

United Nations Development Programme
Office of Audit and Investigations



**SPECIMEN TERMS OF REFERENCE FOR AUDITS
OF NGO AND NIM PROJECTS**

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INTRODUCTION

Throughout this document the term "implementing partner" is used to refer to the institution designated to manage the project. Where the project is nationally implemented (NIM), this will refer to a government institution. Where the project is NGO executed, this will refer to an NGO. The term "government co-ordinating authority" refers to the government institution, which is the official UNDP counterpart.

This specimen Terms of Reference (TOR) is intended to provide guidance to UNDP country offices and to the government implementing partner (IP) (or NGO) in agreeing to the terms of reference for the projects managed by governments (or NGOs). These audits are under the responsibility of the UNDP country office.

This specimen TOR has been revised to highlight requirements in the audit services required (Part E and Annex 1) as well as areas to be covered in the audit report and management letter (Part F and Annex 3), as follows:

- Auditors must certify, express an opinion, and quantify the net financial impact on each of the following:
 - (i) UNDP Statement of Expenditure - the CDR - for the period 1 January to 31 December 2009
 - (ii) Statement of Cash position reported by the project as at 31 December 2009
 - (iii) Statement of assets and equipment as at 31 December 2009
- Auditors must indicate the risks associated with their findings and provide a categorization by risk: High, Medium, or Low.
- Auditors must provide a classification of possible causes of the audit findings.
- Auditors must provide the monetary value of the Net Financial Impact of the qualification if the audit opinion on the CDR is Qualified, Adverse or Disclaimer.

Country offices must ensure the audit services are adequately covered as specified in the present TOR and Combined Delivery Reports (CDRs) are duly certified by the Implementing Partners and Auditors and signed by UNDP CO Management and attached to the audit reports; the same applies for the Statement of Cash and Statement of Assets and Equipment. If the project does not hold any assets of equipment or there is no cash at hand or bank account, the auditors must clearly indicate this in the opinion page and certify it.

Annex 1 to these TOR provides the audit services required or standard scope of audit.

Annex 2 describes the qualifications of an auditor and may help in the process of selecting auditors. Where the TOR is being supplied to a short list of firms as part of a request for proposals (RFP) and the firms short listed have been pre-qualified, then the list of qualifications would not be needed.

Annex 3 is a sample of audit report that needs to be submitted by the auditor. A management letter needs to be attached to the audit report.

Annex 4 provides a definition of audit opinions

Annex 5 defines the three risk categories of audit findings

Annex 6 provides the classification of possible causes of audit findings

Annex 7 provides a template sample of certified prior year updated action plan (Y2008) that need to be uploaded in CARDS – Revised form

Annex 8 provides a Template for audit data and observations for Y2009 audits that auditors need to submit and the CO copy paste in CARDS the information – new annex

Annex 9 provides guidance on formulating audit observations and recommendations– new annex

Annex 10 provides guidance on Audit Materiality (SAS 220) – new annex

What follows is the proposed structure with guidance on the contents of the TOR that need to be communicated to the NGO/NIM auditors by the UNDP country office.

A. Background

The background section of the TOR should include a broad description of the project(s) in the context of its contribution to achieving the goals of the government entity. The auditor should understand the "purpose for which the funds are intended" in the context of project objectives as well as in terms of the specific budget for the project. It should include a general description of the roles of UNDP, the government entity, and the implementing partner with respect to the management and oversight of the project.

This section should indicate that the TOR is directed to the audit of special purpose financial statements, which are referred to as Combined Delivery Reports (CDR).

Finally, the section should include the list of projects identified for auditing.

B. Project Management

This section should contain a description of the government entity and the implementing partner including the physical address, phone numbers, fax numbers, websites and general e-mail addresses. Other details would include:

- An organization chart
- A list of senior officers together with their contact details
- A list of the contact persons responsible for accounting, financial management and internal audit together with phone numbers and email addresses
- A description of the project including the project budget by major expenditure categories and the sources of all funding for the project.

C. Consultations with concerned parties

This section should describe the requirements for consultations. For example, prior to the start of audit work the auditor will be required to consult with the UNDP country office, the government counterpart, and the implementing partner for each project. Further, upon completion of the draft audit report and management letter, the auditor will be required to meet with the UNDP country office and the government entity co-ordinating authority to debrief them on its major findings from the audit and its recommendations for future improvements as well as to seek their feedback thereon.

D. Description of Financial Reports (UNDP CDR) to be audited

This section should include a description of the CDR and supporting schedules (see below). The country office should also include the statement of cash position and the statement of assets and equipment, with year-end inventory listing and a description of the inventory should be included.

