

TERMS OF REFERENCE AND REPORTING REQUIREMENTS

ROAD DEPARTMENT FUND AUDITED PROJECT FINANCIAL STATEMENTS (APFS) STATEMENT OF AUDIT NEEDS (AUDITOR'S TERMS OF REFERENCE¹)

I. Introduction

1. "Road Department" Fund (Client) through the supervision of the Ministry of Territorial and Administrative Infrastructure of the Republic of Armenia (MTAI), requires an auditor to carry out the audit services for the North-South Road Corridor Program - Project 3 Loan number 2993-ARM (ADB), Armenia North-South Road Corridor, separis No 2010-0130, Finance Contract Loan Number FI82.634AM (EIB), and Grant agreement No. FI82.634 under Neighborhood Investment Facility (EIB NIF); for fiscal year ending in 31 December 2021, 31 December 2022 and 31 December 2023.

Background

The Asian Development Bank (ADB) has agreed to provide the Republic of Armenia with a \$500 million multitranche financing facility (MFF) to finance the North-South Road Corridor Investment Program (Investment Program). The North-South Road Corridor (NSRC) runs 556 km from the border with Georgia at Bavra via Gyumri, Ashtarak, Yerevan, Goris, and Kapan, to the border with Iran at Meghri. It is 2-lane throughout, with the exception of an 18 km length on the M-1 (Yerevan-Ashtarak) and the M-2 (Yerevan-Ararat section), which are dual 2-lane. The overall objective of the Investment Program is to provide a high-quality NSRC from the Georgian border to the Iranian border by rehabilitating the whole North-South Road Corridor starting from Bavra in the north on the border with Georgia and Meghry in the south on the board with Iran. The Investment Program will benefit road users, road construction companies, traders, and others who derive income from the development of transport, logistics and trade along the road corridor. The direct benefits include (i) lower road transport and maintenance costs, (ii) faster and more reliable road transport services, (iii) reduced traffic accidents, (iv) improved access to markets and social services, and (v) jobs and income created during implementation (i.e., use of local labor and construction materials) and after completion (i.e., roadside business activities).

The Republic of Armenia through the state budget is providing co-financing of the Investment Program. The Investment Program was initiated in 2009. The "Organization for the Implementation of the North-South Road Corridor Investment Program" State Non-Commercial Organization was established and was operating from May 2010 to February 2017. Due to reorganization within MOTCIT, this organization was merged with the "Transport Projects Implementation Unit" State Institution. The result of the merger is the "Transport Project Implementation Organization" State Non-Commercial Organization (TPIO). The next reorganization has been matched with "Armenian Roads Directory" SNCO on December 30,

¹ This statement of audit needs was developed to guide project teams and executing and implementing agencies in communicating the Asian Development Bank's (ADB) auditing requirements to private auditors. This statement of audit needs may also be used as a guide when communicating auditing requirements with supreme audit institutions, where applicable.

2019 based on Government Degree. The result of the merger is the “Road Department” State Non-Commercial Organization (RD)

The Tranche 3 of the ADB (Loan 2993-ARM) amounts to \$100 million. European Investment Bank (EIB) and Neighborhood Investment Facility co-finance the project (Tranche 3). The Tranche 3 loan of the EIB (Loan FIN82634) amounts to €60 million and NIF (Grant FIN82634) amounts to €6 million. The Republic of Armenia co-finances the project in respect of taxes arising from the implementation of project.

The executing agency (EA), MTAI, which is responsible for planning the overall Investment Program implementation and coordination with Project Governing Council will sign and act as an Employer for contracts with consultants, contractors and suppliers.

The implementing agency (IA) is the Client which is responsible for day-to-day coordination and implementation of the project, implementation, and administration of the individual projects under the Investment Program, including: (i) selection and assessment of candidate individual tranche projects; (ii) maintenance of project accounts; (iii) support for the procurement of works and goods, including equipment and materials; (iv) monitoring and reporting of individual project implementation; (v) facilitation of environmental and social safeguard measures; (vi) support for the selection of consultants; (vii) oversight of the detailed design and construction supervision.

