1. TERMS OF REFERENCE

**Project Name: “Financing of affordable housing according to Shariah standards”**

 **(KGZ-1028)**

**Project History**

1. The Government of the Kyrgyz Republic has received a loan from the Islamic Development Bank in the amount of US$79.0 (seventy-nine million) equivalent from the Islamic Development Bank (“IsDB”) to finance the implementation of the Shariah-compliant Affordable Housing Financing Project, referred to as the “Project”. The Ministry of Economy and Commerce is the governing body and is entrusted with the execution and supervision of the Project through the OJSC “State Mortgage Company”, the binding terms and conditions of the financing are contained in the Financing Agreement no. KGZ-1028 dated 26/04,2024, which may be supplemented by additional letters and/or amendments.

**Context**

2. In accordance with Article 3 of the Installment Sale Agreement KGZ-1028 (e.g., Executing Agency), the Project Governing Body must maintain at all times a financial management system, including records and accounts, and prepare project financial reports in a format acceptable to the Islamic Development Bank and adequate to reflect transactions, resources, and expenditures related to the project. The Governing Body should also maintain records and provide supporting documents for all expenditures for which exemptions from financing have been made (records should reflect all categories of exemptions cost reports, direct payments).

3. The Project Financial Statements (“PFS”) shall consist of (i) the balance sheet of the Project as of the closing date of the financial year (ii) a statement of project income and expenditures for the year then ended (iii) a reconciliation statement of the year-end balance of the project account. In procuring goods, works and services for the Project, the Governing Body shall comply with the Islamic Development Bank Procurement Guidelines. The Financing Agreement requires that the above records, accounts and financial statements for each financial year be audited in accordance with auditing standards consistently applied by independent auditors acceptable to the Bank. The audited PFSs together with the auditor's report must be submitted to the Islamic Development Bank as soon as they become available, but not later than six months after the end of the financial year. In fulfillment of this legal requirement (or the Financing Agreement), the Governing Body shall engage a qualified independent auditing firm in accordance with the terms of reference and scope of work acceptable to the Islamic Development Bank as set out below.

**Target**

4. This is a one-time audit engagement covering the period from January 1, 2024 to June 30, 2025. Should additional phases of the project be implemented or extended, a separate audit engagement may be arranged subject to mutual agreement and IsDB’s no-objection.

The audit is expected to commence by September 15, 2025 and be completed no later than November 30, 2025, in accordance with the Financing Agreement's requirement to submit audited financial statements within six months after the end of the audited period[[1]](#footnote-1).

The main objective of the audit engagement is to enable the auditor to express a professional opinion that: (i) the PFS and supplementary financial information give a true and fair view of the financial position of the project for the period from January 1, 2024 to June 30, 2025, and the funds received, disbursed, and incurred during this period have been used solely for their intended purpose; (ii) expenditures reimbursed on the basis of cost reports are eligible for financing by the Bank and are reflected in the PFS, and for this purpose the auditor should perform all necessary checks on the reports and the underlying records and control systems.

The audit report should also state whether the Islamic Development Bank Procurement Guidelines have been properly applied and in accordance with the KGZ-1028 Project Financing Agreement; (iii) the Implementing Agency's compliance with the terms of the financing agreements and applicable laws and regulations; (iv) the fair presentation of the availability of funds in the Special Account (if any) and the compliance of the transactions with the provisions of the financing agreement; and (v) an assessment of the adequacy of internal controls.

The financial reporting periods and related sources of funds that are the subject of this audit cover the period January 1, 2024 through June 30, 2025 for the Shari'ah Affordable Housing Financing Project, including the following sources of funds: (a) IsDB financing (installment sales) and (b) beneficiary contribution.

The information, both financial and non-financial, to be audited by the auditor is all information to verify that the expenditures, State Mortgage Company (SMC) in the financial statements, have occurred, are accurately recorded, and are eligible for funding under the Project Financing Agreement.

The selection and appointment of the audit firm shall be subject to prior review and written no-objection by the Islamic Development Bank, in accordance with the provisions of the Financing Agreement KGZ-1028 and IsDB’s procurement procedures.

**Scope of work**

5. The audit that is the subject of this terms of reference is considered to be an audit of a special purpose contractual arrangement for which, in addition to compliance with international auditing standards as explained below, the auditor needs to take into account the Islamic Development Bank's reporting requirements and compliance with the IsDB Procurement Guidelines.