Description of the Combined Delivery Report and Supporting Schedules

The report to be audited is referred to as the Combined Delivery Report (CDR). This report is prepared by UNDP, using an in-house accounting software package called ATLAS. The CDR serves as the official financial statement that **must** be certified by the auditors. Project financial statements, if certified, **must** reconcile to the expenditure appearing in the CDR and must be attached to the audit report. As described in more detail below, the CDR combines expenditures from three disbursement sources for a calendar year. The three disbursement sources include:

1. Implementing partner (either Government or NGO)

UNDP procedures require that where funds are advanced to the executing agency, the agency must submit to the UNDP country office, on a quarterly basis, a financial report including: (1) the status of the advance; (2) a list of the disbursements made since the previous financial report; and (3) a request

for a new advance. The UNDP country office enters the disbursements in ATLAS through the year as the financial reports are received. These implementing partner disbursements are recorded in the *Government* expenditure column in the CDR.

2. *UNDP (country office, headquarters and other country offices)*

Disbursements made by UNDP from its own bank accounts are entered in ATLAS by the UNDP country office. These UNDP disbursements are recorded in the *UNDP* expenditure columns in the CDR. These disbursements may be classified as either *direct payments* or *UNDP support services*. This distinction, while very important for audit purposes, is not apparent from the CDR and can only be provided by the UNDP country office as a supporting schedule. A brief description of each category is provided below.

- a) **Direct Payments** - This is where the implementing partner is responsible for the expenditure but requested UNDP to effect payment to the vendor/consultant on its behalf. The implementing partner is accountable for the disbursement and maintains all supporting documentation. UNDP simply effects payments on the basis of properly authorised requests and gives the implementing partner a copy of the related disbursement voucher as evidence that payment was made.
- b) **UNDP Support Services** - This is where the government and UNDP have agreed that UNDP will provide support services to the project and signed a Letter of Agreement. These support services must be described in the Letter of Agreement. UNDP is fully responsible and accountable for these expenditures and, accordingly, maintains all supporting documentation for the disbursement. This expenditure is outside the scope of audit and, therefore, will not be reviewed by the auditors. This scope limitation should not be used as a reason for issuing a qualified audit opinion on the CDR.

3. *UN agencies*

The UN agency reports its expenditures to UNDP and to the government. The UNDP country office enters the expenditures in ATLAS. These UN agency expenditures are recorded in the *UN Agencies* expenditure column in the CDR.

At the end of the year, after receiving the fourth quarter financial report from the implementing partner and the year-end expenditure report from the UN agency, UNDP prepares the CDR and submits it to the implementing partner for signature. UNDP will provide the auditor with the signed CDR together with the following supporting documentation.

1. The quarterly financial reports submitted by the implementing partner.
2. A list of the direct payments processed by UNDP at the request of the implementing partner.
3. A list of the disbursement made by UNDP as part of support services provided to the implementing partner.
4. The UN agency expenditure statement for the year.
5. Relevant financial reports that show expenditure of GFATM sub-recipients for the year which need to be reconciled to the CDR expenditure

E. Audit Services Required

The scope of the audit services required should be sufficiently clear to properly define what is expected of the auditor but not in any way that restricts the audit procedures or techniques the auditor may wish to use to form an opinion. It should specify at least the following:

- A definition of the entity or the portion of an entity that is subject to audit. This will normally be the project office whether located within a government department or in a separate location.
- That the audit will be carried out in accordance with either ISA¹ or INTOSAI² auditing standards.

¹ International Standards of Auditing (ISA) published by the International Auditing Practices Committee of the International Federation of Accountants

- That the audit period is 1 January to 31 December of the year YYYY.
- That the scope of the audit is limited to the implementing partner expenditures, which are defined as including: (1) all disbursements listed in the quarterly financial reports submitted by the implementing partner; and (2) the direct payments processed by UNDP at the request of the implementing partner.
- That the auditor is required to verify the mathematical accuracy of the CDR by ensuring that the expenditures described in the supporting documentation (the quarterly financial reports, the list of direct payments processed by UNDP at the request of the government) are reconciled to the expenditures, by disbursing source, in the CDR.
- That the auditor is required to state in the audit report the amount of expenditures excluded from the scope of the audit because they were made by UNDP as part of direct support services and the amount of total expenditures excluded because they were made by a UN agency. (Please refer to Section D-2(b) above. This scope limitation is not a valid reason for the auditors to issue a qualified audit opinion on the CDR.)
- That the auditor is required to state in the audit report if the audit was not in conformity with any of the above and indicate the alternative standards or procedures followed.
- That the auditor is required to express an opinion as to the overall financial situation of the project for the period 1 January to 31 December YYYY and will certify:
 1. The statement of expenditure (CDR) for the period from 1 January to 31 December YYYY;
 2. The statement of cash position reported by the projects as at 31 December YYYY; and
 3. The statement of assets and equipment held by the project as at 31 December YYYY.
- That the auditor is required to, as applicable, report in monetary value, the net financial impact of any audit qualification (negative opinion: qualified, adverse, disclaimer) on the statement of expenditure (CDR) where applicable.
- That the auditor/audit firm is required to submit a draft audit report by dd/mm/yyyy and a final signed audit report with signed UNDP statements by dd/mm/yyyy_____ 2010.

