

Section 3: Terms of Reference (TOR)

TABLE OF CONTENTS

	Page
A. Background	2
B. Project Management.....	3
C. Consultations with concerned parties.....	5
D. Description of Financial Reports (UNDP CDR) to be audited.....	6
E. Audit Services Required	7
F. The Audit Report and Management Letter	8
ANNEX 1: AUDIT SERVICES REQUIRED.....	11
ANNEX 2: QUALIFICATIONS OF AN AUDITOR.....	12
ANNEX 3: SAMPLE AUDIT REPORT.....	13
ANNEX 4: DEFINITION OF AUDIT OPINIONS.....	17
Annex 5: International Standard for Audit (ISA) 450 and 710	18
ANNEX 6: PRIORITY OF AUDIT OBSERVATIONS AND RECOMMENDATIONS	19
ANNEX 7: TEMPLATE FOR NGO/NIM AUDITORS TO REVIEW AND SIGN THE UPDATED ACTION PLANS FOR PRIOR YEAR AUDIT OBSERVATIONS AND RECOMMENDATIONS.....	20
ANNEX 8: TEMPLATE FOR AUDIT DATA AND OBSERVATIONS	21
ANNEX 9: GUIDANCE OF FORMULATING AUDIT OBSERVATION.....	23
ANNEX 10: SAS 220 - GUIDANCE ON AUDIT MATERIALITY	25

A. Background

The Moldova Energy and Biomass Project (MEBP), a 4 year 14.56 million EUR project (2011-2014), funded by the European Commission and UNDP and implemented by UNDP, aims to contribute to a more secure, competitive and sustainable energy production in the Republic of Moldova through targeted support to the most viable and readily available local source of renewable energy, namely biomass from agricultural wastes.

The MEBP **project purpose** is to increase the use of renewable energy technology significantly through fuel switching and energy efficiency. The project primarily focuses on improving heating comfort levels in rural public sector buildings including schools and community centres by using readily available waste straw supplied from local agricultural enterprises. The project will also stimulate local markets for improved household heating, industrial cogeneration, and biomass-based briquetting, as well as raise local capacity in the biomass sector, and promote the benefits of biomass energy and the project.

MEBP Project outputs

The project consists of four inter-related outputs as follows:

Output 1: Municipal biomass heating and fuel supply markets established;

Output 2: Foundations laid for establishment of efficient household heating, industrial cogeneration and biomass briquetting markets;

Output 3: Capacity for local growth of biomass markets at regional and local levels is built;

Output 4: The opportunities and benefits of biomass energy for Moldova are well known locally, and visibility of project results promoted.

The project has adopted the Harmonized Approach to Cash Transfer (HACT) modality as part of the joint efforts by the UN agencies towards greater ownership of project activities and results by the national counterparts. Hence some project outputs, more specifically Output 1 and Output 2, are managed through direct cash transfer modality and are implemented by Energy Efficiency Agency (EEA) and Project Implementation Unit 2 KR (PIU 2KR), specifically:

Activity 1.2. Fuel cycle facilitated through leasing/hire-purchase mechanism for local fuel suppliers (EEA & PIU 2KR)

Activity 2.1. Market solutions for high efficiency affordable rural biomass household heating identified and piloted (EEA)

Activity 2.2. Industrial cogeneration using biomass fuel demonstrated (EEA)

Adoption of the new harmonized approach by UNDP was a further step in implementing the Rome Declaration on Harmonization and Paris Declaration on Aid Effectiveness that call for a closer alignment of development aid with national priorities and needs. The approach allows development efforts to focus more on strengthening of the national capacities for management and accountability, with a view to gradually shift to utilizing national systems. It is envisaged that HACT will help further shape the capacity development interventions and provide support to new aid modalities. Before applying the modality, HACT micro-assessments of the EEA and PIU 2KR had been conducted in order to evaluate the adequacy of the implementing partner's financial management systems and internal controls.

The main conclusion resulted from these assessments is the confirmation of the fact that both institutions, EEA and PIU 2KR, are eligible and have adequate financial and procurement capacities to implement the proposed activities, form and efficiently manage the Revolving Fund for financing acquisition of baling and briquetting equipment for biomass fuel production. In case of EEA, there were also identified some areas for capacity development and specifically the need to organize on the job trainings for the staff hired to implement the activities mentioned above, as part of MEBP Project. .

