

## **ANNEX 5 TOR PROJECT AUDIT**

### **TERMS OF REFERENCE (TOR)**

#### **FOR THE AUDIT OF THE BUILDING EFFECTIVE, TRANSPARENT AND ACCOUNTABLE PUBLIC FINANCIAL INSTITUTIONS PROJECT FOR THE YEAR ENDED DECEMBER 31, 20XX**

### **Background**

Building Effective, Transparent and Accountable Public Financial Institutions Project aims to improve the efficiency, transparency and sustainability of public expenditure and increase the effectiveness of revenue administration in North Macedonia. It will be financed through a EUR 20 million Investment Project Financing (IPF) from the IBRD and EUR 5.5 million in Recipient-executed grant financing from the EU under the European Commission - World Bank Partnership Programme Part III for Europe and Central Asia Programmatic Single-Donor Trust Fund. The proposed Project, to be carried out over the course of four years, will pursue a comprehensive approach to strengthening both the expenditure and revenue sides of the public financial management cycle that takes into account both fiscal and climate change sustainability. In particular, it contemplates:

- (i) Support to public expenditure management reforms and the development of the IFMIS and the SAMIS, and
- (ii) Strengthening of tax administration processes and systems in the PRO.

These advances will be supported by activities focused on regulatory and institutional reforms, systems modernization, and capacity building. Given the importance of change management and strategic stakeholder engagement within the reform agenda, related activities will be an integral part of the proposed Project.

The Ministry of Finance (MOF) is the main implementing agency of the Project in close cooperation with the Public Revenue Office (PRO), and Cabinet of Deputy Prime Minister in charge for Economic Affairs.

#### **Project Components:**

- Component 1: Supporting Public Expenditure Management Reforms
- Component 2: Strengthening Tax Administration Practices and Systems in PRO
- Component 3: Supporting Change Management, Donor Coordination and Project Management

### **Objective**

The objective of the audit of the project financial statements (PFS) is to enable the auditor to express a professional opinion on the project's financial position as at the end of each fiscal year 202X and 202X and of the income and expenditure for the accounting period ending on each fiscal year until June 30, 2023, including any grace period transactions. The project's books of account provide the basis for preparation of the financial statements and are established to reflect the financial transactions in respect of the project.

## Responsibility for preparation of financial statements

The responsibility for the preparation of financial statements including adequate disclosure is that of the project's management. This includes the maintenance of adequate accounting records and internal controls, the selection and application of accounting policies, and the safeguarding of the assets of the project. As part of the audit process, the auditor will request from management written confirmation concerning representations made to us in connection with the audit.

## Scope

The audit will be conducted in accordance with International Standards on Auditing (ISA) published by the International Auditing and Assurance Standards Board of the International Federation of Accountants (IFAC). Those Standards require that the auditor plans and performs the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In complying with ISA, the auditor is expected to pay particular attention to the following matters, including special considerations for public sector entities:

- a) In planning and performing the audit to reduce audit risk to an acceptably low level, the auditor should consider the risks of material misstatements in the financial statements due to fraud as required by International Standard on Auditing 240: The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements.
- b) When designing and performing audit procedures and in evaluating and reporting the results thereof, the auditor should recognize that noncompliance by the entity with laws and regulations may materially affect the financial statements as required by International Standard on Auditing 250: Consideration of Laws and Regulations in an Audit of Financial Statements.
- c) The auditor should communicate audit matters of governance interest arising from the audit of financial statements to those charged with governance of an entity as required by International Standard on Auditing 260: Communication of Audit Matters with those Charged with Governance.
- d) The auditor should communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified in an audit of financial statements as required by International Standard on Auditing 265: Communicating Deficiencies in Internal Control to Those Charged with Governance and Management.
- e) In order to reduce audit risk to an acceptably low level, the auditor should determine overall responses to assessed risks at the financial statement level, and should design and perform further audit procedures to respond to assessed risks at the assertion level as required by International Standard on Auditing 330: The Auditor's Procedures in Response to Assessed Risks.

- f) In instances where certain aspects of an entity's operations are performed by a third party service provider, the auditor is expected to include an understanding and assessment of the internal control environment of the service provider during the audit process as required by International Standard on Auditing 402: Audit Considerations Relating to an Entity Using a Service Organization.
- g) As part of the audit process, the auditor is expected to obtain written representations from management and, where appropriate, those charged with governance as required by International Standard on Auditing 580: Written Representations.

