TERMS OF REFERENCE FOR THE AUDIT OF PROJECT FINANCIAL STATEMENTS OF [PROJECT NAME] (For audits conducted by CAG)

Background

[Project Aims, Timelines and Objectives]

Objective

The essence of the World Bank audit policy is to ensure that the Bank receives adequate independent, professional audit assurance that the proceeds of World Bank loans were used for the purposes intended, that the annual project financial statements are free from material misstatement, and that the terms of the loan agreement were complied with in all material respects.

The objective of the audit of the Project Financial Statement (PFS) is to enable the auditor to express a professional opinion as to whether (1) the PFS present fairly, in all material respects, the sources and applications of project funds for the period under audit examination, (2) the funds were utilized for the purposes for which they were provided, and (3) expenditures shown in the PFS are eligible for financing under the relevant loan or credit agreement. In addition, where applicable, the auditor will express a professional opinion as to whether the Financial Management Reports submitted by project management may be relied upon to support any applications for withdrawal, and whether adequate supporting documentation has been maintained to support claims made by project management for reimbursement of expenditures incurred under the Statement of Expenditure method of reimbursement.

The books of account that provide the basis for preparation of the PFS are established to reflect the financial transactions of the project and are maintained by the project implementation agency—[_____] Project Implementation Unit and the participating divisions.

Standards

The audit will be carried out in accordance with the Auditing Standards promulgated by the Comptroller and Auditor General of India. The auditor should accordingly consider materiality when planning and performing the audit to reduce audit risk to an acceptable level that is consistent with the objective of the audit. Although the responsibility for preventing irregularity, fraud, or the use of loan proceeds for purposes other than as defined in the legal agreement remains with the borrower, the

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1 The background should normally include a detailed description of the project including information on project sources of funding, the purposes for which the funds are intended; and a general description of implementation arrangements, including the organizational structure of all implementing entities.

2 “World Bank” includes the International Development Agency and the International Bank for Reconstruction and Development. “Loans” includes credits and grants to which the TORs would apply; and “borrower” includes recipients of such loans.

3 The Bank’s charter (Article III Section V(b) of IBRD’s Articles of Agreement and Article V Section 1(g) of IDA’s Articles of Agreement) specify that “The Bank shall make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations.”
audit should be planned so as to have a reasonable expectation of detecting material misstatements in the project financial statements.

**Scope**

In conducting the audit, special attention should be paid to the following:

(a) All external funds have been used in accordance with the conditions of the relevant legal agreements and only for the purposes for which the financing was provided. Relevant legal agreements include the Financing Agreement, the Project Agreement, and the Minutes of Negotiations;

(b) Counterpart funds have been provided and used in accordance with the relevant legal agreements and only for the purposes for which they were provided;

(c) All necessary supporting documents, records, and accounts have been kept in respect of all project transactions including expenditures reported via SOEs/ SAs/ or FMRs where applicable. Clear linkages should exist between the books of account and reports presented to the Bank, and

(d) The project accounts have been prepared in accordance with consistently applied Government Accounting Standards and present fairly, in all material respects, the financial situation of the project at the year end and of resources and expenditures for the year ended on that date.

**Project Financial Statements**

The Project Financial Statements should include:

A. Statement of Sources and Applications of Funds: The contents of Project Financial Statements (PFS) are specific to the sector, the project design and the type of implementing entity. These formats therefore vary from one project to another. The formats of PFS are prepared in consultation with the implementing entity during the preparation of the Project. See Annexure 1 for an example of a Statement of Sources and Applications of Funds that could be prepared for a project implemented by core government departments.

B. Reconciliation of Claims to Total Applications of Funds: The PFS include a reconciliation between expenditure reported as per the Statement of Sources and Applications of Funds and expenditure claimed from the World Bank through Statements of Expenditures (SOE), documented claims or report based methods of reimbursement. An example is shown at Annexure 2.

C. Other Statements or Schedules as may be applicable in particular circumstances and as specified in the relevant legal agreements, such as:

- A statement showing appropriate major heads of expenditure. (say by Project Component/Sub-components)

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4 In response to identified project risks, the scope may be expanded to include a report on the expression of an opinion on specific aspects of the operation such as internal controls, compliance with Bank procurement policies, or efficiency and effectiveness in the use of loan proceeds.