This ToR is directed to the audit of the activities implemented within the Moldova Energy and Biomass Project applying National Implementation Modality, including through HACT, by Responsible Parties (EEA, PIU 2KR) in the period 1 January – 31 December 2013.

The list of activities identified for auditing:

- Activity 1.2. "Fuel cycle facilitated through leasing/hire-purchase mechanism for local fuel suppliers" implemented by PIU 2KR and EEA;
- Activity 2.1 "Market solutions for high efficiency affordable rural biomass household heating identified" implemented by EEA,
- Activity 2.2. "Industrial cogeneration using biomass fuel demonstrated" implemented by EEA.

B. Project Management

The Ministry of Economy (MoE) is the central body which promotes the State's policy in the area of energy efficiency and use of renewable energy sources and conducts its activity in conformity with the Moldovan Constitution and Laws, Parliament Resolutions, President Decrees, Government Resolutions, and other normative documents, international treaties and agreements to which the Republic of Moldova is a party. The entity is subordinated directly to the Moldovan Government.

The Ministry of Economy is the government institution responsible for the implementation of the project. The project is nationally implemented (NIM), in line with the Standard Basic Assistance Agreement (SBAA, 1992) and the Country Programme Action Plan (CPAP, 2007) signed between the UNDP and the Government of Moldova.

A HACT micro-assessment of financial management capacity of the Implementing Partner, the Ministry of Economy, was undertaken in 2009 and concluded with an overall "low" risk rating.

According to the Project Document and the approved Annual Work Plan, project activities:

- 1.2 "Fuel cycle facilitated through leasing/hire-purchase mechanism for local fuel suppliers" (Output 1),
- 2.1 "Market solutions for high efficiency affordable rural biomass" (Output 2),
- 2.2 "Industrial cogeneration using biomass fuel demonstrated" (Output 2),

are implemented by the Ministry of Economy applying the Direct Cash Transfer mechanism in line with the Harmonized Approach to Cash Transfer (HACT). The Ministry of Economy entered into a written agreement with parties responsible for the implementation of the project activities mentioned above (Responsible Parties). The direct cash transfer implies that funds for implementation are transferred to the Responsible Parties based on authorized requests from the Ministry of Economy.

The advances to the Responsible Parties are done by UNDP upon receipt of the financial report, i.e. the Funding Authorization and Certificate of Expenditures (FACE form). Accounting and financial reporting on the project activities mentioned above is the responsibility of the Implementing Partner in collaboration with the Responsible Parties.

For the purpose of implementing the Activity 1.2: "Fuel cycle facilitated through leasing/hire-purchase mechanism for local fuel" of the MEBP, UNDP will transfer to the Government of Moldova, being represented by the MoE, in the period 2011 – 2014, a total amount of €1.000.000 (one million Euro) for the development of a sustainable biomass fuel supply chain and, in particular, to supply a seed capital to develop a Revolving Fund (hereinafter referred as "the Revolving Fund") for the lease / hire purchase of equipment and machinery needed by local entrepreneurs for producing solid biomass based fuel and supply it to the installed boilers within the framework of MEBP.

For the purpose of implementing the Activity 2.1: "Market solutions for high efficiency affordable rural biomass household heating identified and piloted" of the MEBP, UNDP will transfer to the Government of Moldova, being represented by the MoE, in the period 2011 – 2014, a total amount of USD 1,314,373 for the implementation of a subsidy mechanism meant to stimulate the market for high efficiency biomass heating systems suitable for rural areas.

For the purpose of implementing the Activity 2.2: "Industrial cogeneration using biomass fuel demonstrated" of the MEBP, UNDP will transfer to the Government of Moldova, being represented by the MoE, in the period 2011-2014, a total amount of USD 326,554 for the implementation of a co-generation plant within agriprocessing company in Moldova.

