AFRICAN DEVELOPMENT BANK
AFRICAN DEVELOPMENT FUND

GUIDELINES FOR FINANCIAL REPORTING AND AUDITING OF PROJECTS

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1. INTRODUCTION

1.1 Objective and Purpose

1.1.1 The Agreement establishing the African Development Bank requires the Bank to ensure that the proceeds of loans made or guaranteed by the Bank are used economically, efficiently and solely for the purpose for which they are granted[1]. One of the means by which the Bank monitors compliance with these conditions and can effectively follow the progress of the projects it finances is by requiring borrowers and other beneficiaries to make available to the Bank audited financial statements and other selective financial information on a regular basis.

1. 1.2 This booklet provides guidelines which summarize financial and auditing requirements for projects financed by the Bank. Although many of the principles and practices covered can be applied to private sector ventures, they are not intended to be adopted for private sector projects financed by the Bank. Separate guidelines for financial reporting for the private sector will be issued by the Private Sector Unit of the Bank.

1.1.3 Besides sensitizing borrowers to the financial reporting and auditing requirements of the Bank, the guidelines are intended to acquaint its readers with the financial policies and accounting practices considered fundamental in preparing financial statements and for carrying out audits of Bank funded projects.

1.1.4 The guidelines define the parameters for adequate financial reporting and auditing performance by borrowers. Borrowers should use them as a reference to ensure that the contents, format and timing for preparing and submitting financial statements and reports are observed. Bank staff are to use the guidelines to assist borrowers in understanding the various reporting requirements. Staff are also expected to apply the concepts and principles contained herein in the appraisal and supervision of projects[2].

1.1.5 General requirements for financial reporting to the Bank are found in the General Conditions Applicable to Loans and Guarantee Agreements and Protocols of Agreement for Grants. Specific requirements for individual borrowers are provided in the appraisal reports and stipulated in the respective loan agreements and protocols of agreement. Reference throughout the booklet to financial reporting and auditing requirements relate specifically to the requirements contained in these documents.

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[1] References in the Guidelines to Bank loans and projects also apply to those of the African Development Fund and the Nigerian Trust Fund.

[2] In certain circumstances in the document, the expression "borrower" is also used to refer to the executing agency responsible for the implementation and operation of the project.

2. OVERVIEW OF BANK FINANCIAL POLICIES

2.1 Accounting Records and Control

2. 1. 1 Projects financed by the Bank are required to maintain accurate records of all financial transactions and fully account for the resources provided for operations. Borrowers are required to establish and maintain accounting records and documents on all loans made by the Bank. Records must be systematic and readily accessible to Bank staff or any other individual(s) duly authorized by the Bank.

2.1.2 During the appraisal of projects, the Bank will evaluate the borrower's accounting system and controls to verify that their standards are acceptable. Where necessary, the Bank will advise and work with the borrower on ways of strengthening it. Where no accounting system or suitable controls have been set up, the Bank will require that appropriate measures be taken as a condition for the loan. On occasions where an executing agency is responsible for the implementation of a project, it is the policy of the Bank to also evaluate the agency to ensure that the accounting system and controls in place are adequate and can independently and reliably report the financial transactions of the project. Chapter 3 highlights those accounting principles and practices considered by the Bank to be essential and consistent with sound project accounting.

2.2 Financial Reporting

2.2. 1 The Bank has a mandate to promote sound, efficient and well-managed projects. One of the key objectives of financial repoIting is to monitor and ensure that loan resources are properly accounted for by the borrower and that these resources are used efficiently for economic development. Reporting requirements covered in this document are aimed primarily at achieving this.

2.2.2 The Bank seeks to receive accurate and timely information on the operational performance and financial status of the project during the implementation period. The information required are designed to strengthen the financial management and reporting capabilities of the borrower and/or executing agency in connection with the implementation of Bank funded projects. They can also be very useful for managerial decision-making, provided that such information is made available on a timely and consistent basis; Chapter 4 discusses the financial statements and related reports required by the Bank. A general description of the contents of each statement, as well as the general format for preparing them are presented in the text and Annex, respectively. Supplementary financial information which may be required by the Bank are dealt with in Chapter **4.** .

