

Terms of Reference

Financing Agreement (Loan 3432-KGZ (SF)/ Grant 0496 – KGZ (SF)
Asian Developing Bank

CAREC Corridor 1 and 3 Connector Road Project

AUDIT OF ANNUAL PROJECT FINANCIAL STATEMENTS (APFS) AUDITOR'S TERMS OF REFERENCE

Introduction

1. According to Clause 4.02 (a) of the Financing Agreement between the Government of the Kyrgyz Republic and Asian Development Bank for the CAREC Corridor 1 and 3 Connector Road Project dated December 02, 2016 the Beneficiary shall (i) maintain separate accounts and records for the Project, including separate accounts and records for the Loan and Grant; (ii) prepare annual financial statements for the Project in accordance with accounting principles acceptable to ADB; (iii) have such financial statements audited annually by independent auditors whose qualifications, experience, and terms of reference are acceptable to ADB, in accordance with international standards for auditing or the national equivalent acceptable to ADB; (iv) have the auditors prepare a report (which includes the auditor's opinion on the financial statements, use of the Loan and grant proceeds and compliance with the financial covenants of the Financing Agreement as well as on the use of the procedures for imprest fund(s) and statement of expenditures) and a management letter (which sets out the deficiencies in the internal control of the Project that were identified in the course of the audit, if any); and (v) furnish to ADB, no later than 6 months after the end of each related fiscal year, copies of such audited financial statements, audit report and management letter, all in the English language, and such other information concerning these documents and the audit thereof as ADB shall from time to time reasonably request.

2. This Terms of Reference describes the assignment scope to cover audit services for fiscal years 2017- 2021 (up to project closing date).

General Background

3. **Project's location, description, and rationale.** The project will connect two major CAREC regional corridors by rehabilitating a crucial connector road, part of the North–South Alternate Corridor, a priority in the National Sustainable Development Strategy.¹ It will improve connectivity and mobility in the country and link the economic underprivileged regions with the economic hubs, as well as strengthen road maintenance practices and institutional capacity by introducing and implementing a road asset management system and a project implementation unit administrative manual and procedure.²

4. The Project financed by ADB will have the following outputs:

- (i) rehabilitating approximately 70 km road section from Epkin village to Bashkugandy village, incorporating specific features for road safety and climate change adaptation; and

¹ Government of the Kyrgyz Republic, National Council for Sustainable Development of the Kyrgyz Republic, National Sustainable Development Strategy for the Kyrgyz Republic, 2013–2017. Bishkek.

² The Asian Development Bank (ADB) provided project preparatory technical assistance (PPTA) for Preparing Central Asia Regional Economic Corporation Corridors 1 and 3 Connector Road Project (TA 8887).

- (ii) strengthening institutional capacity by providing support for detailed design, construction supervision, project management, audit of the project financial statements, preparation and implementation of road asset management system, road sector management reforming.

5. The Ministry of Transport and Roads (MoTR) of the Kyrgyz Republic is currently the executing agency (EA) for ongoing ADB-financed projects and serves as such for this Project. The existing investment projects implementation group (IPIG) under the EA shall (i) monitor the progress of day-to-day project implementation, (ii) prepare withdrawal applications, (iii) prepare project progress reports, and (iv) maintain project accounts and complete financial records for auditing the Project. The director of the existing IPIG shall be responsible for the day-to-day supervision of implementation activities.

Expertise preferred for this assignment includes:

a. Team Leader (4 person-months over a period of four and a half years)

Preferred Qualification requirements

- More than 10 years total experience, including at least 5 years relevant project auditing experience (see below)
- Higher education and qualification in accountancy, and membership of relevant professional body, chartered status

b. Auditor-Consultant (8 person-months over a period of four and a half years)

Preferred Qualification requirements

- More than 10 years total experience, including at least 3 years relevant project audit experience (see below)
- Higher education and qualification in accountancy, and membership of relevant professional body, chartered status

c. Auditor (10 person-months over a period of four and a half years)

Preferred Qualification requirements

- More than 5 years total experience, including at least 1 year relevant project audit experience (see below)
- Higher education and qualification in accountancy, and membership of relevant professional body, chartered status

Preferred Expertise for 3 specialists:

- evaluation of the systems and operating procedures for accounting in accordance with international accounting standards, custody of assets, control of environment and internal financial control, financial reporting, and related systems,
- checking of correctness and documentary completeness of payments to contractors and consultants in accordance with the respective contracts,
- assessment of compliance with the covenants and all other project documents and ADB procedures,
- preparation of audit reports for similar projects including multilaterally-funded infrastructure projects/contracts of approximately US\$20 million value (implemented over approximately three years, preferably within the MoTR, administered by consultants and project implementation units, including use of direct payment and imprest accounts).

Employment Authority

6. The audit services will be contracted by the MoTR, Kyrgyz Republic.

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Delivery of Opinions and Reports

7. The auditor will provide Audit Opinion on the Annual Project Accounts with Management Letter (with copies to ADB), in accordance with the following timeframes:

- For the fiscal year ending 2017 and 2018 by the end of May 2019;
- For the fiscal year ending 2019 by the end of May 2020;
- For the fiscal year ending 2020 by the end of May 2021;
- For the fiscal year ending 2021 (up to loan/grant closing date) by the beginning of September 2021.

