GUIDELINES AND TERMS OF REFERENCE FOR AUDITS OF PROJECTS WITH FINANCING BY THE WORLD BANK IN THE LATIN AMERICA AND CARIBBEAN REGION

Financial Management/Accountability Team
Operations Support Unit

THE WORLD BANK
May 1999
USEFUL ACRONYMS AND ABBREVIATIONS

FARAH - Financial Accounting, Reporting and Auditing Handbook
GAAP - Generally Accepted Accounting Principles
GAAS - Generally Accepted Auditing Standards
IAS - International Accounting Standards
IASC - International Accounting Standards Committee
IBRD - International Bank for Reconstruction and Development
IDA - International Development Association
IFAC - International Federation of Accountants
INTOSAI - International Organization of Supreme Audit Institutions
ISA - International Standard on Auditing
LACI - Loan Administration Change Initiative
LCR - Latin America and Caribbean Region
OSU - Operations Support Unit
PAD - Project Appraisal Document
SA - Special Account
SAl - Supreme Audit Institution
SAL - Structural Adjustment Loan
SAR - Staff Appraisal Report
SECAL - Sector Adjustment Loan
SOE - Statement of Expenditure
TM - Task Manager
TOR - Terms of Reference
TTL - Task Team Leader (same as Task Manager)
This document provides guidance to borrowers, implementing entities and governmental and private sector auditors involved in the implementation and auditing of projects financed by the World Bank in the Latin America and Caribbean Region.

In general, implementing entities are charged with the responsibility for properly accounting for and reporting on project resources. Auditors are responsible for providing professional opinions on the financial statements prepared by the entities, as well as reporting on the adequacy of the internal controls and the entity's compliance with the terms of the Loan Agreement. One of the purposes of the Guidelines is to establish uniform criteria for project accounting, reporting and auditing.

Implementing entities and their auditors should follow these Guidelines in the preparation of project financial statements, terms of reference for audits, and audit reports. The model project financial statements and model terms of reference provided herein should be used as the main basis for preparing the applicable documents. The Financial Management Specialist assigned by the Bank to work with the project will provide the assistance necessary to ensure compliance with these Bank requirements.

Auditors should read Parts IV and V thoroughly to gain an understanding of the audit requirements for Projects with financing by the World Bank. Auditors with experience in projects financed by international organizations will find most of the information familiar. Other auditors may find the information new and valuable for planning and performing the audit and reporting the results of their work. In all cases, the guidance on the preparation of audit reports will help the auditor prepare reports in the format required.

Zafer Ecevit  
Director  
Operations Support Unit  
Latin America and Caribbean Region  
May 1999

These Guidelines were prepared by the Latin America and Caribbean Region’s Financial Management/Accountability Team. The principal author was Roque A. Ardón, with insightful comments by Orv Grimes and other members of the Team and OSU.
# Table of Contents

**Acronyms and Abbreviations**

**Preface**

I. **Introduction**.................................1

II. **Guidance to Implementing Entities: Accounting and Financial Reporting**..........3
   - Accounting..................................................3
   - Financial Reporting.......................................3

III. **Guidance to Implementing Entities: Selection and Contracting of Auditors** .......9

IV. **Guidance to Auditors: Audit of Projects**..................................................13
   - Summary.....................................................13
   - Detailed Issues............................................14

V. **Guidance to Auditors: Audit of Adjustment Loans**.....................................25

VI. **Annexes**

   Annex I: Model Project Financial Statements....................................................29
   Annex II: Model Terms of Reference for Audits.................................................37
   Attachment 1 to Model TORs.................................................................44
GUIDELINES AND TERMS OF REFERENCE FOR AUDITS OF PROJECTS WITH FINANCING BY THE WORLD BANK IN THE LATIN AMERICA AND CARIBBEAN REGION

I: INTRODUCTION

1.1. In accordance with their agreements with The World Bank (the Bank), the Borrower and the entities executing projects with Bank financing must ensure that the funds loaned or granted by the Bank are used with due attention to economy, effectiveness and efficiency, and only for the purposes for which the financing was provided. Likewise, it is of utmost importance to have transparency in the use and accounting of the funds managed by each implementing entity, not only for the funds obtained from external sources, but also for those from internal sources such as the National Treasury or revenues from services provided by the entity. Transparency in managing the funds and goods entrusted to the management of public entities allows public servants to comply with their accountability duty: to account for the use of resources and the results of their administration.

1.2. Therefore, institutions that manage projects financed with resources from foreign financing, as well as with the Borrower's funds, should implement internal control and financial information systems which will allow them to prepare periodic reports showing the financial situation and general administration of the projects, of the funds managed, and of the institution as a whole.

1.3. All the financial statements, the internal control structure and the systems established for generating the Implementing Entity's financial information, as well as the entity's compliance with laws, regulations and terms of the loan agreements with the Bank, must be periodically evaluated through audits by independent auditors acceptable to the Bank. Those audits must be performed in accordance with the International Standards on Auditing (ISAs) issued by the International Federation of Accountants (IFAC). However, in special situations the Bank also accepts the use of standards compatible with IFAC's, or those of the International Organization of Supreme Audit Institutions (INTOSAI) if the audit is performed by a governmental audit organization.

1.4. The purpose of these Guidelines is to assist: (i) the Borrower and its entities to fulfill their responsibility for preparing the financial statements required by the Bank and for contracting auditors acceptable to the Bank; and (ii) the auditors to become familiar with the requirements for the performance of the audit and the preparation of audit reports satisfactory to the Bank.

1.5. The Guidelines replace prior Bank guidelines identified as FMs (FM-100, 200, 300 and 600). Also, they complement and clarify the information provided by the Bank in the Financial Accounting, Reporting and Auditing (FARAH) Handbook, and are not intended to replace it. However, in case of inconsistency between both sources, the Guidelines should be followed. Borrower staff and the

---

1The term "World Bank," as used in this document, also includes the International Development Association (IDA) and any other entity affiliated with the World Bank Group that is providing financing.

2 "Loans" is used as a generic term, and includes Bank loans, IDA credits and Trust Fund grants.
Guidance for Audit of Projects in the LCR Region

Auditors are encouraged to read FARAH's chapters IV and V as well as Annexes XIII, XIV, XXI and XXII. The auditors should also be familiar with Annexes XV and XVI of FARAH.

1.6. The rest of the body of this document is divided into four main parts. The first two are addressed to the Borrower and the executing entities\(^3\) --but are also useful to the auditors-- and discuss the requirements for accounting and financial reporting, and for selecting and contracting the auditors. The others are addressed to the auditors, and discuss the requirements for the performance of the audit and the preparation of audit reports. In addition, the Guidelines include two annexes which provide information on the Model Project Financial Statements and the Model Terms of Reference for Audit. These models should be used as the basis for preparing the financial statements and the terms of reference for contracting the auditors.

\(^3\) Also referred to in this document as "implementing entities."
II: GUIDANCE TO IMPLEMENTING ENTITIES: ACCOUNTING AND FINANCIAL REPORTING

A. Accounting

2.1. In accordance with the covenants of the loan and credit agreements with the Bank, the borrower and the project implementing entities are required to maintain financial management systems— including accounting, financial reporting, and auditing systems—adequate to ensure that they provide to the Bank accurate and timely information regarding project resources and expenditures.

2.2. Project transactions should be accounted for using accounting standards acceptable to the Bank. All commercial, industrial, and business entities, whether in the public or the private sector, must adhere to the International Accounting Standards issued by the International Accounting Standards Committee (IASC) or other accounting standards compatible with IASC’s. Other entities, such as ministries and other non-revenue earning entities, may adhere to other accounting standards acceptable to the Bank, which should be agreed to before project inception. When project implementation begins, the borrower and the project implementing entities must have in place accounting and internal control systems that accord with such accounting standards and that: (a) reliably record and report all assets and liabilities and financial transactions of the project and, as appropriate, the entity, including those transactions involving the use of Bank funds; and (b) provide sufficient financial information for managing and monitoring project activities.

2.3. Interest and commissions on the loan should not be included in the accounting records of the project since they are not eligible project expenses. If the implementing entity is also the borrower, these costs should be accounted for in the entity’s own records. If the loan is to the government, then the entity in charge of accounting for the foreign debt should also account for these expenses.

2.4. Equipment and other fixed assets procured with project funds are expensed when purchased; thus, no depreciation expense is charged to the project.

2.5. The borrower or executing entity should agree with the Bank in regard to the exchange rate to use for converting foreign exchange to local currency and viceversa, or for accounting for expenses financed with loan funds (e.g. the rate current at the date the funds are disbursed from the Special Account). Gains or losses due to foreign exchange fluctuations should not be charged to the project, specially if losses are due to the untimely submission to the Bank of requests for reimbursement of expenses.

B. Financial Reporting

2.6. Loan and Project Agreements normally require the borrower and the project executing entities to periodically prepare financial statements of the project. The Bank also requires audited financial statements of any revenue-earning borrower or project implementing entity specially if (a) its financial
viability is vital to project success, or (b) one of the project objectives is to improve its capacity. In addition, the Bank may require submission of interim unaudited financial statements used for project management and monitoring purposes.

2.7. In general terms, the Project Implementing Entity is responsible for the periodic timely submission and audit of the financial statements listed below. These annual financial statements must include all the funds managed by the institution regardless of their source, including funds provided by the Bank, other international organizations, the National Treasury, or from the entity’s own revenues:

When required, as stated in paragraph 2.6, the Implementing Entity’s Financial Statements (which must include the corresponding notes to the financial statements and the supplementary financial information):

- Balance Sheet,
- Income Statement, and
- Cash Flow Statement.

Project Financial Statements (which also must include the corresponding notes and supplementary financial information):

- Statement of Sources and Uses of Funds,
- Statement of Cumulative Investments,
- Statement of Requests for Reimbursement (SOE Statement), and
- Statement of the Special Account.

2.8. The financial statements for the entity should provide figures for the current year as well as those for the previous year or period, when applicable. Also, they may be prepared in local currency and in accordance with the accounting principles used in the country, which should be compatible with IASC's accounting standards; and should clearly show (with additional information expressed in United States dollars) the balance for the accounts related to the transactions with the Bank (for example, the liability created by the loan). The Bank-provided funds shown in the entity's financial statements should be reconciled with the Bank funds included in the Project financial statements through a note to the entity's financial statements.

2.9. The Implementing Entity must prepare the project financial statements in dollars or in local currency together with schedules showing the balances in dollars. The Notes to the Financial Statements must state the exchange rate used for converting the transactions in local or other currency to dollars, as well as the accounting standards followed for recording the transactions and preparing the financial statements. If the project or any of its components have operational revenues and expenditures of their own, an Income Statement must be prepared (in addition to the Statement of Assets and Liabilities and the corresponding Notes to the Financial Statements). The SOE and Special Account statements should be expressed in dollars only.