2.3 Auditors' Report

2.3.1 Annual financial statements of all Bank funded projects must be submitted for auditing by a competent independent auditing firm, to certify the reliability of the information and data contained in the financial statements. The services of a qualified auditor should be engaged to conduct a thorough examination of all pertinent records, review the borrowers' accounting policies, operating procedures and financial control mechanisms, to identify deficiencies or weaknesses that could affect the smooth operation and efficiency of the project. Upon the completion of the auditor's work, the auditor would issue an opinion on the financial statements. The major elements required to be covered in the auditor's report are discussed in Chapter *5*. The procedure and selection criteria for appointing auditors which borrowers are expected to follow are also covered in Chapter *5*.

3. PROJECT ACCOUNTING

3.1 Accounting Policies and Standards

3. 1. 1 The Bank encourages borrowers to use internationally accepted accounting principles and practices in the maintenance of accounting records and compilation of financial reports. This helps to reduce inconsistency in reporting and provide a basis for comparison vis-a-vis other borrowers. Under the same token, the Bank recognizes that accounting practices may differ from country to country. The sophistication of the accounting system in place will also vary from project to project, depending on the characteristics and nature of the project. Nonetheless, the Bank considers it essential that the accounting standards and practices of all Bank funded projects must be guided by the following fundamental principles:

- full accountability of all financial resources including resources internally generated from operation and those acquired externally (e.g. Loans, Grants, etc.);
- a true and fair view of the financial position and financial performance presented by the financial statements;
- financial statements should contain full disclosure of all material information and should be. accompanied **by** supplementary notes **to** explain or qualify various accounts;
- full disclosure of the accounting principles and financial policies adopted by the borrower or executing agency as well as disclosure of any subsequent changes in either existing accounting practices or financial policies should be included in the notes to the financial statement; and
- annual financial statements are to be audited and certified by an independent and qualified auditor as a fair presentation of the entity's financial position.

3.2 Loan Accounts and Records

3.2.1 Financial statements should at all times be supported by accurate accounting records maintained in accordance with internationally accepted accounting practices and standards. The Bank requires all borrowers to keep detailed accounts on the draw-down and utilization of its' loans. These include general ledger accounts and subsidiary ledger accounts for project expenditures as well as supporting documents related to these expenditures such as invoices, contracts, bills of lading, insurance certificate, etc.

3.2.2 Detailed information on the various loan accounts and registers required by the Bank to be maintained by borrowers are provided in the Bank's Disbursement Handbook. To recapitulate the major ones:

i) **a currency register** for each currency disbursed, to be used to record disbursements and repayments related to the Bank's loan. Transactions are to be recorded in the specific currency disbursed or repaid When properly maintained, this account should show the borrowers' liability to the Bank in the specific currencies disbursed. The account serves as a basis for verifying bills sent to borrowers and is very useful in settling billing disputes.

ii) **a summary register** denominated in the Bank's Unit of Account (BUA) to which individual disbursements are to be recorded. This register should be periodically compared and reconciled with the quarterly disbursement statement sent to borrowers by the Bank at the end of each quarter. The register will serve as a control for UA amounts available to the borrower for disbursements.

iii) **a category register** to be used to record purchases and expenditures for the project under the various categories agreed to be financed by the Bank. The register should be used to guide borrowers when preparing disbursement requests to ensure that items being requested are within the permissible limits established for the loan.

4. FINANCIAL REPORTING

4.1 General Requirements

4.1.1 Reporting requirements are generally determined by the characteristics of the project, borrower and/or executing agency. The requirements described in this chapter take into account the various types of entities to which the Bank provide loans. For financial reporting purposes these can be categorized into three major groups, namely: (i) government, (ii) autonomous or semi-autonomous agencies, and (iii) national and multinational development finance institutions and agencies.

4.1.2 Borrowers are required to submit annual financial statements on projects financed partly or wholly by the Bank. Financial statements must satisfactorily report the results of operations and effectively summarize all financial transactions relating to the project. Financial statements should be made available throughout the period while disbursements are being made on the loans.

4.1.3 For certain types of projects however, the Bank may require the borrower to submit financial statements beyond the disbursement period of the loan. This may occur in the case where the project financed is designed to improve the long-term institutional or financial performance of the entity. Under these circumstances, the Bank may want to review the results of operations for as long a period as may be necessary to assess the impact of the loan. Lines of credit to national and sub-regional development finance institutions (DFIs) is an example of one of the types of loans which the Bank will want to closely monitor even after the loan has been fully disbursed.

