



## TERMS OF REFERENCE

### **AUDIT of the Financial Statements (Agreed-upon procedures engagement)**

Valid for audit of financial statements of local NGOs; audit of projects under mandate or contribution contracts.

#### **1. Fundamental principles**

1.1 The financial audit of projects (“financial audit”) is to be carried out by an independent auditor (“the auditor”), having the required professional competence and experience, and in accordance with generally accepted international auditing standards.

1.2 These Terms of Reference (“TOR”) define the mandate of the auditor in connection with the financial audit of projects/programs of cooperation/implementing partner (“the partner”), financed by the FDFA. The financial audit is based on the professional requirements and guidelines governing the professional work to be undertaken by an auditor in relation to an audit.

1.3 In planning, conducting and reporting on the financial audit, the auditor shall be given due considerations to the following auditing and other standards promulgated by international professional bodies:

ISA - *International Standards on Auditing*,

Any additional Agree upon procedure will be subject of additional agreement

In addition, the relevant standards of the local accounting profession as well as the local legislation on accounting and reporting in force in the country in which the financial audit is carried out need to be taken into consideration by the auditor.

#### **2. Overall principles of the financial audit to be taken into consideration**

The auditor is required to plan, execute and report on the financial audit engagement in order to form a professional judgment on the following matters relating to the activities and the organisation of the partner:

- **2.1 Principles of orderliness (financial regularity)**
- **2.2 Existence, adequacy and effectiveness of the Internal Control System (ICS)**
- **2.3 Conformity with the project objectives and adherence to the contract conditions**
- **2.4 Economical conduct of business and effective use of financial resources**

#### **3. Documents of reference**

The following documents and matters are to be considered by the auditor as basic references for performing the financial audit:

**Legislation:** National legislation/ other regulations (if applicable)

**Project/program:** Cooperation agreement relative to the project or to the partner organisation;  
Project Document / Terms of Reference (TOR),  
Budgets, financing plans, programs of project activities;  
Project management procedures;  
Any other documents concerning the project/program.

**Accounting:** Accounting documents subject to the financial audit;  
Financial and operational reports concerning the project/program.

**auditor:** The present terms of reference and the related mandate for financial audit;  
Prior internal and external audit reports of the partner;  
Any other information requested from the partner by the auditor.

#### **4. Planning the audit according to ISA**

The auditor shall adequately plan the financial audit engagement well in advance of the work and ensure the execution of the financial audit of highest professional quality in an economical and efficient manner and within the agreed timetable.

On the basis of the information received during the planning phase, including his audit risk assessment, the auditor shall determine for example:

- the type of transactions to be audited and the audit method (full or random sample);
- the type of physical verifications and the sites to be selected;
- the number of site visits to be planned.

The auditor undertakes to ensure continuity in the audit approach of the financial audit engagement and the audit team, even if there is a change in the leader of the audit team from the prior year.

#### **5. Place of financial audit**

The financial audit is to be carried out within the project environment (administrative offices and/or decentralised sites, if applicable).

#### **6. Management representation of full disclosure**

The auditor shall obtain a management representation letter signed by the management of the audited organization, certifying:

- a) the acknowledgement of the organization's responsibility for the keeping of accounts and financial documents that are correct, complete, fair, representing the true facts, in conformity with the objectives of the project, the documents of reference (description of the project, contracts, budgets, etc.) and national legislation
- b) that all accounting records, supporting and other documents, minutes and any other pertinent information necessary for the audit be at the disposal of the auditor
- c) the completeness of information concerning property and goods
- d) the completeness of information concerning financing received or due and own financing concerning the audited period, for the project being examined
- e) the availability of any information and explanations, either orally or by written confirmation, which might be required by the auditor in the execution of his mandate.
- f) In the case of contributions to local NGOs, the declaration has to certify the completeness of information concerning financing received or due and own financing concerning the audited period, for the project being audited **and** for the examination of the consolidated financial statements of the organization. The consolidated financial statements, including balance sheets and profit and loss statements of the project are to be annexed to the declaration and form an integral part thereof. This declaration shall be included in the financial audit report.