For the implementation of the activities mentioned above, UNDP disbursed to the Responsible Parties (EEA, PIU 2KR), in the period 1 January – 31 December 2013, a total amount of 8,294,902.00 MDL as follows:

- 1,952,925.00 MDL were disbursed to PIU 2KR for the implementation of Activity 1.2;
- 6,341,977.00 MDL were disbursed to the EEA for the implementation of Activities 1.2., 2.1., 2.2.

The scope of the audit shall limit only to the disbursements made by UNDP to the Responsible Parties (EEA, PIU 2KR) in the period 1 January – 31 December 2013, as specified above.

The detailed description of activities mentioned above, the implementation modalities and mechanisms are contained in UNDP/Moldova Annex to Project Document and Responsible Party Agreements, which will be provided to the auditors.

Contact details of the Implementing Partner - Ministry of Economy are as follows:

Physical address: 1 Piata Marii Adunari Nationale str., MD-2033, mun. Chisinau

Phone numbers: (373 22) 250500, (373 22) 250107

Fax numbers: (373 22) 234064

Web site: <http://www.mec.gov.md>

General email address: mineconcom@mec.gov.md

Leadership of the MoE:

1. Valeriu Lazar, Deputy Prime Minister, Minister of Economy, tel: (373 22) 250107 and email: valeriu.lazar@mec.gov.md
2. Tudor Copaci, Deputy Minister of Economy, tel: (373 22) 250591
3. Oleg Izboreanu, Director of Energy Efficiency& Renewable Energy Sources Department, tel: (37322) 250665

Contact details of the Responsible Party – Energy Efficiency Agency

Physical address: 1 Alecu Russo str, 10th floor, MD-2068, Chisinau

Phone number: (373 22) 499444

Fax number: (373 22) 311001

Web site: www.aee.md

General email address: info@aee.md

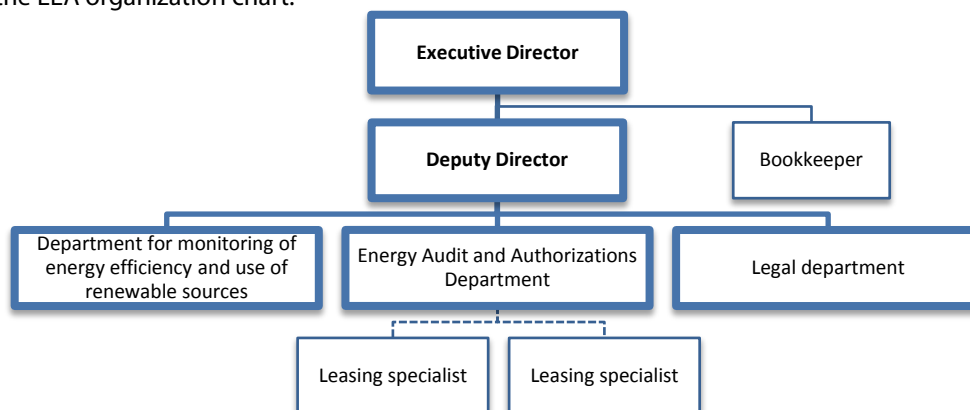
Leadership of the EEA:

1. Mihai Stratan, Director, tel: (373 22) 310332, email: mihail.stratan@aee.md
2. Calin Negura, Deputy Director, tel: (373 22) 310332, email: calin.negura@aee.md
3. Denis Tumuruc, Head of the Energy Efficiency and Renewable Energy Sources Monitoring Service, tel: (373 22) 310012 (ext.3), email: denis.tumurcu@email.com

The contact person responsible for accounting, financial management and internal audit:

1. Eugenia Baciu, Chief Accountant, tel: (373 22) 310012 (ext. 2), email: baciu.eugenia@mail.ru

Below is the EEA organization chart:



Contact details of the Responsible Party – PIU 2KR

Physical address: 18 Calea Basarabiei str., MD-2023, Chisinau

Phone numbers: (373 22) 278463, (373 22) 549881

Fax numbers: (373 22) 278463, (373 22) 549881

Web site: www.2kr.md

General email address: office@2kr.moldnet.md

Leadership of the PIU 2KR:

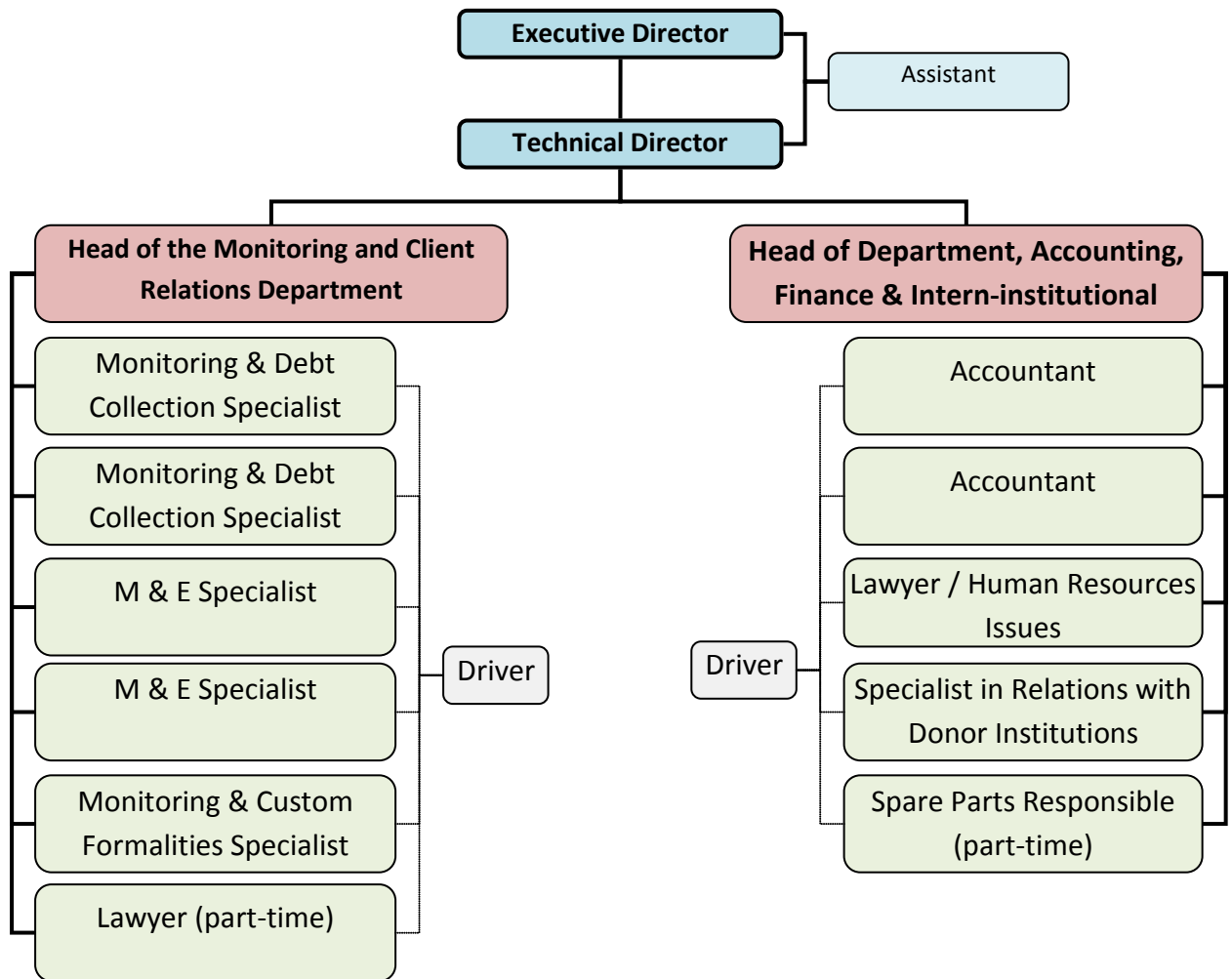
1. Valeriu Bulgari, Executive Director, tel: (373 22) 27 84 63, email: office@2kr.md
2. Prisacaru Dan, Specialist in Relations with Donor Institutions, tel: (373 22) 278463, fax: (373 22) 549881, e-mail: dprisacaru@2kr.md.

