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**AUDIT SERVICES
CORPORATION**

MINISTRY OF FINANCE AND ECONOMIC COOPERATION

URBAN LOCAL GOVERNMENT DEVELOPMENT

PROJECT PHASE II

IDA CREDIT NUMBER 54350-ET

MANAGEMENT LETTER

FOR THE YEAR ENDED 7 JULY 2017



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**The Federal Democratic Republic of Ethiopia
Audit Services Corporation**

2 January 2018

The Minister
Ministry of Finance and Economic Cooperation
Addis Ababa

Dear Sir,

**MINISTRY OF FINANCE AND ECONOMIC COOPERATION
URBAN LOCAL GOVERNMENT DEVELOPMENT PROJECT II
IDA CREDIT NUMBER 54350
MANAGEMENT LETTER
FOR THE YEAR ENDED 7 JULY 2017**

INTRODUCTION

We have pleasure in submitting our findings and recommendations on weaknesses in internal control and other matters which came to our attention during the audit of the financial statements of the Urban Local Government Development Project Phase II (ULGDP II), financed under IDA Credit No. 54350 ET (hereinafter referred to as the Project) for the year 7 July 2017.

We attach the following for reference:-

Independent auditor's report on the financial statements
Balance sheet
Statement of sources and uses of funds
Designated account statements
Notes to the financial statements
Withdrawal application schedule

As part of our audit of the financial statements, we have visited the following implementing partners:-

- Ministry of Urban Development and Housing
- Amhara National Regional State
- Benishangul Gumuz National Regional State
- Southern Nations, Nationalities and Peoples Regional State
- Tigray National Regional State
- Oromia National Regional State

It must be appreciated that the matters dealt with in this report came to our attention during the conduct of our normal audit procedures which are designed primarily with a view to the expression of our opinion on the financial statements of the Project, and therefore, our examination cannot be expected to disclose all possible weaknesses in internal control and to uncover all other findings which a more extensive special examination might reveal.

1. MINISTRY OF FINANCE AND ECONOMIC COOPERATION (MoFEC)

GENERL

Finding

- 1.1 We have noted that the fund utilization by the Regional States, the executing agencies as well as by the fund administrator was not satisfactory as detailed below;-

<u>Region</u>	<u>Available Fund For the year Birr</u>	<u>Unutilized Portion at 7 July 2017 Birr</u>	<u>Percentage of Unutilized portion Birr</u>
Amhara National Regional State	802,388,464	249,677,541	31%
Oromia National Regional State	881,920,021	180,367,905	20%
Southern Nations, Nationality and Peoples Regional State	680,237,895	135,021,811	19%
Gambella National Regional State	25,648,982	7,319,081	28%
Benishangul Gumuz National Regional State	20,658,281	8,665,124	41%
Harari National Regional State	134,688,681	56,095,304	41%
Ministry of Urban Development, Housing and Construction	212,154,194	126,120,125	59%
Ministry of Finance and Economic Cooperation-Finance	2,401,077	1,353,209	56%

Implication

The Project's target might not be met as much as intended.

Management Response

Finding accepted and effort will be made to utilize the program fund more effectively as scheduled.

Recommendations

Due attention should be given to effectively utilize the fund allocated.

Finding

- 1.2 We have also noted that there are substantial amount of advances and payables at the Regional States and the executing agencies as detailed below:-

<u>Region</u>	<u>Advance Birr</u>	<u>Payables Birr</u>
Tigray National Regional State	28,423,803	57,696,551
Amhara National Regional State	31,665,492	238,847,470
Oromia National Regional State	111,660,335	159,796,655
Southern Nations, Nationality and Peoples Regional State	79,506,377	71,794,978
Somali National Regional State	-	3,600,176
Afar National Regional State	47,709	319,507
Benishangul Gumuz National Regional State	1,477,728	6,132,582
Harari National Regional State	42,080,685	2,822,505
Dire Dawa City Administration	193,183,639	7,785,794
Ministry of Urban Development, Housing and Construction	<u>14,977,312</u>	<u>2,449,406</u>
Total	<u>503,023,080</u>	<u>551,245,626</u>

Implication

The monitoring, supervision and follow up tasks were not satisfactory.

