

**INTERNAL AUDIT OF
SECOND GUJARAT STATE HIGHWAY PROJECT (GSHP II)
TERMS OF REFERENCE**

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1. Background

The Gujarat State Highway Project II (GSHP II) would be about US \$ 323 million Project, being implemented by Government of Gujarat (GoG). This will include US \$ 111 million of GoG contribution, US \$ 37 million of private sector financing expected through BOT concessions and the balance US \$ 175million of Bank Loan.

The Roads & Buildings Department (RBD) will have the overall responsibility for implementation. It has established and staffed a Project Implementation Unit (PIU) to manage (on a day to day basis) project preparation and implementation activities. The PIU is headed by a Special Secretary & Chief Engineer (project director) who is assisted by a number of technical staff.

This document presents the Terms of Reference for the Internal Audit of the GSHP II comprising of Highway Improvement Component (US \$ 290million), Sector Policy and Institutional Development Component (US \$ 12 million) and Road Safety Management Component (US \$ 22 million).

The financial management arrangements within the project are largely mainstreamed using the regular budgeting, funds flow and GoG treasury accounting and financial rules being applicable to the project also. The project, through the PIU will submit quarterly interim financial reports to the Bank which will form the basis of reimbursement of expenditures.

2. Objectives

The objective of the consultancy is to provide the project management (PIU and the designated R&BD divisions) timely *fiduciary* assurance that the (i) financial management systems and internal control procedures as applicable to the project are being adhered to by the various implementing units, (ii) the financial reports being submitted to the PIU are in agreement with the books of account and can be relied upon to support the disbursements made by the Bank.

The internal auditor shall provide the PIU with timely information and recommendations on the financial management aspects of the Project to enable the management to take corrective measures, wherever necessary.

3. Scope of the Audit and Outputs

The internal audit will be conducted in accordance with the Standards for Internal Audit issued by Institute of Chartered Accountants of India (ICAI) and will include such tests and controls, as the auditors consider necessary under the circumstances.

The audit will be conducted on a quarterly basis and cover the PIU and the implementing field divisions. Specific areas of coverage of the audit will include the following:

- a. An assessment of the adequacy of and adherence to the Program financial management systems, including internal controls. This would include aspects such as adequacy and timeliness of accounting, financial and operational controls and the need for any revision; level of compliance with established policies, plans and procedures (i.e., those indicated in as per the, GoG Financial Rules and Account Code, GoG Treasury Rules)
- b. As assessment of compliance with provisions of financing agreements, especially those relating to accounting and financial matters.
- c. That all external funds received under the project have been used in accordance with the financing agreement, with due attention to economy and efficiency and only for the purposes for which the financing was provided; that civil works, goods and services, including consultancy services financed have been procured in accordance with the financing agreements and procurement guidelines of the bank;
- d. Review the adequacy of financial and administrative delegation at the district level and whether any contracts are broken up due to lack of adequate delegation.
- e. The budgets are allocated to the district implementing units in a timely manner and expenditure is as per approved budget.
- f. Funds flows are adequate and timely and the LOC are issued in a timely manner and not used for non project activities i.e. adequate control over issue and utilization of LOC.
- g. That all necessary supporting documents, contracts, records, and books of accounts have been kept in respect of all project expenditures reported by the implementing units,.
- h. Clear linkages exist between different accounting records including account books and the IFRs and the activities are appropriately classified into sub-components in the monthly abstracts and
- i. Status of reconciliation of the accounts maintained by PIU and the field divisions with the monthly accounts of AG (A&E) and treasury.
- j. With respect to civil works executed check to ensure that contract registers have been maintained and updated; running bills are properly approved and in agreement with the Measurement Book; advances are properly adjusted and statutory deductions have been made; that the system for monitoring security deposit deducted from contractors is adequate and to ensure that mode of payments and mode of measurements as envisaged in contract agreement and other intermediary deductions as per circulars issued by GoG as incorporated in the agreements(FMG/MISC/CORE TEST)
- k. Check the utilization of the mobilization advance, equipment and material advance and the authenticity of the underlying bank and performance guarantees.
- l. Verify that equipment for which advance has been taken are free of other encumbrances.
- m. That the funds are not parked in the bank accounts outside the treasury especially at year end.
- n. That payments made under modified annuity component is in accordance with the contract terms and as per the verification of the independent monitoring agency (if any)
- o. Those adequate records are maintained regarding the assets created and assets acquired by the project, including details of cost, identification and location of assets.

