



Mekong River Commission

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TERMS OF REFERENCE

FOR A PILLAR ASSESSMENT CONTRACTED BY AN ENTITY REQUESTING TO BE ENTRUSTED WITH IMPLEMENTATION OF THE EU BUDGET UNDER INDIRECT MANAGEMENT

MEKONG RIVER COMMISSION SECRETARIAT

Entity requesting the assessment:	Mekong River Commission
Country:	Cambodia and Lao PDR
Reference / date of request for services:	Ref.
Period subject to assessment:	The year (12 months period) ending on the day of the start of the field work (<u>on-site</u> procedures) of the assessment
Starting date of the Assessment:	1 April 2016
Ending date of the Assessment:	31 April 2017

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1 Introduction

Context

Article 58 of the Financial Regulation ('FR') applicable to the General Budget of the European Union ('EU') sets out the methods of implementation of the budget including 'indirect management'. Under indirect management the Commission can entrust budget implementation tasks to the countries, organisations and bodies (further referred to as 'Entities') indicated in Article 58 of the FR. The following Entities may be concerned:

- Third countries or the bodies they have designated. *E.g.* Ministry of Interior, Kingdom of Cambodia;
- International organisations and their agencies. *E.g.*: UNDP (United Nations development Programme);
- Public law bodies. *E.g.*: DFID, KfW;
- Bodies governed by private law with a public service mission to the extent that they provide adequate financial guarantees. *E.g.*: British Council.

These Entities shall guarantee a level of protection of the financial interests of the EU equivalent to that required under the FR when they manage EU funds. They must meet requirements with regard to seven 'Pillars' relating to the internal control system, the accounting system, an independent external audit and rules and procedures for providing financing from EU funds through grants, procurement and financial instruments and Sub-Delegation. Hence, Entities wishing to work with EU funds under the indirect management mode must therefore be made subject to a comprehensive Pillar Assessment.

Based on the results of the Pillar Assessment the Commission will decide whether it can entrust budget implementation tasks to the Entity and whether it can conclude specific agreements (i.e. Indirect Management Delegation Agreements) with the Entity.

The following are the terms of reference ('ToR') on which the Mekong River Commission Secretariat (MRCS) agrees to engage the Auditor to perform a **Pillar Assessment** of the MRCS and to report on this assessment. These ToR are annexed to the Entity's tender dossier. The ToR are for the use of the Auditor and the Entity and may be disclosed to the European Commission upon its request.

In these ToR and in Annexes 1 to 5 which form an integral part of these ToR the following terms apply:

- **'Pillar Assessment', 'assessment' or 'engagement'** refers to this assurance engagement. Pillars are the broad areas covered by this assessment and include internal control, accounting and independent external audit. Moreover, Pillars may also include procedures and rules for grants, procurement and financial instruments as well as a specific Pillar for Sub-Delegation. At least one of the latter four Pillars should always apply otherwise no budget implementation tasks can be entrusted (see Section 2 Objectives below).

- '*Auditor*' refers to the audit firm contracted for performing this engagement and for submitting a report to the Commission. 'Auditor' can refer to the person or persons conducting the assessment, usually the engagement partner or other members of the engagement team. The engagement partner is the partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who has the appropriate authority from a professional, legal or regulatory body.
- '*Entity*', refers to the entity subject to the Pillar Assessment and which is the contracting authority for this assessment.
- '*Commission*' refers to the European Commission which may be represented by a service or unit of EuropeAid Development and Co-operation Directorate General ('DEVCO') or by an EU Delegation of the Commission.

2 Objectives

The Auditor is engaged to assess the systems put into place and the controls, rules and procedures applied by the Entity for each Pillar against the criteria set by the Commission for each Pillar. The **objective** of this Pillar Assessment is to enable the Auditor to report on whether the Entity fulfils the requirements set out in points (a) to (d) of the first subparagraph of Article 60.2 of the Financial Regulation applicable to the General Budget of the European Commission and Article 29.1 of the Financial Regulation applicable to the European Development Fund for each relevant Pillar and to express a conclusion as to whether the Entity:

- has set up and ensures the functioning in all material respects of an effective and efficient **internal control system** and in accordance with the criteria set by the European Commission; and
- uses an **accounting system** that provides in all material respects accurate, complete and reliable information in a timely manner and in accordance with the criteria set by the European Commission; and
- is subject to an **independent external audit**, required to be performed in all material respects in accordance with internationally accepted auditing standards by an audit service functionally independent of the entity concerned and in accordance with the criteria set by the European Commission; and
- applies appropriate rules and procedures in all material respects for providing financing from EU funds through **procurement** and in accordance with the criteria set by the European Commission; and