Management Response

Finding accepted and effort will be made to clear these balances timely.

Recommendations

More effort should be exerted for timely clearance of these project advance and payable balances.

2. MINISTRY OF URBAN DEVELOPMENT, HOUSING AND CONSTRUCTION

Finding

- 2.1 Advances made to the National Regional Sector Bureau and some other implementing agencies included an aggregated outstanding balance of Birr 955,830 for more than a year, as detailed below:

<u>Implementer</u>	<u>Amount Birr</u>
DBS Centre for Development Research	671,132
Individuals and Private Organizations	30,884
Tigray Regional Construction, Road and Transport Bureau	12,057
S/N/N/P State Management Institute	<u>241,757</u>
Total	<u>955,830</u>

Implication

Follow up to recover outstanding advances was not satisfactory.

Management response

Finding is accepted and remedial action will be taken as soon as possible.

Recommendation

Analysis should be made in respect of outstanding advances and effort be exerted for early recovery.

3. AMHARA NATIONAL REGIONAL STATE

3.1 BUREAU OF FINANCE AND ECONOMIC DEVELOPMENT

No significant finding.

3.2 WOLDIA CITY

No significant finding.

3.3 MOTA TOWN

No significant finding.

3.4 FINOTE SELAM TOWN

No significant finding.

3.5 BAHIR DAR CITY

No significant finding.

4. TIGRAY NATIONAL REGIONAL STATE

4.1 BUREAU OF FINANCE AND ECONOMIC COOPERATION

No significant finding.

4.2 MEKELE CITY

No significant finding.

4.3 ADWA CITY

No significant finding.

4.4 WUKRO TOWN

No significant finding.

4.5 ALAMATA TOWN

No significant finding.

5. SOUTHERN NATION NATIONALITY AND PEPOLES REGIONAL STATE

5.1 BUREAU OF FINANCE AND ECONOMIC DEVELOPMENT (BOFED)

No significant finding.

5.2 YIRGALM TOWN ADMINISTRATION

Finding

- 5.2.1 Included in the “Advance within Government” account was Birr 671,592, which was paid to Yirgalem higher court from the Project fund in relation to court case.

Implication

The payment is not eligible expenditure.

Management Response

The amount was refunded in the subsequent year to the Project fund (Reference- Cash Receipt Voucher number 493529 dated 23/4/10).

Recommendation

The Project fund should be used only for eligible expenditures.

Finding

- 5.2.2 Expenditure account was understated by Birr 2,262,682 due to posting error of an adjustment of Birr 1,131,341 which was erroneously credited to expense account. (Reference-Journal Voucher number 485905 dated 30/09/09).

Implication

Expenditure was understated by Birr 2,262,682.

Management Response

Finding accepted and corrective action will be taken as early as possible.

Recommendation

Due care should be taken while recording and keeping documents.

Finding

- 5.2.3 Out Birr 14,000,000 held for grace period payments, Birr 3,484,376 is outstanding until 20/4/10.

Implication

We are unable to ascertain the genuineness of the remaining payable balance.

Management Response

Finding is accepted and remedial action be taken in the future.

Recommendation

The grace period payable determination process should be reviewed.

5.3 HAWASSA TOWN ADMINISTRATION

No significant finding.

5.4 AREKA TOWN ADMINISTRATION

Finding

- 5.4.1 All payment vouchers and related supporting documents were not stamped or marked for having been "PAID".

Implication

Documents may be presented for payment for more than once.

Management Response

Finding is accepted and remedial action be taken in the future.

Recommendation

Payment vouchers along with their respective supporting documents be marked "PAID" to avoid payments for more than once.