6. The audit will be conducted in accordance with International Standards on Auditing (ISA) issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFA) or Auditing Standards issued by the International Organization of Supreme Audit Institutions (IOSAI), taking into account relevant financial agreements and the special requirements of the Islamic Development Bank, with the auditor paying attention to:

1. Fraud and corruption: an audit should consider the risk of material misstatement resulting from fraud or error. It should include procedures to provide reasonable assurance that material misstatements, if any, will be detected,
2. Laws and regulations: the auditor should assess the expert's and SMC's compliance with the provisions of laws and regulations that may materially affect the PFS.
3. Governance: report to the Executing Agency (“EA”) and the SMC on significant audit matters related to governance.
4. Risks: in order to reduce audit risk to a relatively low level, the auditor will apply appropriate audit procedures and handle anomalies/risks identified during their assessment.

In particular, the auditor should pay special attention to the following:

* 1. All funds, including IsDB financing, counterpart funds, beneficiary contributions and co-financing from other development partners provided for the Project have been utilized, accounted for and classified in accordance with the relevant financing agreements;
	2. All transactions related to the project are reflected in the PFS issued in accordance with Generally Accepted Accounting Policies;
	3. Funded goods, works and services have been procured in accordance with the relevant funding agreement.
	4. All necessary copies of supporting documents, records and accounts have been retained for the entire project. There should be a clear relationship between the books and records provided to the Bank.
	5. Compliance with certain covenants of the Financing Agreement {Project Agreement and Subsidiary Financing Agreement} (e.g., compliance with short-term and long-term borrowing covenants, cash flow covenant);
	6. The relevance of the expenditures declared in the cost report submitted to the Islamic Development Bank for replenishment. This shall be in addition to the justification of these expenditures;
	7. External funds have been utilized in accordance with the terms of the relevant financial agreements, with due regard to economy and efficiency, and only for the purposes for which the funding was provided;
	8. Counterparty funds have been made available and utilized in accordance with the relevant financial agreements and only for the purposes for which they were made available;
	9. A fixed asset register is maintained for all fixed assets acquired under the project.
	10. The accounting system and general internal controls for monitoring expenditures and other financial transactions are sufficient and effective and provide for the safe custody of Project-financed assets.
	11. In conducting the audit, the auditor should physically inspect all significant assets acquired and confirm their existence and use for project purposes.
	12. The auditor verifies financial transactions by means of documentary or other evidence necessary to satisfy the auditor as to the genuineness and propriety of the transactions, their full and proper recording in the books of account, financial results and state of affairs.
	13. The PFSs have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), or other accounting standards compatible with IASB, and give a true and fair view of the financial position of the Project for the period January 1, 2023 through June 30, 2024, and of the resources and expenditures for the fiscal year ending on that date.
	14. Ensuring the verification of expenditures of OJSC SMC.

7. In addition, the auditor shall assess the extent to which the project’s financing disbursements and cost recovery mechanisms comply with the principles of Shariah-compliant financing as outlined in the Financing Agreement, the Installment Sale Agreement, and the Project Appraisal Document (PAD). This includes verifying that the use of funds and contractual arrangements under the Ijarah Muntahiya Bitamlik structure adhere to the approved Shariah principles. The auditor shall apply recognized Shariah audit standards in this assessment and report any non-compliance findings.

8. The financial statements, including the audit opinion, and the management letter shall be prepared in English or bilingual (English and Russian). These must conform to the Islamic Development Bank’s reporting requirements and templates, and must be received by the project implementing agency no later than six months after the end of the audited financial year. The implementing agency shall submit at least two hard and one electronic copy of the audit package to the Islamic Development Bank.

**Project Financial Statements**

The PFS will include:

* + Annual and cumulative reports on sources and uses of funds, which should disclose separately and in relation to the relevant financial arrangements, IsDB funds, counterparty (government) funds, funds of other donors and funds of beneficiaries;
	+ Balance sheet, which should show the balances of bank and cash accounts (these should be reconciled with the Statement of Sources and Uses of Funds).;
	+ Annual and cumulative list of disbursement requests authorized and submitted to the IsDB, by cost and type of expenditure;
	+ Summary of transactions and reconciliation of the SA (Special Account) to the financial statements;
	+ Cumulative status of funds showing total disbursements and expenditures against approved appropriations in the Financing Agreement;
	+ Report on comparison of actual expenditures with the annual budget;
	+ Summary of accounting policies and other explanatory notes to the financial statements; and
	+ A reconciliation between the amounts shown as received by the project and those shown as disbursed by IsDB and/or other financing parties (multilateral donors, government and beneficiaries, if any) should be attached as an annex to the Project Financial Report (PFR). As part of the reconciliation, the auditor will indicate the procedure used for disbursement - special account (SA) funds, reimbursement, or direct payment - and clarify whether the expenditure is fully documented.