Note: Audit opinions must be one of the following: (a) qualified (negative), (b), unqualified (favourable), (c) adverse (negative), or (d) disclaimer (negative). If the audit opinion is other than “unqualified” (favourable) the audit report **must** describe both the nature and amount of the possible effects on the financial statements. The report should also make a reference to the section of the management letter with regard to the related audit observation number and the action taken or planned to be taken to address the issues underlying the qualification. A definition of audit opinions is provided in Annex 4.

F. The Audit Report and Management Letter

The TOR should clearly indicate the expected contents of the audit report and management letter and the topics/areas to be covered by the auditors.

a. Audit Report

The audit report should clearly indicate the auditor’s opinion (Refer to Annex 3 for a sample Audit Report). This would include at least the following:

- That it is a special purpose and confidential report.

² International Organization of Supreme Audit Institutions

- The audit standards that were applied (INTOSAI standards, ISAs, or national standards that comply with one of these in all material respects).
- The period covered by the audit opinion
- The amount of expenditure audited
- The amount of the net financial impact of the qualification on the CDR, when applicable.
- The reason(s) resulting in the issuance of a qualified, adverse or disclaimer opinion (the reasons should be also included in the management letter as an audit observation(s))
- The scope limitation (description and value) for those transactions that are the responsibility of UNDP (as part of support services) or a UN agency. Important to note: Such scope limitation should not be reason for a qualified audit opinion as such transactions would be, in general, excluded from the audit scope.
- Whether the UNDP Combined Delivery Report (CDR) - for the period from 1 January to 31 December YYYY is adequately and fairly presented and whether the disbursements are made in accordance with the purpose for which funds have been allocated to the project;
- Whether the statement of assets and equipment is fairly and adequately presented as at 31 December YYYY (the equipment on hand is cumulative since the project's inception and thus does not constitute only those items purchased during a given year).
- Whether the statement of cash position reported by the project is fairly and adequately presented as at 31 December YYYY.

b. Management Letter

The management letter should be attached to the audit report and cover the following topics/issues:

- A general review of a project's progress and timeliness in relation to progress milestones and the planned completion date, both of which should be stated in the project document or Annual Work Plan (AWP). This is not intended to address whether there has been compliance with specific covenants relating to specific performance criteria or outputs. However, general compliance with broad covenants such as implementing the project with economy and efficiency might be commented upon but not with the legal force of an audit opinion.
- An assessment of a project's internal control system with equal emphasis on: (i) the effectiveness of the system in providing the project management with useful and timely information for the proper management of the project; and (ii) the general effectiveness of the internal control system in protecting the assets and resources of the project.
- A description of any specific internal control weaknesses noted in the financial management of the project and the audit procedures followed to address or compensate for the weaknesses. Recommendations to resolve/eliminate the internal control weaknesses noted should be included.

The management letter should also include the following:

- Effective audit observations/recommendations (guidelines in Annex 9)
- The categorization of audit observations by risk severity: High, Medium, or Low. Definitions of these categories are given in Annex 5.
- The classification of possible causes of the audit observations. Definitions of these causes are given in Annex 6.

- Management comments/response to audit observations and recommendations (project management and/or UNDP, as applicable).
- Indication of observations that affect the audit opinion (when qualified, adverse or disclaimer opinion is given)

More detailed guidance for the above general categories is provided below.

Review of project progress

As part of the general review of project progress, specific steps could include the following:

- Review annual and quarterly work plans, quarterly and annual financial reports, and requests for direct payments and assess in terms of their timeliness and their compliance with the project document or the AWP, and the UNDP Programme Operations Policies and Procedures (POPP) on Results Management.
- Review the annual project report prepared by the implementing partner and assess in terms of compliance with UNDP guidelines and whether the implementing partner met its responsibilities for monitoring described in the project document or AWP.
- Review whether the decisions and/or recommendations of the above activities have been followed through by the implementing partner.
- Review the pace of project progress and comment on the causes for delays.
- Comment on whether implementation services of the UN Agency(s) were provided in line with the project document or AWP.