5.5 ARBAMINCH TOWN ADMINISTRATION

No significant finding.

6. BENISHANGUL GUMUZ NATIONAL REGIONAL STATE

6.1 BUREAU OF FINANCE AND ECONOMIC DEVELOPMENT (BOFED)

No significant finding.

6.2 ASSOSA TOWN

No significant finding.

7. OROMIA NATIONAL REGIONAL STATE

7.1 BUREAU OF FINANCE AND ECONOMIC DEVELOPMENT (BOFED)

No significant finding.

7.2 ROBE TOWN

No significant finding.

7.3 BURAYU TOWN

No significant finding.

7.4 ASSELA TOWN

No significant finding.

8.1 BATU TOWN

Finding

- 8.1.1 All payment vouchers and related supporting documents were not stamped or marked for having been "PAID".

Implication

Documents may be presented for payment for more than once.

Management Response

Finding is accepted and remedial action be taken in the future.

Recommendation

Payment vouchers along with their respective supporting documents be marked "PAID" to avoid payments for more than once.

CONCLUSION

We would like to express our appreciation to the management and staff of the project for the assistance and courtesy extended to our representatives during the course of our audit.

We have discussed the contents of this report with the appropriate officials of your Ministry who, in general, accept our findings and recommendations. We shall be pleased to provide further explanation that may be required.

Yours faithfully,

Audit Services Corporation



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The Federal Democratic Republic of Ethiopia Audit Services Corporation

INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS OF MINISTRY OF FINANCE AND ECONOMIC COOPERATION URBAN LOCAL GOVERNMENT DEVELOPMENT PROJECT II

We have audited the accompanying financial statements of Urban Local Government Development Project II (ULGDP II) financed under IDA Credit number 54350 ET of the Federal Democratic Republic of Ethiopia, Ministry of Finance and Economic Cooperation, which comprise the balance sheet as at 7 July 2017, the statement of sources and uses of funds and the designated account statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Responsibility for the Financial Statements

The Ministry of Finance and Economic Cooperation is responsible for the preparation and fair presentation of these financial statements in accordance with the Ethiopian Government's Manual of the Federal Accounting System which is based on a modified cash basis of accounting and for such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the 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 financial statements.

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**INDEPENDENT AUDITOR'S REPORT ON
THE FINANCIAL STATEMENTS OF
MINISTRY OF FINANCE AND ECONOMIC COOPERATION
URBAN LOCAL GOVERNMENT DEVELOPMENT PROJECT II (continued)**

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Urban Local Government Development Project II (ULGDP II) financed under IDA Credit number 54350 ET as at 7 July 2017 and of its sources and uses of funds for the year then ended in accordance with the Ethiopian Government's Manual of the Federal Accounting System which is based on a modified cash basis of accounting.

Reports on other requirements

As required by the World Bank guidelines we report that, to the extent we can assess:-

- during the period IDA funds have been used in accordance with the conditions of the relevant financing agreements and only for the purposes for which the financing were provided;
- counter-part funds have been provided and used in accordance with the financing agreement and only for the purposes for which the financing was provided;
- goods, works and services financed have been provided in accordance with the relevant financing agreements and disbursement letters;
- all necessary supporting documents, records and accounts have been maintained in respect of all Project's activities;
- the funds disbursed covered expenditure that are eligible for financing under IDA Credit No. 54350 ET;
- there was a clear linkage between the books of accounts and the financial statements; and
- our examination revealed no major weaknesses or irregularities in the system of internal controls over financial expenditure other than those mentioned in the management letter.

