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## LICENSING AND SUPERVISION OF MICRO FINANCING BUSINESS APPOINTMENT OF EXTERNAL AUDITOR OF A MICROFINANCE INSTITUTION DIRECTIVE NO.MFI/37/2024

**Whereas**, it is essential to ensure that a Microfinance Institution maintains accurate and reliable records and prepares financial statements in line with International Financial Reporting Standards (IFRS) and regulatory requirements;

**Whereas**, it is essential to ensure that a Microfinance Institution has adequate governance on, and monitoring of the external audit function;

**Whereas**, increased reliance on the works of external auditors is believed to enhance quality and effectiveness of Risk Based Supervision;

**Whereas**, disclosure is necessary to enhance market discipline and public confidence thereby inducing Microfinance Institutions to behave in a prudent manner;

**Now, therefore**, in accordance with Article 27(2) of National Bank of Ethiopia Establishment Proclamation No.591/2008 and Articles 12, 13, 18(7d) and 34(2) of Microfinance Business Proclamation No.626/2009 as amended by Proclamation No.1164/2019; the National Bank of Ethiopia has issued this Directive;

### 1. Short Title

This Directive may be cited as “**Appointment of External Auditor of a Microfinance Institution Directive No.MFI /37/2024**”.

### 2. Definitions

For the purpose of this Directive, unless the context requires otherwise, the term:

2.1 “**audit engagement letter/audit contract**” means a document containing auditor's acceptance of the appointment, objective and scope of audit, extent of auditor's responsibilities to the client and vice versa, as required under financial reporting





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framework of Accounting and Auditing Board of Ethiopia (AABE) and International Standard on Auditing (ISA).

- 2.2 “**audit manager**” means, a person, by whatever title he may be referred to, who is in charge of the specific audit engagement in a Microfinance Institution on behalf of the audit firm.
- 2.3 “**business associates**” means an external party with whom the person has, or plans to establish some form of business relationship with;
- 2.4 “**chief executive officer**” means a person by whatever title that person may be referred to; who is primarily responsible to the day to day management of the affairs of a Microfinance Institution;
- 2.5 “**component**” means a division, branch, subsidiary, joint venture, associated company or other entity whose financial information is included into the financial statements of a Microfinance Institution being audited by the principal auditor;
- 2.6 “**director**” means any member of the board of directors of a Microfinance Institution by whatever title he may be referred to;
- 2.7 “**employee**” means a chief executive officer, a senior executive officer or any other employee who is appointed or hired by a Microfinance Institution to carry out its day to day activities;
- 2.8 “**external audit**” means a process by which an independent external auditor obtains sufficient and appropriate audit evidence so as to give reasonable assurance that the financial statements as a whole are free from material misstatement, whether due to fraud or error;
- 2.9 “**external auditor**” means an audit firm licensed by Accounting and Auditing Board of Ethiopia to provide audit service,





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- 2.10 “**financial institution**” means an insurance company, a bank, a microfinance institution, a capital goods finance company, a re-insurer, a micro insurance provider, a payment instrument issuer, a payment system operator or other similar institution as determined by the National Bank;
- 2.11 “**group auditing**” means the auditing of a group of financial statements that includes the financial information for more than one entity or component or business activity for which financial information is separately prepared, and which is included in the group financial statements;
- 2.12 “**immediate family member**” means spouses person having relationship with first degree consanguinity or affinity to the auditor and shall include children, parents and sibling of the auditor;
- 2.13 “**independence**”, notwithstanding other relevant laws, means freedom from conditions that threaten ability of external auditor to carry out its responsibilities in an unbiased manner;
- 2.14 “**Microfinance Institution**” means a company licensed by the National Bank to undertake a microfinance business;
- 2.15 “**National Bank** ” means the National Bank of Ethiopia;
- 2.16 “**Other auditor**” means an auditor, other than the principal auditor, with responsibility for reporting on the financial information of a component which is included in the financial statements audited by the principal auditor. Other auditors include affiliated firms, whether using the same name or not, correspondents, or unrelated auditors;
- 2.17 “**person**” means natural or juridical person;





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- 2.18 “**principal auditor**” means the auditor with responsibility for reporting on the financial statements of a Microfinance Institution when those financial statements include financial information of one or more components audited by auditor;
- 2.19 “**substantive procedures/tests**” means those activities to be performed by the external auditor to detect material misstatement or fraud at the assertion level;
- 2.20 “**Expressions**” in masculine gender also include feminine gender;

### 3. Scope of the Directive

This Directive shall be applicable to all Microfinance Institutions operating in Ethiopia.