- p. The auditors will also confirm that the relevant GoG rules and procedures and applicable GOs' are followed.
- q. In each audit cycle the audit team will visit the Divisions and verify that the Divisions are utilizing the moneys as per the conditions of the loan and grant agreements, and for the purposes for which the funding is given, and conduct a physical verification of assets created through the loans.

4. Audit Reporting and Opinion

The internal auditors should review and assess the analysis drawn from the internal audit evidence obtained as the basis for their conclusion on the efficiency and effectiveness of systems, processes and controls including items of financial statements.

The report should be discussed and agreed with Superintending Engineer, (PIU) and should be structured in a manner giving the observations, the implications of the observations, the suggested recommendation and the management comments/agreed actions. This will be in the form of a quarterly internal audit (Management Letter) report with the following suggested sections.

- Introduction – scope, nature and coverage of the audit including period covered, units audited.
- Executive Summary – highlighting the critical issues preferably classified as per thematic area with the response of the auditee.
- Specific report on any fraud, illegal act or mis-appropriation and significant non – compliance.
- Report on the records verified, deviations, if any, the adequacy of internal controls and the adherence to GoG Finance Code, Treasury code, Accounts code and Government orders, observation on the accounting records, systems and controls that were examined during the course of the audit, identify specific deficiencies and areas of weakness in systems and controls and make recommendation for their improvement, Report on the degree of the compliance of the financial covenants on the financial agreements.
- Matters that may have a significant impact on the implementation of the project and bring to the borrower's attention any other matter that the auditors consider pertinent.
- Status of actions on the previous recommendations.
- Recommendations for improvement.
- A Suggestive checklist of Internal Audit coverage is attached as *Annexure – 1*.

5. Timelines and submission of reports

The auditors will commence their audit immediately at the close of the quarter, complete the audit and submit their audit report within 30 days from the end of the closure of the quarter. Two copies of the report with all supporting documents will be furnished to the Superintending Engineer, (PIU). Annual opinion on the internal control system will be addressed to the Superintending Engineer, (PIU) and two copies will be submitted along with the report for the quarter ending every March.

The Auditors shall have also to provide soft copy of the audit report.

6. Composition of Review Committee to Monitor Internal Auditor's works

The following officers will be on the committee to monitor the Internal Auditor's Report.

1. Superintendent Engineer, PIU.
2. Finance Controller, PIU.
3. Executive Engineers of Divisions.

The Committee will review the audit report and send the action taken report to the funding agency.

7. Procedure for review of Audit Report

Each field division shall review the Audit Reports within 20 days from the submission of report by consultant and will send the status of compliance report to the PIU. The PIU will consolidate all field division reports and send it to Government, World Bank these comments within 20 days from the date of receipt from the field divisions. During the audit of next quarter, Internal Auditor shall check the compliance done by the Divisions and certify that compliance has been verified. If there is any incomplete compliance, it shall be reported in the next quarter audit report as pending compliance.

8. Key Personnel

As the project is proposed to be implemented within the Government it is a pre-requisite that the key personnel should be familiar with General Financial and treasury rules & procedures and works accounting & LOC system, as well as government accounting and financial procedures. The list of key personnel and whose CVs and experience would be evaluated for this consultancy is as follows:

Sr. No	Key Professionals	Description of Services to be provided	Experience
1	Audit Team Leader/Audit Partner	Overall coordination, & planning, team leadership, reporting, liaison with client. Responsibility to lead the audit teams in the field, planning and execution of the audits, discussion with heads of offices at district / state units and reporting writing	Qualified Chartered Accountant with minimum post qualification experience of 10 years or more with expertise in the area of internal audit planning, execution and reporting. Out of which at least 5 years' experience as internal auditor of Govt.

		and finalization and presentation before Review Committee	establishment/Govt. undertakings.
2	Audit Manager	Field level audit of divisions (mainly relating to civil works) including sample physical verifications of activities/ assets.	Qualified Chartered Accountant with minimum post qualification experience of 5 years or more Out of which at least 2years experience as internal auditor of Govt. establishment/Govt. undertakings.