II. Management Responsibility for Preparing Project Financial Statements

2. Management is responsible for preparing and fairly presenting the project financial statements, and for maintaining sufficient internal controls to ensure that the financial statements are free from material misstatement, whether due to fraud or error. In addition, management is responsible for ensuring that funds were used only for the purpose(s) of the project, for compliance with financial covenants (where applicable), and for ensuring that effective internal controls, including over the procurement process, are maintained. In this regard, management must:

- (i) Prepare and sign the Audited Project Financial Statements.
- (ii) Prepare and sign a Statement of Compliance.

3. Management must include the following in the Statement of Compliance:

- (i) That project financial statements are free from material misstatements including omissions and errors, and are fairly presented;

- (ii) That the borrower or executing agency has utilized the proceeds of the loan only for the purpose(s) of the project;
- (iii) That the borrower or executing agency was in compliance with the financial covenants of the legal agreement(s) (where applicable);
- (iv) That the advance fund procedure, where applicable, has been operated in accordance with the Asian Development Bank's (ADB) Loan Disbursement Handbook;
- (v) That adequate supporting documentation has been maintained to authenticate claims stated on the statement of expenditures (SOE), where applicable, for reimbursement of eligible expenditures incurred and liquidation of advances provided to the advance account; and
- (vi) That effective internal control, including over the procurement process, was maintained.

III. Objectives

4. The objectives of the audit of the project financial statements is to enable the auditor to (i) express an independent and objective opinion as to whether the project financial statements present fairly, in all material respects, or give a true and fair view of the project's financial position, its financial performance and cash flows, and (ii) provide a reasonable assurance opinion over certain specific representations made in the Statement of Compliance.

(please refer to paragraph 10).

Scope of Services

4.1. The Consultant should audit the Projects financial statements of the North-South Road Corridor Investment Program-Project 3, financed by the Asian Development Bank, Loan Agreement N 2993-ARM and financed by the European Investment Bank, Finance Contract N FIN 82634-AM. The Consultant should review the compliance on each of the financial covenants in the loan agreements.

4.2. The Consultant's examination should include an evaluation of the systems and operating procedures for accounting, custody of assets, control of environment and internal financial control, financial reporting, and related systems. RD and MTAI will provide to the Consultant all information necessary to support the Consultant's opinion and to construct the final audit report.

4.3. The Consultant should get acquainted with the project, the functions of the RD and MTAI; the contents of the Report and Recommendation of the President (RRP); periodic financing request report and legal agreements; and the ADB's guidelines, i.e. Financial Management and Analysis of Project, Loan Disbursement Handbook, Procurement Handbook

and other guidelines available at ADB's web site and act in accordance with the requirements described in guidelines.

Reporting Requirements and Time Schedule for Deliverables. The Consultant will provide the following Audit Opinion on the Annual Project Financial Statements (including separate opinion on the use of loan proceeds and on compliance with loan covenants, if applicable) with Management Letter, in accordance with the following timeframes:

- Loan 2993-ARM (ADB); Loan FIN82634 (EIB) and Grant FIN82634 (EIB NIF) (combined report) for the fiscal year ending on 31 December 2021 – not later than 30 June 2022;
- Loan 2993-ARM (ADB); Loan FIN82634 (EIB) and Grant FIN82634 (EIB NIF) (combined report) for the fiscal year ending on 31 December 2022 – not later than 30 June 2023;
- Loan 2993-ARM (ADB); Loan FIN82634 (EIB) and Grant FIN82634 (EIB NIF) (combined report) for the fiscal year ending on 31 December 2023 – not later than 20 April 2024,

All reports shall be provided in three copies each in the English and Armenian languages. In case of discrepancy between the English and the Armenian versions, the English version will prevail.

Supporting Documentation and Timing. The Annual Project Financial Statements and supporting documentation will be provided to the Consultant till the following estimated dates:

- for the year 2021 by 31 May 2022;
- for the year 2022 by 31 May 2023; and
- for the year 2023 by 15 March, 2024.

IV. Auditing Standards

5. The audit is required to be conducted in accordance with International Standards on Auditing (ISA). These standards require that the auditor comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the project financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the project financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the project financial statements whether due to fraud or error. In making those risk assessments, the auditor considers the internal control relevant to the entity's preparation and fair presentation of the project financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the project financial statements.

6. The standards to be applied will be documented in the project/loan documents, and will include: International Standards on Auditing (ISA) promulgated by the International Auditing and Assurance Standards Board (IAASB).