2.10. The amounts in the financial statements must be adequately cross-referenced to the Notes, supporting schedules or supplementary financial information; and the information in the financial

---

4 If they are not, the main differences between them must be disclosed in the notes to the financial statements.
statements must be sufficient to show the flow of funds from the Bank to the Project. In addition, adequate reconciling schedules should be prepared for those cases in which line items which would normally match do not match due to a valid reason (for example, exchange rate differentials). Annex I to these Guidelines and Annex XIII to the FARAH Handbook provide examples of a set of project financial statements.

2.11. Most projects are implemented by government entities and are financed through the budgetary process; thus, project accounts are maintained under the cash method of accounting. Those entities need only prepare the financial statements discussed in these Guidelines. However, where accrual accounting is adopted, a balance sheet is also required (in addition to the assets and liabilities of the project, it should show the net fund created by the project). Regardless of the accounting method used, implementing entities should maintain records of all the fixed assets (e.g., vehicles and equipment) procured with project resources, and should prepare a list that, whenever practical, should be included in the set of financial statements.

2.12. It is important to note that the requirement for preparation of project financial statements does not change regardless of whether the project is being financed under traditional disbursement methods or under the Loan Administration Change Initiative (LACI) method. Nor is there any change in the basic financial information required. Under the LACI method, however, there is no SOE Statement since that mechanism is not used, and the format of the reports agreed between the Bank and the executing entity may be somewhat different from the examples provided in Annex I to these Guidelines.

Statement of Sources and Uses of Funds and Statement of Cumulative Investments

2.13. These two statements constitute the basic financial statements for the project because they show the funds received and the disbursements made during the period audited, as well as the cumulative investments from project inception to the end of the period audited. They must provide information about the financial activities of the whole project, and as such must disclose the funds received from all funding sources, not just the Bank loan (if no funds were received from a participating source during a particular year, the amount should be shown as zero rather than the entry being omitted from the statement). Funds received from the Bank must be disclosed according to the disbursement mechanism used (direct payments, SOE procedures, advance to the Special Account, etc.).

2.14. The financial statements should include all relevant information concerning the sources and uses of funds. For example, if the government prefinances the expenditures and later requests reimbursement from the Bank for the amounts applicable to the loan, then the sources of funds should include a line item labeled "Expenses on behalf of the World Bank" (or similar) disclosing the amounts expended and still pending reimbursement from the Bank. Also, in-kind contributions (such as labor contributed by communities) should be accounted for as a source and use of funds using a reasonable cost basis. In all cases, sufficient additional information should be disclosed in the notes to the financial statements.

2.15. The Bank requires that the basic financial statements report project expenditures by main disbursement categories, as shown in the examples provided. Those categories are identified in the document prepared for defining the project (Staff Appraisal Report --SAR-- or the Project Appraisal Document --PAD) and the loan agreement. This grouping allows the verification of the figures reported with data in Bank records. If so desired, project implementing entities may additionally report
expenses grouped by project component; but such information should not substitute for the
information required.

2.16. One key feature of these statements is that they must provide: (i) a comparison between actual
expenditures (investments) and the original projections made in the project evaluation report or as
amended; and (ii) explanations for significant variances. This information helps assess the financial
performance of the project, and should be provided for the period audited and for the cumulative
period from project inception to the date of the financial statements.

2.17. If the comparison cannot be performed because the project evaluation report does not contain
amounts projected per year, this situation must be clearly stated in the financial statements. The Bank's
Financial Management Specialist assigned to the project should be requested, through the Task
Manager, to help the entity prepare such projections as soon as possible.

2.18. Annex I to these Guidelines and Annex XIII to the FARAH Handbook provide examples of
acceptable, albeit different, statements. The ones in Annex I are prepared from a cash flow point of
view: they report on funds received and funds expended, and provide initial and ending cash balances.
The ones in FARAH basically allocate expenses to the different funding sources, but no information is
shown as to the actual flow of funds to the Project. In the latter case, the financial statements should
contain an additional schedule reporting on the flow of funds, as well as on initial and ending balances.

Statement of Requests for Reimbursement (SOE Statement)

2.19. The SOE Statement lists the Statements of Expenditure (SOEs) submitted to the Bank during the
reporting period. SOEs should be grouped into two classes: "Reimbursed" and "Pending
Reimbursement," depending on their status at the end of the reporting period. Each SOE should show
the amounts requested by disbursement category. If the amounts requested and the amounts reimbursed
by the Bank are different, then both amounts must be included and clearly identified. Annex I to these
Guidelines provides an example of this statement, which is not prepared under the LACI disbursement
method.

Statement of the Special Account

2.20. The purpose of the Special Account Statement is to provide a summary of the Special Account's
activity during the reporting period, not cumulatively. As such, it should be prepared based on the
periodic statements of account prepared by the depository bank (or from its records), rather than from
the accounting records of the executing entity. As shown in Annex I, this statement should provide
sufficient detail to help the reader verify the information with other statements (e.g., deposits
corresponding to reimbursement of SOEs should match those reported in the SOE Statement as
reimbursed).

Notes and Supplementary Financial Information

2.21. Consistent with International Accounting Standards 1 and 5, all significant accounting policies
which have been adopted in the preparation and presentation of the project financial statements need to
be disclosed as an integral part of the financial statements. Moreover, all material information should
be disclosed that is necessary to make the financial statements clear and understandable.
2.22. The supplementary financial information should focus on the physical-financial execution and results, including additional financial and statistical information. This would depend on the nature of the operation financed by the Bank: investment project, financing project (e.g., subloans to targeted beneficiaries), technical assistance, financing of imports, etc. Examples of the information to be prepared and presented for the examination of the external auditors include:

- A summary of significant bids processed and awarded during the reporting period (including name of suppliers, general description, amount paid by each financing party, and date of Bank no-objection, when required).

- A list of the main national or foreign contractors and contracts, except consultants, awarded during the reporting period (original and adjusted costs, date of Bank approval when required, amount paid by each financing party, advances, withholdings, amount payable at the end of the Fiscal Year, etc.).

- A status of the financial execution of technical assistance: reconciliation of the technical assistance funds available at the beginning and end of the reporting period on the basis of the technical assistance used or canceled for each of the studies or components provided in loan or credit agreements.

- A list of the main national or foreign consultants participating in the technical assistance provided (including amount and date of the contracts and their purpose, payments made by each financing party, date of last progress report presented by the consultant, date of Bank no-objection when required, etc.).

- A statement of sub-loans approved during the reporting period, for each executing bank or participating financial intermediary. Additional annexes may be required regarding analysis and composition of the respective portfolio, such as: current and due portion, analysis by type of guarantee, sub-loans by sectors or sub-sectors of the economy, financing for new industries or for those already established, geographical distribution of the portfolio, etc.

**Periodicity of the Financial Statements**

2.23. Although the Bank typically requires annual audited financial statements, this does not mean that more frequent financial statements should not be prepared. On the contrary, good financial management would suggest that project financial statements be prepared at least quarterly, or if possible, monthly. Such a practice would promote good project management and facilitate decision-making since timely information would be available. In addition, it would help the auditors perform interim audit work and therefore prepare their annual report well before the deadline established in the loan agreement.

**Responsibility for the Preparation of Financial Statements**

2.24. The financial statements and supplementary financial information must be prepared by the executing entity from the project accounting system. They should not be prepared by the auditors because this could be perceived as a conflict of interest or as an impairment to their independence.
Consolidated Financial Statements

2.25. The Bank normally requires project financial statements from all entities executing the project, as well as financial statements for the project as a whole. To this effect, whenever a project is implemented by more than one entity, each must prepare all the project financial statements pertaining to the part or component for which it is responsible (if the entity is not responsible for managing the Special Account or preparing SOEs, it need only so state in the basic financial statements). One entity, preferably the Project Coordinating Unit (PCU) or equivalent, should be in charge of preparing consolidated or combined financial statements for the whole project. It is preferable that such statements be audited, but they do not need an audit opinion if they have been prepared from individual financial statements for each project part or component which have been audited. Most of the time, however, the consolidated financial statements could require auditing, and the main auditors may have to rely on the work of the other auditors.

2.26. When consolidated financial statements are required, the PCU should establish procedures to ensure that the project implementing entities periodically (preferably monthly) report on the status of the resources provided, and that both the PCU and each implementing entity reconcile their information with that prepared by the other.
III. GUIDANCE TO IMPLEMENTING ENTITIES: SELECTION AND CONTRACTING OF AUDITORS

Overview of the Process

3.1. All the financial statements, the internal control structure and the systems for generating the Implementing Entity's financial information, as well as the entity's compliance with laws, regulations and terms of the loan agreements with the Bank, must be periodically audited by independent auditors acceptable to the Bank. The auditor is selected by the borrower or executing agency from among those satisfactory to the World Bank. Criteria for acceptability and selection include the reputation of the auditor and its independence, its experience in auditing similar entities and projects, the number of qualified employees it is able to use in performing the audit, and the familiarity of audit personnel with international accounting and auditing standards. Generally, but not always, local audit firms affiliated with international firms are likely to meet the requirements.

3.2. For a government audit agency to be acceptable to the Bank it must first be evaluated administratively and technically by the Bank, including an assessment of its "control philosophy," an aspect of key importance. The practice of "prior control" and approval of competitive bidding, contracts or other type of transactions that should be decided by the management of the borrower or implementing entity is generally not considered compatible with the function of modern government auditing, and an agency which performs such activities is not considered appropriate for auditing operations financed by the Bank. The evaluation of the audit agency also includes its work programs; professional mix; proportion between the number of entities subject to its jurisdiction and availability of qualified audit staff; form and content of audit reports; knowledge and application of international or INTOSAI auditing standards; and its budget structure and administrative and financial autonomy within the government hierarchy and vis-à-vis the entity to be audited. Government auditors should be proposed for auditing World Bank operations only when their independence and capacity have been verified by the Bank.

3.3. Even when local law assigns to a government auditor the responsibility for auditing activities implemented by governmental institutions, such responsibility does not make the auditor acceptable for auditing Bank-financed projects. Although the Bank would like to avoid duplication of efforts, in those cases in which the government auditor is not considered acceptable, the audit needs to be performed by an acceptable audit firm.

3.4. Before selecting the auditor, the implementing entity must prepare the applicable Terms of Reference for the audit (TORs), which should be in accordance with the Model TORs for the LCR Region (Annex II), and a short list of three to six audit firms likely to be acceptable to the Bank. The short list and the audit TORs are submitted to the Bank for its no-objection (procurement documents, such as the Requests for Proposals and the draft contract, should also be submitted to the Bank at this time). The Bank may provide its no-objection to all or only some of the firms. If the Bank does not
accept one or more of the firms, it may request the implementing entity to obtain additional information from that particular firm, or may request that the firm be left out of the current process.

3.5. Once the Bank has evaluated the acceptability of the auditor and the adequacy of the TORs, and provided its no-objection, the executing entity requests proposals from the acceptable firms. The implementing entity evaluates the Technical and Financial proposals received —and selects and contracts the auditor— in accordance with the procedures agreed with the Bank. If the Bank is financing the audit, the implementing entity should refer to the Guidelines for Selection and Employment of Consultants by World Bank Borrowers and other applicable guidelines before initiating the process.