9. GENERAL

The Internal Auditor would be given access to all documents, correspondence, and any other information relating to the project and deemed necessary by the Internal Auditor. The Internal Auditor should become familiar with the project (this may involve training on the innovative financing component as well) and with the relevant policies and guidelines of GoG and the World Bank (including those relating to procurement and financial management and reporting). The Internal Auditor would be provided copies of the Project Implementation Plan; Project Appraisal Documents, agreement with contractors, consultants, Loan Agreement and project Agreement with IDA/IBRD (including agreed Minutes of negotiations); guidelines, policies and procedures issued by project management and implementing agencies including Government Orders and project budget lines;

10. Terms of Payments

25% payment within 45 days after the receipt of 1st quarterly report.

25% payment within 45 days after the receipt of 2nd quarterly report.

25% payment within 45 days after the receipt of 3rd quarterly report.

25% payment within 45 days after the receipt of 4th quarterly report.

Annexure 1
Suggestive check list of Internal Audit Coverage

Executive Summary**Division XXXX**

Sr.No	Assessment Parameters/Internal Checks/Controls	Unit	Observation		Basis of Observations					Additional Remarks
					Numbers			Percentage		
					Total Range/Size	Sample Checked	Erring sample	Sample Checked	Erring sample	
A	Contractors Ledger		Minor	Major	A	B	C	D=B/A	E=C/B	
1	Contractor's ledger opened for all the contracts				100	80	5	80%	6%	
2	Ledger accounts updated closed & balanced monthly.									
3	Outstanding payments (more than 45 days or outstanding beyond contract terms)									Attach Annex providing details & reason of contractor wise outstanding payments
4	Outstanding mobilization advances (unsettled beyond contract terms)									Attach Annex providing details & reason of contractor wise outstanding advances
5	Equipment advance: Is advance given for a equipment hypothecated by other bank									
B	Contract Management									
1	Contract extended beyond the original contract time period without appropriate authorization	No. of contracts								Attach Annex providing details & reason of all contracts for which time period exceeded
2	Any variations in contract value or any payments made above the Contract value without prior approval (both technical and administrative)	No. of contracts								Attach Annex providing details & reason of all contracts for which payment was exceeded
		Amount exceeded in total								
3	Is there a Price escalation clause in every contract exceeding 18 months with a formula for calculation of price variation based on indices published by Govt.									
C	Guarantee Register									

1	Guarantee register maintained & updated									
2	Whether bank guarantees are reviewed frequently	Days								
3	Whether contracting authority has verified all Bank guarantees furnished by contractor with corresponding banker?									Attach Annex providing details & reason of all such contracts
4	If contract price is revised than whether additional guarantee towards performance is obtained?									If not than attach annex providing details & reason of all such contracts
5	In case where contract has been extended, extension of bank guarantee taken or not?									If not than attach annex providing details & reason of all such contracts
D	Insurance									
1	Insurance register updated & maintained in line with BG register									
2	Check for each contract that worker's insurance is being obtained by contractor as per contract terms									
3	If No to above than PIU has obtained insurance at contractor's cost when IPC is submitted									If not than attach annex providing details & reason of all such contracts
4	Insurance / Renewal of insurance strictly enforced as per Contract terms									
E	General									
1	Any errors in MB which were not taken in consideration and results in revenue loss.									
2	Reconciliation of monthly divisional accounts with AG?									
F.	Payments									
	Specific									
1	Are Liquidation damages recovered from IPC									If not than attach annex providing details & reason of all such contracts
2	Are payments charged to correct account code & head of expenditure?									

	General									
1	Are the payments properly approved in line with the financial delegation?									
2	Are the supporting documents filed properly and easily accessible?									
3	Is there a serial control over payment, receipt and Journal voucher?									
4	Is the settlement of advance done after receipt of bills from contractors at appropriate time?									
5	Is ageing report on advances generated for overall review once in a quarter?									
6	Is reconciliation between Treasury accounts and divisional accounts									
7	Have the procurement procedure prescribed in the procurement guidelines followed by all concerned?									
8	Are the procurements supported by adequate and valid supporting documents?									
9	Whether assets procured are documented location wise narrating full cost (including assets transferred / received in kind) and physically verified and reconciled with book balance once in a year?									