The contact persons responsible for accounting, financial management and internal audit:

3. Stela Lisii, Accountant, tel: (373 22) 54 69 19, email: stela@2kr.md;

4. Vasile Paladi, Chief Accountant, tel: (373 22) 27 84 63, email: paladi@2kr.md;

Below is the organization chart of the PIU 2KR:



C. Consultations with concerned parties

The consultations within the process of audit are mandatory. The requirements for consultations are the following:

- Prior to the start of work, the auditor should meet with the UNDP Office to hear their concerns/proposals/recommendations and with MEBP management to get a broader description of activities subject to audits and their implementation modalities and mechanisms;
- Prior to the start of work, the auditor should meet with senior officials of the implementing partner (Ministry of Economy) and Responsible Parties (EEA, PIU 2KR), to understand how cooperation within the project is managed, and any issues of concern they may have.
- Upon completion of the draft report, the auditor should first hold a debriefing meeting with Responsible Parties and MEBP representatives, to discuss findings and recommendations for future improvements, as well as to seek their feedback thereon.
- The auditor will then meet with the UNDP office and the Implementing Partner to discuss the draft report prior to its finalization.

The auditor should have full and complete access at any time to all records and documents (books of account, legal agreements, minutes of committee meetings, bank records, invoices and contracts, etc.) and all employees of the Responsible Parties in connection with the implementation of aforementioned activities. The auditor should be advised that he/she has a right of access to banks and depositories, consultants, contractors and other persons or firms engaged by the partner/project.

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

The auditors must certify, express an opinion and quantify the net financial impact on each of the following:

- (i) UNDP statement of Expenses(the CDR) , Government expenses column, for the period 1 January to 31 December 2013;
- (ii) Statement of Cash position reported by the Responsible Parties as of 31 December 2013 related to the implementation of Project Activities 1.2., 2.1., 2.2.;
- (iii) Statement of assets and equipment reported by the Responsible Parties as of 31 December 2013 related to the implementation of Project Activities 1.2., 2.1., 2.2..

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 its Enterprise Resource Planning system called ATLAS. The CDR serves as the official financial statement that must be certified by the auditors, namely the column "Govt Exp". As described in more detail below, the CDR combines expenses from three disbursement sources for a calendar year. However, the scope of work only relates to the column aforementioned and should not extend to any other amounts, internal controls or internal procedures. The section below refers to the changes applied to the CDR since the adoption of the International Public Sector Accounting Standards (IPSAS) by UNDP effective 1 January 2012. The three disbursement sources include:

1. Implementing partner (either Government or NGO)

UNDP procedures require that where funds are advanced to the responsible party, it 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. The disbursements reported by the responsible parties are recorded in the *Government expenses* 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. The UNDP disbursements are recorded in the *UNDP expense* column 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 expenses 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 authorized requests and gives the implementing partner a copy of the related disbursement voucher as evidence that payment was made. This expense 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. Where there is no signed Letter of Agreement for UNDP Support Services or a CPAP with the respective clauses of the LOA for UNDP Support Services, the audit should also cover the UNDP expenditures under CO support.
- 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 expenses and, accordingly, maintains all supporting documentation for the disbursement. These expenses are 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. Where there is no signed Letter of Agreement for UNDP Support Services or a CPAP with the respective clauses of the LOA for UNDP Support Services, the audit should also cover the UNDP expenses under CO support.

3. UN agencies

The UN agency reports its expenses to UNDP and to the government. The UNDP country office enters the expenses in ATLAS. These UN agency expenses are recorded in the UN Agencies

expense column in the CDR. Note: Any expenses under this column are outside the auditors' scope of audit. UN entities are audited under their own audit arrangement, following the 'Single Audit' principle and are not covered by UNDP's audit regime.

At the end of the year, after receiving the fourth quarter financial report from the implementing partner and responsible parties and the year-end expense report from the UN agency, UNDP prepares the CDR and submits it to the implementing partner and responsible parties 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 and responsible parties (FACE forms)
2. MEBP Project Document
3. Annex to the MEBP Project Document
4. Responsible Parties Agreements
5. MEBP Budget for the Action
6. MEBP Annual Work Plan for 2013
7. UNDP Framework for cash transfers to Implementing Partner.