3 Standards and Guidance

The Auditor who performs this Pillar Assessment is governed by:

- The IFAC *International Framework for Assurance Engagements* and *International Standard on Assurance Engagements ('ISAE') 3000 for Assurance Engagements other than Audits or Reviews of Historical Financial Information* insofar as these can be applied in the specific context of this Pillar Assessment.
- The IFAC *Code of Ethics for Professional Accountants* (issued by IFAC's *International Ethics Standards Board for Accountants (IESBA)*), which establishes fundamental ethical principles for Auditors with regard to integrity, objectivity, independence, professional competence and due care, confidentiality, professional behaviour and technical standards;
- The IFAC *International Standards on Quality Control (ISQCs)*, which establish standards and provide guidance on an Auditor's system of quality control.

4 Requirements for the Auditor

4.1 General Principles

The Auditor must be an **independent external** auditor who is a registered member of a national accounting or auditing body or institution which in turn is member of the International Federation of Accountants (IFAC) and who is certified to perform audits.

The Auditor must be functionally independent of the Entity concerned and hence the Internal Auditor of an Entity subject to assessment is not eligible to perform a Pillar Assessment.

By agreeing these ToR the Auditor confirms that s/he meets at least one of the following conditions:

- The Auditor and/or the firm is a member of a national accounting or auditing body or institution which in turn is member of the International Federation of Accountants (IFAC).
- The Auditor and/or the firm is a member of a national accounting or auditing body or institution. Although this organisation is not member of the IFAC, the Auditor commits him/herself to undertake this engagement in accordance with the IFAC standards and ethics set out in these ToR.
- The Auditor and/or the firm is registered as a statutory auditor in the public register of a public oversight body in an EU member state in accordance with the principles of public oversight set out in Directive 2006/43/EC of the European Parliament and of the Council (this applies to auditors and audit firms based in an EU member state)¹.
- The Auditor and/or the firm is registered as a statutory auditor in the public register of a public oversight body in a third country and this register is subject to principles of public

¹ Directive 2006/43 of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253 EEC.

oversight as set out in the legislation of the country concerned (this applies to auditors and audit firms based in a third country).

4.2 Qualifications, Experience and Team Composition

Qualifications and Experience

The Auditor will employ adequate staff with appropriate professional qualifications and suitable experience with IFAC standards, in particular the *International Framework for Assurance Engagements and International Standard on Assurance Engagements ('ISAE') 3000 for Assurance Engagements other than Audits or Reviews of Historical Financial Information* and with experience in performing institutional or compliance assessments and/or performing systems audits or equivalent engagements of entities comparable in size and complexity to the Entity.

In addition the engagement team as a whole should have:

- Experience with institutional or compliance assessments and/or systems audits or equivalent engagements of development aid programmes and projects funded by national and/or international donors and institutions. It is desirable that the leader of the fieldwork team i.e. either the manager (category 2) or the senior auditor (category 3) has experience with systems audits of EU funded external aid actions and/or institutional or compliance assessments of organisations in the development aid sector.

Team composition

The team of auditors required for this Pillar Assessment will be composed of a category 1 auditor who has the ultimate responsibility for the assessment and an engagement team which is composed of an appropriate mix of category 2 – 4 auditors. It is the responsibility of the Auditor to propose and use an engagement team which is composed of an appropriate mix of auditors for this engagement.

The Commission distinguishes 4 categories of auditors.

Category 1 – Audit Partner

An audit partner should be a highly qualified expert with a relevant professional qualification and assuming or having assumed senior and managerial responsibilities in public audit practice.

S/he should be a member of a national accounting or auditing body or institution. S/he must have at least 12 years of professional experience as a professional Auditor or accountant in public audit practice. Experience with working with the recipient countries of Community external aid will also be taken into account.

An audit partner, or another person in a position similar to that of a partner, is the person of the audit firm who is responsible for the audit and its performance, and for the report that is issued on behalf of the firm. S/he has the appropriate authority from a professional, legal or regulatory body and is authorized to certify accounts by the laws of the country in which the audit firm is registered.

Category 2 - Audit Manager

Audit managers should be qualified experts with a relevant university degree or professional qualification. They should have at least 6 years' experience as a professional auditor or accountant in public audit practice including relevant managerial experience of leading audit teams.

Category 3 – Senior Auditor

Senior auditors should be qualified experts with a relevant university degree or professional qualification and at least 3 years professional experience in public audit practice.