In evidencing compliance with agreed project financing arrangements, during the audit of the Project Financial Statements the auditor is expected to carry out tests to confirm that:

- a) External funds have been used in accordance with the conditions of the relevant general conditions, relevant financing agreements, with due attention to economy and efficiency, and only for the purposes for which the financing was provided. Relevant general conditions and financing agreements are:
  - The Legal Agreement for IBRD Loan number 8525 – MK between International Bank for Reconstruction and Development and Public Enterprise for State Roads, dated October 6, 2016.
  - Disbursement Letter dated October 6, 2016.
  - General Conditions for Loans dated March 12, 2012.
- b) Counterpart funds have been provided and used in accordance with the relevant general conditions, relevant financing agreements, and only for the purposes for which they were provided;
- c) Goods and services financed have been procured in accordance with the relevant general conditions and relevant financing agreements<sup>1</sup>, including specific provisions of the World Bank Procurement Guidelines<sup>2</sup>;
- d) Necessary supporting documents, records, and accounts have been kept in respect of all Project ventures including expenditures reported via Summary Report or Statements of Expenditures (SOEs), or Designated Accounts (DAs). The auditor is expected to verify that respective reports issued during the period were in agreement with the underlying books of account;
- e) Where Designated Accounts have been used, they have been maintained in accordance with the provisions of the relevant general conditions, relevant financing agreements and Disbursement letter; Review the compliance on each of the financial covenants in the Legal Agreement for the IBRD Loan 8525-MK dated October 6, 2015.

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<sup>1</sup> Depending on the complexity of procurement activities, the auditor may consider involving technical experts during the audit engagement. In cases where such experts are involved, the auditor is expected to comply with provisions of International Standard on Auditing 620: Using the Work of an Expert. Consideration to use of the work of experts should be brought to the early attention of the borrower and the World Bank for mutual agreement and appropriate guidance.

<sup>2</sup> See Guidelines: Procurement of Goods, Works, and Non-Consulting Services under IBRD Loans and IDA Credits & Grants - January 2011 and Guidelines: Selection and Employment of Consultants under IBRD Loans & IDA Credits & Grants by World Bank Borrowers - January 2011.

## **Project Financial Statements prepared under the IPSAS**

The Project Financial Statements should include as a minimum the information required by the International Public Sector Accounting Standards IPSAS Financial Reporting under IPSAS. The financial statements should include:

- a) A Summary of Funds received, showing the World Bank, Project funds from other donors, and counterpart funds separately.
- b) A Summary of Expenditures paid in cash, shown under the main project headings and by main categories of expenditures, both for the current fiscal year and accumulated to-date;
- c) Accounting policies and explanatory notes (including additional accounting policies and disclosures), covering
  - a Summary of Summary Reports or SOEs used as the basis for the submission of withdrawal applications in the notes, as appropriate;
  - a Statement of Designated Account in the notes, as appropriate;
  - a Statement of Financial Position showing Accumulated Funds of the Project, bank balances, other assets of the Project, and liabilities, if any; and
- d) When the entity makes publicly available its approved budget, a comparison of budget and actual amounts either as a separate additional financial statement or as a budget column in the statement of cash receipts and payments.

### **Summary Reports or Statement of Expenditures**

The auditor is required to audit all Summary Reports or SOEs submitted to the World Bank in support of requests for periodic replenishment of the project designated account(s).

Expenditures should be examined for eligibility based on criteria defined in the terms of the financing agreement and detailed in the Project Appraisal Document. Where ineligible expenditures are identified as having been included in withdrawal applications and reimbursed, they should be separately reported.

The Project Financial Statements should include a schedule listing of individual Summary Reports or SOEs withdrawal applications by specific reference number and amount.

The auditor should pay particular attention as to whether:

- a) The Summary Reports or SOEs have been prepared in accordance with the provisions of the relevant financing agreement.
- b) Expenditures have been made wholly and necessarily for the realization of project objectives.
- c) information and explanation necessary for the purpose of the audit have been obtained;
- d) supporting records and documents necessary for the purpose of the audit have been retained, and

- e) The Summary Reports or SOEs can be relied upon to support the related withdrawal applications.
- f)

### **Designated Accounts**

During the audit of the project financial statements, the auditor is required to review the activities of the project's designated account(s). Activities to be examined will include deposits received, payments made, interest earned and reconciliation of period-end balances.