Note: With the adoption of the International Public Sector Accounting Standards (IPSAS) by UNDP effective 1 January 2012, the CDR is now prepared in two sections; the first section containing the total expense information as explained above (by Implementing Partner, UNDP and UN Agencies) and the second section showing the following information:

- Outstanding NEX advances
- Un-depreciated Fixed Assets
- Inventory
- Prepayments
- Commitments

In addition to the verification of the total expenses reflected in the CDR column "Govt Exp", the auditors will now be responsible for validating certain areas of the information appearing in the Funds Control section of the CDR as shown above and specifically Outstanding NEX advances.

Outstanding NEX advances – If there is an amount appearing under this category, the auditors should reconcile it to the cash at hand at the activity level. In principle, this amount should represent the balance of any advances transferred to the responsible parties minus the total expenses reported in the quarterly financial reports (FACE forms) submitted by the implementing partner and responsible parties to UNDP.

Un-depreciated Fixed Assets – Any amounts appearing under this category would be provided for informational purposes only and, therefore, the auditors would not be required to undertake any audit procedures related to the verification or validation of same.

Inventory – Any amounts appearing under this category would be provided for informational purposes only and, therefore, the auditors would not be required to undertake any audit procedures related to the verification or validation of same.

Prepayments – Any amounts appearing under this category would be provided for informational purposes only and, therefore, the auditors would not be required to undertake any audit procedures related to the verification or validation of same.

Commitments – Any amounts appearing under this category would be provided for informational purposes only and, therefore, the auditors would not be required to undertake any audit procedures related to the verification or validation of same.

E. Audit Services Required

The scope of the audit services required is to audit the activities implemented within the Moldova Energy and Biomass Project applying National Implementation Modality, including through HACT, and specifically the following activities implemented by Responsible Parties (EEA, PIU 2KR) and Implementing Partner through HACT:

- Activity 1.2. Fuel cycle facilitated through leasing/hire-purchase mechanism for local fuel suppliers
- Activity 2.1. Market solutions for high efficiency affordable rural biomass household heating identified and piloted
- Activity 2.2. Industrial cogeneration using biomass fuel demonstrated.

The auditor will take into consideration the following:

- The activities mentioned above implemented by responsible parties, Energy Efficiency Agency,

- located at 1 Aleco Russo str., block A1, 10th floor, Chisinau, MD 2068, Moldova and Project Implementation Unit 2KR, located at 18, Calea Basarabiei str., Chisinau, Moldova, are subject to the audit.
- The audit will be carried out in accordance with either ISA¹ or INTOSAI² auditing standards.
 - The audit period is 1 January to 31 December of the year 2013.
 - The scope of the audit is limited to the responsible parties' expenses in connection with activities mentioned above, which are defined as all disbursements listed in the quarterly financial reports (FACE forms) submitted by the implementing partner.
 - 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.
 - The auditor is required to express an opinion as to the overall financial situation of the project activities implemented by Responsible Parties (EEA, PIU 2KR) for the period 1 January to 31 December 2013 and will certify:
 1. The statement of expenses (**the CDR**), column "Govt exp" for the period from 1 January to 31 December 2013;
 2. The statement of cash position (cash and bank balances for the Project Activities 1.2., 2.1., 2.2) reported by the Responsible Parties as of 31 December 2013; and
 3. The statement of assets and equipment held by the Responsible Parties as of 31 December 2013 in connection with the implementation of Project Activities 1.2., 2.1., 2.2.
 - The auditor is required to, as applicable, report in monetary value, the net financial impact of any modified audit opinion (modified opinions can be qualified, adverse, or disclaimer) on the statement of expenses (Combined Delivery Report (CDR)) where applicable.
 - The auditor/audit firm is required to submit a draft audit report by 05/04/2014 and a final signed audit report with signed UNDP statements by 20/04/2014.

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 and conclusively correct the issues underlying the qualification. A definition of audit opinions is provided in Annex 4.