**Expense reports**

In addition to auditing the Project Financial Report (PFR), the auditor shall audit all disbursement requests for direct payments and Expenditure Reports (ERs)/other documents used as the basis for withdrawal requests. The auditor should apply such tests and controls as he/she considers necessary and relevant in the circumstances. ER expenditures should be scrutinized to ensure that they are eligible in accordance with the funding agreement, referring to the PPR (Project Preparation Report)/ PAD (Summary, Project Action Plan) for guidance where necessary. In case ineligible costs included in disbursement requests and reimbursed are identified, the auditor should separately identify these costs. The Project Financial Report (PFR) should be accompanied by a schedule showing the individual ER disbursement requests with specific reference number and amount. The total amount of disbursements under the ER procedure should be part of the overall reconciliation of disbursements by IsDB and/or other financing organizations described above. The auditor should pay particular attention to the following points:

1. The ERs were prepared in accordance with the provisions of the relevant funding agreement;
2. the expenditure was incurred solely to realize the objectives of the Project;
3. Information and explanations necessary for the purposes of the audit have been obtained;
4. supporting records and documents required for audit purposes are accurate, reliable and retained; and
5. ERs can be relied upon to support appropriate withdrawal requests.

**Special Account**

In conjunction with the audit of the PFS, the auditor is also required to audit the operations of the special account (SA) associated with the project, including the initial advance or deposit. The auditor should form an opinion on the extent of compliance with IsDB procedures and the balance of the special account at year-end. The audit should include a review of the following:

1. Initial deposits and replenishments received from IsDB and/or other financing organizations (if any);
2. Payments supported by disbursement claims;
3. Interest that may accrue on outstanding balances; and
4. Year-end balances, transfer of funds to operating bank accounts in local currency and use of correct exchange rates to convert local currency expenditures into United States dollars.

All transactions in the SA should be fully recorded in the accounting records and be in accordance with the terms of the financing agreement. As part of the PFS opinion, the audit report will include an opinion on the ERs and SAs, indicating the extent to which these procedures can be relied upon to disburse loans under the Project.

9. The auditor will be required to analyze all correspondence with the Islamic Development Bank on the project, including copies of aides-memoires, mission reports, and assess progress on all financial matters. The auditor will pay special attention to any specific risk area identified in project documents (such as PAD).

10. There are two main outcomes of an audit engagement:

(i) An audit report, which should contain a clear professional opinion that (a) the project's financial statements give a true and fair view of the state of affairs of the project, and (b) expenditures reimbursed on the basis of expenditure reports are eligible for Bank financing and are reflected in the PFS. The auditors should take into account relevant statutory and other mandatory disclosure and accounting requirements of the Financing Agreement and report on any relevant exception and the impact of the exception on the PFS.

(ii) **A management letter that should address:**

(i) all significant accounting and control issues identified during the audit that were identified in the review of internal controls and the risks associated therewith;

(ii) the economy, efficiency and effectiveness of the use of resources;

(iii) the degree of compliance with each of the financial covenants in the financing agreements, recommendations for improvement, including internal and external factors affecting such compliance;

(iv) the amount of expenditures deemed ineligible that have been paid from a special account or directly claimed to the bank;

(v) matters that have come to the attention of the auditor during the audit and may have a significant impact on project implementation.

The letter, with management responses and recommendations to address the identified weaknesses and situations, should be provided to the project's governing body in a timely manner. In the annex to the management letter, the auditor will indicate whether the recommendations issued in the previous management letter, OJSC SMC, have been addressed.

The Implementing Agency shall prepare and submit a Management Response Plan to the Islamic Development Bank within 30 calendar days of receiving the final audit report and management letter. The Plan should clearly outline the actions taken or planned in response to each audit observation, including timelines and responsible units.

The auditor's reports should conform to the reporting forms required by International Standards on Auditing (ISA) or the International Organization of Supreme Audit Institutions (IOSAI) and should include the following matters:

* 1. A heading identifying the person or persons to whom the report is addressed;
	2. An introductory paragraph identifying the audited financial statements and the basis of accounting used in the preparation of the financial statements;
	3. Separate sections, with appropriate headings, on:
		+ Relevant responsibilities of project management (or equivalent)
		+ Basis for the audit report
		+ Auditor's opinion on the financial statements;
	4. The handwritten or typed signature of the auditors; and
	5. Date of the audit report.

**General principles of auditing**

11. The auditor should be registered as a chartered accountant with the country's relevant professional body and have significant experience in auditing large projects in the country, including projects financed by international financial institutions or multilateral development banks. In the case of public audits, the audit team should be staffed by qualified auditors with relevant education and audit experience. The same audit principles should apply if the audit is conducted by private or public auditors.

The key audit team should include, at a minimum, the following:

Team Leader/Project Manager: A senior auditor or accounting professional with a bachelor's degree and at least 10 years of experience in auditing, accounting and financial management, with in-depth knowledge of International Financial Institutions (IFIs) / Multilateral Development Banks (MDBs) financing procedures. He/she should be a member of a recognized professional accounting body.