3.6. The implementing entity should engage the auditor using a contract which is acceptable to the Bank, and which explicitly incorporates the audit TORs and the Guidelines. Engagement Letters prepared by the auditor should not be used instead of a contract, since they only reflect the auditor's understanding of the engagement and other information which does not substitute for the requirements defined in the contract, the TORs or the Guidelines. Engagement Letters, if any, should be used for matter of additional understanding, such as access to premises, records, documentation and other information the auditor may request in connection to the audit; or the use of internal auditors.

Preparation of the Audit TORs

3.7. When preparing the audit TORs, the executing entity uses the Model TORs provided in Annex II and follows the instructions to suit the document to the entity's particular requirements. The Model TORs are suitable for most projects and for revenue-earning and non-revenue-earning entities (for example, utilities and government ministries, respectively). Normally, entity financial statements are only required for revenue-earning entities; thus, the corresponding paragraphs should not appear in the audit TORs for non-revenue-earning entities.

3.8. The TORs should provide sufficient information for the auditor to understand the scope of the audit in order to prepare its proposal and, if accepted, to plan and perform its work. To this effect, background information on the project should be provided as an attachment to the TORs (Attachment 1 to Annex II provides an example of the information that might be provided).

Timing of Audit Services and Retention of Auditors

3.9. The auditor must be contracted early enough for the auditor to plan and perform its work and to submit its report in a timely and efficient fashion. Bank policy requires that the auditors be appointed well before the beginning of each fiscal year. This allows the auditor to become familiar with the objectives of the systems and operations of the implementing organization and of the project, and to make whatever arrangements are necessary for interim work and for year-end verifications. For example, the audit for the project activities during 2000 should be contracted before the end of 1999.

3.10. The Bank recommends that the borrower or the project executing agency retain the audit firm for the life of the project, or for a period of no less than three years, provided the auditor's work remains satisfactory to the Bank and there are no concerns regarding the continued independence of the auditor. If there is need for a change of auditors, the borrower should request the Bank's
concurrence prior to the change. The appointment of the new auditor, who should be satisfactory to the Bank, should be timely, as stated in the preceding paragraph.

Duration of Audit Requirements

3.11. The requirement to submit audit reports on project implementation ceases with the completion of the project. The last project audit is consequently prepared for the fiscal year during which the last disbursement under the loan or credit is made or the last counterpart or cofinancing funds are used. This is also applicable for audits of the financial statements of the project executing entity, except when the entity is also the borrower and the loan or credit agreement requires otherwise. In such cases, audits of the borrower’s financial statements may be required even for the life of the loan.

Financing of the Audit

3.12. The Borrower normally finances the cost of the audit. However, in some cases the Bank and the Borrower may agree that loan proceeds may be used to pay for reasonable fees for the audit of the project. When the project is financed by more than one international donor, it is still expected that the auditors will audit the project as a whole, and the cost of the audit will be allocated to the Borrower and/or the resources provided by each of the participating donors.
IV. GUIDANCE TO AUDITORS: AUDIT OF PROJECTS

A. Summary

4.1. Audits of Bank-financed projects should be performed in accordance with the Terms of Reference which received the Bank's no-objection and with these Guidelines. In addition, the auditors should perform their work taking in consideration the Financial Accounting, Reporting and Auditing Handbook (FARAH). An audit report on a project is complete and satisfies the pertinent clause in the loan or credit agreement when it is submitted by the borrower or executing agencies and received by the Bank in a timely manner, has adequate project (and, if applicable, entity) financial statements, and has been prepared in accordance with the auditing guidelines stated herein.

4.2. The Bank requires that the audit be performed in accordance with the International Standards on Auditing (ISAs) issued by the International Federation of Accountants (IFAC) or with generally accepted auditing standards compatible with IFAC's. In the case of government auditors, they may use auditing standards compatible with those of the International Organization of Supreme Audit Institutions (INTOSAI). In all cases, the auditor must disclose in his reports which standards were followed in performing the audit.

4.3. Audits of projects with Bank financing are performed annually, or more frequently if stipulated by the loan or credit agreement. The auditor should perform interim inspections throughout the year, prior to the "end-of-year inspection" for preparation of the final report (if the auditor is contracted with a timeframe that prevents the performance of interim audit work, this fact should be explicitly mentioned in the audit report). It is understood that any financial or operational aspect of importance that affects the project executing agency or the project itself detected during an interim audit inspection is to be communicated immediately in writing to the Bank and the borrower or executing agency. Also, interim reports are periodically prepared; such reports do not need an audit opinion, but should disclose the problems and deficiencies identified during the interim period reviewed.

4.4. A project audit goes beyond what is required in a normal financial audit, because it also requires that the auditor: (i) perform a more detailed review of the eligibility of the expenses reported to the Bank under Statements of Expenditure (SOEs); (ii) issue an opinion on the entity's compliance with the terms of the loan agreement and with applicable laws and regulations; (iii) issue a report on the internal controls for the project (when applicable, the auditor must also disclose the current status of the findings reported and recommendations made in prior audits); and (iv) include a summary of the audit procedures performed. Prior to contract signature and in any case before beginning its examination, the auditor should be familiar with the additional aspects subject to auditing as provided for by the pertinent loan or credit agreement.

4.5. For audits of projects executed by administrative or technical units of the Central Government (Ministries, Secretariats, Directorates, etc.), the audit is restricted to the "project accounts" and does not cover all operations carried out by the entity (except when otherwise established in the loan or credit agreement). In the case of the Special Account maintained in the Central Bank or other
official bank, the audit is limited solely to the transactions and availability of funds in that account and the respective controls exercised over it, and not to all operations of the depository bank.

4.6. The auditor may obtain confirmation on the loan's balance and disbursements during the period audited by contacting, through the implementing entity, the Disbursement Officer (or the Loan Department's Financial Management Specialist) for the corresponding country, at The World Bank, 1818 H Street N.W., Washington, D.C. 20433.

Relationships and Responsibilities

4.7. The Implementing Entity is the client for the audit, and the Bank is an interested party. Thus, the Bank may supervise the work performed by the auditors to ensure that it complies with the Terms of Reference and the applicable auditing standards. Also, prior to the signing of the audit contract, the Bank will approve the terms of reference to be used, the selection of the public accounting firm (or government auditors) to perform the audit, and the contract to be signed.

4.8. The Bank representatives or their designees may participate in the entrance and exit meetings of the audit to provide additional information or to discuss areas that they wish to emphasize. They also may provide written comments on the draft reports.

4.9. The Implementing Entity is responsible for preparing all the financial statements and reports required, and for ensuring that all the necessary records are available for the audit, that all the accounting entries and adjustments have been made, and that all the necessary actions have been taken to allow auditors to issue the final report before the date the report is due at the Bank.

4.10. The Implementing Entity should promptly send to the Bank's representative, upon request, a copy of the draft reports immediately after they are received from the auditor. The Implementing Entity also sends a copy of all final audit reports to the Bank before the due date.

4.11. The auditors should perform interim work throughout the year in order to promptly identify areas that require the attention of the Project's management. No formal audit opinions need to be issued throughout the year; however, the auditors should prepare interim reports defining material problems found, including untimely record-keeping, internal control deficiencies and noncompliance issues. Such reviews should provide an opportunity for the timely correction of problems. The auditor must explicitly state in the audit report whether or not it was possible to perform interim work.

4.12. The auditors should maintain on file adequate working papers for a period of three years after the end of the audit. During this period, the auditors should promptly provide the working papers requested by the Bank.

B. Detailed Issues

4.13. The following paragraphs follow closely those in the Model Terms of Reference for Audit presented in Annex II (Model TORs) and provide detailed information on the requirements and general guidance provided in those TORs. For convenience, they are shown under the same headings.
Title of the Audit

4.14. The purpose is this requirement is to avoid confusion or misunderstanding as to what is covered by the audit report. To this effect, all proposals, audit working papers and audit reports should refer to the audit using a standard name. This name provides information about the period audited, the name of the implementing entity, the name of the project and the loan identification number. In case the audit report only covers part or a component of a project, that fact must be clearly mentioned. An example of a satisfactory format for the title is shown below:

Audit of the Resources Managed during the period from January 1 to December 31, 1999 by the Ministry of Health under Part A of the "Water Rehabilitation and Management in Region One" Project, financed partially by World Bank Loan 1234-AA.

Overall Audit Objectives

4.15. The overall objective of the audit is to allow the auditor to express a professional opinion on the financial position of the project (and, as applicable, the Implementing Entity) at the end of the period audited, to report on the adequacy of the internal controls, and to express an opinion on the compliance with the covenants of the loan agreement and applicable laws and regulations. The engagement is for a special purpose audit of the Project, which should cover the resources provided by the Bank, other cofinancing institutions, if any, and the Government and other local entities (counterpart funds).

Specific Audit Objectives

4.16. Audit of the Project. The specific objectives of the audit are to:

- Issue an opinion as to whether the Project financial statements\(^1\) present fairly, in all material respects, the financial situation of the project, the funds received and the disbursements made during the period audited, as well as the cumulative investments as at the closing date, in accordance with international accounting standards issued by IASC and in accordance with the requirements of the respective agreements with the Bank and other cofinancing organizations, if applicable.

   Also, for LACI-compliant projects an objective is to issue an opinion as to whether: (a) the expenditures reported for the loan are eligible for financing; and (b) loan funds have been used only for Project purposes.

- Issue an opinion on whether the supplementary financial information for the Project is fairly presented, in all material respects.

- Issue a report with respect to the adequacy of the internal control structure of the implementing institution with regard to the project. For this, the auditor should evaluate and obtain a sufficient understanding of the internal control structure of the institution as it relates to the Project, evaluating control risks and identifying reportable conditions, including material weaknesses in the internal control structure and deficiencies and

\(^1\) The project financial statements are considered special purpose financial statements. The auditors should refer to section 800 of the ISAs for guidance concerning such engagements.
Weaknesses that do not affect the financial statements. This evaluation should also include the internal controls related to the contribution of counterpart funds for the Project.

It is important to note that the review of internal controls requested is not the same as that required for a normal financial audit, where it is performed mostly for planning purposes. The review requested is to provide certain level of comfort as to the existence and adequacy of the internal controls.

- Issue an opinion with respect to the implementing entity's compliance with the terms of the loan agreement and applicable laws and regulations (with regard to the financial aspects). For this, the auditors should perform tests to determine if the institution has complied, in all material respects, with the terms of the agreements with the Bank and any cofinancing organization, including the actions and activities agreed to by the Implementing Entity and the Borrower during loan negotiations, as listed in the loan agreement and other Project documents, and with the laws and regulations applicable to the Project. As possible, all instances of material noncompliance, as well as all indications of illegal acts, must be identified. These tests must also take into account the compliance requirements for counterpart contributions.

- For projects using the SOE mechanism: issue an opinion as to whether: (a) the expenditures included in the requests for reimbursement (SOE) are eligible, and if the information presented in the SOEs is reasonably dependable; (b) the accounting and the internal control procedures used for the preparation of the SOEs are adequate; and (c) loan funds have been used only for Project purposes.