Category 4 – Assistant Auditor

Assistant auditors should have a relevant university degree and at least 6 months professional experience in public audit practice.

Curricula Vitae ('CVs')

The Auditor will provide the Entity with CV's of the partner or other person in the audit firm who is responsible for the Pillar Assessment and for signing the report together with the CVs of the managers, senior auditors and assistant auditors proposed as part of the engagement team. CVs will include appropriate details on the type of engagements carried out by the staff indicating capability and capacity to undertake the assessment as well as details on relevant specific experience. The Entity will examine the CV's before it signs an order form or other applicable contractual document for this engagement and reserves the right to reject them if they are not considered suitable for the requirements of the engagement.

5 Scope

5.1 Location and period covered by the Assessment

This Pillar Assessment will be performed at MRC Office of the Secretariat in Vientiane, Lao PDR.

The Auditor should confirm the location(s) for the assessment with the Entity **prior** to the start of the fieldwork and ensure that relevant supporting documents as well as key staff will be available during the assessment. The Auditor should take into account that the Entity normally requires meetings to prepare the assessment and to discuss the draft report and that this may involve additional travelling (see Section 7).

The **period to be covered by the assessment** should normally be the year (12 months period) ending on the day of the start of the field work of the assessment i.e. the day on which the Auditor effectively starts on-site (at the location where the Entity is established) assessment procedures and tests.

5.2 Engagement context

Use of Annex 1 Engagement Context – Key Information for a Pillar Assessment

The Auditor must obtain a preliminary understanding of the **engagement context** on the basis of *Annex 1 Engagement Context – Key Information for A Pillar Assessment*. The understanding must be sufficient for the Auditor to submit a meaningful offer to the Entity.

Use of Annex 2a Assessment Questionnaire (indicative questions)

The Entity will provide a completed *Annex 2a* to the Auditor as soon as possible **after** the Auditor has been contracted by the Entity but **prior to** the start of the Auditors' assessment procedures.

In a second phase *Annex 2a* will become a support tool for the Auditor to design, plan and perform the assessment procedures and to take into account the criteria which the European Commission deems essential or important for the Entity subject to assessment to comply with.

The completed *Annex 2a* Questionnaire is an essential source of assessment information and evidence for the Auditor. However, it is by no means the only source for the Auditor to plan and perform assessment procedures and to draw conclusions. All information completed and provided by the Entity is indicative and provisional and subject to the assessment procedures the Auditor deems necessary. The Auditor must not rely on information until s/he has ensured through assessment procedures that information is sufficiently accurate and complete for the purpose of the assessment and to arrive at informed conclusions for key questions.

Hence the Auditor can modify, complete and add information in the findings column as s/he sees fit. The Auditor may also add additional questions if s/he considers that this is necessary to arrive at an informed conclusion for key questions.

The Auditor must take into account the specific engagement circumstances and apply professional judgment throughout the assessment process. The Auditor remains fully responsible at all times to design, plan and perform the assessment procedures he/she deems necessary in addition to the indicative questions and procedures in the *Annex 2a* Questionnaire.

The Auditor uses the information in the *Annex 2a* Questionnaire and the results of the assessment procedures to complete *Annex 2 Assessment Questionnaire and Criteria* (see Section 5.4 below) and to draw a conclusion for each pillar subject to assessment.

5.3 Nature, extent and timing of procedures and tests for each pillar

For each pillar the Auditor must assess the **design** of relevant systems, controls, rules and procedures. This means that the Auditor should perform procedures and tests on the basis of which s/he should arrive at a conclusion whether the system, controls, rules and procedures are present i.e. existing.

Moreover the Auditor must assess the **operating effectiveness** of systems, controls, rules and procedures for all relevant Pillars (see Section 2 Objectives above) except for

the Pillar Independent External Audit where the Auditor only assesses the design of the procedures for external audit.

The design and operating effectiveness of relevant systems, rules and procedures must be assessed against the criteria defined by the Commission for each pillar (see Section 5.4 below). For this purpose the Auditor must use the questionnaires provided by the Commission.

The Auditor determines the nature, extent and timing of all the procedures and tests s/he deems necessary to perform in order to arrive at a conclusion with regard to the design and operating effectiveness of systems, controls, rules and procedures.

5.4 Criteria and materiality

For each Pillar there are 3 levels of criteria which have been defined by the European Commission through the formulation of (key) questions in in *Annex 2 Assessment Questionnaire and Criteria* and in *Annex 2a Assessment Questionnaire (indicative questions)*.