### 4. General Provisions on Appointment of an External Auditor

- 4.1 A Microfinance Institution shall select and appoint an external auditor through a competitive bid and in compliance with other relevant laws;
- 4.2 If a Microfinance Institution fails to select and appoint an external auditor through a competitive process due to any compelling circumstances, the National Bank may appoint an external auditor to the Microfinance Institution in accordance with the relevant laws;
- 4.3 A Microfinance Institution may re-appoint an external auditor appointed as per sub-article 4.1 hereinabove, for the next two years without competitive bid; however, an external auditor shall not hold office for more than three consecutive years in a Microfinance Institution;
- 4.4 An external auditor may be appointed through competitive bid for a maximum of 2 (two) consecutive terms. However, an external auditor who served for two consecutive terms may be considered for competitive bid only after lapse of three consecutive years.





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- 4.5 An external auditor selected by the subscribers meeting for audit of its first year operation may be re-appointed by the first annual general meeting. In such conditions, three years term stated under sub-article 4.3 hereinabove, shall include first year of operation;
- 4.6 Upon re-appointment of an external auditor, the terms of audit engagement letter/audit contract shall be revised if the level of change in the Microfinance Institution's business, or composition of external audit team warrants doing so and/or if there exists misunderstandings of the objective and scope of the audit;
- 4.7 An external auditor who ceased an audit engagement of a Microfinance Institution on or before the end of the first or second three years term due to any reason shall only be considered for next competitive bid after lapse of three consecutive years from the date when the audit engagement was discontinued.
- 4.8 If an external auditor of a Microfinance Institution is subject to conflict of interest, no longer meets eligibility requirements and/or fails to adequately perform the required functions or duties; the National Bank may order a Microfinance Institution to replace the external auditor in line with relevant laws.

## 5. Selection of an External Auditor

In conducting the selection and appointment of an external auditor, a Microfinance Institution shall:

- 5.1 ensure that an external auditor or any partner thereof is licensed by AABE and has subsequently renewed its business license as appropriate;
- 5.2 ensure that all members of audit team have IFRS knowledge as evidenced with IFRS training certificate;





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- 5.3 ensure that the audit manager has at least three years' experience in auditing financial institutions; and other audit team members shall have banking and microfinance sector experience and/or adequate experience in auditing financial Institutions, in consideration of size and complexity of the Microfinance Institution;
- 5.4 assess that the proposed audit team members have adequate knowledge, understanding and training with regards to fair value estimation and are able to check the robustness of the processes for determining fair value of assets and liabilities; and also are able to evaluate key assumptions and inputs that a Microfinance Institution has used in its valuations;
- 5.5 ensure that audit team members were not employee of the Microfinance Institution to be audited, in the last three years, to safeguard the objectivity, independence and effectiveness of the audit work;
- 5.6 secure ethical **declaration** and ensure that an external auditor, its partner or its staff member is not:
- a) a shareholder, a director or an employee of a Microfinance Institution to be audited,
  - b) a spouse or relative by consanguinity or affinity to the first degree to a shareholder, a director or an employee of that Microfinance Institution,
  - c) a shareholder, a director or an employee of a firm which is directly or indirectly owned by:
    - i) a shareholder, director or employee of that Microfinance Institution, and
    - ii) a spouse or relation by consanguinity or affinity to the first degree to a shareholder, a director or an employee of that Microfinance Institution, and/or
  - d) an agent or any service provider to that Microfinance Institution in any matter;