5 Until such time as the pronouncements of the Government Accounting Standards Advisory Board are accepted and prescribed by the Ministry of Finance, the accounting standards followed by the Government of India will be defined by the General Financial Rules, PWD codes, Treasury codes and similar financial rules and codes as are in effect and applicable to the operations of the project.
A summary of cumulative expenditures by category of expenditure such as buildings, equipment, furniture, vehicles, major rehabilitation of canals etc.

D. Management Assertion: Management should sign the project financial statements and provide a written acknowledgement of its responsibility for the preparation and fair presentation of the financial statements and an assertion that project funds have been expended in accordance with the intended purposes as reflected in the financial statements. An example of a Management Assertion Letter is shown at Annexure 3.

Statements of Expenditures and Financial Management Reports

In addition to the audit of the PFS, the auditor is required to audit all Statements of Expenditures (SOEs) and/or Financial Management Reports (FMRs) for withdrawal applications made during the period under audit examination. The auditor should apply such tests as the auditor considers necessary under the circumstances to satisfy the audit objective. In particular, these expenditures should be carefully examined for project eligibility by reference to the relevant financing agreements. Where ineligible expenditures are identified as having been included in withdrawal applications and reimbursed against, these should be separately noted by the auditor.

Audit Report

An audit report on the project financial statements should be prepared in accordance with the Auditing Standards promulgated by the Comptroller and Auditor General of India. Those standards require an audit opinion to be rendered related to the financial statements taken as a whole, indicating “unambiguously whether it is unqualified or qualified and, if the latter, whether it is qualified in certain respects or is adverse or a disclaimer of opinion.” In addition, the audit opinion paragraph will specify whether, in the auditor’s opinion, (a) with respect to SOEs, adequate supporting documentation has been maintained to support claims to the World Bank for reimbursements of expenditures incurred; and (b) except for ineligible expenditures as detailed in the audit observations, if any, appended to the audit report, expenditures are eligible for financing under the Loan/Credit Agreement. Relevant CAG Auditing Standards are reproduced in Annexure 5. A sample audit report wording for an unqualified audit opinion is shown at Annexure 4.

The project financial statements and the audit report should be received by the Bank not later than 6 months after the end of the fiscal year. The auditor should also submit two copies of the audited accounts and audit report to the Implementing Agency.

The audit report is issued without prejudice to CAG’s right to incorporate the audit observations in the Report of CAG of India for being laid before Parliament/State or UT Legislature.

Management Letter

In addition to the audit report on the project financial statements, the auditor may prepare a management letter containing recommendations for improvements in internal control and other matters coming to the attention of the auditor during the audit examination.

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6 See relevant portions of Auditing Standards of the Comptroller and Auditor General of India as applicable from time to time.
Where a management letter is prepared by the auditor, a copy of the same will be supplied to the Bank. Else, a written advice may be made that no management letter was prepared together with the audit report on the project financial statements.

**General**

The auditor should be given access to any information relevant for the purposes of conducting the audit. This would normally include all legal documents, correspondence, and any other information associated with the project and deemed necessary by the auditor. The information made available to the auditor should include, but not be limited to, copies of the Bank's Project Appraisal Document, the relevant Legal Agreements, a copy of these Guidelines, and a copy of the Bank's Financial Management Assessment of the project entity. It is highly desirable that the auditor become familiar with other Bank policy documents, such as OP/BP 10.02, the Bank's internal guidelines on Financial Management that include financial reporting and auditing requirements for projects financed by the World Bank. The auditor should also be familiar with the Bank's Disbursement Manual. Both documents will be provided by the Project staff to the auditor.
Annexure 1

Example of a Statement of Sources and Application of Funds (projects implemented by core government departments)

Name of the Project
Loan/Credit/Grant No.
Statement of Sources and Applications of Funds
Report for the year ended ____________

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Current Year</th>
<th>Previous Year</th>
<th>Project to date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening Balance, (if cash balances are controlled by the entity) (A)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receipts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Funds from Government through Budget (These will include external assistance received by Government for the project.)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Funds received directly by Project Implementing authority through external assistance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Beneficiary Contribution (if any)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Receipts (B)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Sources (C = A + B)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Expenditures by Component</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Expenditures (D)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Closing Balance, (if cash balances are controlled by the entity) (C-D)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Notes:
1. This financial statement is prepared on a cash basis of accounting as per provisions of the Financial Rules and codes applicable.
2. The above figures will be based on monthly/quarterly abstract accounts prepared by the accounts compiling officers, duly reconciled by the respective DDOs, with details of unreconciled amounts to be furnished.
3. Names of accounting units whose financial statements are aggregated to prepare the consolidated accounts.
4. Any other project specific notes.
Sample Reconciliation of Claims to Total Applications of Funds