#### **7. Detailed financial audit procedures according to ISA**

Appropriate audit procedures are to be applied by the auditor in order to form a professional judgement on the matters outlined below. These procedures applied, either on a full scope or random basis, may include for example: controls, checking, evaluation, inspection, interview, analysis and other audit techniques. When selecting the audit procedures, the auditor shall give consideration to the results of his audit risk assessment (during planning stage and during the course of the audit work).

Accordingly, he must define and carry out suitable audit tasks in order to obtain an overview of the aforementioned aspects before he assesses the individual findings and reaches a final independent decision on the audit.

The auditor is expected to select and apply any other audit procedures that he may consider necessary in the professional execution of the financial audit engagement.

Upon receipt of the financial audit report, the FDFA or any third persons designated by the FDFA reserve the right to request other audit procedures to cope with the change in circumstances in the project or of the organisation of the partner.

Examples of possible audit procedures are:

### **7.1 Principles of orderliness (financial regularity) – Principle 2.1**

Project related matters:

- a) Authorizations/approvals of expenditures and validity with supporting documents,
- b) Details of funds received for the project and reconciliation with the information supplied by the donor(s),
- c) Physical existence and movements of the goods representing the property of the project (fixed assets, inventory items, current assets);
- d) Allocation of expenditures in conformity with the agreed budget(s),
- e) Conformity of local contracts with local legislation currently in force,
- f) Disposition and implementation of observations, adjustments and recommendations resulting from previous financial audit reports.

Accounting related matters:

- g) Arithmetic exactitude of the accounts, supporting documents and financial statements and reports,
- h) Correctness of the accounting entries,
- i) Timeliness of recording economic events and transactions in the general ledger accounts,
- j) Financial statements and report information in agreement with the general ledger accounts,
- k) Adequacy and completeness of revenues, revenues are booked correctly
- l) Assessment of accounts receivable and advances; justification for overdue/unpaid amounts in excess of one month,
- m) Reconciliation of balances of cash in hand and in banks with the general ledger accounts,
- n) Disposition and implementation of observations and recommendations as well as adjustments and recommendations resulting from previous financial audit and/or audit reports.

**7.2 Existence, adequacy and effectiveness of the Internal Control System (ICS) - Principle 2.2** within the ISA procedures:

- a) Adequacy of the internal organization (structures, functions, tasks, authority, responsibilities, methods, procedures, segregation of duties etc.),
- b) Effectiveness of project and financial accounting and reporting processes,
- c) Adherence to applicable laws, regulations and instructions,
- d) Physical safeguard of assets,
- e) Prevention of accounting errors and financial fraud,
- f) Adequacy and completeness of information and financial reporting system.

**7.3 Conformity with the project objectives and adherence to the contract conditions – Principle 2.3** within the ISA procedures:

- a) Agreement of transactions, expenditures and receipts by comparison with the basic project documents (project description, programs of activities, contracts, terms of reference, budgets etc.);
- b) Verification that goods purchased with allocated funds are utilized within the defined objectives and are still available or have been disposed/sold in conformity with the procedures defined in the project agreement/contract;
- c) Verification whether the clauses of the project agreement/contract have been respected;

- d) Verification that the expenditures correspond to the agreed budgets. Analysis of deviations between budgeted and actual expenses and substantiation of major budget variations (+/- 10 % of the budget).

**7.4 Economical conduct of business and effective use of financial resources** – Principle 2.4 within the ISA Procedures:

- a) Financial resources are utilized for the activities, as stipulated in the project agreement, contract with the consultant/implementer and terms of reference, always ensuring an appropriate level of cost and benefits;
- b) Existence and application of adequate measures in the internal control system (ICS) in respect of the utilization of committed resources;
- c) Application of management procedures relative to the various project transactions. In particular, adequate segregation of duties for vital functions and processes, like entering commitments, authorizing and accounting of expenditures, reconciliation of cash on hand and in banks, follow-up on long outstanding debtors and creditors, physical control over inventories, etc.);
- d) Expenditures are in line with the agreed budget positions;
- e) Any deviations of actual expenses from the agreed budget are reasonably explained and adequately documented by the project management
- f) Existence of adequate bid and purchasing procedures. e.g. best cost/benefit ratio for materials and services, conformity of price offers with local practices and cost levels;
- g) Confirmation that prices and rates are subject to regular verification and that the accounting system in use is adequate to the requirements of a management tool, particularly as it concerns cost analysis;
- h) Review and substantiation of expenditures of local and foreign experts/consultants (rent, travel expenses, accommodations, allowances etc.);
- i) Review and substantiation of expenditures related to national staff (gross salary, social and pension contributions, income taxes etc.);
- j) Existence of the vehicle logbook and verification that private use of vehicles has been invoiced and paid;
- k) Verification that private use of mobile and fix net phones by members of the staff has been invoiced and paid.