8. Each Audit Report (project accounts, financial statements, imprest funds as applicable), should be submitted to ADB not more than 6 months following the end of each fiscal year as specified in the Financing Agreement of the project between ADB and the Government.

9. All reports must be provided in four copies in the English and Russian languages.

Objectives

10. The objective of the APFS audit is to enable the auditor to express an opinion on the financial position of the project and on the funds received and expenditures made covering the relevant fiscal years.

11. The Audit Report shall include: (i) name of the auditor; (ii) date of the report writing; (iii) address (EA and/or borrower); (iv) identification of financial information audited; (v) reference to audit standards or methods; (vi) provision of audit opinion including qualification; waiver of audit opinion on financial information; (vii) auditor's signature; (viii) auditor's address, and (ix) date of report signature.

Description of Materials and Timing of Delivery

12. The APFS and supporting documentation will be provided to the auditor on the following estimated dates:

- For the fiscal year ending 2017 and 2018 by the end of March 2019;
- For the fiscal year ending 2019 by the end of March 2020;
- For the fiscal year ending 2020 by the end of March 2021;
- For the fiscal year ending 2021 (up to loan/grant closing date) by the beginning of August 2021.

Audit Scope

13. The auditor should obtain an understanding of the project and the functions of IPIG, MoTR, including the contents of the RRP, legal agreements and the ADB's guidelines, i.e. Financial Management and Analysis of Project, Loan Disbursement Handbook, Procurement Handbook, etc.

14. The auditor's examination should include an evaluation of the systems and operating procedures for accounting, custody of assets, control of environment and internal financial control, financial reporting, and related systems covering the following:

Auditing Standards and Program. The audit will be carried out in accordance with the agreed auditing standards as specified in the Agreed Auditing Standards, including professional or general standards, standards of fieldwork, and reporting standards.

The audit program will consider the risk of material misstatements resulting from fraud or error. It should include procedures that are designed to provide reasonable assurance that material misstatements (if any) are detected.

Accounting Policies and Changes. The auditor should comment on the project's accounting policies, and confirm the extent to which the agreed project accounting policies have been applied. In particular, the auditor should note the impact on the APFC arising from any material deviations from the agreed accounting standards. The auditor should also comment on any accounting policy changes, either during a financial year, or from one year to another.

Imprest Account (or Special Account). The Imprest Account reflects: (i) deposits and replenishment received from financiers, (ii) payments substantiated by withdrawal applications, and (iii) the remaining balance at financial year-end. The auditor will examine whether the Imprest Account has been maintained in accordance with the provisions of the relevant financing agreements.

The auditor must form an opinion on whether the Imprest Account was used in compliance with required procedures (e.g., those of ADB), and the fairness of the presentation of Imprest Account activity and the year-end balance. The auditor should examine the eligibility and correctness of financial transactions during the period under review, account balances at the end of the period, the operation and use of the Imprest Account in accordance with the financing agreement, and the adequacy of internal controls for this particular disbursement mechanism.

Statements of Expenditures (SOE). The auditor will audit all SOEs used as the basis for the submission of grant and credit withdrawal applications to ADB as well as governmental withdrawal applications to the GoKR. These expenditures should be compared for project eligibility with the relevant financing agreements (and with reference to the RRP and other project documents for guidance when considered necessary). Where ineligible expenditures are identified as having been included in withdrawal applications and reimbursed against, these should be separately noted by the auditor. The annual audit report should include a separate paragraph commenting on the accuracy and propriety of expenditures withdrawn under SOE procedures, and the extent to which ADB can rely on those SOEs as a basis for grant and credit disbursement. Annexed to the APFS should be a schedule listing individual SOE withdrawal applications by specific reference number and amount.

Compliance with Financial Covenants. The auditor will confirm compliance with each financial covenant contained in the project legal documents. Where present, the auditor should indicate the extent of any noncompliance by comparing required and actual performance measurements for each financial covenant with the financial year concerned.

Compliance with Financial Assurances. The auditor will confirm compliance with all financial assurances contained in the project legal documents (see terms and definitions). Where

present, the auditor should indicate the extent of any non-compliance by comparing required and actual performance of the Recipient in respect of these ADB requirements for the financial year concerned.

Use of Funds for the Purpose Intended. The auditor will confirm, or otherwise, that:

- All external funds have been used in accordance with the relevant financing agreements covering each project, with due attention to economy and efficiency, and only for the purpose for which the financing was provided.
- Counterpart funds, i.e. Government and/or co-financiers have been provided and used in accordance with the relevant financing arrangements and only for the purpose for which the financing was provided and
- Goods and services financed have been procured in accordance with the relevant financing agreements.

Record Keeping. The auditor will pay particular attention to whether all necessary supporting documents, records, and accounts have been kept in respect of all project activities, with clear linkages between the accounting records and the APFS. This will include: (i) computation and recalculation, including checking the mathematical accuracy of estimates, accounts, or records; (ii) reconciliation, including reconciling related accounts to each other, subsidiary records to primary records and internal records to external documents; and (iii) tracing, including tracing journal postings, subsidiary ledger balances, and other details to corresponding general ledger accounts or trial balances.