4. 1.4 In some cases, the Bank may require borrowers to submit interim financial statements during the course of the year. Interim financial statements are not required to provide comprehensive financial details as in the case of annual financial statements. Instead they are specifically designed to monitor the implementation and progress of the project during the year.

4. *1.5* Interim financial statements generally comprise statements of expenditure for funds disbursed from various financing sources for the project. In most cases, they are incorporated into the general progress report for the project which is submitted to the Bank quarterly. These statements are not normally required to be audited. The precise form and contents of these statements will be discussed with the borrower during the appraisal and loan negotiations.

4. 1.6 Financial statements submitted to the Bank should be prepared in the borrower's local currency oran internationally accepted currency relevant to the project. In the case where the national (local) currency is used, adequate disclosure must be made in the supplementary notes accompanying the financial statement of the basis for translating all foreign exchange transactions, commitments and obligations into the local currency.

4. 1.7 Financial statements should be presented together with comparative figures for the previous year. In presenting comparative statements, borrowers should ensure that all financial transactions have been consistently recorded and classified. Disclosure of any changes in accounting practices (e.g. classification of balance sheet or income statement items) or financial policies from the previous year, should be appropriately highlighted and explained in the supplementary notes accompanying the financial statements.

4.2 Specific Requirements

Financial Reporting for Projects Implemented by Autonomous or Semi-autonomous Agencies

4.2.1 Most revenue-earning projects or projects with commercial orientation are executed or operated by autonomous or semi-autonomous agencies. When the project or agency responsible for implementing or operating the project is a financially autonomous or semi-autonomous entity, a comprehensive set of financial statements showing the operating results of the project should be made available to the Bank.

4.2.2 There is a common practice for executing agencies to prepare consolidated financial statements which include financial transactions related to the project(s) being executed. Consolidated financial statements which combine the operations of the executing agency and that of the project, should provide sufficient details to allow the accounts of the project and that of the executing agency to be separately analyzed. During the project appraisal and loan negotiations, Bank staff will determine and advise the borrower of the extent to which the project's accounts are to be separated and reported. This will also be specified in the loan agreement.

4.2.3 Financial statements submitted to the Bank by autonomous and semi-autonomous agencies should normally include the following:

i. an income statement or statement of revenue and expenditure;

ii. a balance sheet;

iii. a cash flow statement; and,

iv. notes containing supplementary information and disclosure to explain entries in (i) and (ii) above.

4.2.4 The function and key eJements of each statement are described below.

Income Statement - The income statement reports on the financial results of operation for the reporting period. In showing the results for the reporting period, the statement should normally reflect financial information under the following categories:

REVENUES (broken down into sources)

- Sales (in some cases sales may be required to be shown separately for each major category or operational activity. For example, a telecommunication project may be requested to show sales related to telephone, telex, telegraph, etc.)
- Service fees
- Commissions
- Interest income
- Other income

EXPENDITURES

- Supplies
- Salary and wages
- Utilities
- Rent

- Miscellaneous
- Others
- Depreciation
- Interest or financial charges
- Taxes

NET INCOME before and after appropriations.

When using the classification others" for revenue or expenditure items, full explanation should be provided in the supplementary notes in respect of any amount considered materially significant. A sample format for a typical income statement is presented in Table I of the Annex.

Balance Sheet - The balance sheet is intended to show the financial position of the borrower/executing agency or project at the end of the reporting period. The statement should provide a breakdown of assets into: fixed asset (plant, building, machinery); current assets (inventories, account receivable, short term investments, cash) and other assets. Alongside assets should be presented current and long-term liabilities. Current liabilities should contain all obligations due within one year, including taxes and other accrued expenses and the portion of the long term obligations maturing in one year.

The overall presentation of the balance sheet including the capital structure of the entity, should as much as possible, reflect the characteristics of the entity; appropriately highlighting key variables such as paid- in capital, reserves, leverages liquidity, etc. Table II of the Annex contains an example of the format for a balance sheet.

Cash Flow Statement - A cash flow statement provides information on the changes in net assets and the financial structure including the liquidity and solvency of the entity during the reporting period. The statement should report cash flows during the period classified by operating, investing and financing activities. Cash flows generated from operating activities are primarily derived from the revenue- producing activities of the entity and comprise those elements that are factors in the determination of net income. Cash flows from investing activities relate to the acquisition and disposal of long-term assets (e.g. purchase of machinery and equipment). Cash flows from financing activities are those activities that result in changes in the size and composition of the equity base (capital) and borrowings (debt) of the entity. Where consolidated financial statements have been prepared for both the project and the executing agency, the cash flow statement should show separately flows specific to the project or provide the necessary details in the supplementary notes to show this. An example showing the format for a cash flow statement is presented in Table III in the Annex.