Name of the Project
Loan / Credit / Grant No.
Reconciliation of Claims to Total Applications of Funds
Report for the year ended ______

<table>
<thead>
<tr>
<th>Schedules</th>
<th>Amt (Rs. '000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td></td>
</tr>
<tr>
<td>II</td>
<td></td>
</tr>
<tr>
<td>III</td>
<td></td>
</tr>
<tr>
<td>IV</td>
<td></td>
</tr>
</tbody>
</table>

Bank Funds claimed during the year (A)

Total Expenditure made during the year (B)
Less: Outstanding AC bills (C)
  Ineligible expenditures (D)
  Expenditures not claimed (E)
Total Eligible Expenditures Claimed
  (F)=(B)-(C)-(D)-(E)

World Bank Share @ x% of (F) above (G)

CFAO

Project Director

Date

Notes:
1. Total expenditure made during the year (B above) must be the same as the Total Expenditures shown on the Statement of Sources and Applications of Funds (D on the Statement of Sources and Applications of Funds)
2. Outstanding AC bills (C above) reflect funds drawn against AC bills that have been booked as expenditure but not settled by the end of the year (ie, unsettled advances). The project should show in Schedule II the opening balance of unsettled AC bills, AC bills drawn during the year, AC bills settled during the year, and AC bills unsettled at the end of the year.
3. Expenditures not claimed (E above) may reflect timing differences for eligible expenditures incurred during the year but claimed after the year end.
4. Amounts A and G above must be equal.
Example of a Management Assertion Letter

(To Auditor)  (Date)

This assertion letter is provided in connection with your audit of the financial statements of the __________ Project for the year ended __________. We acknowledge our responsibility for the fair presentation of the financial statements in accordance with the cash basis of accounting followed by the Government of India, and we confirm, to the best of our knowledge and belief, the following representations made to you during your audit:

- The project financial statements are free of material misstatements, including omissions.
- Project funds have been used for the purposes for which they were provided.
- Project expenditures are eligible for financing under the Loan/Credit agreement.
- We have made available to you all books of account and supporting documentation relating to the project.
- The project has complied with the conditions of all relevant legal agreements, including the Financing Agreement, the Project Agreement, the Project Appraisal Document, the Minutes of Negotiations, and the Borrower’s Project Implementation Plan.

(Senior Executive Officer)

(Senior Financial Officer)

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Sample Audit Report—Unqualified Opinion

Report of the Comptroller and Auditor General of India

Addressee

Report on the Project Financial Statements

We have audited the accompanying financial statements of the _______ Project financed under World Bank Loan No._____/IDA, which comprise the Statement of Sources and Applications of Funds and the Reconciliation of Claims to Total Applications of Funds for the year ended _______. These statements are the responsibility of the Project's management. Our responsibility is to express an opinion on the accompanying financial statements based on our audit.

We conducted our audit in accordance with the Auditing Standards promulgated by the Comptroller and Auditor General of India. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. Our audit examines, on a test basis, evidence supporting the amounts and disclosures in the financial statements. It also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the sources and applications of funds of _______ Project for the year ended _________ in accordance with Government of India accounting standards.

In addition, in our opinion, (a) with respect to SOEs, adequate supporting documentation has been maintained to support claims to the World Bank for reimbursements of expenditures incurred; and (b) except for ineligible expenditures as detailed in the audit observations, if any, appended to this audit report, expenditures are eligible for financing under the Loan/Credit Agreement. During the course of the audit, SOEs/FMRs (each application no. and amount to be indicated) and the connected documents were examined and those can be relied upon to support reimbursement under the Loan/Credit Agreement.

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8 See relevant portions of Auditing Standards of the Comptroller and Auditor General of India as applicable from time to time for conditions where unqualified, qualified, adverse or disclaimers of opinion may appropriately be rendered.

9 The auditor's report should be addressed to the person stipulated in the underlying loan agreement as responsible for providing audited project financial statements.

10 Insert titles of other required statements and schedules included in or annexed to the project financial statements, if any.

11 Until the Ministry of Finance prescribes adoption of the accounting standards pronounced by GASAB or other body such as IPSAS, the accounting standards followed by the Government of India shall be the cash basis of accounting applied with due regard to the General Financial Rules, PWD codes, Treasury codes and similar financial rules and codes as are in effect and applicable to the operations of the project.
This report is issued without prejudice to CAG's right to incorporate the audit observations in the Report of CAG of India for being laid before Parliament/State or UT Legislature.