Internal Control Systems. The auditor will assess the adequacy of the project financial management systems, including internal controls, including whether: (i) proper authorizations are obtained and documented before transactions are entered into; (ii) accuracy and consistency are achieved in recording, classifying, summarizing, and reporting transactions.

Management Letters

On conclusion of the audit, the auditor will prepare a management letter for the audited project, detailing:

- Any material weaknesses in the accounting and internal control systems that were identified during the audit, including those regarding SOEs and Imprest Accounts (if applicable);
- Recommendations to rectify identified weaknesses;
- Status of significant matters raised in previous management letters;
- Practical recommendations on the steps that could be taken to become materially compliant with the agreed project accounting policies, together with a time frame for making these changes;
- The degree of compliance with each of the financial covenants in the Financing Agreement and recommendations for improvement;
- Matters that have come to the auditor's attention during the course of the audit which have a significant impact on project implementation;
- Any other matters that the auditor considers should be brought to the attention of the project's management; and
- Significant matters that the auditor considers should be brought to ADB's attention.

Statement of Access

15. The auditor will have full and complete access, at all reasonable times, to all records and documents including books of account, legal agreements, bank records, invoices, and any other information associated with the project and deemed necessary by the auditor.

16. The auditor will be provided with full cooperation by all employees of MoTR and the IPIG, whose activities involve, or may be reflected in, the annual financial statements. The auditor will be assured rights of access to banks and depositories, consultants, contractors, and other persons or firms hired by the employer.

Independence

17. The auditor will be impartial and independent from any aspects of management or financial interest in the entity under audit. In particular, the auditor should be independent of the control of the entity. The auditor should not, during the period covered by the audit, be employed by, or serve as director for, or have any financial or close business relationship with the entity. The auditor should not have any close personal relationships with any senior participant in the management of the entity. The auditor must disclose any issues or relationships that might compromise their independence.

Auditor and Audit Staff Competence

18. The auditor must be authorized to practice in the country and be capable of applying the agreed auditing standards. The auditor should have adequate staff, with appropriate professional qualifications and suitable experience, including experience in auditing the accounts of entities comparable in nature, size, and complexity with the entity whose audit they are to undertake.

19. To this end, the auditor is required to provide curriculum vitae (CV) of the auditors who will provide the opinions and reports, together with the CVs of managers, supervisors, and key personnel likely to be involved in the audit work. These CVs should include details of audits carried out by these staff, including ongoing assignments.

Submission of Proposal and Work Plan

20. You are invited to submit a proposal and a work plan to provide the audit services described in this letter. Proposals should address, among other things:

- The extent (if any) that you would not conform to the agreed auditing standards and indicate any alternative standards to which you may (be required to) conform.
- Whether the audit would be conducted as a completed audit (i.e., will the auditors carry out their audit after financial year-end, when the books of account are, or are being, closed).
- Whether an audit carried out after financial year-end would be supplemented by one or more interim audits during a financial year. The principal purpose is to test ongoing systems and internal controls, and to relieve pressure on the staff of the entity and on the auditor at year-end.
- The manner in which the auditor proposes to address any statutory requirements relating to audit (e.g., certifications relating to shareholders' equity required under the companies' act) or to which they may be implicitly bound by contractual obligations of the employer (e.g., ADB auditing requirements, Statements of Expenditure, Imprest Accounts).
- Procedural requirements for certain verification procedures (e.g., checking of stocks, inventories, assets, etc.).
- Specific actions required on the part of the employer (e.g., access to computer systems and records, disclosures).
- Discussions before signing the opinion and report on any matters arising from the audit, and with whom these discussions would be held.
- The timetable for provision of opinions and reports.

TERMS AND DEFINITIONS

21. This section defines the terms used in this document.

a. Annual Project Financial Statements (APFS)

The APFS comprise:

- Statement of Accounting Policies,
- Statement of Cash Flows/Cash Receipts and Payments,
- Statement of Uses of Funds by Project activity,
- Notes to the Financial Statements, and
- Other information including, (a) summary of received funds indicating individually ADB funds, (b) summary of expenditures indicated under the Project main components and main expenditure categories (as stated in loan documents) and cumulative Project expenditures, and (c) balance statement covering each audit period.

b. Agreed Project Accounting Policies

“Agreed project accounting policies” with regards to preparation of Annual Project Accounts, means the International Public Sector Accounting Standards (IPSAS) (cash method of accounting) issued by the Committee for public sector accounting of the International Federation of Accountants (IFAC).

c. Agreed Auditing Standards

“Agreed auditing standards” means the International Standards on Auditing (ISA 800) promulgated by the International Auditing and Assurance Standards Board (IAASB).

d. Financial assurances

The following financial assurances were provided (item 10, Annex 5, Loan Agreement):

Without restricted application of the Loan Provision Section 6.06, the Borrower shall ensure timely provision of all funds and resources required for the Project implementation, in accordance with the financing plan agreed for the purposes of the Project.