Audit Services Corporation

2 January 2018

**MINISTRY OF FINANCE AND ECONOMIC COOPERATION
URBAN LOCAL GOVERNMENT DEVELOPMENT PROJECT II
IDA CREDIT NUMBER 54350 ET
BALANCE SHEET
AS AT 7 JULY 2017**

	<u>Notes</u>	<u>Birr</u>	<u>2016</u> <u>Birr</u>
CURRENT ASSETS			
Advances	3	503,023,080	384,266,271
Cash and bank balances	4	<u>2,870,470,331</u>	<u>2,672,975,364</u>
		3,373,493,411	3,057,241,635
CURRENT LIABILITIES			
Accounts payable	5	<u>551,245,626</u>	<u>439,189,758</u>
NET ASSETS		<u>2,822,247,785</u>	<u>2,618,051,877</u>
<u>REPRESENTED BY</u>			
ACCUMULATED FUND	6	<u>2,822,247,785</u>	<u>2,618,051,877</u>

The notes on pages 7 to 11 form an integral part of these financial statements.

**MINISTRY OF FINANCE AND ECONOMIC COOPERATION
URBAN LOCAL GOVERNMENT DEVELOPMENT PROJECT II
IDA CREDIT NUMBER 54350 ET
STATEMENT OF SOURCES AND USES OF FUNDS
FOR THE YEAR ENDED 7 JULY 2017**

	<u>Note</u>	<u>Year ended</u> <u>7 July 2017</u> <u>Birr</u>	<u>Cumulative 8</u> <u>July 2014 to 7</u> <u>July 2017</u> <u>Birr</u>	<u>Year ended</u> <u>7 July 2016</u> <u>Birr</u>
SOURCES				
Credit from IDA		1,917,107,690	6,835,540,848	1,959,056,724
Contribution from Regions and cities		1,121,718,624	2,748,315,021	930,179,645
Gain on foreign exchange		60,530,523	119,169,915	41,707,272
Refund for payments made from IDA before approval of Capital Investment Plan (CIP)		<u>13,403,553</u>	<u>13,403,553</u>	<u>-</u>
		<u>3,112,760,390</u>	<u>9,716,429,337</u>	<u>2,930,943,641</u>
USES				
Works		2,608,616,214	6,228,266,663	2,295,958,622
Consultancy services		33,752,780	78,676,033	28,890,980
Training		<u>270,369,865</u>	<u>592,938,784</u>	<u>209,395,833</u>
		2,912,738,859	6,899,881,480	2,534,245,435
EXCESS OF SOURCES OVER USES OF FUNDS		200,021,531	2,816,547,857	396,698,206
PRIOR YEAR ADJUSTMENT	7	<u>4,174,377</u> <u>204,195,908</u>	<u>5,699,928</u> <u>2,822,247,785</u>	<u>1,525,551</u> <u>398,223,757</u>

The notes on pages 7 to 11 form an integral part of these financial statements.

**MINISTRY OF FINANCE AND ECONOMIC COOPERATION
URBAN LOCAL GOVERNMENT DEVELOPMENT PROJECT II
USD DESIGNATED ACCOUNT STATEMENT**

For the year ended	7 July 2017
Account number	0100101300487
Depository bank	National Bank of Ethiopia
Address	Addis Ababa, Ethiopia
Related credit	IDA Credit No.54350 ET
Currency	USD

	<u>USD</u>	<u>Birr</u>
Beginning balance – 8 July 2016	91,721,760.74	2,002,359,414.36
Add: IDA Loan during the year	<u>83,200,215.68</u>	<u>1,917,107,689.72</u>
	174,921,976.42	3,919,467,104.08
Less: Transfer to Birr account	<u>87,500,000.00</u>	<u>1,956,447,000.00</u>
	87,421,976.42	1,963,020,104.08
Gain on foreign exchange	<u>-</u>	<u>58,954,046.34</u>
Ending balance -7 July 2017	<u>87,421,976.42</u>	<u>2,021,974,150.42</u>

The notes on pages 7 to 11 form an integral part of these financial statements.