F. The Audit Report and Management Letter

Audit Report

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

- That it is a special purpose and confidential report
- The audit standards that were applied (ISAs, or national standards that comply with one of the ISA in all material respects)
- The period covered by the audit opinion
- The amount of expenses audited
- The amount of the net financial impact of the modified audit opinion on the CDR, if modified
- The reason(s) resulting in the issuance of a modified audit opinion, qualified, adverse or disclaimer opinion (the reason(s) must 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 direct CO support services to NIM) 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 2013, "Govt Exp" column is adequately and fairly presented and whether the

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

² International Organization of Supreme Audit Institutions

disbursements are made in accordance with the purpose for which funds have been allocated to the project

- (a) A Financial Audit to express an opinion on the responsible parties' financial statements that includes:
- Expression of an opinion on whether the statement of expenses presents fairly the expense incurred by the responsible parties over a specified period and that the expenses incurred were: (i) in conformity with the approved activities' budgets; (ii) for the approved purposes of the activities; (iii) in compliance with the relevant regulations and rules, policies and procedures of the Government or UNDP; and (iv) supported by properly approved documents and other supporting documents. The Combined Delivery Report (CDR) is the mandatory and official statement of expenses to be certified. Other forms of statement of expenses that may be prepared by a project office are not accepted.
 - Expression of an opinion on the value and existence of the Responsible Parties' statement of assets and equipment as at a given date. This statement must include all assets and equipment available as of 31 December 2013, and not only those purchased in a given period. Where a NGO/NIM project does not have any assets or equipment, it will not be necessary to express such an opinion, however, this should be disclosed in the audit report.
 - Express an opinion on the value and existence of the cash held by the Responsible Parties as at a given date, i.e. 31 December 2013, where a dedicated bank account is opened and used by the Responsible Parties solely for the cash transactions of a NGO/NIM project/activity. The Audit Firm is required to express an opinion on the Statement of Cash Position where a dedicated bank account for the NGO/NIM project has been established and/or the Responsible Parties hold petty cash. Where the Responsible Parties do not hold any cash, this should be disclosed in the audit report.

The Financial Audit will be conducted in accordance with International Standards of Auditing (ISA).

- (b) An audit to assess and express an opinion on the responsible parties' internal controls and systems.

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

- A general review of the progress and timeliness of activities implemented by Responsible Parties (EEA, PIU 2KR) 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 activities with economy and efficiency might be commented upon but not with the legal force of an audit opinion.
- An assessment of Responsible Parties' internal control system with equal emphasis on: (i) the effectiveness of the system in providing the activities' management with useful and timely information for the proper management of the activities; and (ii) the general effectiveness of the internal control system in protecting the assets and resources in connection with the implementation of activities.
- A description of any specific internal control weaknesses noted in the financial management of the activities 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 audit of internal controls and systems will be conducted in accordance with the International Standards for Audit (ISA).

The management letter should also include the following:

- Effective audit observations/recommendations (guidelines in Annex 10)
- The categorization of audit observations by risk severity: High, Medium, or Low. Definitions of these categories are given in Annex 6.
- The classification of possible causes of the audit observations.
- Management comments/response to audit observations and recommendations (activities 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 activities' progress

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

- Review annual and quarterly work plans, quarterly and annual financial and progress reports, and Funding Authorization and Certificate of Expenditures (FACE) forms, including all supporting documents, and assess in terms of their timeliness and their compliance with the project document or the AWP, and the UNDP Framework for Cash Transfers to Implementing Partner.
- Review whether the decisions and/or recommendations of the above activities have been followed through by the responsible parties.
- Review the pace of project progress and comment on the causes for delays.

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 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 the expenses made by the responsible parties and assess whether they are in accordance with the project document, AWP and budgets.
- Review the process for procurement/contracting activities and assess whether it was transparent and competitive.
- Review the process for recruiting personnel and consultants in relation to the implementation of activities and assess whether it was transparent and competitive.
- Review the responsible parties' 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 reports and FACE forms.
- Review the records of FACE forms and ensure that they were signed by authorized government officials and direct payments to vendors were authorized by a designated official of the Responsible Parties.

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 and/or responsible parties 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 responsible parties related to activities implemented as part of MEBP and kept at the responsible parties' headquarters and those that are located at other offices.

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.

ANNEX 1: AUDIT SERVICES REQUIRED

The scope of audit services shall be in accordance with International Standards for Audit (ISA) and 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 expenses, 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 projects implemented by responsible parties:

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 expense reports, records maintenance and control.