The auditors should take special care to comply with this objective since there may be two or more levels of SOEs: SOEs submitted directly to the Bank and SOEs submitted by the Implementing Entity or an intermediary for reimbursement from funds available in the Special Account. The auditors should ensure that there are Statements of Requests for Reimbursement for each of the levels involved, and must verify the adequacy of the documentation that supports such Statements.

- Issue an opinion as to whether the Statement for the Special Account used for managing the funds provided by the Bank presents fairly the availability of funds at the end of the period audited, as well as the transactions made during the period audited, in accordance with the provisions for the use of the funds established in the corresponding agreements with the Bank.

4.17. Audit of the Implementing Entity. The financial audit should also be performed in accordance with generally accepted auditing standards compatible with those issued by IFAC or by INTOSAI, depending on the type of auditor engaged. The specific objectives of this type of audit are to:

- Issue an opinion on whether the financial statements of the Implementing Entity present fairly, in all material respects, the financial position of the entity at the date of the financial statements, the results of its operations, and the cash flow during the period audited, in accordance with generally accepted accounting principles compatible with those issued by
IASC. Any important differences in the application of accounting principles other than IASC’s must be disclosed.

• Issue an opinion on whether the supplementary financial information related to the Implementing Entity has been reasonably presented in all material respects in relation to the basic financial statements taken as a whole.

Procedures and Scope of the Audit

4.18. The audit must include adequate planning, evaluation and testing of the internal control structure and systems, and the securing of enough evidence to allow the auditors to reach reasonable conclusions on which to base their opinions. The audit reports must include a summary of the main audit procedures used for planning the audit, evaluating the internal control structure, checking the figures included in the financial statements and other reports subject to audit, and evaluating the compliance with terms of the applicable agreements, laws and regulations.

4.19. The audit should be performed in accordance with acceptable auditing standards, and therefore should include the tests of the accounting records that the auditors consider necessary under the circumstances. The auditors must be alert for situations or transactions that may indicate fraudulent, wasteful or illegal acts and expenditures. If such evidence exists, the auditors must contact a duly authorized representative of the Bank, and exercise caution and due professional care in expanding their audit steps and procedures related to illegal acts.

4.20. For the audit of the Project, the auditors should use the following paragraphs as a basis for preparing the audit programs and planning the review. This information should not be considered to include everything or to restrict the auditor in any way, nor would it discharge the auditor from the responsibility to exercise due care and professional judgment. The audit steps should be modified to adjust to local conditions, the specific design and implementation procedures of the Project, and provisions of the loan agreement. Any limitation in the scope of work must be communicated as soon as possible to a Bank representative.

A. Obtain preliminary information about the Project. The following is a non-exhaustive list of documents that may be applicable to projects financed by the Bank. The auditors must select those that they consider necessary to perform the audit:

1. The Loan Agreement between the Bank and the Borrower.
2. The Project Agreement between the Borrower and the Implementing Entity.
3. The Bank’s Staff Appraisal Report (SAR) or Project Appraisal Document (PAD).
4. The Bank’s procurement (bidding) regulations.
5. The Borrower’s procurement (bidding) regulations.
8. The Project’s financial and physical progress reports; plan or chart of accounts; description of the accounting systems; procurement policies and procedures; procedures for the receipt, storage and distribution of goods and materials; and any other documentation that may be necessary for the successful completion of the audit.
B. Examine the Project financial statements, segregating the funds provided by the Bank, including (a) the amounts budgeted by category and type of expenditure; (b) the funds received from the Bank during the period covered by the audit; (c) the expenses reported by the Implementing Entity as made during the period audited; and (d) the goods and technical assistance provided directly by the Bank to the Implementing Entity. The following considerations are also applicable for the review of the Statement of Requests for Reimbursement (SOE Statement) and the Special Account (SA) Statement:

1. In designing the audit program, the auditor must take into consideration the effectiveness and reliability of the accounting and administrative procedures and the internal controls, including those corresponding to the SOEs and the SA. These systems, including internal auditing, must be evaluated to determine the degree of reliance that can be placed on them, and the extent of testing that the auditor needs to perform.

2. The auditor must evaluate the procedures for:
   a. safeguarding the assets through an adequate division of responsibilities between operational, custodial, accounting, and other functions, ensuring that these responsibilities are clearly defined and that there is sufficient personnel to perform each function effectively and efficiently;
   b. ensuring that the assets and other resources are used in accordance with applicable instructions and regulations in an effective and economical manner;
   c. ensuring that all transactions are recorded adequately and in a timely manner; and
   d. preparing and verifying the eligibility of SOEs.

3. The auditor must obtain sufficient supporting evidence through the review of the accounting records and other probative documents, direct physical inspections, general observations, questions, and confirmations, including:
   a. tests to ensure that all assets and liabilities have been adequately recorded;
   b. verification of balances for inventory accounts and other similar assets through physical inspection;
   c. verification that the expenditures are in accordance with the budgetary provisions and in compliance with relevant regulations and guidelines;
   d. arithmetic tests (e.g., for payrolls, or for verification of the proper percentage in the requests for reimbursement from the Bank);
   e. review of the systems for committing funds and making payments, to verify and confirm the allotment and discharge by creditor; and of revenue collection, to ensure that all the payments for services have been received and accounted for, and that the accounts receivable have been recorded (such a verification should include an inspection of certificates and other means of confirmation of debtors and creditors);
f. verification of investments and cash on deposit through direct confirmations with banks, and by reviewing (or preparing) any corresponding reconciliations;

g. review of the data processing controls to determine if they are adequate; and

h. verification of the financial statements against the main accounting records, and verification of these against the subsidiary records, vouchers, corresponding checks paid by the Bank, contracts, purchase orders, and other probative original documents.

4. The auditors should verify that the borrower and the implementing entity followed the procurement methods and procedures agreed to with the Bank. Normally the review would be limited to the transactions selected for the internal controls or compliance review, and does not imply that the auditors will perform a procurement assessment.

5. In cases in which it is not feasible to apply certain types of tests necessary for an adequate review in accordance with ISAs or other acceptable standards, the auditors -- based on their professional judgment -- must use alternative tests and procedures appropriate to the circumstances (even if local standards do not require them). For example, if local banks do not return to the issuer the checks paid, the auditor should use alternate procedures to ensure that the checks were cashed by the payee.

6. The report on internal controls (or Management Letter) must include comments and recommendations for improving financial and administrative systems and controls, as well as findings that require the attention of the Implementing Entity’s management.

C. Concerning SOEs and the Special Account. The auditor should: (i) verify the SOEs against the accounting records, supporting documentation, and physical inspections of the work performed and/or the goods and services procured; and (ii) determine whether the expenditures included in the requests for reimbursement are eligible for financing under the terms of the loan agreement. It is of utmost importance that the auditor keep in mind that the supporting documentation for the SOEs is normally not reviewed by the Bank. Thus, the auditor is the one on whom the Bank relies for providing assurance as to the adequacy and proper recording of those expenses. Normally, the size of the sample of the SOEs reviewed must be higher than the one for other transactions; however, the decision as to the sample size clearly is one to be made by the auditor based on the results of the evaluation of the internal control structure and other considerations.

The auditor must verify: (a) whether the transactions included in the Special Account Statement have been recorded correctly, including the reconciliation of the amount of interest received by the Implementing Entity and paid by the Bank where the account is maintained; (b) the balances of the Special Account; and (c) that the operation and use of the account is in accordance with the loan agreement.

There is a clear relationship between the transactions shown in the SOEs and the payments made from the Special Account. As such, any anomaly (ineligible payments, overpayments, payment duplications, diversion of funds, incorrectly applied exchange rate, etc.) noticed in the review of the SOEs will have an impact on the reasonableness of transactions and proper availability of funds in the Special Account. It is therefore
GUIDANCE FOR AUDIT OF PROJECTS IN THE LCR REGION

requested that the auditor pay special attention to ensuring that the implications of any such deficiency have been properly assessed before issuing an opinion on the SOEs or the Special Account.

Other Responsibilities of the Auditor

4.21. The auditor should comply with the following requirements:

A. Conduct entrance and exit conferences with the Implementing Entity. The date of these meetings should be communicated to the Bank representative so that he/she can participate in them, if deemed necessary.

B. Plan the audit work so that preliminary reviews can be conducted during the period under review (including the first few months), with the purpose of evaluating the systems of internal control and communicating to the implementing unit in a timely manner any situations that merit the attention of management before the issuance of the final audit report.

C. Independently reference the audit report before issuing it. As part of their quality control, the auditors must independently reference the final draft of the audit report and the Management Letter (which in the rest of this section are included in the term "the report"). Before referencing, the draft report must be adequately indexed and cross-referenced to the working papers. Each statement, date, number, amount and fact that appears in the report must be referenced to the corresponding working papers. The referencer must not be a member of the audit team, and should report directly to the partner in charge of the audit.

The referencer must ensure that (a) the content of the report is supported by sufficient, competent and relevant evidence in the working papers; (b) the conclusions in the report are logical and related to the findings; and (c) the recommendations can be implemented and are directed to the cause of the problem or deficiency. The referencer must ensure that: the contents of the report comply with IFAC's International Standards on Auditing; each audit objective has been satisfied; and the findings are related to the audit objectives. Each statement, number or amount must also be cross-referenced to the working papers. Any information presented in tables should also be verified, adding all the figures and amounts listed, and checking these against the applicable working papers.

All referencer comments must be recorded in a summary sheet and resolved satisfactorily by the audit team or by the partner-in-charge. This summary sheet must be filed in the working papers together with the indexed report, and must be available for any quality control review by the Bank.

D. Obtain a representation letter in accordance with section 580 of the International Standards on Auditing, signed by the management of the Project Implementing Entity.
GUIDANCE TO AUDITORS

Audit Reports

4.22. Once the audit has been completed, the auditors will issue the opinions and reports required. All the reports resulting from the project audit (project financial statements, SOEs, Special Account, internal controls and compliance) should be incorporated into one document. This report (as well as the audit report for the entity, if one was required) should specifically contain the detail of the funds provided by the Bank and should be addressed and delivered to the Implementing Entity. However, if the Bank representative requests it so, the auditor should send to this representative a copy of the Project audit report (and of the Implementing Entity's audit report, if applicable).

4.23. The auditor should deliver the final audit report to the Implementing Entity before the deadline provided in the loan agreement (or by the date agreed in the audit contract, if past the due date). Reports are to be issued in English, duly signed and bound, in an original and in the number of copies requested by the executing entity. The report for the Project should contain at least:

A. A title page, table of contents, a transmittal letter to the Implementing Entity, and a summary that includes: (a) a background section with a general description of the Project, the period covered, the Project objectives, and a clear identification of all the entities mentioned in the report; (b) the objectives and scope of the audit, and an clear explanation of the procedures performed (including alternate procedures when it was not possible to apply normal ones) and any limitation to the scope of the audit; (c) a brief summary of the audit results; costs or expenses questioned; internal control deficiencies; compliance with laws, regulations and terms of the agreements; and the status of recommendations made in prior audits; and (d) a brief summary of the comments made by the Entity's management with respect to the findings reported by the auditors.