**MINISTRY OF FINANCE AND ECONOMIC COOPERATION
URBAN LOCAL GOVERNMENT DEVELOPMENT PROJECT II
SCHEDULE OF MOVEMENTS IN THE BIRR ACCOUNT**

For the year ended	7 July 2017
Account number	0100101040661
Depository bank	National Bank of Ethiopia
Address	Addis Ababa, Ethiopia
Related credit	IDA Credit No. 54350 ET
Currency	Ethiopian Birr
Beginning balance-7 July 2016	6,747,933
Transfer from USD Designated Account	<u>1,956,447,000</u>
	1,963,194,933
Less: Transfer to beneficiaries	
Afar	11,882,119
Tigray	284,295,757
Amhara	455,846,374
Oromia	490,052,367
Southern Nations, Nationalities and Peoples	
Regional State	354,835,969
Harari	45,454,281
Dire Dawa	112,624,993
Ministry of Urban Development, Housing and Construction	96,133,840
Ministry of Finance and Economic Cooperation	1,880,800
Somali	63,731,237
Gambella	18,074,414
Benshangul Gumuz	<u>12,260,426</u>
	1,947,072,577
Less: Bank charge	<u>4,891,117</u>
	<u>1,951,963,694</u>
Ending balance 7 July 2017	<u><u>11,231,239</u></u>

The notes on pages 7 to 11 form an integral part of these financial statements.

**MINISTRY OF FINANCE AND ECONOMIC COOPERATION
URBAN LOCAL GOVERNMENT DEVELOPMENT PROJECT II
IDA CREDIT NUMBER 54350 ET
NOTES TO THE FINANCIAL STATEMENTS**

1. PROJECT INFORMATION

The Project was established to implement IDA Credit No. 54350 ET made between the Government of the Federal Democratic Republic of Ethiopia and the International Development Association (IDA) on 6 May 2014. The main objective of the Project is to support improved performance in the planning, delivery and sustained provision of priority municipal services and infrastructure by urban local governments.

The Ministry of Finance and Economic Cooperation (MoFEC) is the administrator of the Credit while the Ministry of Urban Development and Housing (MUDH) is the executing agency for the Project.

2. SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted by the Project, which are consistent with those applied in the preceding year, are stated below:-

a) Basis of preparation

These financial statements have been prepared in accordance with the Ethiopian Governments Manual of the Federal Accounting System which is based on a modified cash basis of accounting.

b) Currency

These financial statements are presented in Birr. Transactions in foreign currencies are translated into Birr at the approximate rates of exchange prevailing at the dates of the transaction. Cash balances denominated in foreign currencies are translated into Birr at the exchange rates ruling at the balance sheet date.

MINISTRY OF FINANCE AND ECONOMIC COOPERATION
URBAN LOCAL GOVERNMENT DEVELOPMENT PROJECT II
IDA CREDIT NUMBERS 54350 ET
NOTES TO THE FINANCIAL STATEMENTS (continued)

3. ADVANCES

	<u>Birr</u>	<u>2016</u> <u>Birr</u>
Advance payment to:-		
contractors	251,067,315	192,148,226
Suppliers	180,583,720	137,992,548
Consultant	-	650,025
Cooperatives	25,809,170	20,635,712
Purchase advance to staff	4,587,903	9,983,202
Other advances within government	34,597,208	20,245,457
Others	<u>6,377,764</u>	<u>2,611,101</u>
	<u>503,023,080</u>	<u>384,266,271</u>

4. CASH AND BANK BALANCES

	<u>Birr</u>	<u>2016</u> <u>Birr</u>
USD Designated account	2,021,974,150	2,002,359,414
Ethiopian Birr Designated Account	11,231,239	6,747,934
Ministry of Urban Development and Construction	126,120,125	107,260,810
Ministry of Finance and Economic Cooperation	1,353,209	492,220
Other Birr Account	709,229,375	555,826,135
Cash on hand	<u>562,233</u>	<u>288,851</u>
	<u>2,870,470,331</u>	<u>2,672,975,364</u>