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- 5.7 ensure that the audit firm and its partners, directors, managers or members of the proposed audit team:-
- a) have not been insolvent or declared bankrupt by court,
  - b) have not been convicted by the court for any criminal offence, fraud/forgery, financial crime or other illegal activities,
  - c) are not defaulter of any Microfinance Institution or other financial institution, and
  - d) are not defaulter of any tax obligation;
- 5.8 ensure that the external auditor, its partners or its audit team members as well as their associates do not operate any deposit account and are not direct or indirect borrower and/or user of your Microfinance Institution, except at arm's length basis;
- 5.9 clearly state in the audit contract that the contract with the audit firm may be cancelled if an audit firm fails to fulfill the criteria set out in this Directive due to change in its ownership, directors and managers, and any disciplinary or legal actions taken against the firm or any of its audit team; and
- 5.10 require an external auditor to complete and submit a written “Independence Confirmation” and “Fit and Proper Declaration” forms for each and every proposed audit team member, for every appointment or re-appointment, as per **Annex I** and **II** of this Directive, respectively;





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## 6. Approval by the National Bank

- 6.1 Every year including its first year of operation, a Microfinance Institution shall submit written approval request for the appointment or re-appointment of an external auditor to the National Bank within **fifteen** working days from date of appointment or reappointment, along with annual general meeting minutes and other supporting documents as per Annex III of this Directive.
- 6.2 If the terms of audit engagement letter/audit contract is revised as per sub-article 4.6 of this Directive, a Microfinance Institution shall submit written approval request to the National Bank within **fifteen** working days of such revision.
- 6.3 No Microfinance Institution shall remove or change its external auditor/s already appointed and approved by the National Bank without the prior written approval of the National Bank.

## 7. Responsibilities of an External Auditor

Without prejudice to the duties imposed by other relevant laws, an external auditor appointed by a Microfinance Institution shall:

- 7.1 provide reasonable assurance that the financial statements, as of June 30 of every year, submitted to the National Bank have been prepared in accordance with relevant regulatory requirements, among others, and if not provide opinion on the matter;
- 7.2 focus on the recoverability and the carrying value of loans, investments and other assets shown in the financial statements; and also identification and adequate disclosure of all material commitments and liabilities. More specifically, an external auditor shall, at least:







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- a) independently verify and validate the framework, structure, key assumptions and inputs and processes used for fair value estimation; and ensure that the valuation practices by a Microfinance Institution are consistent with IFRS as adopted in Ethiopia;
- b) cover reasonable and appropriate number of branches and or sub branches of a Microfinance Institution;
- c) assess adequacy of provisions held for non-performing loans and other long outstanding assets as per IFRS and National Bank Directive before annual accounts of a Microfinance Institution are finalized and/or dividends paid to the shareholders;
- d) ensure that risks, fair value estimates and methodologies and uncertainties surrounding estimates have properly been disclosed;
- e) ascertain that loan loss provisions and day one gain/loss recognition are reflected in fair value estimates and have been carried out properly as per IFRS;
- f) review computation of capital adequacy and liquidity ratios in accordance with the requirements of the National Bank;
- g) identify and assess the risk of material misstatements in the Microfinance Institution's financial statements, taking into consideration complexities of Microfinancing activities and the need for the Microfinance Institution to have a strong control environment;
- h) assess internal controls over fair value and other accounting estimates; and the overall adequacy of internal controls over financial reporting;

7.3 base its audit work on the assessment of inherent risk of material misstatement (including findings of an internal auditor, among others) and control risks, substantive





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testing of the internal controls designed to prevent or detect and correct material misstatements and other requirements of audit procedure as specified under international standard on auditing;

- 7.4 conduct its audit on a group basis; and if board of directors or management of Microfinance Institution imposes a limitation on the scope of the auditor's work, the auditor shall not accept such a limited scope as an audit engagement. However, an external auditor may rely on the work of other auditor to provide its opinion on group basis provided that it will not result in material misstatement;
- 7.5 express appropriate audit opinion in the event of concluding that the work of the other auditor cannot be used and the principal auditor has not been able to perform sufficient additional procedures regarding the financial information of the component audited by the other auditor; and
- 7.6 keep any information obtained during the course of the audit confidential or do not disclose to any third party other than specifically allowed as per this Directive and other relevant laws, until the final report is issued.