Financial Reporting for Projects Implemented by Non-Autonomous or Governmental Agencies

4.2.5 The previous section described the types of financial statements required for commercial entities and financially autonomous borrowers. However, where the project or executing agency responsible for the implementation of a project is a ministry or govern mental agency, which normally does not have an accounting organization independent of Government itself, financial reporting will differ from the typical statements described.

4.2.6 Usually, accounting for projects being implemented by a ministry or governmental agency is carried out as part of that organization's budget or by a central accounting unit within the Ministry of Finance. The Bank's reporting requirement in this respect, is formulated keeping in mind that the project being financed by the Bank is only one of several being simultaneously implemented and accounted for by the Government.

4.2.7 Under these circumstances, financial reporting is only required of the project transactions themselves. Standard financial statements described in the previous section, may be substituted by a Statement of Receipt and Expenditure (SRE) which reports in summary form both the cumulative and current financial transactions of the project. All SREs however, must be supported by detailed supplementary notes to explain or qualify entries made in the statement.

4.2.8 The Statement of Receipt and Expenditure should be divided into two sections: (i) Receipts and Sources of Funds and (ii) Project Expenditures. Under the heading ***Receipts and Sources of Funds*** should be listed all funds received during the reporting period including: income generated, if any; loans obtained (ADB & others).; grants from Government and other donors. Under Project Expenditure should be listed all expenditures made during the reporting period classified into the various categories established for the project.

4.2.9 Expenditures during the period should be separated to distinguish capital investments from operating expenses. If the two are combined in the statement, sufficient details must be provided in the supplementary notes to allow them to be separately analyzed. In cases where statements have been prepared on a "cash basis", it is necessary that the borrower provide information to facilitate conversion of the various accounts on an "accrual basis" in order to be able to precise the extent to which the project or entity is financially obligated.

4.2.10 Since both the cumulative and current financial transactions of the project are required to be reported in each statement, it is preferable to prepare SREs in the form of a balance sheet. Table IV in the Annex provides an example of the balance sheet format for the statement.

Reporting Requirements for Development Finance Institutions and Agencies

4.2.11 Financial reporting requirements for development finance institutions (DFIs) and agencies, which include national and sub-regional development banks in member countries are principally the same as those for financially autonomous borrowers described in Sections 4.2.1 - 4.2.4. Besides monitoring the financial soundness of these institutions, the Bank wishes to ensure that their principal assets, (i.e. loans to sub-borrowers) are secured and also achieving the developmental objectives for which the credit facilities were established. The Bank wishes to receive quarterly operational summaries for each sub-project financed with its credit facility.

4.2. 12 Operational summaries should include a brief write-up on the general performance of each sub-project, highlighting major problem areas and measures being taken by the management of the OFT to overcome these problems. For sub-projects still under implementation, the write-up should report on the status or progress of the implementation of the project itself (i.e. construction work-in-progress, schedule of completion, etc.). For on-going sub- projects that have become fully operational, the writeup should focus on the operational activities and performance of the project, such as, profitability and the servicing of its debt to the OFT.

4.2. 13 To illustrate and support its assessment of the performance of any sub-borrower, DFIs may proceed to attach copies of the financial statements of the sub-borrower to the operational summaries sent to the Bank. Notwithstanding the foregoing, the Bank reserves the right to request DFIs to provide financial statements of any sub-borrower benefiting from its credit facility.

4.3 Supplementary Financial Information

4.3.1 In addition to the financial statements and reports already discussed in the previous section, the Bank may require borrowers to prepare and submit supplementary information which are neither disclosed or normally included in financial statements. Such supplementary information is used by the Bank to carry out comprehensive analysis and assessment of the financial performance of the borrower. Some of the supplementary information that may be requested by the Bank are listed below:

Balance Sheet

- a schedule containing a summary of fixed assets (e.g. building, equipment, land etc.) along with disclosure of the basis for their valuation. Separation of assets currently in service and those under construction should be made,
- provisions for depreciation by category of assets including the depreciation method and rates employed,
- a schedule of inventory of stocks and the basis of their valuation. Depending on the nature of the project, distinction should be made of finished products and that of work-in-progress,
- a schedule containing an age analysis of accounts receivable and accounts payable prepared on the basis of major categories of clients and creditors (e.g. government or private),
- summary statement of outstanding debt (long-term) providing details of lenders, terms, principal amounts outstanding, currency denomination of loans, amounts undisbursed and the currency amount of repayments,
- cash and bank balances,

- a schedule of deferred liabilities, and
- notification of assets pledged as collateral for loans.