[Auditor's Signature]

[Date]

[Address]

1. The report should be dated as of the date to which the auditor has become aware of and considered the effects of events and transactions. This is generally the date of fieldwork, as opposed to the date of signing the audit report.
Annexure 5


11. The form and content of audit opinion and report.

11.1 The form and content of all audit opinions and reports are founded on the following general principles:

(a) Title. The opinion or report should be preceded by a suitable title or heading, helping the reader to distinguish it from statements and information issued by others.

(b) Signature and date. The opinion or report should be properly signed. The inclusion of a date informs the reader that consideration has been given to the effect of events or transactions about which the auditor became aware up to that date (which, in the case of regularity (financial) audits, may be beyond the period of the financial statements).

(c) Objectives and scope. The opinion or report should include reference to the objectives and scope of the audit. This information establishes the purpose and boundaries of the audit.

(d) Completeness. Opinions should be appended to and published with the financial statements to which they relate, but performance reports may be free standing. The auditor’s opinions and reports should be presented as prepared by the auditor. In exercising its independence CAG may acquire information from time to time, which in the national interest cannot be freely disclosed. This can affect the completeness of the audit report. In this situation the auditor should consider the need to make a report, possibly including confidential or sensitive material in a separate, unpublished report.

(e) Addressed. The opinion or report should identify those to whom it is addressed, as required by the circumstances of the audit engagement and local regulations or practice. This is unnecessary where formal procedures exist for its delivery.

(f) Identification of subject matter. The opinion or report should identify the financial statements (in the case of regularity (financial) audits) or area (in the case of performance audits) to which it relates. This includes information such as the name of the audited entity, the date and period covered by the financial statements and the subject matter that has been audited.

(g) Legal basis. Audit opinions and reports should identify the legislation or other authority providing for the audit.

(h) Compliance with standards. Audit opinions and reports should indicate the auditing standards or practices followed in conducting the audit, thus providing the reader with an assurance that the audit has been carried out in accordance with generally accepted procedures.

(i) Timeliness. The audit opinion or report should be available promptly to be of greatest use to readers and users, particularly those who have to take necessary action.

11.2 An audit opinion is normally in a standard format, relating to the financial statements as a whole, thus avoiding the need to state at length what lies behind it.
but conveying by its nature a general understanding among readers as to its meaning. The nature of these words will be influenced by the legal framework for the audit, but the content of the opinion will need to indicate unambiguously whether it is unqualified or qualified and, if the latter, whether it is qualified in certain respects or is adverse or a disclaimer of opinion.

11.3 An unqualified opinion is given when the auditor is satisfied in all material respects that:

(a) The financial statements have been prepared using acceptable accounting bases and policies which have been consistently applied;

(b) The statements comply with statutory requirements and relevant regulations;

(c) The view presented by the financial statements is consistent with the auditor's knowledge of the audited entity; and

(d) There is adequate disclosure of all material matters relevant to the financial statements.

11.4 **Emphasis of Matter.** In certain circumstances the auditor may consider that the reader will not obtain a proper understanding of the financial statements unless attention is drawn to unusual or important matters. As a general principle the auditor issuing an unqualified opinion does not make reference to specific aspects of the financial statements in the opinion in case this should be misconstrued as being a qualification. In order to avoid giving that impression, references that are meant as "emphases of matter" are contained in a separate paragraph from the opinion. However, the auditor should not make use of an emphasis of matter to rectify a lack of appropriate disclosure in the financial statements, nor as an alternative to, or a substitute for, qualifying the opinion.

11.5 **Adverse Opinion.** Where the auditor is unable to form an opinion on the financial statements taken as a whole due to disagreement which is so fundamental that it undermines the position presented to the extent that an opinion which is qualified in certain respects would not be adequate, an adverse opinion is given. The wording of such an opinion makes clear that the financial statements are not fairly stated, specifying clearly and concisely all the matters of disagreement. Again, it is helpful if the financial effect on the financial statements is quantified where relevant and practicable.

11.6 **Disclaimer of Opinion.** Where the auditor is unable to arrive at an opinion regarding the financial statements taken as a whole due to an uncertainty or scope restriction that is so fundamental that an opinion, which is qualified in certain respects, would not be adequate, a disclaimer is given. The wording of such a disclaimer makes clear that an opinion cannot be given, specifying clearly and concisely all matters of uncertainty.

11.7 It is customary to provide a detailed report amplifying the opinion in circumstances in which it has been unable to give an unqualified opinion.