## **8. Responsibilities of the Board of Directors of a Microfinance Institution**

The board of directors of a Microfinance Institution shall:

- 8.1 ensure that the external auditor who examines and reports on its financial statements has complete and unhindered access to and is provided with all necessary information;
- 8.2 ensure attendance and participation of the full board for a separate entry and exit meetings to be done with external auditors.





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- 8.3 monitor the independent conduct of the audit function and shall maintain effective communication with the external auditor to enhance the quality of the overall audit findings;
- 8.4 ensure that all significant line of businesses, activities and processes have been audited and/or validated by the external auditor; and opinion has been reflected thereof;
- 8.5 review the terms of audit engagement letter prior to offering the audit work and ensure that it is prepared in line with the provisions of this Directive and other relevant laws; and the agreed terms shall be documented in a clearly written audit engagement letter;
- 8.6 ensure that the external auditor/s fulfills requirements set out in this Directive and recommend for the appointment and approval to the shareholders' meeting;
- 8.7 ensure fair and transparent reporting and prompt publication of the financial statements and the disclosures thereof;
- 8.8 conduct detailed deliberations on all matters and findings with the external auditor, in the presence of its internal auditors; and strengthen corporate governance of the Microfinance Institution accordingly; and
- 8.9 evaluate the effectiveness of the external audit process at the end of every audit cycle or every year and periodically assess if required disclosures are made;

## 9. Special Audit

- 9.1 The National Bank may require an external auditor of a Microfinance Institution to carry out special audit on its area of interest and to submit a report accordingly.
- 9.2 Notwithstanding with the provision stated under such article 9.1 above, the National Bank may provide an external auditor with any information, knowledge





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or concern that it deems important for the proper conduct of the special audit.

- 9.3 Any remuneration for an audit conducted by an external auditor according to sub-article 9.1 of this Article, shall be paid by the Microfinance Institution being audited.

## 10. Immediate Notification Requirements

- 10.1 An external auditor shall confidentially and immediately notify, to the National Bank, any hindrance of access to necessary information that can materially affect expression of its opinion on the financial statements of the Microfinance Institution.
- 10.2 An external auditor shall immediately inform a Microfinance Institution, with which it has engaged, any changes in its ownership, directors and managers and any disciplinary or legal actions taken against the firm or any of its audit team members.
- 10.3 An external auditor shall immediately and directly report to the National Bank on matters arising from the audit including, but not limited to insolvency, illiquidity, acts of fraud or theft and others that the auditor deems significant to the regulators function due to its nature or potential financial impact.
- 10.4 If an external auditor of a Microfinance Institution terminates its service before its term of office for any reason by itself, a Microfinance Institution shall immediately notify such fact to the National Bank, with reasons and proposed subsequent actions to be approved by the National Bank.

## 11. Reporting Requirements

- 11.1 External audit report of a Microfinance Institution shall be directly presented by the external auditor to the shareholders of a Microfinance Institution and submitted to the National Bank including management letter within **six** months from the end of Ethiopian financial year, i.e., June 30 (Hamle 07) of each year.





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- 11.2 Management Letter in sub-article 11.1 hereinabove, shall include all early warning or any signaling issues irrespective of their materiality; and accordingly it shall include at least the followings:
- a) any weaknesses in internal control system;
  - b) mis-valuation of assets or any misstatements and frauds committed;
  - c) breach of laws or regulations or National Bank directives or the Microfinance Institution's memorandum of association or failure to meet National Bank's requirements as identified during the course of audit;
  - d) irregularities which may jeopardize the security of depositors and other creditors;
  - e) issues that affect the Microfinance Institution's ability to continue as a going concern;
  - f) any adjustments made to the financial statements;
  - g) material adverse changes in any risks of the Microfinance Institution's business;
  - h) any other governance related weaknesses.
- 11.3 Where it deemed important, the National Bank may access external auditor's working papers, demand walk through presentation, require the auditor to extend the scope of the audit and call the auditor for tripartite meeting with the management of the Microfinance Institution.
- 11.4 The National Bank may order conduct of a second audit or require appointment of another external auditor in the event that it is not satisfied with the work and outcome of the previous external audit report.