Income Statement

- a summary statement of non-operating revenues and expenses broken down into major categories, and
- a schedule of income derived from investments of surplus funds including pension and reserves.

4.3.2 Supplementary information which may be required will be determined by Bank's staff during the project's appraisal and discussed with the borrower at the loan negotiations.

4.4 Multi-sector Operations

4.4.1 Reporting to the Bank on multi-sector operations (including structural adjustment loans, sector adjustment loans, support for social dimensions of adjustment, poverty alleviation and institutional support and technical assistance) are made through quarterly progress reports on the implementation of the measures in the policy matrix. Financial reporting with respect to these loans focus primarily on justifying the use of resources in compliance with the terms of the loan.

4.4.2 Unlike the fixed time-frame for preparing financial statements as in the case of project loans, financial reporting for multi-sector operations is in function of the pace of disbursement. Disbursement of each loan tranche is directly matched with performance and progress made in the implementation of specific policies, reforms or components thereof in the various programmes.

4.4.3 Financial reporting to the Bank for multi- sector operations may be presented in the form of a Statement of Expenditure (SOB) prepared by the executing agency providing a summary of goods (commodities) and services purchased with loan resources provided by the Bank. The statement should also provide figures of the cumulative disbursements and expenditures from the start of the programme including funds received from other lenders and donors. Borrowers must satisfactorily justify the use of all funds disbursed prior to the Bank disbursing any other new tranche of the loan.

4.4.4 Eligible categories of goods and services detailed in the appraisal report are checked against the list of items in the various statements to ensure that they comply with the terms of the loan. All SOEs submitted must be accompanied by relevant supporting documents to authenticate the purchases or expenditures. These documents include: invoices, shipping documents (bills of lading), insurance certificates, contracts, etc.

4.4.5 The contents and format of an SOE depend on the type of policy operation being implemented. Generally, these are decided during the appraisal process and specified in the appraisal report. Some of the basic information required to be provided in the statement are: the importer's name, list of goods and services purchased, amount paid and date of purchase and the origin and make of commodities purchased.

4.4.6 Generally, for operations where disbursements are being made under a negative list, only the requisite supporting schedules providing necessary details described above are required. However, for those operations where disbursements are being made under a positive list, goods and services procured must be appropriately classified into the various expenditure categories specified in the appraisal report and loan agreement.

4.4.7 In cases where disbursements by the Bank are being made through a “special account” established for the loan, the Bank may require the borrower to provide bank statements of the account detailing the transactions carried out over the reporting period. If required, this will be agreed with the borrower during the loan negotiations and stipulated in the loan agreement.

5. PROJECT AUDITING & AUDITORS’ REPORT

5.1 Auditing Standards

5. 1.1 Auditing standards to be applied when auditing a project are those prescribed by legislation or otherwise adopted by the governing accounting body in the particular country. In some countries, the latter is the Institute of Certified Public Accountants, Institute of Chartered Accountants or an organization of similar status established to formulate policies and standards for accounting and auditing in the country. Despite differences in each country, it is expected that local auditing standards for the most part will be consistent with internationally accepted auditing standards.

5.2 Criteria for the Selection of Auditors

5.2. 1 The borrower is responsible for the selection and appointment of auditors. Auditors should be appointed well in advance of the close of the financial period for which the audit is to cover to allow sufficient time to plan and carry out a comprehensive examination of the borrowers’ financial statements.

5.2.2 Prior to appointing any auditor, the borrower must provide the Bank with the names of candidates for its review. However, where audit fees are to be financed as a component of the Bank’s loan, the borrower must apply procedures stipulated in the

Bank’s Rules of Procedure for Procurement of Goods and Services. It is the policy of the Bank not to become directly involved or influence the borrower’s decision in the selection of auditors. The Bank, rather, provides guidance to borrowers in the form of professional advice based on its experience, working relationship and knowledge of the qualifications of the various auditing firms. Subsequent appointment of auditors and contract renewals should be subject to review at least on an annual basis.