For the purpose of determining what is a material weakness or deficiency in systems, controls, rules and procedures the Auditor must take into account the criteria and the levels of importance (i.e. scoring thresholds) defined by the Commission as these factors might influence the decision of the Commission to entrust budget implementation tasks under indirect management to the Entity.

Level 1 (Financial Regulation)

For each pillar there is **one** overarching Level 1 question (in *Annex 2 Assessment Questionnaire and Criteria*) defined on the basis of the Financial Regulation. This question is fundamental. Only two types of conclusions are possible:

- The answer to the question at level 1 is 'yes'. This means that the Entity complies with the requirements for the Pillar concerned. The conclusion of the Auditor must be formulated in the positive form which is equivalent to an 'unqualified opinion'.
- The answer to the question at level 1 is 'no'. This means that the Entity does not comply with the requirements the Pillar concerned. In this case the conclusion must be formulated in the adverse form which is equivalent to what is called an 'adverse opinion' under international standards.

Level 2 (Pillar key components)

Key questions at level 2 relate to criteria which the Commission considers essential. For this purpose key questions and criteria are defined for the key components of each Pillar. Components are essentially 'sub-pillars' which in turn are composed of blocks of indicative questions in *Annex 2a Assessment Questionnaire (indicative questions)*.

The Auditor must apply professional judgment to **attribute a score on a scale 0 to 10 to each level 2 component** in *Annex 2 Assessment Questionnaire and Criteria* based on the information and evidence s/he has obtained in *Annex 2a*.

Level 3 (Assessment Questionnaire with blocks of indicative questions)

Annex 2a Assessment Questionnaire (indicative questions) includes blocks of **indicative** questions which relate to the Pillar key components at level 2. These blocks of detailed questions provide directions to the Auditor and basically serve as non-exhaustive examples. This means that the Auditor can – but does not necessarily have to – use (all) these (blocks of) questions to determine a score for each component at level 2.

The Auditor can formulate additional questions and perform additional tests and procedures as s/he deems necessary or appropriate. The Auditor fully applies his / her professional judgment for all questions in *Annex 2a* in order to attribute scores to the Pillar key components at level 2.

5.5 Other matters

The Auditor is requested to collect information with regard to some specific accounting policies / methods which the Entity may apply and on which the European Commission would like to be informed for the purpose of managing future specific agreements / contracts that the Commission may conclude with the Entity. This information is not subject of the Pillar Assessment. The Auditor is requested to obtain relevant and appropriate information (see Annex 3 Other questions) and to report on these matters in Chapter 10 (Other Specific Matters) of the Pillar Assessment report.

5.6 Limitations in the scope

The Auditor will inform the Entity of any **limitations in the scope** of work s/he may find prior to or during the assessment and discuss with the Entity what action may be required and whether or how the assessment can be continued.

6 Assessment Procedures

The Auditor should perform the assessment in accordance with *Annex 4 Assessment Procedures* which cover documentation and evidence, planning, fieldwork, and reporting. This Annex includes assessment procedures which the Auditor should apply and procedures which the Auditor may opt to use. The Auditor's attention is drawn to the specific aspects set out in Sections 6.1 to 6.3 below. The Auditor should exercise due professional care and judgment and determine the nature, timing and extent of assessment procedures to fit the objectives, scope and context of the assessment.

6.1 Documentation and Evidence

The Auditor should in accordance with ISAE 3000, prepare documentation and obtain sufficient appropriate evidence to support assessment findings and to draw reasonable conclusions on which to base the conclusion of the assessment for each Pillar. The Auditor uses professional judgment to determine whether evidence is sufficient and appropriate (see Annex 4.1).

6.2 Planning and Fieldwork

Start of the assessment

The date of signature of the Entity's order form or other applicable contractual document for the assessment is the official starting date of the assessment. The Auditor shall then agree as soon as possible a date to start the fieldwork with the Entity.

Preparatory meeting with the Entity

The Entity foresees a preparatory meeting with the Auditor (see Annex 4.2.1) which will be held at MRC Office of the Secretariat in Vientiane 184 Fa Ngoum Road, Vientiane, Lao PDR. The Entity shall inform the Commission about this meeting which may be attended by Commission representatives.

Procedures for the planning and fieldwork of the assessment

The Auditor's procedures should include obtaining an understanding of the engagement context which is sufficient to design and perform further assessment procedures.