Assessment of internal control

The auditor is required to conduct a general assessment of internal controls according to established internal control standards. An example of established internal control standards is available from the Organization of Supreme Audit Institutions (INTOSAI). The INTOSAI standards are intended for use by government managers to use as a framework to establish effective internal control structures. For further information, the INTOSAI *Guidelines for Internal Control Standards* can be found on the INTOSAI Web site www.intosai.org. An overview of the standards can be found in the UNDP Contact tool (Chapter 6).

In addition to the above general assessment, additional specific steps could include the following:

- Review expenditures made by the implementing partner and assess whether they are in accordance with the project document, AWP and budgets; and are in compliance with the UNDP POPP on Results Management.
- Review the process for procurement/contracting activities and assess whether it was transparent and competitive.
- Review the use, control and disposal of non-expendable equipment and assess whether it is in compliance with UNDP POPP on Results Management; and also whether the equipment procured met the identified needs and whether its use was in line with intended purposes.
- Review the process for recruiting project personnel and consultants and assess whether it was transparent and competitive.
- Review the implementing partner accounting records and assess their adequacy for maintaining accurate and complete records of receipts and disbursements of cash; and for supporting the preparation of the quarterly financial report.
- Review the records of requests for direct payments and ensure that they were signed by authorised government officials.

Recommendations for improvement

Recommendations should be directed to a specific entity so there is no confusion regarding who is responsible for implementation. The response of the entity should be included in the management letter, immediately following the recommendation.

Also, the auditor may wish to comment on "good practices" (if any) that were developed by the implementing partner that should be shared with other project personnel.

Available Facilities and Right of Access

There should be a description of the nature and the location of all records belonging to the project. This list should specify those records kept at the implementing partner's headquarters and those that are located at other offices.

The TOR should state that the auditor would have full and complete access at any time to all records and documents (including books of account, legal agreements, minutes of committee meetings, bank records, invoices and contracts etc.) and all employees of the entity. The auditor should be advised that he/she has a right of access to banks, consultants, contractors and other persons or firms engaged by the project management. If an auditor may not have unrestricted access to any records, person or location during the course of the audit, this restriction should be clearly defined, with reasons, in the TOR.

ANNEX 1: AUDIT SERVICES REQUIRED

The scope of audit services shall cover the overall management of the project's implementation, monitoring and supervision. The audit work should include the review of work plans, progress reports, project resources, project budgets, project expenditure, project delivery, recruitment, operational and financial closing of projects (if applicable) and disposal or transfer of assets. To this effect, the scope of the audit shall cover the following areas as they are performed at the level of the project:

Human resources

The audit work shall cover the competitiveness, transparency and effectiveness of the recruitment and hiring of personnel and include performance appraisal, attendance control, calculation of salaries and entitlements, payroll preparation and payment, and management of personnel records.

Finance

The audit work shall cover the adequacy of the accounting and financial operations and reporting systems. These include budget control, cash management, certification and approving authority, receipt of funds, and disbursement of funds, recording of all financial transactions in expenditure reports, records maintenance and control.

Procurement

The audit work shall cover the competitiveness, transparency and effectiveness of the procurement activities of the project in order to ensure that the equipment and services purchased meet the requirement of either the government (or NGO) or UNDP and include the following:

- As applicable, delegations of authorities, procurement thresholds, call for bids and proposals, evaluation of bids and proposals and approval/signature of contracts and purchase orders
- Receiving and inspection procedures to determine the conformity of equipment with the agreed specifications and, when applicable, the use of independent experts to inspect the delivery of highly technical and expensive equipment
- Evaluation of the procedures established to mitigate the risk of purchasing equipment that do not meet specifications or is later proven to be defective
- Management and control over the variation orders.

The audit work in the area of procurement shall also cover the use of consulting firms and the adequacy of procedures to obtain fully qualified and experienced personnel and assessment of their work before final payment is made.

Asset Management

The audit work shall cover equipment (typically vehicles and office equipment) purchased for use of the project. The procedures for receipt, storage, and disposal shall also be reviewed.

Cash Management

The audit work shall cover all cash funds held by the project and review procedures for safeguarding of cash.

General Administration

The audit work shall cover travel activities, vehicle management, shipping services, office premises and lease management, office communications, and records maintenance.

Information System

The audit work shall cover the information and communication systems and the control and security of equipment and data.

Note: The above scope shall cover those transactions performed at the level of the project to include direct payments made by the UNDP country office at the request of the project.