5.2.3 The Bank considers it essential to take into account when selecting an auditor, certain basic standards with respect to the independence, qualifications and experience of the auditor. These are, that:

(a) auditors must be completely independent and under no circumstances be controlled or influenced by the entity being audited, officers of the entity or the persons appointing them. Any previous financial or business ties with the entity or officers of the entity being audited must be disclosed;

(b) auditors must be well qualified and possess appropriate professional qualifications in accounting and auditing or have equivalent certification from an accredited institution with adequate years of experience in the field;

(c) auditors must be well-established and have good standing in the community. They must also demonstrate competence with a proven track record of having performed auditing work of a similar nature and complexity.

5.2.4 In all cases involving the appointment of a private auditor, the Bank will seek assurances from the borrower that it will apply the criteria stipulated above and, in this connection, provide the Bank with the following information on each candidate before reaching a final decision to appoint the auditor:

i. name of the auditing firm;

ii. qualifications and experience of the principals and senior managers of the firm;

iii. numerical strength of professional staff;

iv. a listing of clients previously audited along with a clear description of the type or nature of activities of the firms audited; and,

v. names of any international accounting or auditing firms to which the firm is affiliated.

5.3 Government Auditor

5.3.1 Projects executed by government ministries or agencies often have statutory requirements which specify that government auditors are to be responsible for auditing the accounts of these projects. During the appraisal of such projects, the Bank will confirm and review government auditing arrangements to ensure that the auditing standards and services provided are satisfactory both in terms of the quality and timeliness of the auditor’s report.

5.3.2 While reviewing these arrangements, the Bank will satisfy itself that the type of reports produced are adequate and meet the needs of the specific project. These reports should extend beyond the routine reporting on stewardship and compliance, to include other important. aspects of the project such as financial performance, financial controls, operating procedures, etc.

5.3.3 The timeliness of the auditor’s report is important to the Bank. Common fiscal year-end and closing of accounts by government entities and agencies may result in the government auditor’s report not being available at the specified time. Iii such circumstances, the Bank would try to work out suitable alternative auditing arrangements with the borrower which would meet the specific requirements of the project (para. *5.3.5).*

5.3.4 The Bank insists on the independence of government auditors from the entities or projects being audited. A government auditor responsible for auditing a project should not control nor be controlled or influenced by the entity or agency being audited or any other organizational unit which is directly involved with or can be tied to the management of the entity being audited. The Bank, generally, will accept the independence of the government auditor if the constitutional provisions or government structure provides for government auditors to report directly to the legislature or to an independent body with similar autonomy. These arrangements will be reviewed by the Bank during the appraisal of the project and appropriate decisions taken thereafter.

5.3.5 Where the Bank determines that the independence of the government auditor could be compromised, either as a result of the auditor's direct or indirect involvement in the accounting, financial management of the entity being audited, or otherwise, the Bank in such situations, may request that a private auditor assist the government auditor in carrying out the audit, or that a private auditor provide an independent audit report in addition to the report prepared by the government auditor. Such a request would also be made in cases where the government auditor is deemed unable to provide adequate audit report within the time period specified by the Bank.

5.4 Scope and Terms of Reference of Audit

Scope of Audit

5.4.1 For projects being executed by a governmental agency, the Bank normally requires the audit of only the project. The extent to which project- related accounts can be separated from the operations of the executing agency will generally determine whether it is necessary to audit the financial statements of the executing agency as well. These issues will be reviewed by the Bank during the appraisal of the project and agreed upon with the borrower.

5.4.2 The scope and detail of an audit examination is determined in accordance with the legal and technical requirements of the project or entity being audited. It may also be supplemented by specific instructions from the borrower to extend the detail and coverage of the audit. Under the same token, borrowers may not restrict the scope of an audit examination to inhibit the auditor from expressing an opinion. The Bank's primary concern is to ensure that the scope and depth of each examination is comprehensive enough to allow the auditor to express an opinion, qualification or disclaimer on the borrower's financial statements.