7. In complying with ISA, the auditor will pay particular attention to the following standards:

- ISA 800– Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks.
- ISA 240– The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements.
- ISA 250 – Consideration of Laws and Regulations in an Audit of Financial Statements.
- ISA 260 – Communication With Those Charged with Governance.
- ISA 265 – Communicating Deficiencies in Internal Control To Those Charged with Governance and Management.
- ISA 330 – The Auditor’s Responses to Assessed Risks.

V. Project Financial Reporting Framework

8. The auditor will verify that the project financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). The executing agency and/or implementing agency are responsible for preparing the project financial statements, not the auditor.

VI. AUDIT DELIVERABLES

1. Audited Project Financial Statements

9. An auditor’s opinion providing reasonable assurance over the project financial statements, and project financial statements comprising the following:

Table 1: Content of the Project Financial Statements

For Cash-Based Financial Statements
A statement of cash receipts and payments for the fiscal year showing comparative (current and preceding years) and cumulative figures
A statement of budgeted versus actual expenditures
A statement of loan withdrawals
Statement of Project sources
Statement of Uses of funds by Project Activity
Compliance with the
Report on Project’s implementation progress
Report on Actual Withdrawal amounts
A summary statement of expenditures (where applicable)

For Cash-Based Financial Statements
Significant accounting policies and other explanatory notes
Any additional schedules agreed (e.g., a summary of assets)

2. Reasonable Assurance Opinion over the Use of Loan Proceeds and Compliance with Financial Covenants

10. The auditor will provide a reasonable assurance opinion following ISAE 3000 “Assurance Engagements other than Audits or Reviews of Historical Financial Information” for the following confirmations provided by Management in the Statement of Compliance:

- (i) That the proceeds of the loan were used only for the purpose(s) of the project; and
- (ii) That the borrower or executing agency was in compliance with the financial covenants of the legal agreement(s), where applicable.

11. The auditor will outline the degree of compliance for each of the financial covenants in the loan agreement.

3. Management Letter

12. The auditor will provide a management letter containing, at a minimum, the following:

- (i) Any weaknesses in the accounting and internal control systems that were identified during the audit, including any irregularity in the use of the advance fund and statement of expenditures (SOE) procedures (where applicable);
- (ii) Any identified internal control weaknesses related to the procurement process such as, over the bidding, evaluation and contract management domains;
- (iii) Recommendations to rectify identified weaknesses;
- (iv) Management’s comments on the audit recommendations along with the timeframe for implementation;
- (v) The status of significant matters raised in previous management letters;
- (vi) Any other matters that the auditor considers should be brought to the attention of the project’s management; and
- (vii) Details of any ineligible expenditure² identified during the audit. Expenditure is considered ineligible if it refers to (i) expenditures incurred for purposes other than the ones intended under the legal agreement(s); (ii) expenditures not allowed under the terms of the legal/financing agreements; and (iii) expenditures incurred in violation of applicable government regulations.

4. Specific Considerations

² If the auditor reports any ineligible expenditure in the management letter, the details of the findings should include the funding source to which the observation relates.

13. The auditor will, during the course of the audit, pay particular attention to the following:
- (i) The use of external funds in accordance with the relevant legal and financing agreements;
 - (ii) The provision of counterpart funds in accordance with the relevant agreements and their use only for the purposes intended;
 - (iii) The maintenance of proper books and records;
 - (iv) The existence of project fixed assets and internal controls related thereto;
 - (v) Where the audit report has been issued under ISA 800 , it shall include the mandatory Emphasis of Matter paragraph alerting users of the audit report that the project financial statements are prepared in accordance with a special purpose framework and that, as a result, the project financial statements may not be suitable for another purpose. The auditor shall include this paragraph under an appropriate heading;
 - (vi) Where reasonable assurance has been provided using ISAE 3000 , the assurance report must contain, among others:
 - A statement that the engagement was performed in accordance with ISAE 3000 ;
 - Subject matter;
 - Criteria for measurement;
 - A summary of the work performed; and
 - The auditor's conclusion.
 - (vii) On the advance fund procedure (where applicable), audit procedures are planned and performed to ensure (a) the advance account (and any sub-accounts) has been managed in accordance with ADB's Loan Disbursement Handbook, (b) the cash balance of the advance account (and any sub-accounts) is supported by evidence, (c) the expenditures paid from the advance account (and any sub-accounts) comply with the approved project purpose and cost categories stipulated in the loan agreement, and (d) the amount of expenditures paid from the advance account (and any sub-accounts) comply with disbursement percentages stipulated in the loan agreement;
 - (viii) Adequate supporting documentation has been maintained to authenticate claims stated in the SOE for reimbursement of eligible expenditures incurred and liquidation of advances provided to the advance account (where applicable);
 - (ix) On the SOE procedure (where applicable), audit procedures are planned and performed to ensure that (a) the SOEs have been prepared in accordance with ADB's Loan Disbursement Handbook, (b) the individual payments for expenditures stated in the SOE are supported by evidence, (c) the expenditures stated in the SOEs comply with the approved project purpose and cost categories stipulated in loan agreement, and (d) the amount of expenditures stated in the SOEs comply with disbursement percentages stipulated in the loan agreement; and