5. ACCOUNTS PAYABLE

	<u>Birr</u>	<u>2016</u> <u>Birr</u>
Retentions	164,093,577	124,077,901
Contractors	164,695,154	188,180,560
Other payable within government	65,762,164	24,419,747
Taxes payable	21,880,224	22,315,381
Others	<u>134,814,507</u>	<u>80,196,169</u>
	<u>551,245,626</u>	<u>439,189,758</u>

**MINISTRY OF FINANCE AND ECONOMIC COOPERATION
URBAN LOCAL GOVERNMENT DEVELOPMENT PROJECT II
IDA CREDIT NUMBERS 54350 ET
NOTES TO THE FINANCIAL STATEMENTS (continued)**

6. ACCUMULATED FUND

	<u>Birr</u>
Balance at 8 July 2016	2,618,051,877
Prior year adjustment	<u>4,174,377</u>
	2,622,226,254
Excess of financing over expenditure	<u>200,021,531</u>
Balance at 7 July 2017	<u>2,822,247,785</u>

7. PRIOR PERIOD ADJUSTMENT

	<u>Birr</u>	<u>2016 Birr</u>
Grace period payable in excess of actual expenditure	3,618,946	1,525,551

8. DATE OF AUTHORIZATION

Channel One Programs Coordinating Directorate Director of The Federal Democratic Republic of Ethiopia, Ministry of Finance and Economic Cooperation authorized the issue of these financial statements on 2 January 2018.

MINISTRY OF FINANCE AND ECONOMIC COOPERATION
URBAN LOCAL GOVERNMENT DEVELOPMENT PROJECT PHASE II
IDA CREDIT NUMBER 54350 ET
WITHDRAWAL APPLICATION SCHEDULE
Submitted during the
YEAR ENDED 7 July 2017

<u>Withdrawal Application No.</u>	<u>USD</u>	<u>Equivalent in Birr</u>
ULGDP-II-04	<u>83,200,215.68</u>	<u>1,917,107,689.72</u>
	<u>83,200,215.68</u>	<u>1,917,107,689.72</u>

MINISTRY OF FINANCE AND ECONOMIC COOPERATION
URBAN LOCAL GOVERNMENT DEVELOPMENT PROJECT PHASE II
IDA CREDIT NUMBER 54350 ET
RECONCILIATION OF SEMI ANNUAL REPORTS DURING THE YEAR ENDED
7 JULY 2017 WITH THE YEAR END STATEMENT OF SOURCE AND USES OF
FUNDS AND BALANCE SHEET

	<u>1stSemi</u> <u>Annual</u> <u>Birr</u>	<u>2ndSemi</u> <u>Annual</u> <u>Birr</u>	<u>Cumulative</u> <u>7 July2014 to</u> <u>7 July 2017</u> <u>Birr</u>
<u>Sources</u>			
Opening Balance 7/7/16			2,618,051,877
Prior Year Adjustment			<u>4,174,377</u>
			2,622,226,254
IDA Contribution	-	1,917,107,690	1,917,107,690
Regional Contribution	255,997,605	244,262,477	500,260,082
ULGs Contribution	373,922,343	247,536,199	621,458,542
Gain on foreign exchange	41,685,642	18,844,881	60,530,523
Refund for payments made from IDA before approval of Capital Investment Plan (CIP)	<u>-</u>	<u>13,403,553</u>	<u>13,403,553</u>
Total Sources	671,605,590	2,427,751,247	5,734,986,644
<u>Expenditures</u>			
Program expenditures	<u>349,759,062</u>	<u>2,562,979,797</u>	<u>2,912,738,859</u>
Excess /(Deficiency) of sources over expenditures			<u>2,822,247,785</u>
Cash at bank			2,869,908,098
Cash on hand			562,233
Advances			503,023,080
Payables			<u>(551,245,626)</u>
Accumulated fund			<u>2,822,247,785</u>