Scope Limitation

Transactions/actions that are performed by the UNDP office at the request and on behalf of the project (i.e. UNDP support services) are **not** to be included in the audit scope. **Important note:** Such scope limitation should not be a reason for issuing a qualified (negative) audit opinion by the auditors. Please refer to Section D., 2(b) for additional information.

ANNEX 2: QUALIFICATIONS OF AN AUDITOR

If included as part of a Request for Proposal, this section will need to be modified to take into consideration whether the firms invited to propose have already been pre-qualified.

The TOR should state that the auditor must be completely impartial and independent from all aspects of management or financial interests in the entity being audited. The auditor should not, during the period covered by the audit nor during the undertaking of the audit, be employed by, serve as director for, or have any financial or close business relationships with any senior participant in the management of the entity. It may be appropriate to remind an auditor of any existing statutory requirements relating to independence and to require an auditor to disclose any relationship that might possibly compromise his/her independence.

The auditor should be experienced in applying either ISA or INTOSAI audit standards, whichever is applicable for the audit. The auditor must employ adequate staff with appropriate professional qualifications and suitable experience with ISA or INTOSAI standards, including experience in auditing the accounts of entities comparable in size and complexity to the entity being audited.

Curriculum vitae (CVs) should be provided to the client by the principal of the firm of auditors who would be responsible for signing the opinion, together with the CVs of managers, supervisors and key personnel proposed as part of the audit team. It would be appropriate to indicate required/minimum professional qualifications necessary for the senior auditors/principals responsible for the audit. CVs should include details on audits carried out by the applicable staff, including ongoing assignments indicating capability and capacity to undertake the audit.

ANNEX 3: SAMPLE AUDIT REPORT

Auditor's report to:

**The National Project Director and
The Resident Representative**

a) Certification of UNDP Statement of Expenditure - Combined Delivery Report (CDR)

We have audited the accompanying UNDP Statement of Expenditure ("**the CDR**") of the UNDP award and project number _____ [*Atlas award and project number*] for the period 1 January 2009 to 31 December 2009. The CDR is the responsibility of the UNDP CO. Our responsibility is to express an opinion on the CDR based on our audit.

We conducted our audit in accordance with International Standards of Auditing (ISA). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the CDR is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the CDR. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the CDR. We believe our audit provides a reasonable basis for our opinion.

In our opinion, **the CDR presents fairly (unqualified (positive audit opinion))**, in all material respects the expenditure of _____ [*insert amount in US\$*] incurred by the project and audited by us for the period 1 January 2009 to 31 December 2009 in accordance with UNDP accounting requirements.

Or (qualified - a negative audit opinion)

In our opinion, **the CDR, except for** the reasons indicated above in paragraphs (1), (2), (3), etc., presents fairly in all material respects the expenditure of _____ [*insert amount in US\$*] incurred by the project which we have audited for the period 1 January 2009 to 31 December 2009 in accordance with UNDP accounting requirements. The total **net financial impact** of this qualified opinion is _____ [*insert amount in US\$*].

Or (disclaimer - a negative audit opinion)

We were **unable to obtain sufficient appropriate audit evidence** and accordingly are unable to express an opinion on the statement of expenditure of _____ [*insert amount in US\$*] incurred by the project and audited by us for the period 1 January 2009 to 31 December 2009. The total **net financial impact** of this disclaimer opinion is _____ [*insert amount in US\$*]. **Note:** *The total amount indicated should be the amount of the CDR expenditure.*

Or (adverse - a negative audit opinion)

We noted material differences between _____ and the statement of expenditure. As such, we **do not express an opinion** on the statement of expenditure, of _____ [*insert amount in US\$*] incurred by the project and audited by us for the period 1 January 2009 to 31 December 2009. The total **net financial impact** of this adverse opinion is _____ [*insert amount in US\$*].

b) Certification of Statement of Assets and Equipment

We have audited the accompanying Statement of Assets and Equipment ("**the statement**") of the UNDP project number _____ [*Atlas award and project #*] as at 31 December 2009. The statement is the responsibility of the management of the project. Our responsibility is to express an opinion on the statement based on our audit.

We conducted our audit in accordance with International Standards of Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the statement. We believe our audit provides a reasonable basis for our opinion.

In our opinion, the statement of assets and equipment presents fairly (**unqualified/favourable**), in all material respects the inventory balance of the project amounting to _____ [insert amount in US\$] as at 31 December 2009 in accordance with UNDP requirements.

c) Certification of Statement of Cash Position

We have audited the accompanying Statement of Cash Position ("the statement") of the UNDP project number _____ [Atlas award and project #] as at 31 December 2009. The statement is the responsibility of the management of the project. Our responsibility is to express an opinion on the statement based on our audit.