(x) Any weaknesses in internal controls over the procurement process.

14. All reports must be presented in the English language within 6 months following the end of the fiscal year.

15. Public disclosure of the project financial statements, including the auditor's opinion on the audited project financial statements, will be guided by ADB's Public Communications Policy (2011). After review, ADB will disclose the audited project financial statements and the opinion of the auditor on the audited project financial statements no later than 14 calendar days of ADB's confirmation of their acceptability by posting them on ADB's website. The management letter and the additional auditor's opinions will not be disclosed³.

VII. OTHER MATTERS

5. Statement of Access

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

17. The auditor will be provided with full cooperation by all employees of "Road Department" SNCO and the project implementing units, whose activities involve, or may be reflected in, the annual project financial statements. The auditor will be assured rights of access to banks and depositories, consultants, contractors and other persons or firms hired by the employer.

6. Independence

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

7. Auditor Experience

19. The auditor must be authorized to practice in the country and be capable of applying the agreed auditing standards. The auditor should have adequate staff, with appropriate professional qualifications and suitable experience, including experience in auditing the accounts of projects or entities comparable in nature, size and complexity to the project or entity whose audit they are to undertake. To this end, the auditor is required to provide curriculum vitae (CV) of the personnel who will provide the opinions and reports, together with the CVs of managers, supervisors and key personnel likely to be involved in the audit work. These CVs should include details of audits carried out by these staff, including ongoing assignments.

The Consultant's team shall include the following key experts:

- **Team Leader/Auditor** (one person, 1.5 person-months) – The Team Leader/Auditor should have higher education in finance, accounting, economy, business administration or related field, with professional experience of auditing with preferably ten years of relevant experience, with international and national appropriate standards knowledge base and experience, having confirmed experience in auditing of international projects financed by Asian Development Bank, World Bank (preferable) or projects of other

³ This type of information would generally fall under public communications policy exceptions to disclosure. ADB. 2011. *Public Communications Policy*. Paragraph 97(iv) and/or 97(v).

finance/donor organizations. The international certification in finance could be an advantage.

- **Auditor Manager** (one person, 3 person-months) – The Auditor Manager should have higher education in finance, accounting, economy with professional experience of auditing with preferably seven years of relevant experience, with international and national appropriate standards knowledge base and experience, having confirmed experience in auditing of international projects. The international certification in finance could be an advantage.
- **Auditors** (2 persons, 3 person-months) – The Auditor should have higher education in finance, accounting, economy, business administration or related, with professional experience of auditing with preferably five years of relevant experience, including support to the audit works of one international project can be considered. Particularly, it is required to involve at least one professional in international auditing standards and one professional in Armenian appropriate legislation.

All proposed key experts shall be fluent in English and Armenian languages.

8. Payment Terms.

- 9. The Consultant should be paid for every annual audit separately, after submission of audit report and acceptance of it by the Client in accordance with the contract. The Client will pay the Consultant for the Services on the basis of claims submitted by the Consultant to the Client in accordance with the Payment Schedule specified in Contract provided that the quality of the outputs(s)/deliverable(s) to which the claim relates is satisfactory to the Client. A payment does not constitute acceptance of the Services nor relieve the Consultant of any obligations.**