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## 12. Disclosure Requirements

- 12.1 A Microfinance Institution, in its official website, shall post audited financial statements and related disclosures including its core activities, capital and capital adequacy, risk profile, risk assessment processes, fair value estimates and methodologies and uncertainty surrounding estimates, within 2 (two) weeks from the date of approval of the external audit report by annual general meeting.
- 12.2 A Microfinance Institution shall have disclosure policies and procedures which shall address matters related to disclosures of financial records and related information including internal controls and periodical assessment needed over the disclosure process.

## 13. Penalty and Administrative Sanctions

- 13.1 A person who contravenes or obstructs the provision of this Directive shall be penalized in accordance with Article 33 of Microfinance Business Proclamation No. 626/2009 as amended by Microfinance Business Proclamation No. 1164/2019.
- 13.2 National Bank may suspend or remove directors, chief executive officer and/or other officers of a Microfinance Institution who obstructs an external auditor in the performance of his duties, or fails, refuses or neglects to provide an external auditor with such books, accounts, computer systems, vouchers and other financial records as requested by the external auditor.

## 14. Effective Date

This Directive shall enter into force as of 12<sup>th</sup> day of September 2024.

  
**Mamo Esmelealem Mihretu**  
Governor





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**Annex I: External Audit Team Member’s Independence Confirmations Form<sup>1</sup>**

This is a confirmation of independence and compliance with ethical requirements provided in respect of the audit of the financial statements of \_\_\_\_\_ Microfinance Institution S.C. for the financial year ended \_\_\_\_\_

I confirm that I am in compliance with the applicable independence rules as specified below, with respect to \_\_\_\_\_ **Microfinance Institution S.C.**; hereafter referred to us “**a client**”, in addition to the requirement of the International Ethical Requirements for external auditors.

- 1) I or my immediate family members do not have a financial interest in a joint venture or business relationship (or commitment to do so) with the client or any related entity or any chief executive officer, senior executive officer, director or other individual who performs senior managerial functions for this client thereof.
- 2) I or my immediate family members are not the beneficiaries of any estate or trust which has a direct financial interest in this audit client or any related business entity.
- 3) No close family member is a director, chief executive officer, senior executive officer or is in a position to exert direct and significant influence over the financial statements of this client or any related entity, or was employed in such a role.
- 4) I or my immediate family members including spouse and dependents do not have a direct or indirect financial interest in this audit client or any related entity.

<sup>1</sup> This form should be completed at the engagement planning stage by each of the audit team members





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- 5) I or my immediate family members have not served as a trustee or as an executor over any interest that has or is committed to acquire a direct or material indirect financial interest in this client or any related entity.
- 6) I or my immediate family members do not have any loans, other than those extended under arms length basis and within the ordinary course of business with this client or any related entity or any shareholder, chief executive officer, senior executive officer or director thereof.
- 7) I do not have a close personal relationship with a director, executive officer or any employee of the client or related entity that is in a position to exert direct and significant influence over the financial statements.
- 8) I am not an employee of this client or any related party and I will not entertain an offer of employment with this client or a related entity during my office term.
- 9) I further confirm that if the above circumstances change during the engagement period, I will notify the audit manager or the client any such changes in a timely manner.
- 10) I signed under the table below that I am in compliance with independence rules listed from No.1 to 9 hereinabove and I will comply with independence rule No. 9, hereinabove. Otherwise, I will be legally responsible.







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No.	Name of Engagement Team Member	Designation/ Engagement Role	Signature
1			
2			
3			
4			
5			
6			
7			





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**Annex II: External Audit Team Members’ Fit and Proper Declaration Form**

Name of the audit firm: \_\_\_\_\_

Name of the audit team member: \_\_\_\_\_

Engagement Role: \_\_\_\_\_

**Specific Tests to Assess Fit and Proper Criteria**

Please answer “YES”/”NO” questions and sign accordingly.

No	Items	Yes	No
1.	Have you been insolvent or declared bankrupt by a court?		
2.	Have you been convicted by the court for any criminal offence, fraud/forgery, financial crime or other illegal activities?		
3.	Have you been a defaulter of any Microfinance Institution or other financial institution?		
4.	Have you been a defaulter of any tax?		
5.	Have you ever been subject to any proceeding of a disciplinary or criminal nature, or notified of any impending proceedings or of any investigation, which might lead to such proceedings?		
6.	Have you, or any business in which you have had controlling interest or have exercised significant influence, been investigated, suspended or criticized by a regulatory or professional body, a court, whether publicly or privately?		