B. The audit report and opinion for the Project financial statements, their corresponding notes and supplementary information. This section should include the financial statements, their notes and attachments. For LACI compliant projects it should also include an opinion on the eligibility of the expenditures reported and the correct use of the Loan funds.

Any costs that are not supported by adequate records or that are not eligible under the terms of the loan agreement (questioned costs) should be identified in a separate schedule. Detailed information concerning those costs should be provided in the report on internal controls. If material, these costs should be used as a basis to qualify the audit opinion.

C. The report on the internal control structure for the Project. This report (which sometimes is also referred to as the "Management Letter") should include, as a minimum: (a) the scope of the work performed by the auditor to obtain an understanding of the internal control structure and to evaluate the control risk; (b) a discussion of the most important internal controls of the Implementing Entity, including controls established to ensure compliance with the terms of the agreements and applicable laws and regulations that could materially impact the financial statements or the contribution of counterpart funds; (c) the reportable conditions (those that have an impact on the financial statements), including the identification of material weaknesses in the internal control structure of the implementing unit; and (d) unsupported and ineligible costs. Other conditions which do not affect the financial statements but hinder adequate control should also be included in the report, properly identified.
This report should detail reportable deficiencies in the internal control structure and/or deviations from the established controls detected for the period audited. For a better comprehension by readers, the findings must include the following elements: condition, criteria, cause and effect (although these elements do not have to be explicitly identified in the report, they must be so identified in the working papers). It is important that the findings also include a recommendation to help correct the cause. In those cases in which the auditors cannot identify the cause due to circumstances beyond their control, they should report the condition, the criteria and the possible effect, and furnish this information to management so that it may determine the cause and the effect, and implement timely and adequate corrective actions.

This report should also include a section on the follow-up of internal control and compliance recommendations made in prior audits, indicating the current status of the recommendations as corrected, partially corrected, or not corrected. The deficiencies that still have not been corrected should be reported again in the current audit report, and the auditor should explicitly state the year in which the deficiency was originally reported.

D. The audit report and opinion on the Implementing Entity's compliance with the terms of the loan agreement and applicable laws and regulations related to the Project's financial activities. The report must be consistent with section 800 of IFAC's International Standards on Auditing. Instances of material noncompliance must be reported and discussed along with their corresponding findings. Instances of non-material noncompliance should also be included in the report and properly identified as such.

This report should contain a detailed discussion of the important deviations detected in the period audited, described in findings that include the elements of: condition, criteria, cause and effect. This discussion should also include a recommendation that will aid in correcting the deficiencies. In those cases when the auditors cannot identify the cause due to circumstances beyond their control, they should report the condition, the criteria and the possible effect, so that management may determine the cause and the effect, and implement corrective actions.

This opinion should also cover counterpart contributions and the timely submission of audit reports. The amounts of counterpart not provided must be investigated and identified as cases of noncompliance by the Implementing Entity or the Borrower, as appropriate. If it is evident that the audit report cannot be delivered by the due date because the auditor was not contracted in a timely manner, or was contracted past the due date, this should be reported as an instance of noncompliance.

E. For non-LACI projects, an audit report on the Statement(s) of Requests for Reimbursement (SOE Statement(s)) for the period audited. The auditor must issue an opinion on the eligibility of the expenditures submitted for reimbursement, the adequacy of the control procedures and the correct use of the Loan funds.

F. An audit report and opinion on the Special Account Statement for the period audited. The auditor must issue an opinion as to whether the SA Statement adequately reflects the flow
of funds for the SA during the period audited, and if this activity has been only for purposes of the project.

G. A summary of the main audit procedures performed for planning the audit, evaluating the internal control structure, verifying the figures included in the financial statements and other areas subject to audit, and evaluating compliance with terms of the applicable agreements, laws and regulations. This section should explicitly state whether the auditor was able to perform interim audit work, and if not, why not.

H. If appropriate, the audit report of the Implementing Entity’s financial statements, including all supplementary information. This report must be prepared in accordance with Generally Accepted Auditing Standards, and must clearly identify the funds provided by the Bank as well as the associated liabilities.

Inspection and Acceptance of the Audit Work and the Reports

4.24. The Bank is responsible for reviewing and accepting the audit reports, and may appoint individuals or firms to carry out these activities, including the review of the working papers and of the auditor’s quality control procedures.

4.25. After the report has been reviewed by a Financial Management Specialist, the Bank will notify the Borrower/Implementing Entity of the results of the review. If the report is not acceptable or not fully satisfactory, the Bank will request the Implementing Entity to take the actions needed to correct the deficiencies observed, and to advise the Bank accordingly. The Implementing Entity will also be informed of any aspects of the audit report that are not in compliance with the Terms of Reference, so that the auditor can take prompt corrective action to satisfy the requirement. Any such corrective actions will be carried out at no additional cost to the Implementing Entity, the Project or the Bank.

4.26. The issuance of unqualified opinions on financial statements not prepared in accordance with Bank requirements is considered deficient audit work.

4.27. The representative of the Bank may contact the auditors directly to request any additional information related to the audit or the Project financial statements. The auditors must satisfy such requests promptly.
V. GUIDANCE TO AUDITORS: AUDIT OF ADJUSTMENT LOANS

5.1. Adjustment loans are those related to operations involving a change in policies, either for the economy in general (structural adjustment) or for a particular sector of the economy (sectoral adjustment or restructuring). Normally, expenses are not directly related to the supporting documentation submitted to justify the expenditure, and many times the borrower is only required to produce documentation related to import transactions for an amount equivalent to that of the loan. In other cases, such as in privatization activities, the borrower is required to produce documentation demonstrating, for example, that it has made severance payments to former employees. In all cases, the type of supporting documentation is stated in the loan agreement.

5.2. The auditor of adjustment loans is faced with circumstances that do not normally occur in audits of conventional projects. In this type of audit the auditor must focus primarily on the adequacy of procedures used to prepare customs or similar certificates. The audit would therefore be limited to an examination of the certificates on which the SOEs have been based, and an opinion as to the reliability of the procedures applied in verifying or issuing such certificates. Several issues require particular care: (i) the TORs must satisfy the financial covenants of the loan agreement; (ii) it must be clear that documentation for an adjustment loan has not been used to justify another adjustment loan or financing by another international donor; (iii) the nature of the claims must be verified to ensure that items are correctly documented; (iv) negative list items should be verified; and (v) compliance with cut-off dates should be verified.

5.3. In the case of loans justified by import certificates, audit efforts concentrate on verifying that lists of imports made during the eligible period meet conditions of eligibility and documentary support for inclusion in the SOEs subsequently submitted to the World Bank by the country -- generally through its Central Bank and in certain cases the Finance Ministry or equivalent -- to justify the amounts of the imports in question. Verifying compliance by the Government with the conditions and plan for macroeconomic or sectoral adjustment measures accompanying that financing is not normally the responsibility of the auditor (unless some of those measures are of an accounting, management or other nature and fall within the scope of the audit).

5.4. The audit of adjustment loans includes:

(a) Examination of the SOEs submitted to the World Bank in support of eligible transactions during the period under review. For imports, this may include an examination of the pertinent documentation in the commercial banks.

(b) Verification of the adequacy of the accounting and administrative internal control system, quality of accounting records, timely recording of transactions, and observance of World Bank procedures by the Central Bank or official agency.
(c) Opinion on whether the SOEs examined correspond solely to eligible transactions, were properly prepared and are reasonably reliable so as to support, in conformity with the loan or credit agreement, the applications for reimbursement submitted to the World Bank.

5.5. The audit report should follow, insofar as possible, the instructions provided in these Guidelines for audit reports of projects. Thus, it might include a simplified Statement of Sources and Uses of Funds as well as an SOE Statement, with the corresponding opinions thereon, and will include sections such as the one for summary information, follow-up on prior audit recommendations, and the main audit procedures performed. For example, in the case of import transactions, some of the procedures that should be performed, and therefore mentioned in the audit report (if applicable), are: (i) evaluation of the quality of records and controls at the government entity regarding the imports to be examined; (ii) verification that the lists of SOEs submitted by the government include the necessary data to identify import licenses; (iii) verification that the import dates correspond to the period stated in the loan or credit agreement; (iv) verification of the eligibility of the imports and that they do not include items prohibited in the loan or credit agreement; (v) verification of payments in foreign exchange made through the commercial banks; and (vi) verification in the Central Bank or other official entity, as well as commercial banks, of the documentation supporting the imports and receipt in the country of the imported goods.
ANNEXES
### SOURCES OF FUNDS

<table>
<thead>
<tr>
<th>Source</th>
<th>12/31/X2</th>
<th>12/31/X1</th>
<th>Cumulative at 12/31/X2</th>
</tr>
</thead>
<tbody>
<tr>
<td>IBRD/IDA Loan</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct payments</td>
<td>0</td>
<td>900,000</td>
<td>11,463,109</td>
</tr>
<tr>
<td>SOE Procedures</td>
<td>3,552,208</td>
<td>1,000,000</td>
<td>18,744,109</td>
</tr>
<tr>
<td>Total from IBRD/IDA Loan</td>
<td>3,552,208</td>
<td>1,900,000</td>
<td>30,207,218</td>
</tr>
<tr>
<td>Contributions by the Central Government</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contributions by Provinces</td>
<td>14,189</td>
<td>90,798</td>
<td>997,828</td>
</tr>
<tr>
<td>Contributions by Municipalities</td>
<td>24,362</td>
<td>10,894</td>
<td>1,000,194</td>
</tr>
<tr>
<td>Other contributions</td>
<td>0</td>
<td>2,122,185</td>
<td>4,554,986</td>
</tr>
<tr>
<td>Total local funds</td>
<td>1,342,748</td>
<td>3,923,877</td>
<td>19,757,161</td>
</tr>
<tr>
<td>Total Funds Received</td>
<td>4,894,356</td>
<td>5,823,877</td>
<td>49,964,399</td>
</tr>
</tbody>
</table>

### USES OF FUNDS

<table>
<thead>
<tr>
<th>Category</th>
<th>12/31/X2</th>
<th>12/31/X1</th>
<th>Cumulative at 12/31/X2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Civil works</td>
<td>9,708,093</td>
<td>3,120,180</td>
<td>12,828,273</td>
</tr>
<tr>
<td>Laboratory equipment</td>
<td>690,474</td>
<td>580,150</td>
<td>9,211,210</td>
</tr>
<tr>
<td>Vehicles</td>
<td>0</td>
<td>0</td>
<td>2,467,083</td>
</tr>
<tr>
<td>Research materials</td>
<td>471,356</td>
<td>426,785</td>
<td>4,968,029</td>
</tr>
<tr>
<td>Consulting services</td>
<td>145,000</td>
<td>220,000</td>
<td>749,148</td>
</tr>
<tr>
<td>Training</td>
<td>163,093</td>
<td>425,373</td>
<td>3,431,901</td>
</tr>
<tr>
<td>Personal services</td>
<td>0</td>
<td>0</td>
<td>13,024,756</td>
</tr>
<tr>
<td>Other disbursements</td>
<td>904,661</td>
<td>230,140</td>
<td>2,476,608</td>
</tr>
<tr>
<td>Total Project Investments</td>
<td>12,082,677</td>
<td>5,002,628</td>
<td>49,157,008</td>
</tr>
</tbody>
</table>