The auditor should pay particular attention as to the compliance with the Bank's procedures and the balances of the Designated Accounts at the end of the fiscal year and the adequacy of internal controls for this type of disbursement mechanism.

### **Audit Reports**

The auditors will issue an audit opinion on the Project Financial Statements.

In addition to the audit opinion, the auditor will prepare a "management letter," in which the auditor will:

- a) provide comments and observations on the accounting records, systems, and controls that were examined during the course of the audit;
- b) identify specific deficiencies and areas of weakness in systems and controls and make recommendation for their improvement;
- c) report on instances of non-compliance with the terms of the financial agreement(s);
- d) quantify and report expenditures that are considered to be ineligible and either paid out of the designated account(s) or which have been claimed from the World Bank;
- e) communicate matters that have come to their attention during the audit which might have a significant impact on the implementation of the project;
- f) bring to the borrower's attention any other matters that the auditor considers pertinent; and
- g) include management's comments in the final management letter.

If none of the above applies, and a management letter is therefore not prepared, the auditor will issue a letter stating that during the audit nothing has come to their attention that the auditor considers pertinent to be brought to the attention of the borrower. The financial statements, including the audit opinion, and management letter should be received by the Project implementing agency, no later than six (6) months after the end of the audited fiscal year. The Project's implementing agency should then promptly forward two copies of these to the World Bank.

### **Public Disclosure**

In accordance with "The World Bank (the Bank) Policy on Access to Information" dated July 1, 2010 for Bank-financed operations for which the invitation to negotiate is issued on or after July 1, 2010, the Bank requires that the borrower makes the audited financial statements publically available in a timely fashion and manner acceptable to the Bank. In addition, following the Bank's formal receipt of these

financial statements from the borrower, the Bank makes them available to the public in accordance with this policy.

Management Letters, special audits (i.e. whose nature is not financial), and unaudited financial statements (e.g. Interim Financial Reports) are not considered to be a part of the definition of the audited financial statements for the purposes of disclosure.

Only in exceptional cases the Bank may agree i.e., when the audited financial statements contain proprietary or commercially sensitive information—that the borrower or designated project entity may be exempted from disclosing the full set of audited financial statements, but is still required to disclose an abridged version of them in a form acceptable to the Bank. Exceptions are approved by World Bank management.

## **General**

The responsibility for the preparation of financial statements including adequate disclosure is that of the Project Implementation Unit within the Ministry of Finance. As part of the audit process, the auditor will request from management written confirmation concerning representations made to the auditor in connection with the audit.

The auditor is entitled to unlimited access to all information and explanations considered necessary to facilitate the audit including legal documents, project preparation and supervision reports, reports of reviews and investigations, correspondences, and credit account information. The auditor may also seek written confirmation of amounts disbursed and outstanding in the Bank records.

The auditor is encouraged to meet and discuss audit related matters including input to the audit plan with the World Bank project task team.

It is highly desirable that the auditor become familiar with the relevant World Bank guidelines, which explain the Bank's financial reporting and auditing requirements. These guidelines include:

- Reference Material to the Financial Management Manual for World Bank-Financed Investment Operations (March 2010): *RM 3 - Financial Reporting and Auditing*;
- Disbursement Handbook for World Bank Clients, dated May 2006 (available on Client Connection web site);
- Disbursement Guidelines for Projects, dated May 2006 (available on Client Connection web site).
- Guidelines: Procurement of Goods, Works, and Non-Consulting Services under IBRD Loans and IDA Credits & Grants - January 2011.
- Guidelines: Selection and Employment of Consultants under IBRD Loans & IDA Credits & Grants by World Bank Borrowers - January 2011.

This term of engagement will remain effective for every fiscal year, 202x and 202x (plus any grace period) unless it is terminated, amended or superseded.

The auditor should understand that working papers under World Bank project can be subject to the review by Client's and/or World Bank designated staff.

## **Auditors Experience and Qualifications**

1. The audit firm should be registered and have a license from a national or regional professional Accountancy Body. The firm should have relevant experience in accounting and auditing of development projects, especially donor-funded operations.
2. The key audit team will comprise, at least:
  - (a) An audit manager with at least 10 years' experience in auditing. In addition, he/she should be a member of a recognized accountancy professional body. Knowledge and experience in donor-financed projects is a strong advantage;
  - (b) A team leader with at least a master's degree in auditing/accounting or equivalent with a minimum of 10 years' experience in auditing; and
  - (c) An assistant auditor with adequate experience of minimum 3 years and professional qualifications.