We conducted our audit in accordance with International Standards of Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the statement. We believe our audit provides a reasonable basis for our opinion.

In our opinion, the statement of cash position presents fairly (unqualified (positive audit opinion)), in all material respects the cash balance of the project amounting to _____ [insert amount in US\$] as at 31 December 2009 in accordance with UNDP requirements.

This report is intended solely for the information and use of UNDP and the Government of XYZ Country (or NGO).

Date of issuance: _____

AUDITOR'S NAME (Please print): _____

AUDITOR'S SIGNATURE: _____

STAMP AND SEAL OF AUDIT FIRM: _____

AUDIT FIRM ADDRESS: _____

AUDIT FIRM TEL. NO. _____

Note: Audit opinions must be one of the following: (a) qualified, (b), unqualified, (c) adverse, or (d) disclaimer. If the audit opinion is other than "unqualified" the audit report must describe both the nature and amount of the possible effects on the financial statements (**NET FINANCIAL IMPACT**). A definition of audit opinions is provided in Annex 4.

ANNEX 4: DEFINITION OF AUDIT OPINIONS

Unqualified (Clean or positive) Opinion

An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

Qualified Opinion – a negative audit opinion

A qualified opinion should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management, or limitation on scope is not so material and pervasive as to require an adverse opinion or a disclaimer of opinion. A qualified opinion should be expressed as being 'except for' the effects of the matter to which the qualification relates.

Disclaimer of opinion – a negative audit opinion

A *disclaimer of opinion* should be expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and accordingly is unable to express an opinion on the financial statements.

Adverse – a negative audit opinion

An *adverse opinion* is expressed by an auditor when the financial statements are significantly misrepresented, misstated, and do not accurately reflect the expenditure incurred and reported in the financial statements (CDR, statement of cash, statement of assets and equipment).

An *adverse opinion* is expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.

ANNEX 5: CATEGORIZATION OF AUDIT FINDINGS BY RISK SEVERITY

High	Action that is considered imperative to ensure that UNDP is not exposed to high risks (i.e. failure to take action could result in major consequences and issues).
Medium	Action that is considered necessary to avoid exposure to significant risks (i.e. failure to take action could result in significant consequences).
Low	Action that is considered desirable and should result in enhanced control or better value for money.

ANNEX 6: CLASSIFICATION OF POSSIBLE CAUSES OF AUDIT FINDINGS

1. Lack of/or inadequate policies/procedures/guidelines
2. Lack of/or inadequate guidance/supervision at the project level
3. Inadequate guidance/monitoring at UNDP country office level
4. Lack of/or insufficient resources (specify: financial, human or, technical resources)
5. Inadequate planning
6. Inadequate training
7. Human error
8. Intentional overriding of internal controls
9. Inadequate management structure

ANNEX 7: TEMPLATE FOR NGO/NIM AUDITORS TO REVIEW AND SIGN THE UPDATED ACTION PLANS FOR PRIOR YEAR AUDIT OBSERVATIONS AND RECOMMENDATIONS

Award No.:		Project No.:		Opinion Type:									
Obs No	Observation	Recommendation	Audit Area	Audit Cause	Risk Severity	Proj/CO Mngt Comments	Action(s) Planned	Target Impl. Date	Action Unit	Person Respsble. for Action	Updated Status	Actual Impl. Date	Description of Status Update
Award No.:		Project No.:		Opinion Type:									
Obs No	Observation	Recommendation	Audit Area	Audit Cause	Risk Severity	Proj/CO Mngt Comments	Action(s) Planned	Target Impl. Date	Action Unit	Person Respsble. for Action	Updated Status	Actual Impl. Date	Description of Status Update
Award No.:		Project No.:		Opinion Type:									
Obs No	Observation	Recommendation	Audit Area	Audit Cause	Risk Severity	Proj/CO Mngt Comments	Action(s) Planned	Target Impl. Date	Action Unit	Person Respsble. for Action	Updated Status	Actual Impl. Date	Description of Status Update

<p>Implementing Partner (IP)</p> <p>Signature of IP Official: _____</p> <p>Name and title (print): _____</p> <p>Date: _____</p>	<p>UNDP Country Office</p> <p>Signature of UNDP Official: _____</p> <p>Name and title (print): _____</p> <p>Date: _____</p>	<p>Government Auditors/Audit Firm</p> <p>Signature of Audit firm Official: _____</p> <p>Name and title (print): _____</p> <p>Date: _____</p> <p>Stamp and Seal of audit firm: _____</p>
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Note: The values for the "Updated Status" could be: Implemented, In Progress, Not Implemented, N/A or Withdrawn. "N/A" means not applicable and would be used if there is an overall change in a project's working environment that makes last year's audit observation no longer applicable. For example, the project has been closed. Another example for using "N/A" is a project that had its own bank account and last year' audit recommendation called for the need to perform monthly bank reconciliation. However the following year, the auditor notes

that the bank account has been closed. "Withdrawn" would be used if there is an overall change in a project's working environment that makes last year's audit observation and recommendation no longer valid. "Withdrawn" is very rarely used.