Cash at beginning of the period      | 7,995,112| 7,173,863|
Cash at end of the period            | 807,391  | 7,995,112|

See explanatory notes (1 to 4) [Explanatory notes should be attached to the project financial statements to ensure all relevant information is clearly stated]

---

1. X2 refers to the current year; X1 refers to the preceding year.
2. Cumulative from Project inception.
3. If the Project receives funds from other international institutions, these sources must be shown individually.
4. Should match with the figures on the Statement of Requests for Disbursement (SOE Statement) and the Special Account Statement.
5. Most important disbursement categories shown in the SAR (see paragraph 2.15).
GUIDANCE FOR AUDIT OF PROJECTS IN THE LCR REGION

[NAME OF THE EXECUTING ENTITY]
[PROJECT IDENTIFICATION]
STATEMENT OF CUMULATIVE INVESTMENTS
Expressed in US dollars

<table>
<thead>
<tr>
<th>INVESTMENTS:</th>
<th>Cumulative at 12/31/X1</th>
<th>Totals of the year X2</th>
<th>Cumulative at 12/31/X2</th>
<th>Cumulative Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Local</td>
<td>IBRD</td>
<td>Total</td>
<td>Local</td>
</tr>
<tr>
<td>Civil works</td>
<td>1,001,214</td>
<td>2,118,966</td>
<td>3,120,180</td>
<td>405,608</td>
</tr>
<tr>
<td>Laboratory equipment</td>
<td>3,857,518</td>
<td>4,663,218</td>
<td>8,520,736</td>
<td>370,018</td>
</tr>
<tr>
<td>Vehicles</td>
<td>2,127,462</td>
<td>339,621</td>
<td>2,467,083</td>
<td>-</td>
</tr>
<tr>
<td>Research materials</td>
<td>1,927,148</td>
<td>2,569,525</td>
<td>4,496,673</td>
<td>169,946</td>
</tr>
<tr>
<td>Consulting services</td>
<td>285,416</td>
<td>318,732</td>
<td>604,148</td>
<td>69,580</td>
</tr>
<tr>
<td>Training</td>
<td>2,832,427</td>
<td>436,381</td>
<td>3,268,808</td>
<td>60,775</td>
</tr>
<tr>
<td><strong>Total Investment Costs</strong></td>
<td><strong>12,031,185</strong></td>
<td><strong>10,446,443</strong></td>
<td><strong>22,477,628</strong></td>
<td><strong>1,115,927</strong></td>
</tr>
<tr>
<td>Recurring Costs:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personal services</td>
<td>6,120,138</td>
<td>6,304,618</td>
<td>13,024,756</td>
<td>-</td>
</tr>
<tr>
<td>Maintenance and Repairs</td>
<td>245,148</td>
<td>1,326,799</td>
<td>1,571,947</td>
<td>442,189</td>
</tr>
<tr>
<td><strong>Project Investments</strong></td>
<td><strong>6,365,286</strong></td>
<td><strong>8,231,417</strong></td>
<td><strong>14,596,703</strong></td>
<td><strong>442,189</strong></td>
</tr>
</tbody>
</table>

[Explanatory notes should be attached to the project financial statements to ensure all relevant information is clearly stated]

1 This financial statement shows Project expenses for the year, and cumulative at the closing dates for the current and the preceding year. Additional schedules should be used in order to provide more detailed information and a comparison with amounts programmed in the SAR or the PAD.

2 Covered with disbursements from the Special Account and Direct Payments.

3 Cumulative budget since the beginning of the Project through the date of the Financial Statement, as established in the SAR/PAD and pertinent amendments.
### [NAME OF THE EXECUTING ENTITY]

[PROJECT IDENTIFICATION]

**STATEMENT OF CUMULATIVE INVESTMENTS**

(Schedule Comparing Actual Vs. Programmed)

Expressed in US dollars

<table>
<thead>
<tr>
<th>INVESTMENTS:</th>
<th>Cumulative at 12/31/X1</th>
<th>Totals of the year ended on 12/31/X2</th>
<th>Cumulative at 12/31/X2</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Actual</td>
<td>Programmed</td>
<td>Variance</td>
</tr>
<tr>
<td>Investment Costs:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Civil works</td>
<td>3,120,180</td>
<td>6,384,000</td>
<td>3,263,820</td>
</tr>
<tr>
<td>Laboratory equipment</td>
<td>8,520,736</td>
<td>8,358,000</td>
<td>(162,736)</td>
</tr>
<tr>
<td>Vehicles</td>
<td>2,467,083</td>
<td>1,050,000</td>
<td>(1,417,083)</td>
</tr>
<tr>
<td>Research materials.</td>
<td>4,496,673</td>
<td>4,200,000</td>
<td>(296,673)</td>
</tr>
<tr>
<td>Consulting services</td>
<td>604,146</td>
<td>2,940,000</td>
<td>2,335,852</td>
</tr>
<tr>
<td>Training</td>
<td>3,268,808</td>
<td>3,024,000</td>
<td>(244,808)</td>
</tr>
<tr>
<td>Total Investment Costs</td>
<td>22,477,628</td>
<td>25,956,000</td>
<td>3,478,372</td>
</tr>
<tr>
<td>Recurring Costs:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personal services</td>
<td>13,024,756</td>
<td>9,460,000</td>
<td>(7,564,756)</td>
</tr>
<tr>
<td>Maintenance and Repairs</td>
<td>1,571,947</td>
<td>840,000</td>
<td>(731,947)</td>
</tr>
<tr>
<td></td>
<td>14,596,703</td>
<td>6,300,000</td>
<td>(8,296,703)</td>
</tr>
<tr>
<td>Project Investments</td>
<td>31,074,331</td>
<td>32,256,000</td>
<td>(1,181,669)</td>
</tr>
</tbody>
</table>
[NAME OF THE IMPLEMENTING ENTITY]
[Project Identification Number]
Notes to the Project Financial statements
Years ended on December 31, X2 and X1

[The purpose of this example is to provide an idea of the information that should be included in the notes to the project financial statements, and does not pretend to represent established policies concerning the use of specific exchange rates or similar issues. The notes should provide adequate additional information that is relevant to the needs of the users about the items in the statements of Sources and Uses of Funds and of Cumulative Investments. For example, the notes should provide information on the composition of the cash balance at the end of the period. If the entity is not in charge of the Special Account, this fact must be disclosed, stating the form in which loan proceeds were received from the Bank.]

NOTE 1 - OBJECTIVES AND NATURE OF THE PROJECT

[Give a clear summary description of the objectives and nature of the Project. The following paragraphs provide a very general example, which should not be considered as all-inclusive.

The Project's objectives are: (i) to implement a series of research programs that will help improve agricultural practices in the national territory; (ii) to increase production levels and the quality of products; and (iii) to establish improved mechanisms for marketing agricultural products. The project includes environmental control and training components.

In order to finance the Project, which has an estimated cost of US$110.0 million, the National Government (NG) obtained a long term loan from the International Bank for Reconstruction and Development (IBRD) for US$77.0 million. The remaining US$33.0 million will be financed from local counterpart funds contributed by the various governmental entities participating in the Project.

Responsibility for the Project's management and implementation was assigned to the National Agricultural Institute (NAI), a decentralized dependency of the Ministry of Agriculture. NAI set up a special Project Implementing Unit (PIU) to carry out all project administrative and operational tasks.

As of December 31, X2, approximately 45% of the programs proposed had been implemented, and the amount invested represented approximately 49% of the total estimated cost.

NOTE 2 - MAIN ACCOUNTING POLICIES

1. The PIU uses the cash basis of accounting to account for project transactions. Under that basis, income is recognized when funds are received and expenses are recognized when payment is made. At December 31, X2 and X1, there were no material transactions pending disbursement.

2. Transactions are recorded in local currency. For preparing the statements of Sources and Uses of Funds and of Cumulative Investments, receipt of local currency is translated to US dollars using the
exchange rate current at the date of receipt. Expenditures in local currency are translated using an average exchange rate for the month of disbursement.

3. All fees and charges for undisbursed loan funds, as well as losses due to exchange rate fluctuations are not considered eligible project costs and are absorbed by the National Government.

4. Fixed assets procured with project resources are recorded at their acquisition cost at the date of purchase. No depreciation is recorded for project assets.

5. Since the main objective of these financial statements is to disclose the sources and uses of funds, it is not necessary to present information adjusted for inflation. The increase in price level during the last two years has been moderate.

NOTE 3 - RESTRICTED USE OF FUNDS AND OTHER ASSETS

In accordance with the loan agreement between the NG and IBRD, funds available in the Special Account are restricted to project purposes only. Project funds still unused at the end of the project will be returned to the National Treasury for distribution to the providers in accordance with the provisions of the corresponding financing agreements. Fixed assets procured with project funds belong to NAI and are restricted to project purposes until project completion. NAI must maintain adequate records to control those assets.

NOTE 4 - IBRD LOAN

IBRD's US$77.0 million loan will be repaid in equal semiannual installments with a final due date of August 31, 2020. Interest and other fees and charges will be paid by the NG. At December 31, X2, IBRD had disbursed a total amount of US$30,207,218, and the NG had made two interest payments for US$392,000 each. That interest, as well as any payment of the principal, are not part of the project expenses reported in these financial statements.