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No	Items	Yes	No
7.	Have you ever been associated, in ownership or management capacity, with a company, partnership or other business association whose license revoked, withdrawn or terminated?		
8.	Have you ever contravened any of the requirements and standards of a regulatory body, professional body, government or its agencies?		
9.	Have you ever been a director, partner, or otherwise involved in the management, of a business that has gone into receivership, insolvency or liquidation while you have been connected with that business or within one year after that connection?		
10.	Have you ever been dismissed, asked to resign or resigned, from employment or from a position of trust, fiduciary appointment or similar for negligence, incompetence or mismanagement?		
11.	Have you ever been disqualified from acting as director or serving in a managerial capacity?		
12.	Have you ever been diagnosed as being mentally ill or unstable?		
13.	Do you have reasons to believe that any of your close relatives or business associates, if subject to the above tests, would have responded as "Yes" to any of the above questions?		

I hereby declare that to the best of my knowledge and belief the statements made and the information supplied in this questionnaire hereinabove and the attachments are correct and that there are no other facts that are relevant for assessing my fitness and propriety;





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I understand that the client may seek additional information from any third parties it deems necessary in view of my fit and proper test; and I undertake to bring to the attention of the Engagement Partner/Manager and/or a Client any matter which may potentially affect my status as being a fit and proper person as and when they arise.

Name\_\_\_\_\_

Signature\_\_\_\_\_

Date: \_\_\_/\_\_\_/\_\_\_

**Annex III: Information and Documents Required for Approval of a Newly Appointed or Re-appointed External Auditor**

**A) Profile/s of External Auditor/s**

1. Name of the Microfinance Institution  
:\_\_\_\_\_
2. Date of application: \_\_\_\_\_
3. Name of the external auditor \_\_\_\_\_
4. Name of the external auditor’s partner (if any)\_\_\_\_\_
5. Type of appointment: First appointment \_\_\_\_\_Re-appointment for 2<sup>nd</sup> time  
\_\_\_\_\_Re-appointment for 3<sup>rd</sup> time: \_\_\_\_\_
6. Address of the external auditor
  - City/Town: \_\_\_\_\_
  - Sub-city: \_\_\_\_\_





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- Woreda \_\_\_\_\_
- Kebele: \_\_\_\_\_
- Telephone: \_\_\_\_\_
- P.O. Box: \_\_\_\_\_
- E-mail: \_\_\_\_\_
- House No: \_\_\_\_\_

**B) Documents Required to be submitted**

- 1) Application letter;
- 2) Copy of board of directors meeting minutes and annual general meeting minutes of shareholders showing approval of the appointment of the external auditor;
- 3) Proposed contract or audit engagement letter to be signed;
- 4) “Independence confirmations” and “fit and proper declarations”;
- 5) Renewed trade license and renewed professional license provided by AABE;
- 6) Curriculum vitae of the proposed audit team members including audit certifications if any;
- 7) The name, qualification and experience of the audit manager in this specific audit;
- 8) Details of the audit firm’s and audit team members experience in auditing a Microfinance Institution or other financial institutions;
- 9) Details of any existing business relationships between the external auditor or its partners or its staff with the Microfinance Institution;
- 10) Copy of the license to practice auditing, including for each partner;
- 11) Taxpayer registration number, and tax clearance certificate;
- 12) A copy of certificate from AABE that the audit firm does not have any record of disciplinary action taken against unethical and unprofessional conduct;
- 13) Certificate of good conduct from police for the auditor and all audit team members;
- 14) Copy of ID card or Passport of all audit team members;





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- 15) In case of re-appointment, a Microfinance Institution may not submit some of the above documents which have already been submitted previously; and
- 16) The National Bank may require verification of any information submitted by the Microfinance Institution for the purpose of approval of the external auditor.
- 17) In addition, the National Bank may require other information it considers necessary.