**7.5. Findings and recommendations in accordance with the ISA**

In his financial audit report, the auditor is expected to

- explain and quantify any adjusting and/or reclassification entries, and to
- formulate recommendations for the improvement of the internal control system (ICS) as well as of project and accounting procedures.

**8. Closing meeting**

After the completion of the financial audit engagement, but before leaving the project or the premises of the partner, the auditor shall hold a closing meeting with the persons responsible for the project/program (directors) and the staff responsible for accounting and reporting. The meeting shall address the results of the project audit, discuss major weaknesses in the project, administrative and financial management (including the deficiencies of individual staff members) and propose recommendations to improve the project management, the accounting procedures and the internal control system (ICS).

The content of the closing meeting is to be summarized in writing and signed both by the representative of the implementing partner and the leader of the audit team. These minutes shall be annexed to the financial audit report (see 9.1.13).

## **9. Financial audit report according to ISA**

The audit report of the auditor shall explicitly be responsive to the overall principles applicable to the audit engagement, as stated under 2. above.

The principle of orderliness (financial regularity) and the existence of the ICS have to be positively confirmed by the auditor.

The aspects adequacy and effectiveness of ICS, the conformity with the project objectives and adherence to the contract conditions and the economical conduct of business and effective use of financial resources are to be expressed in a so called “negative confirmation” based on the executed audit actions.

We expect the following paragraph to be included in the report:

“Based on our audit, nothing has come to our attention that causes us to believe that

- the Internal Control System (ICS) is not adequately or effectively organized
- the project execution is not in conformity with the project objectives and does not adhere to the contract conditions
- the business is not economically conducted and the financial resources are not effectively used.”

In reporting on the results of the financial audit, the auditor shall address the following matters and follow the following structure in the audit report:

### **9.1 Content and structure of auditor’s financial audit report in accordance to ISA**

9.1.1 Auditor’s opinion (specifically addressing the four overall principles stated under 2. above)

9.1.2 Name of project and partner, incl. subcontractor(s)

9.1.3 Brief description of relevant information on the partner (history, management, accounting system, internal control system, activities unrelated to the project sponsored by the FDFA etc.)

9.1.4 Period covered by the financial audit

9.1.5 Date and place of audit, name of audit firm, deviations from original audit programme

9.1.6 Description of audit procedures applied and findings on financial information subject to the audit

- Balance sheet
- Statement of income and expenses (statement of operations)
- List of proposed adjustments and reclassifications
- Other relevant matters

9.1.7 Analysis of the statement of funds received from the FDFA

9.1.8 Analysis of the statement of funds received from other donors, if applicable

9.1.9 Recommendations on project management, accounting procedures and internal control system (ICS)

9.1.10 Comments with regard to adherence to project agreement/contract and terms of reference

9.1.11 Budget comparison of the project, including comments on major variations

9.1.12 List of inventories and fixed assets acquired by the project during the accounting period under audit

9.1.13 Minutes of the closing meeting, as discussed under 8. above.

9.1.14 Management’s general representation letter in relation to the financial audit, as discussed under 6. above.

### **9.2. Currency and language of the financial audit report**

The financial information contained in the financial audit report of the auditor is to be expressed in the currency provided for in the contract. The financial audit report of the auditor and all other documents resulting from the financial audit engagement must be in English.

**9.3. Signature**

The financial audit report is to be signed by a representative of the auditor as well as by the leader of the audit team.

Place and date: \_\_\_\_\_

For the FDFA: \_\_\_\_\_

For the auditor: \_\_\_\_\_