NOTE 5 - CASH AVAILABILITY AT DICIEMBRE 31, X2

Cash available at December 31, X2, expressed in US dollars, included:

<table>
<thead>
<tr>
<th></th>
<th>Loan Funds</th>
<th>Counterpart Funds</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Special Account</td>
<td>38,541</td>
<td></td>
<td>38,541</td>
</tr>
<tr>
<td>Fixed funds</td>
<td></td>
<td>596,366</td>
<td>596,366</td>
</tr>
<tr>
<td>Checking account</td>
<td>21,489</td>
<td>150,995</td>
<td>172,484</td>
</tr>
<tr>
<td></td>
<td>60,030</td>
<td>747,361</td>
<td>807,391</td>
</tr>
</tbody>
</table>
GUIDANCE FOR AUDIT OF PROJECTS IN THE LCR REGION

[NAME OF THE EXECUTING ENTITY]
[PROJECT IDENTIFICATION]
STATEMENT OF REQUESTS FOR DISBURSEMENT
(SOE STATEMENT)
For the year ended on December 31, X2

<table>
<thead>
<tr>
<th>Disbursement Categories (1)</th>
<th>Civil Works</th>
<th>Laboratory Equipment</th>
<th>Research Material</th>
<th>US. $</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Requests Reimbursed:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>February 26</td>
<td>13</td>
<td>86,463</td>
<td>69,170</td>
<td>190,217</td>
</tr>
<tr>
<td>May 30</td>
<td>14</td>
<td>146,521</td>
<td>33,813</td>
<td>45,084</td>
</tr>
<tr>
<td>August 30</td>
<td>15</td>
<td>191,414</td>
<td>33,178</td>
<td>30,626</td>
</tr>
<tr>
<td>November 18</td>
<td>16</td>
<td>403,663</td>
<td>13,455</td>
<td>31,396</td>
</tr>
<tr>
<td>Sub-total</td>
<td></td>
<td>828,061</td>
<td>149,616</td>
<td>297,323</td>
</tr>
<tr>
<td>Requests Pending Reimbursement:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>December 2</td>
<td>17</td>
<td>315,000</td>
<td>10,500</td>
<td>24,500</td>
</tr>
<tr>
<td>TOTAL AMOUNT REQUESTED DURING THE YEAR X2</td>
<td></td>
<td></td>
<td></td>
<td>1,625,000</td>
</tr>
</tbody>
</table>

(1) Note: disbursement categories are those stated in the loan/credit agreement and the SAR. Only a few are used here for illustration purposes.
[NAME OF THE EXECUTING ENTITY]  
[PROJECT IDENTIFICATION]  
SPECIAL ACCOUNT STATEMENT  
ACCOUNT No. [Special Account No.]  
AT [Banking Institution]  
For the year ended December 31, X2

<table>
<thead>
<tr>
<th>Description</th>
<th>US$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance at 12/31/X1</td>
<td>7,000,000</td>
</tr>
<tr>
<td>World Bank/IDA Reimbursements:</td>
<td></td>
</tr>
<tr>
<td>requests made in the year X1</td>
<td>2,277,208</td>
</tr>
<tr>
<td>requests made in the year X2</td>
<td>1,275,000</td>
</tr>
<tr>
<td>Interest earned</td>
<td>10,894</td>
</tr>
<tr>
<td>Total deposits made during X2</td>
<td>3,563,102</td>
</tr>
<tr>
<td>Funds available in the year X2</td>
<td>10,563,102</td>
</tr>
<tr>
<td>Less:</td>
<td></td>
</tr>
<tr>
<td>Payments for goods and services</td>
<td>10,524,561</td>
</tr>
<tr>
<td>Service charges for the account</td>
<td>0</td>
</tr>
<tr>
<td>Total project investments</td>
<td>10,524,561</td>
</tr>
<tr>
<td>Balance at the end of the period</td>
<td>38,541</td>
</tr>
</tbody>
</table>

1 Other deposits should also be disclosed.
Annex II

TERMS OF REFERENCE FOR THE AUDIT OF THE [name of the Project] PROJECT, PARTIALLY FINANCED BY WORLD BANK LOAN No. [number and code of the Loan] AND IMPLEMENTED BY [Name of the Implementing Entity] DURING THE PERIOD FROM [Date] TO [Date] 1

[Note: This document must be used as a basis for preparing the Terms of Reference (TOR) for audits. The text in Italic provides instructions for the institution finalizing the TOR, and should not appear in the final version of the document. The rest of the text must be used in the TOR unless there are special circumstances and the Bank approves its omission. All TORs must be approved by the Bank before the Implementing Entity (IE) proceeds with their distribution.

I. Basic Considerations for Audits of Projects Financed by the World Bank

These Terms of Reference provide the basic information needed by the auditor to obtain an understanding of the engagement, in order to prepare a proposal and to plan and perform the audit. However, this information must be complemented with that provided in the two most relevant Bank publications regarding auditing: the Guidelines and Terms of Reference for Audits of Projects with Financing by the World Bank in the Latin America and Caribbean Region (The Guidelines) and the Financial Accounting, Reporting and Auditing Handbook (FARAH). If the entity is receiving funds under the LAC! disbursement procedures, the auditors must also be familiar with the LAC! Implementation Handbook. These publications constitute the basic criteria against which the Bank will measure the quality of the auditor’s work when performing the desk review of the audit report. Furthermore, the “Guidelines” are specifically considered an integral part of the TORs.

II. Relationships and Responsibilities

The client for this audit is the Implementing Entity (IE), and the Bank is an interested party. A Bank representative may participate in the entrance and exit conferences, supervise the work performed by the auditors to ensure that it complies with the terms of reference and the applicable auditing standards, and to provide comments on the draft audit report.

The IE is responsible for preparing all the financial statements and reports required, and for ensuring that all the necessary records are available for the audit, that all the accounting entries and adjustments are made, and that all the necessary actions have been taken to allow the auditors issue the final report before [give same date as in section IX].

The auditors should maintain on file adequate working papers for a period of three years after the end of the audit. During this period, the auditors should promptly provide the working papers requested by the Bank.

1 If financing is through IDA, substitute “International Development Association (IDA)” and “Credit” for “World Bank” and “Loan” respectively. The TOR can also be used for operations financed with Trust Funds.
GUIDANCE FOR AUDIT OF PROJECTS IN THE LCR REGION

III. Project Background

[The purpose of this section is to help the auditors obtain a concrete idea about the Project so they may prepare an adequate proposal. This information is also useful for preparing the audit report. The Guidelines provide a detailed example of the information that should be included in normal Terms of Reference.]

See Attachment 1 for information on the Project to be audited.

IV. Audit Background

[Provide pertinent information, stating whether the project has been audited in prior years, and if so, state the results of those audits].

V. Title of the Audit

All proposals, audit working papers and audit reports should refer to this audit using the following name:

"Audit of the Resources Managed during [state dates, for example: the period from January 1 to December 31, 1999 or the year ended on December 31, 1999] by [name of the Implementing Entity²] under the Project [Name of the Project, e.g., "Rehabilitation and Management of the Water and Sewerage Systems of Region One"], financed partially by World Bank Loan No. [number and code of the loan]."

VI. Audit Objectives

The overall objective of this engagement is to allow the auditor to express a professional opinion on the financial position of the project at the end of the period audited, to report on the adequacy of the internal controls, and to express an opinion on the compliance with the covenants of the loan agreement and applicable laws and regulations. The engagement will include [: (1) ] a special purpose audit of the Project, including the resources provided by the Bank, those of other cofinancing institutions, if any, and counterpart funds provided by the Government and other local sources [if an audit of the financial statements of the IE as a whole is required by the terms of the loan or project agreement(s) add the following: (2) an audit of the financial statements of the IE as a whole. The Bank funds shown in the Project financial statements should be reconciled with the Bank funds included in the entity's financial statements through a note to the financial statements].

[The following section ("Audit of the Project") must be included in all TORs]

Audit of the Project. This special purpose audit must be performed in accordance with the International Standards on Auditing issued by the International Federation of Accountants (IFAC) [or by the International Organization of Supreme Audit Institutions (INTOSAI)]³, and

² Also referred to in the Bank as the "Executing Entity."
³ INTOSAI Standards may be used only if the audit will be performed by a government auditor acceptable to the Bank.
therefore must include the tests of the accounting records that the auditors consider necessary under the circumstances. The specific objectives of the audit are to:

- Issue an opinion as to whether the Project financial statements present fairly, in all material respects, the financial position of the project, the funds received and the disbursements made during the period audited, as well as the cumulative investments at the end of the period, in accordance with international accounting standards and the requirements of the respective agreements with the Bank [add "and other cofinancing organizations" if applicable].

[For LACI-compliant projects add the following objective: Issue an opinion as to whether: (a) the expenditures reported are eligible for financing; and (b) loan funds have been used only for Project purposes.]

- Issue an opinion on whether the supplementary financial information for the Project is fairly presented, in all material respects.

- Issue a report with respect to the adequacy of the internal control structure of the implementing institution in regard to the project.

- Issue an opinion with respect to the implementing entity's compliance with the terms of the loan agreement and applicable laws and regulations (with regard to the financial aspects).

- [This paragraph is only applicable to projects which use the SOE mechanism, not to LACI-compliant projects.] Issue an opinion as to: (a) whether the expenditures included in the requests for reimbursement (SOE) are eligible, and if the information presented in the SOEs is reasonably dependable; (b) whether the accounting and the internal control procedures used for the preparation of the SOEs are adequate; and (c) whether loan funds have been used only for Project purposes, in accordance with the requirements established in the corresponding agreements with the international organizations.

- Issue an opinion as to whether the Statement of the Special Account used for managing the funds provided by the Bank presents fairly the availability of funds at the end of the period audited, as well as the transactions made during the same period, in accordance with the provisions for the use of the funds established in the corresponding agreements with the Bank.

[Include the section below ("Audit of the Implementing Entity") only if the loan or project agreement(s) require such an audit, which normally only applies to projects implemented by Revenue Earning Entities.]

Audit of the Implementing Entity. The financial audit should be performed in accordance with generally accepted auditing standards compatible with IFAC's [or "INTOSAI's" if the audit will be performed by a government auditor]. The specific objectives of the audit are to:

- Issue an opinion on whether the financial statements of the IE present fairly, in all material respects, the financial position of the entity at the date of the financial statements, the results of its operations and cash flow during the period audited, in accordance with generally
accepted accounting principles, which must be compatible with those issued by the International Accounting Standards Committee (IASC). Any important differences in the application of accounting principles other than IASC’s must be disclosed.

- Issue an opinion on whether the supplementary financial information related to the IE has been reasonably presented in all material respects in relation to the basic financial statements taken as a whole.

VII. Scope of the Audit

The audit must include adequate planning, the evaluation and testing of the internal control structure and systems, and obtaining sufficient objective evidence to allow the auditors to reach reasonable conclusions on which to base their opinions. In conducting their work, the auditors should pay special attention to the following requirements:

- All project funds --external or counterpart funds-- should be used in accordance with the conditions of the relevant financing agreements, with due attention to economy and efficiency, and only for the purposes for which the financing was provided.

- Counterpart funds should be provided in accordance with the relevant financing agreements.

- Goods and services financed should be procured in accordance with the relevant financing agreement.

- Implementing entities should keep all necessary supporting documents, records, and accounts in respect of all project ventures including expenditures reported via SOEs or Special Accounts. Clear linkages should exist between the books of account and reports presented to the Bank.

- Where Special Accounts have been used, they should be maintained in accordance with the provisions of the relevant financing agreement.

- The project accounts should be prepared in accordance with International Accounting Standards consistently applied, and give a true and fair view of the financial situation of the project at the end of the period and of the resources and expenditures for the year ended on that date.

The audit should be performed in accordance with acceptable auditing standards, and therefore should include the tests of the accounting records that the auditors consider necessary under the circumstances. The auditors should be alert for situations or transactions that may indicate fraudulent, wasteful or illegal acts and expenditures. If such evidence exists, the auditors must communicate the situation simultaneously to a duly authorized representative of the Bank and to the Project management, and exercise caution and due professional care in expanding their audit steps and procedures related to illegal acts. Section 240 of the International Standards on Auditing provides guidance on this respect.
VIII. Other Responsibilities of the Auditor

The auditor should comply with the following requirements:

A. Conduct entrance and exit conferences with the IE.

B. Plan the audit work so that preliminary reviews can be conducted during the period under review (including the first few months), with the purpose of evaluating the systems of internal control and communicating to the implementing unit in a timely manner any situations that merit the attention of management before the issuance of the final audit report.