Terms of Reference of Auditor

5.4.3 The terms of reference of the auditor is normally prepared by the borrower except in cases where the Bank is to finance the audit fees as a component of the loan, in which case, the Bank insists on jointly drafting the terms of reference with the borrower. Notwithstanding, the Bank must review and approve the terms of reference of all auditors before finally engaging their services.

5.4.4 During the loan negotiations, Bank staff will point out specific issues and concerns to the borrower which, in the Bank's opinion, should be highlighted in the terms of reference of the auditor. Bank staff will also be prepared to assist the borrower in the preparation of the document whenever it is needed or requested by the borrower.

5.4.5 For some projects, the Bank may seek to have specific financial information certified or to have the auditor analyze and report on certain policies or issues which may not be covered under the routine scope of the audit. Two examples are certificates for project expenditures and disbursement by the Bank and certification of compliance with financial and related covenant in the loan agreement. In such cases, the Bank usually requires the borrower to arrange separate independent audits or interim audits of the documentation relating to these specific issues. In some cases, it may be possible to incorporate these audits in the routine audit examination, provided that the annual report of the auditor is not delayed or the auditor's report on these specific issues are not required at more frequent intervals. These issues will be discussed with the borrower during the loan negotiations and included in the terms of reference of the auditor.

5.5 Audit Procedures

5.5.1 Audit procedures involve a systematic review of the accounting records and systems of control of the entity being audited. The particular procedures adopted depend on the type of project being audited as well as the efficiency of the entity's accounting and systems of internal control. Audit procedures should be thorough and properly planned so as to provide adequate time to collect and compile information on each of the points mentioned in the auditor's terms of reference. Besides covering the functional areas such as financial performance, operating procedures and financial controls, the Bank requires the following basic procedures directly related to the verification of financial transactions should be applied in all audits. These procedures include:

i) a substantial test of the financial transactions of the entity against supporting documentation to enable him to be satisfied with the authenticity and correctness of the transactions, their complete and proper citing in the books of account;

ii) an examination of the adequacy of the recording of assets and liabilities of the entity and of the methods of their valuation;

iii) in connection with (i) & (ii) above, request by auditors of direct confirmation from creditors and debtors of amounts stated in the books as payable by and due to the entity, respectively; and,

iv) conduct of an on-site visit by auditors to undertake physical count of the fixed assets, stocks and petty cash.

5.5.2 The extent of carrying out various procedures will vary depending on the type of project being audited. For example, projects for agriculture, health and education normally involve the construction of buildings, warehouses, equipments and the buildup of materials and supplies, etc. Auditors would need to conduct a physical check of the facilities and supplies, more so than for a road construction project where most of the equipment and material used for construction are provided by the contractor.

5.6 Auditor's Report

5.6.1 Following the completion of an audit, the auditor is required to report the results of his examination by issuing an opinion on the financial statements to the project managers (executing agency) or designated authorities engaging the services of the auditor. A copy of the auditor's report should be submitted to the Bank as soon as they are received by the borrower.

5.6.2 An auditor's report may be presented in either the Short Form Report or the Long Form Report. The Short Form Report usually contains only the auditor's opinion on the financial statements. The Long Form Report goes beyond this to provide detailed comments on the adequacy of the accounting and financial controls as well as the operating procedures of the entity with appropriate recommendations to the borrower. The Bank will decide and agree with the borrower on the form of the audit report during the loan negotiations. This will also be specified in the auditor's terms of reference.

5.6.3 In the case of a government auditor, however, constitutional or statutory requirements may prohibit the submission of his report on the audit of a government department or entity prior to it being submitted to the legislature. During the appraisal of the project, Bank staff will ascertain this practice and work out alternative arrangements with the borrower. Among the alternatives available, is to request the borrower to obtain special legislative exemptions to allow the issuance of the audit report or, have an appropriate certificate issued which would incorporate the various elements contained in an auditor's report. Where these options are not practical, the Bank will seek the borrowers' agreement to have the project audited by a private auditing firm.

6. TIMING AND SUBMISSION OF REPORTS

6.0. 1 The submission of various financial reports to the Bank including interim financial reports and annual financial statements is determined on a project by project basis. Specific periods for submitting financial statements and reports are stipulated in each loan agreement. The Bank, nevertheless, will make efforts during the loan negotiations to ensure that the timetable suggested and subsequently agreed upon is realistic and consistently reflects the ability of the borrower to comply.

