all effective and disbursing loans and grants. Loans under suspension will be noted as such in the list.
- ▶ The control list will include the loan number and amount; project name and the borrower; effective, closing and completion dates; the name of the CI and the auditors; the dates on which the audit report was received in IFAD; the date the audit report was received by the CI; the type of audit report; any comments; and follow-up action from CI and IFAD, if any.
- ▶ In IFAD, audit reports will be received by the central Information Resources Centre of IFAD, stamped appropriately, and copies routed to the respective CPM and loans officer.
- ▶ CIs will carry out the review of the audit reports and, based on their communication to the borrower and IFAD, FC/Loans will note the relevant information relating to audit compliance and results of the CI's review (i.e., date report was reviewed, compliance with audit requirements, irregularities noted in the review, date of communication to borrower, deadline for remedial action, if any, etc.).
- ▶ Reports relative to audit report submission will be sent to IFAD by all CIs twice a year, either electronically or by regular mail. The transmission of electronic documents will be encouraged for both CIs and borrowers.
- ▶ FC/Loans will review the reports for all IFAD directly supervised projects and take note of the result of the review for any necessary follow-up action.
- ▶ A copy of the audit report will be retained in FC/Loans until satisfactory conclusion of all follow-up actions by the CI (and IFAD).
- ▶ Audit reports will then be sent to IFAD's central Information Resources Centre for retention together with other project-related documents.

39. Based on data obtained from audit report monitoring, a regular report on project audit status covering IFAD's portfolio will be produced and submitted to Management. Ad hoc reports on the status of audit reports for any given project or for the entire portfolio will also be produced as needed. Such reports would be used for portfolio quality management purposes within IFAD. Audit report monitoring will also provide an effective mechanism for monitoring IFAD's delegated project administration responsibilities relating to audit reports carried out by CIs.

Annex I

(SAMPLE) AUDIT LETTER TO BORROWER OR PCU

Reminder to Borrower of Requirement to Appoint Auditors

(For audits by private firms only)

To be sent annually, three months before the end of each fiscal year

Re: Loan/Grant _____

Annual Audit for Year _____

Dear _____

This is to remind you that IFAD *Guidelines on Project Audits* recommend that the independent auditor be appointed **at least 3 months before the end of each fiscal year**.

Please notify us of the name of the firm and whether the same firm, _____, has been appointed to perform the annual audit for _____.

If not, please furnish the names of firms being considered and other relevant information, as set out in the *Guidelines*, paragraphs _____, so that we may review the selection process and send our communication to you in time regarding acceptability of the auditors.

Sincerely yours,

Name of CI

cc. IFAD - CPM and FC/L

Annex II

(SAMPLE) AUDIT LETTER TO BORROWER OR PCU

Reminder to Borrower on Submission of Project Audit Report

To be sent 90 days before audit report due date

Re: Loan/Grant _____

Annual Audit for Year _____

Dear _____

This is to remind you that the annual financial statements of _____ are required to be submitted to IFAD no later than _____ pursuant to Section _____ of the above Loan/Grant Agreement and that the annual audit is required to be submitted to IFAD no later than _____ pursuant to Section _____ of said Loan/Grant Agreement.

We would appreciate your reminding the auditors of the need to begin the planning for the year-end audit work (if not done already) in such a way as to ensure timely compliance with IFAD's audit requirement.

Please advise us and IFAD promptly if you anticipate any constraints in meeting this requirement.

Sincerely yours,

Name of CI

cc: IFAD – CPM and FC/L

Annex III

GUIDELINES FOR DESK REVIEW OF AUDIT REPORTS

1. These guidelines are intended for use by the staff of a cooperating institution (CI) assigned to administer IFAD projects (if the CI does not have its own guidelines), and by IFAD staff responsible for directly supervised projects, when they carry out Desk Review of audit reports submitted by borrowers.
2. It is important to note that these guidelines do not cover all possible scenarios and that the CI and IFAD staff with responsibility for monitoring and reviewing of audit reports should seek the assistance of a professional accountant or financial management specialist whenever considered necessary.¹ For example, a review of financial statements of a revenue-earning entity, or that of a participating bank or financial intermediary in a smallholder credit project, is relatively more complex than the review of a simple project audit report that consists only of the Statement of Sources and Application (or Receipts and Payments) of Funds.

PRELIMINARY STEPS – PREPARATION FOR REVIEW

3. The following preparatory steps should be taken by the staff before the actual review of the audit report and financial statements is undertaken:
 - ▶ Note the date of receipt of the audit report in the CI (or IFAD) and ensure that a prompt acknowledgement has been sent to the borrower.
 - ▶ Compare the name of the auditor with that agreed to by the CI, IFAD and the borrower at appointment of auditor.
 - ▶ Ensure that the terms of reference (TOR) for the audit is consistent with the TOR previously approved.
 - ▶ Verify if the audit report received is in accordance with the requirements as set out in the loan covenants and the agreed TOR. The requirements would normally include: (i) financial statements of the project or project coordination unit (PCU), or both; (ii) overall audit opinion on the financial statements;² (iii) statements of expenditure (SOE) review statement and audit opinion; (iv) special account (SA) review and audit opinion; and (v) management letter.
 - ▶ Ascertain from the audit covenants in the loan agreement if there are any special conditions that require additional compliance by the borrower e.g. financial targets for a revenue-earning entity.
 - ▶ If it is determined that the borrower's submission is incomplete, the CI (or IFAD staff) will communicate this to the borrower and follow-up appropriately until complete documentation is received.