C. Independently reference the audit report before issuing it.

D. Obtain a Management Representation Letter in accordance with section 580 of the International Standards on Auditing, signed by the management of the Project IE.

IX. Audit reports

The auditors shall issue their report containing the specific opinions and conclusions required. All the reports resulting from the audit of the project should be incorporated into one document. This report [add "as well as the one for the IE," if there is also one for the entity] should be addressed and delivered to the IE before [enter a date here which will allow sufficient lead time for the audit report to be delivered to the Bank on or before the legal deadline agreed]. The report[s] shall be issued in English, duly signed and bound, in original and [number of copies requested] copies. The report for the Project should contain at least:

A. A title page, table of contents, a transmittal letter to the IE, and a summary containing the information required in the Guidelines.

B. The audit report and opinion for the Project financial statements, their corresponding notes and supplementary information. [For LACI compliant projects add the following: Also, an opinion on the eligibility of the expenditures reported and the correct use of the Loan funds.] Any costs that are not supported by adequate records or that are not eligible under the terms of the loan agreement (questioned costs) should be identified.

C. The audit report on the internal control structure for the Project. The report should disclose, among other information discussed in the Guidelines, the reportable conditions (those that have an impact on the financial statements), including the identification of material weaknesses in the internal control structure of the implementing unit, as well as the IE's comments.

This report should include a section on the follow-up of recommendations made in prior audits, indicating the current status of the recommendations as corrected, partially corrected, or not corrected. The deficiencies that still have not been corrected should be reported again in the current audit report, along with the corresponding management's comments.
D. The audit report and opinion on the IE's compliance with the terms of the loan agreement and applicable laws and regulations related to the Project's financial activities. This opinion should also be consistent with section 800 of IFAC's International Standards on Auditing.

E. [This paragraph is only applicable to projects that use the SOE mechanism, not to LACI-compliant projects, which are explicitly included in item B above.] An audit report and opinion on the Statement of Requests for Reimbursement (SOE Statement) for the period audited. The auditor must issue an opinion explicitly covering: (i) the eligibility of the expenditures submitted for reimbursement, (ii) the adequacy of the control procedures for preparing the SOE, and (iii) the correct use of the Loan funds.

F. An audit report and opinion on the Special Account Statement for the period audited. The opinion should state whether the SA Statement adequately reflects the flow of funds for the SA during the period audited, and if this activity has been only for purposes of the project.

G. A summary of the main audit procedures performed for planning the audit, evaluating the internal control structure, checking the figures included in the financial statements and other areas subject to audit, and for evaluating compliance with terms of the applicable agreements, laws and regulations.

[If an audit of the financial statements of the entity is required, include the following item:

H. The audit report of the IE's financial statements, including all supplementary information. This report must be prepared in accordance with Generally Accepted Auditing Standards, but must clearly identify the funds provided by the Bank and the associated assets and liabilities.]

X. Inspection and Acceptance of the Audit Work and the Reports

The Bank is responsible for inspecting and accepting the audit reports, and may appoint individuals or firms to carry out these activities, including the review of the working papers and of the auditor's quality control procedures. If the report is not acceptable or not fully satisfactory due to deficiencies in the audit work or because the report does not comply with the requirements stated in these TORs or the Guidelines, the auditor shall perform the necessary additional work at no additional cost to the IE, the Project or the Bank.

Also, the representative of the Bank may contact the auditors directly to request any additional information related to any aspect of the audit or the Project financial statements. The auditors must satisfy such requests promptly.

XI. Terms of Performance

[Include the following sentence if applicable: The auditor will perform interim work during the year [year].] [Include the following in all cases, providing the applicable dates] The auditor will issue the draft report on or before [enter date], and the final report on or before [enter date]. These dates are important to allow the IE to send to the Bank the final audit report for the Project [if applicable, add: "and for the entity financial statements"] before [enter date].
Payment for the audit services will be as follows: [State the terms of payment. For example: 20% on the beginning date of the audit, 50% on the date of the draft report, and 30% upon the acceptance of the final report by the IE.]
III. Project Background

The services of water and sewerage in the country have experienced significant deterioration in recent years. By mid-1995 the water and sewerage infrastructure had deteriorated so much that it was necessary to substantially rehabilitate them in order to assure their operation. Proper management of water resources was also urgent, especially in urban centers with limited water availability. In addition, the country experienced the beginning of a widespread and fatal cholera epidemic, which was due in part to the poor state of the water and sewerage infrastructure, especially in the urban areas.

On January 1, 1998 the World Bank and the Government of the Country signed loan agreement No. 11-Country for US $50.0 million to finance the cost of the project "Rehabilitation and Management of the Water of Region One" (the Project). The purpose of the loan is to assist the Borrower to promote economic development and reduce poverty.

The objectives of the Project are to improve the efficiency of water distribution and sewerage services in the area known as Region One; to promote water conservation; to support the privatization of the Autonomous Water Service (AWS, the Project Implementing Entity); to rehabilitate the water and sewerage systems that are in poor condition; to extend these services to the poorer population in marginal zones; and to support reforms of the legal and institutional structure of the water and sewerage sector.

The Project has four components: a water conservation program, rehabilitation of the water and sewerage infrastructure, expansion of water and sewerage lines to low-income areas, and technical assistance for institutional capacity building.

[The Terms of reference normally should contain a description of each component of the Project.]

The estimated cost of the Project is of US$76.2 million. The Bank will contribute with a loan for US$50.0 million, a cofinancier --the Foreign Economic Cooperation Fund-- will provide a loan of US$6.2 million for various specific subcomponents, and AWS will contribute US$20 million. The funds will be contributed and distributed as shown below:

Sources of Funds for the Project

<table>
<thead>
<tr>
<th>Institution</th>
<th>Amount in millions of US$</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>The World Bank</td>
<td>50.0</td>
<td>66.0</td>
</tr>
<tr>
<td>Cofinancier</td>
<td>6.2</td>
<td>8.0</td>
</tr>
<tr>
<td>AWS</td>
<td>20.0</td>
<td>26.0</td>
</tr>
<tr>
<td>Total</td>
<td>76.2</td>
<td>100.0</td>
</tr>
</tbody>
</table>
### Total Costs of the Project (Distribution)

<table>
<thead>
<tr>
<th>Component</th>
<th>Local Funding</th>
<th>Foreign Funding</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rehabilitation 1</td>
<td>11.5</td>
<td>15.4</td>
<td>26.9</td>
</tr>
<tr>
<td>Water Conservation</td>
<td>2.6</td>
<td>11.6</td>
<td>14.2</td>
</tr>
<tr>
<td>Expansion of Water Provision</td>
<td>1.8</td>
<td>11.8</td>
<td>13.6</td>
</tr>
<tr>
<td>Institutional Development</td>
<td>0.7</td>
<td>8.1</td>
<td>8.8</td>
</tr>
<tr>
<td><strong>Total Base Cost</strong></td>
<td><strong>16.6</strong></td>
<td><strong>46.9</strong></td>
<td><strong>63.6</strong></td>
</tr>
<tr>
<td>Physical Contingencies</td>
<td>1.5</td>
<td>5.7</td>
<td>7.2</td>
</tr>
<tr>
<td>Price Contingencies</td>
<td>1.9</td>
<td>3.6</td>
<td>5.5</td>
</tr>
<tr>
<td><strong>Total Project Cost</strong></td>
<td><strong>20.0</strong></td>
<td><strong>56.2</strong></td>
<td><strong>76.2</strong></td>
</tr>
</tbody>
</table>

*Foreign funding includes US$ 6.2 million financed by the Foreign Economic Cooperation Fund*

The Project is implemented by a Project Implementing Unit (PIU) created specifically for this purpose, which reports to a Project Committee headed by the Implementing Entity's General Manager. This PIU is responsible for the complete implementation of the project, including all procurement processes, preparation of Requests for Reimbursement (SOEs), management of the Project bank accounts, accounting and preparation of Project reports (including financial and non financial). The PIU will also directly implement the activities of the Project during its first phase, in which it will invest 20% of the amount of the Project funds.

The funds provided by the Bank loan must be deposited by the AWS in a Special Account in dollars in a commercial bank acceptable to the World Bank. The amount approved for this account is US$8.0 million, sufficient to cover the four months of expenditures. However, this limit will be US$4.0 million until the cumulative amount of disbursements exceeds US$20.0 million. The limit under which it is obligatory use this account is US$800,000. The Bank will reimburse the Special Account based on Statements of Expenditure (SOEs) by the Borrower. The PIU controls the Special Account and is responsible for preparing the SOEs, which submitted monthly or when the balance of the account is less than 67% of the opening balance. The PIU has established a separate account for the local currency. These counterpart funds are deposited at regular intervals in order to adjust to the funds requirements for each component under implementation, in accordance with a program presented every three months. Both accounts are managed in accordance with specific procedures approved by the Bank.

The PIU supervises the implementation of all the Project components and the implementing entity's compliance with the terms of the loan agreement. It is also in charge of procuring goods and services. All the contracts for equipment and materials for less than US$250,000 (up to a cumulative total of $2.0 million) and civil works under $3.0 million (up to a total cumulative amount of $42.9 million) may be processed using local procurement procedures. Purchases over these limits are made using competitive international procurement procedures and standard Bank documents. It is estimated that approximately 70 percent of all the works will be contracted through international procurement. Services such as consulting, engineering,
supervision and technical studies will be obtained in accordance with Bank guidelines. Contracts for supervision and engineering designs in excess of $50,000 for firms and $20,000 for individuals require prior Bank approval.

The activities related to the international procurement, such as advertising, preparation of bidding documents, review of proposals, and granting of contracts are subject to the Bank's review. Likewise, local procurement in excess of $500,000 for civil works and $100,000 for goods is subject to the Bank's no-objection. If the Bank determines that procurement was inconsistent with the procedures agreed, such expenditures shall not be financed with loan funds, and the Bank will be free to cancel an equivalent amount off the loan.

The loan will cover 100 percent of foreign currency expenditures for consultants, goods and civil works, 85 percent of the expenditures for local consultants, and 66 percent of the local expenditures for civil works, materials and equipment. The loan funds are provided through a Special Account. Reimbursement for contracts for civil works under $500,000, procurement of goods under $100,000, and consulting contracts with firms or individuals under $100,000 and $20,000 respectively are processed through SOEs prepared and certified by the PIU. The loan disbursement plan covers a period of six years, ending on December 31, 2003. The Project completion date is June 30, 2004.

The loan will finance expenditures made during the period between the years 1997 and 2003. Expenditures for 1997 refer to contracts granted after May 15, 1997, for emergency rehabilitation and consulting services; the Bank financed eligible expenditures up to $3 million.

The PIU prepares and delivers to the Bank quarterly reports on the Project's progress. These reports describe and compare the progress of the Project against estimates made during project appraisal, state the level of compliance with the monitoring indicators agreed, and will evaluate problems and issues identified during Project implementation. They also propose adjustments and corrective actions in case of unsatisfactory progress. The reports are delivered to the Bank no later than March 31, June 30, September 30, and December 31 of each year.

[In addition, the PIU should provide information about project activities during the period to be audited.]