ANNEX 8: TEMPLATE FOR AUDIT DATA AND OBSERVATIONS

The information in the four tables below should be completed by the NGO/NIM auditors and signed. The CO can obtain the electronic version of the word document and copy and paste the information in CARDS for each award/project audit report.

Table 1 - Template for NGO/NIM auditors to report on the audit of the UNDP CDR

UNDP Combined Delivery Report (CDR) as at 31 December 2009								
1	Award No.	Project No.	Amount audited and certified (US\$)	Audit opinion (unqualified, qualified, adverse, disclaimer)	Total amount of qualification of audit opinion (if qualified, adverse or disclaimer opinion)	Total amount of Net financial impact (NFI) of qualification of audit opinion (if qualified, adverse or disclaimer opinion)	Reason(s) for qualification of audit opinion and breakdown of NFI amount (US)	Observation(s) that had impact on qualification of audit opinion (list observation number(s) and page of audit report/management letter)

Table 2 - Template for NGO/NIM auditors to report on the audit of the statement of cash position

Statement of Cash Position					
Award No.	Project No.	Value of Cash Position Statement as at 31 December 2009 (US\$)	Audit Opinion - Statement of Cash Position	Total amount of qualification - Statement of Cash Position (US\$)	Total amount of Net financial impact (NFI) of qualification of audit opinion - Statement of Cash Position (US\$)

Table 3 – Template for NGO/NIM auditors to report on the audit of the statement of assets and equipment

Statement of assets and equipment					
Award No.	Project No.	Value of Assets and equipment as at 31 December 2009 (cumulative from project start date) (US\$)	Audit Opinion - Statement of Assets and Equipment	Total amount of qualification on the Statement of assets and equipment (US\$)	Total amount of Net financial impact (NFI) of qualification of audit opinion on Statement of assets and equipment (US\$)

Table 4 - Template for NGO/NIM auditors to report on audit observations and recommendations

Award No.	Project No.	Observ. No	Audit Observation	Recommendation	Audit Area	Audit Cause	Risk Severity	Project/CO Mngmt. Comments

Name and position of Auditor: _____

Signature of Auditor: _____

Date: _____

Name and stamp of Audit Firm: _____

ANNEX 9: GUIDANCE ON FORMULATING AUDIT OBSERVATIONS

Parts of the note that follows are from an article in the *Internal Auditor*, April, 1999 by Brian M. Schwartz. The purpose of this note is to provide guidance on formulating audit observations and recommendations that are effective.

Effective audit observations should consist of 5 common elements:

- 1) Condition;
- 2) Criteria;
- 3) Cause;
- 4) Effect, potential impact or Risk; and
- 5) Recommendation.

Items 1 to 4 must be part of what constitutes an audit observation. Below are helpful tips on each of these areas.

CONDITION

The "Condition" refers to a conclusion, problem, or opportunity noted during the audit review. It directly addresses a control objective or some other standard of performance. Sample condition statements include:

- "The appropriate individual did not authorize this document."
- "The account has not been reconciled for three months."
- "The process can be streamlined to save six hours per day."

When documenting the condition, it is important to include the necessary level of detail in the description of the problem. Someone who has not participated in the audit, but has some basic understanding of the subject matter or function, should be able to comprehend any condition statement.

CRITERIA

This element describes the standard being used as the benchmark for evaluation. In other words, it depicts the ideal condition. The criteria may reference a specific policy, procedure, or government regulation. At other times, the criteria may simply be a matter of common sense or prudent business practice. For example, a criteria statement might state that "Per policy #1234, all loans greater than \$100,000 must be approved by the board of directors;" or "Payroll processing responsibilities should be segregated to control the authorization of master file changes."

CAUSE

As the name suggests, the cause statement explains why the identified problem occurred in the first place. The cause is probably the most critical attribute of the finding form. Without determining why the condition occurred, the situation cannot be properly remedied.

In documenting the cause, the auditor should identify the underlying reason behind the problem. A surface explanation that fails to uncover the root cause will not lead to an effective recommendation.

In addition, a quote from an appropriate individual could serve as the cause statement, i.e. why the condition has occurred. Some audit managers consider only a cause statement from management as appropriate, while other prefer a statement from the individual who actually performs the respective task. It is usually preferred to obtain both points of view, since such an approach is more likely to identify the root cause of the problem.