¹ In MDBs, audit reports are routinely reviewed by their financial management specialists. Within IFAD, the reviews will be done by the Loans and Grants Unit in the Controller's Office (FC/Loans).

² The auditor may also provide a single opinion covering the financial statements, SOE and SA, which would be acceptable.

REVIEW OF FINANCIAL STATEMENTS

4. As part of the Desk Review of audited financial statements, the reviewing staff in CI and IFAD should:
 - ▶ ensure that the audit report and financial statements are submitted as a complete set, with all relevant sections identified (i.e., auditor's opinion, cash flow statement, balance sheet, income statement, and notes to financial statements);
 - ▶ where project financial statements are presented as an integral part of the PCU's financial statements, identify the section relating to the project;
 - ▶ identify loan or grant withdrawals based on SOEs and ensure that the related transactions are integrated into the project financial statements;
 - ▶ identify the linkage in the project financial statements with the SA, which should also be integrated in the project accounts;
 - ▶ where **interim un-audited** financial statements have been received, compare such statements with the annual audited financial statements and identify any differences between the two, and seek from the borrower explanation for any significant discrepancy;
 - ▶ review the contents of the financial statements as a whole to form a judgment on the performance of the project or the relevant organization, or both;
 - ▶ compare actual expenditures by category as itemized in the project financial statements with cost estimates at appraisal or as set out in the agreed project annual budget and work programme, and seek explanations from the borrower for large deviations, particularly significant project cost overruns;³
 - ▶ record the receipt of audit report and results of the review in the CI's system for audit report monitoring, and in the Audit Report Monitoring System of IFAD as necessary;
 - ▶ follow up on prior year's audit recommendations; and
 - ▶ reconcile loan, grant and SA balances with IFAD records.

3 Notes to the financial statements and the management letter usually provide a wealth of information on project performance.

**REVIEW OF
AUDIT REPORTS**

5. The actual review of the audit report and of the accompanying financial statements by CI or IFAD staff should be as comprehensive as possible and include the following:
 - ▶ the auditor's certification and opinion should be signed by the auditor and dated on the letterhead of the audit firm or on paper showing the official name and address of the auditor;
 - ▶ the audit report should be addressed to the borrower's representative or PCU (e.g. the project manager or head of the PCU);
 - ▶ there should be a definite and clear opinion given by the auditor;
 - ▶ ascertain if the audit opinion is unqualified, qualified, adverse or is a disclaimer (for explanation of these terms. refer to General Principles Governing Project Audits, included in Annex I to the *Guidelines on Project Audits* (for borrowers' use);
 - ▶ the audit opinion should identify what accounting principles have been applied (usually International Accounting Standards (IAS) or Generally Accepted Accounting Principles (GAAP), and relevant national standards) in the preparation and presentation of the financial statements;
 - ▶ if the auditor has given a qualified, adverse or disclaimer opinion, it is important to identify the reasons for the auditor's qualifications, and seek an explanation from the borrower or the auditor, or both, and take follow-up action as necessary;
 - ▶ follow up on the prior year's audit report recommendations;
 - ▶ verify whether a separate management letter is attached or has been sent separately to the CI; if there is such a management letter, ascertain whether the letter includes a discussion of issues that are not directly material to the audit but contain material that could affect a true and fair view of the financial statements, so that the auditor considers them useful to communicate to the project management, the government and the donors;

- ▶ review carefully any notes to the financial statements and the contents of the management letter (where applicable) to ascertain that there are no critical concerns or issues that would require a change in the auditor's opinion as given. For example, the notes and management letter may indicate circumstances that would require that an unqualified opinion be changed to that of a qualified opinion;
- ▶ where the SOE procedure has been used for disbursements, the auditor's opinion should have reference to the satisfaction or otherwise of the use of SOEs by the project;
- ▶ where an SA has been established, ensure that expenditures incurred out of the SA are integrated into the project financial statements, and that the auditor's opinion has reference to the proper use of the SA by the project;
- ▶ where the auditor's TOR requires any compliance testing, ensure that the auditor has addressed these in the opinion, with appropriate reference to provisions in the loan agreement; and
- ▶ form an overall conclusion on whether or not the auditor has performed to the reviewer's reasonable satisfaction, and that the report and the financial statements, including SOEs and SA, are reliable.

► July 2009



Enabling poor rural people
to overcome poverty

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