6.0.2 Borrowers are urged to submit financial statements and reports to the Bank as promptly as possible after the close of the period for which the statements are prepared. Generally, the Bank expects interim financial statements and financial reports to be provided within three months after the closing date of the statements. Unaudited annual financial statements are expected to be available within three - four months after the close of the financial year. Audited annual financial Statements including the Auditor's Report are expected to be provided no later than six months after the close of the financial year.

6.0.3 Allowances are provided in special cases where the borrower or project is still developing its accounting system, or, is in the process of implementing programmes to strengthen its accounting efficiency and controls. The Bank, in such cases may extend the period for submitting financial statements beyond the period normally required. However, evidence of the programmes being implemented to strengthen the accounting system of the project/borrower must be reported regularly and confirmed by Bank staff.

7. FINANCING OF FEES FOR EXTERNAL AUDITORS

7.0. 1 It is the current practice of the Bank to insist that audit fees for external auditors are included as part of the project cost. Financing for this component will be discussed along with the Financing Plan of the project during the appraisal of the project and agreed upon at the loan negotiations.

Annex:

TABLE I

NAME OF THE ORGANIZATION:
INCOME STATEMENT FOR THE YEAR ENDED
(Local currency in thousands or in millions) **199X 199X-1**

	199X	199X-1
REVENUE:		
Sales		
Miscellaneous		
Total Revenue		
EXPENDITURE:		
Operation		
Administrative & General Expenses		
Other expenses		
Depreciation		
Total Expenditure		
NET OPERATING INCOME		
FINANCIAL EXPENSES & INCOME		
Financial Charges		
Interest Income		
Exchange gains/(losses)		
INCOME BEFORE TAXATION		
Taxes		
NET INCOME		

Annex:

TABLE II

NAME OF THE ORGANIZATION:

BALANCE SHEET AS AT

(Local currency in thousands or in millions) **199X 199X-1**

	199X	**199X-1**
ASSETS		
Inventories		
Account Receivable		
Other Debtors		
Short Term Investments		
Bank & Cash Balances		
Total Current Assets		
Fixed Assets:		
Plant & Equipment in Operation		
Less: Cumulative Depreciation		
Net Plant & Equipment in Operation		
Total Assets		
LIABILITIES		
Current Liabilities:		
Account Payable		
Taxation		
Short-term debt		
Total Current Liabilities		
Long Term Debt		
Equity:		
Share Capital		
Retained Earnings		
Capital Reserves		
Total Equity		
Total Liabilities		

Annex:
TABLE III

NAME OF THE ORGANIZATION:
STATEMENT OF CASHFLOWS AS AT
(Local currency in thousands or in millions) **199X 199X-1**

	199X	199X-1
Cash flows from Operating Activities		
Net profit before taxation & extraordinary items		
Adjustments for:		
Depreciation		
Foreign exchange loss		
Investment income		
Financial charges		
Operating profit before working capital changes		
Increase in trade & other receivables		
Decrease in inventories		
Decrease in trade payables		
Cash generated from operating activities		
Interest paid		
Income taxes paid		
Cash flow before extraordinary item		
Net cash from operating activities		
Cash flows from Investing Activities		
Acquisitions of subsidiary		
Purchase of property, plant and equipment		
Proceeds from sale of equipment		
Interest received		
Dividend received		
Net cash flow (used) from investing activities		
Cash flows from financing activities		
Proceeds from issuance of share capital		
Proceeds from long-term borrowings		
Dividends paid		

Net cash flow (used) from financing activities
Net increase in cash and cash equivalents
Cash and cash equivalents at the beginning of the period
Cash and cash equivalents at the end of the period

Annex:
TABLE IV

NAME OF THE ORGANIZATION:
STATEMENT OF RECEIPT AND EXPENDITURE FOR THE YEAR
(Local currency in thousands or in millions)

PROJECT EXPENDITURE

EXPENSE CATEGORY: <u>Current Year</u>
Balance
Cum. Bal
b/f Local
Foreign
Cost
Cost

Property
Equipment
Materials
Consultancy
Administrative Cost
Manpower Development & Training
Utilities
Others
Sub-total
Cash and Bank balance
Total

SOURCES OF FUNDS

SOURCES: <u>Current Year</u>
Balance
Cum. Bal
b/f Local
Foreign
Cost
Cost

Government Contributions
Grants (List donors)
Loans
- ADB
- ADF
- NTF

Others (co-financiers' names)
Revenue
Total