Senior Auditor: Senior auditor or accounting specialist with a bachelor's degree and at least 5 years of experience in auditing, accounting and financial management.

Auditor: Assistant Auditor or Accounting Specialist with a Bachelor's degree and at least 3 years of experience in auditing, accounting and financial management.

**Violations, including fraud**

12. The executing agency is responsible for establishing and maintaining an adequate system of internal control. It is also responsible for ensuring compliance with laws and regulations and for preventing and detecting irregularities, including fraud. While auditors are not required to specifically look for such matters, an audit should be planned and performed to provide auditors with a reasonable expectation of detecting material misstatements resulting from irregularities, including fraud, or violations of regulations

13. Auditors will report in writing any serious deficiencies, fraud, irregularities or accounting irregularities encountered in the course of their duties to the designated official, the implementing agency and the Islamic Development Bank without delay.

**Access**

14. The Auditors shall have the right of access to the books, accounts, vouchers, the Financing Agreement, the Project Agreement and related Side Letters, the Project Appraisal Document, correspondence and all other documents related to the Project and to such information and explanations as the Auditors deem necessary for the performance of their duties and obligations.

15. The Auditors shall have the right of access to the books, accounts, vouchers, the Financing Agreement, the Project Agreement and related Side Letters, the Project Appraisal Document, correspondence and all other documents related to the Project and to such information and explanations as the Auditors deem necessary for the performance of their duties and obligations.

16. In turn, on occasion, representatives of the Islamic Development Bank may wish to meet with project auditors in connection with a visit to the auditor's office, to review audit working paper files, and to discuss the work performed and conclusions reached by the auditors. The auditor shall not restrict access in any manner and shall respond to all inquiries made by the representative of the Islamic Development Bank. Failure to comply with this provision may disqualify auditors from working with all projects financed or managed by the Islamic Development Bank. Formal discussions should normally be organized through the designated office staff member or project representative. The Islamic Development Bank will have this exclusive right during the audit and for two years after the completion of the audit assignment

The auditor should disclose whether he or she is acting on behalf of or as part of a larger body and any matters or relationships that may compromise his or her independence.

The auditor should be impartial and independent of any aspect of management or financial interest in the audited organization. In particular, the auditor should be independent of control over the organization and should not have any financial, personal or business relationship with the organization during the period covered by the audit.

**Independence and Conflict of Interest**

17. The auditor must be independent of the Project’s management and operations. The audit firm must confirm in writing that it:

* Has no existing or prior relationships with the State Mortgage Company (SMC), Ministry of Economy and Commerce, or any other entity involved in the Project, which could impair its independence;
* Will disclose any potential or perceived conflicts of interest that arise during the engagement;
* Is not involved in the preparation of the Project’s financial statements or in any advisory role related to the Project's financial management;
* Complies with the ethical requirements and independence standards of the International Federation of Accountants (IFAC), as well as any applicable national regulations.

**Miscellaneous**

18. **Annual Meetings.** The Auditor will be requested to attend the meeting of the EXECUTIVE at which the annual reports and financial statements of the project are presented. The Auditor will receive all notices and other communications pertaining to this meeting that any member of the EXECUTIVE is entitled to receive. The auditor shall discuss the audit and management report and any portion of the work that concerns the auditor.

19. **Termination of appointment.** If there are serious deficiencies on the part of the auditor, the Governing Body, in consultation with the Islamic Development Bank, may decide to remove the auditors from office before the expiry of their term of appointment.

20. **Limitation of auditor's liability.** There is no limitation on the auditors' liability with respect to the audit opinions issued under this engagement. The Project Implementing Agency will not accept any such limitation of liability.

21. These financial statements, including adequate disclosures, are the responsibility of the State Mortgage Company. This includes maintaining adequate accounting records and internal controls, selecting and applying accounting policies, and safeguarding the assets of the organization. As part of the audit process, the auditor will request written confirmation from management regarding representations made to the auditor in connection with the audit.

22. The financial statements, including the audit opinion, and the management letter should be received by the project implementing agency no later than six months after the end of the audited financial year. The project implementing agency should then promptly send two copies of the audited project financial statements (including the audit opinion) and the management letter to the Bank.

**Commitment letter**

The auditor is required to prepare an engagement letter. The form and content of the letter should generally include references to the matters addressed in the engagement letter. In addition, it should include management's responsibilities for preparing the PFS, the auditor's responsibilities for rendering an opinion on the PFS and internal controls, the audit fee, and a schedule indicating the anticipated start date of the engagement and the end date for providing audit opinions for the period January 1, 2024 through June 30, 2025.

1. Dates are subject to change based on actual procurement process. [↑](#footnote-ref-1)