Possible Causes

In addition to explaining the and giving details about the “Cause” in the text of an audit observation, UNDP requires that the auditor also summarizes the cause statement in the audit report by using one of the following 9 pre-established cause statements:

1. Lack of/or inadequate policies/procedures/guidelines
2. Lack of/or inadequate guidance/supervision at the project level
3. Inadequate guidance/monitoring at UNDP country office level
4. Lack of/or insufficient resources (specify: financial, human or, technical resources)
5. Inadequate planning
6. Inadequate training
7. Human error
8. Intentional overriding of internal controls
9. Inadequate management structure

EFFECT, POTENTIAL IMPACT OR RISK

The effect statement describes the particular risk that could exist (the potential impact or risk) or that has already existed (the effect) as a result of the condition or problem. Basically, it answers the question, "so what?" Effect statements often discuss the potential for loss, noncompliance, or customer dissatisfaction created by the problem.

Management is likely to zero in on the information provided in this aspect of the audit observation, as it allows them to see how the condition will negatively impact their activities. As a result, the effect statement often serves as the catalyst for a positive change.

One note of caution is in order - the risk suggested by the effect statement should not be overblown or exaggerated. While auditors are responsible for pointing out risks associated with control breakdowns, the effect statement should remain reasonable, plausible and should not be worded as if the world were coming to an end. If auditees are to take the audit observation seriously and respect what an auditor has to say, an auditor talks about risk in realistic, not exaggerated, terms.

Risk Levels

In addition to explaining the and giving details about the “Effect, potential impact or risk” in the text of an audit observation, UNDP requires that the auditor also identifies the risk level in the audit report by using one of the following 3 pre-established risk levels:

High	Action that is considered imperative to ensure that UNDP is not exposed to high risks (i.e. failure to take action could result in major consequences and issues).
Medium	Action that is considered necessary to avoid exposure to significant risks (i.e. failure to take action could result in significant consequences).
Low	Action that is considered desirable and should result in enhanced control or better value for money.

RECOMMENDATION

This aspect suggests how the situation might be remedied. An effective recommendation directly relates to and targets the cause. It isn't enough to state in general terms that management should fix the problem; the recommendation statement should also explain how remediation is to be achieved.

A good recommendation maintains the proper balance between the risk presented and the cost to control it. Before making a recommendation, the auditor should consider the following questions:

Does the recommendation solve the problem and eliminate or reduce the risk?

- Can the recommendation be implemented within the current environment?
- Is the recommendation cost-effective?
- Will the recommendation act as a temporary bandage or a permanent solution?

Examples of effective recommendations include monthly or quarterly physical inventories of all assets and equipment with reconciliation to appropriate records.

ADDITIONAL TIPS

Whenever possible, similar findings should be combined into one form so that the case for implementing the recommendation is strengthened.

Playing devil's advocate can be an extremely helpful exercise. After completing the audit observation and recommendation, auditors should place themselves in the auditee's shoes and challenge/question the validity of the issue. If the issue cannot stand up to this exercise, it probably should not be included in the audit report.

ANNEX 10: SAS 220 - GUIDANCE ON AUDIT MATERIALITY

Below are some highlights from the Statement of Auditing Standards (SAS) 220 – Audit Materiality. These are meant to provide guidance to the auditors in determining the materiality of observations for reporting purposes and as they might affect the audit opinion. The auditors should refer to SAS 220 for more details.

The purpose of the SAS is to establish standards and provide guidance on the concept of materiality and its relationship with audit risk.

Auditors should consider materiality and its relationship with audit risk when conducting an audit (SAS 220.1)

A matter is material if knowledge of the matter would reasonably influence the economic decisions of users taken on the basis of the financial statements. Materiality may be considered in the context of the financial statements as a whole, any individual statements within the financial statements or individual items included within the financial statements.

Materiality depends on the nature and size of the item or error judged in the particular circumstances. Since materiality has both qualitative and quantitative aspects, it is not capable of any general mathematical definition.

Auditors should plan and perform the audit so as to provide them with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement and give a true and fair view. (SAS 220.2)

The assessment of what is material is a matter of professional judgement.

Auditors would consider the possibility of misstatements of relatively small amounts that, cumulatively, could have a material effect on the financial statements. For example, an error in a month end procedure could be an indication of a potential material misstatement if that error is repeated each month.

In evaluating the fair presentation of the financial statements, auditors should assess whether the aggregate of uncorrected misstatements that have been identified during the audit is material (SAS 220.4).