- Obtaining evidence regarding the design of systems, controls, rules and procedures (Annex 4.3.1);
- Performing tests of the operational effectiveness of systems, controls, rules and procedures (Annex 4.3.2);
- Sampling and other means of selecting items for testing where appropriate (Annex 4.3.3);
- Using the work of Internal Auditors where applicable (Annex 4.3.4);

6.3 Reporting

Use of the Pillar Assessment model report in Annex 5

The use of the model report for a Pillar Assessment in Annex 5 is compulsory.

Language

The report should be presented in English. An executive summary of the assessment report in English should be provided along with the report (See Annex 4.4.1).

Findings

There are two types of findings:

- Main findings are findings which relate to material weaknesses or deficiencies in systems, controls, rules and procedures. Material means that the Auditor considers that these factors are so important for the Commission that they might influence the decision of the Commission to entrust budget implementation tasks under indirect management to the Entity. Hence, where material findings are found for a Pillar this must lead the Auditor to express an adverse conclusion for the Pillar.

Main findings also include cases where several findings which taken individually do not relate to a material weakness or deficiency but which taken in the aggregate involve a

finding of material weakness or deficiency. The combined impact of such findings is so important (i.e. material) that this must lead the Auditor to the conclusion that the Entity does not meet the requirements for the Pillar concerned (i.e. the conclusion is 'No').

- Other findings are all non-material findings which the Auditor believes should be brought to the attention of the Entity. These findings relate to weaknesses and deficiencies in systems, controls, rules or procedures which, individually or in the aggregate, involve a less immediate level of risk that objectives for the Pillar concerned are not achieved.

Findings must be reported in accordance with the (table) formats specified in the model report for a Pillar Assessment in Annex 5.

Recommendations

There are two types of recommendations:

- Critical recommendations relate to material weaknesses and deficiencies in systems, controls, rules or procedures and to cases where the criteria defined by the European Commission and /or internationally accepted standards for Pillars are not complied with (on a regular basis).
- Other recommendations relate to all other findings which are not of a material nature. In these cases the weaknesses and deficiencies in systems, controls, rules or procedures have no major and immediate impact on the objectives of these systems, controls, rules or procedures. Nevertheless, it is relevant for the Entity to implement the suggested measures as it would have the opportunity to improve systems, controls, rules or procedures and to achieve greater effectiveness and/or efficiency.

Recommendations must be reported in accordance with the (table) formats specified in the model report for a Pillar Assessment in Annex 5.

Conclusions

The assessment report should include a conclusion for each pillar. There are two types of conclusions. Conclusions must either be formulated in the positive form (i.e. has set up, uses, is subject to or applies) or by using an adverse formulation (i.e. has not set up, does not use, is not subject to or does not apply).

The use of a conclusion of the qualified type (using the 'except for ' formulation) is not possible in a Pillar Assessment.

Date of the Assessment Report

The date of draft and pre-final reports should be the date when these reports are sent for consultation. The date of the final assessment report should be the date when the final Independent Auditor's Report is signed (Annex 4.4.2).

Procedures and timetable for the submission of draft and final assessment reports

The Auditor should respect the procedures and timetable for the consultation and submission of the draft and final assessment report as set out in Annex 4.4.3 and 4.4.4.

The Auditors' attention is specifically drawn to the following:

- The Auditor should submit a **draft report** to the Entity within **30 calendar days after the day of the closing meeting** (i.e. the end of field work).
- The period between the **assessment closing meeting** and the submission to the Entity of the **final assessment report** should **not exceed 81 calendar days**. The Auditor should explain and document any reporting delays in the working papers.

7 Other Matters

7.1 Follow-Up

The Entity may request the Auditor for further assistance with the follow-up of the final assessment report. The Entity may also request the Auditor to carry out a re-assessment of one or more Pillars if the final assessment report concluded that the Entity did not comply with the requirements for the Pillar(s) concerned.

This work is not covered by these ToR and if this is required the Entity will issue an addendum to the order form or to the other applicable contractual document for such an engagement.

7.2 Various Matters

Fees must cover the remuneration actually paid to the concerned expert(s) per working days, administrative costs of employing the expert(s) and service provider's overheads, profit and backstopping facilities.

Actual costs (air ticket, land transportation to the airport and visa fees) will be reimbursed only on submission of original invoices/receipts.

Annexes

Annex 1 Engagement Context – Key Information for a Pillar Assessment

Annex 2 Assessment Questionnaire and Criteria

Annex 2a Assessment Questionnaire (indicative questions)

Annex 3 Other Questions

Annex 4 Assessment Procedures

Annex 5 Pillar Assessment Report

IMPORTANT: Annexes 1 to 5 form an integral part of the present terms of reference.