Procurement

The audit work shall cover the competitiveness, transparency and effectiveness of the procurement activities of the responsible parties 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;
- 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 IT systems, and records maintenance.

Scope Limitation

Transactions/actions that are performed by the UNDP office at the request and on behalf of the project (i.e. UNDP direct support services to NIM) where there is a signed Letter of Agreement (LOA) are **not** to be included in the audit scope. **Important note:** Such scope limitation should not be a reason for issuing a modified audit opinion by the auditors. Please refer to Section D.

ANNEX 2: QUALIFICATIONS OF AN AUDITOR

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.

The auditor should be experienced in applying ISA audit standards. The auditor must employ adequate staff with appropriate professional qualifications and suitable experience with ISA 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.

Minimum qualification requirements

Firm requirements

- Mandatory experience with International Organizations, similar Programme / Projects
- Proven experience in applying ISA, INTOSAI and national audit standards
- Principal Auditor with minimum 10 years of professional experience
- Valid license for conducting audits

Team Leader (Audit Manager)

- Education - bachelor degree (or higher) in finance or other relevant field
- Minimum 5 years of professional experience in conducting audits
- Proven experience in applying ISA and national audit standards
- Available audit certificate
- Fluency in English

Team members/experts

- Education - bachelor degree (or higher)
- Minimum 2 years of professional experience
- Proven experience in applying ISA and national audit standards
- Fluency in Romanian and Russian

ANNEX 3: SAMPLE AUDIT REPORT

Auditor's report to:

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

Format for Financial Certifications

I. Sample Certification for Statement of Expenses (UNDP CDR)

REPORT OF THE INDEPENDENT AUDITORS TO UNDP [insert project name] (Refer to ISA 700)

We have audited the accompanying Statement of expenditure (“the statement”) of the project [insert project and project number(s)], [insert official title of project] for the period [insert period covered].

Management is responsible for the preparation of the statement for <name/title> project and for such internal control as management determines is necessary to enable the preparation of a statement that is free from material misstatement, whether due to fraud or error.

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

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

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

Clean Opinion: Option 1: (Unmodified)

In our opinion, the attached statement of expense presents fairly, in all material respects, the expense of [insert amount in US\$] incurred by the project [insert official title of project] for the period [insert period covered] in accordance with agreed upon accounting policies [if needed add - and the note to the statement] and were: (i) in conformity with the approved project budgets; (ii) for the approved purposes of the project; (iii) in compliance with the relevant UNDP regulations and rules, policies and procedures; and (iv) supported by properly approved vouchers and other supporting documents.

Modified Opinions (Refer to ISA 705)

Option 2: (Qualified opinion)

In our opinion, the attached statement of expense, except for the reasons indicated above in paragraphs (1), (2), (3), etc., [there should be a separate Basis for Qualified Opinion Paragraph where the basis for Qualified opinion is clearly explained] presents fairly in all material respects the expense of [insert amount in US\$] incurred by the project [insert official title of project] for the period [insert period covered] in accordance with UNDP accounting policies [if needed add: and the note to the statement].

Option 3: (Adverse opinion)

In our opinion, based on the significance of the matter discussed in paragraph (1), (2), (3) etc. [there should be a separate Basis for Adverse Opinion Paragraph where the basis for adverse opinion is clearly explained] the statement of expense does not give a true and fair view of the expense of [insert amount in US\$] incurred by the project [insert official title of project] for the period from [insert period covered].

Option 4: (Disclaimer of opinion)

Because of the significance of the matter described in paragraph (1),(2), (3), etc. [there should be a separate Basis

for Disclaimer of Opinion Paragraph where the basis for disclaimer of opinion is clearly explained] we were unable to obtain sufficient appropriate evidence to provide a basis for an audit opinion. Accordingly we are unable to express an opinion on the statement of expense of [insert amount in US\$] incurred by the project [insert official title of project] and audited by us for the period from [insert period covered].

Emphasis of Matter [if applicable] (Refer to ISA 706)

We draw attention to Note [insert number] to the statement of expense which describes the uncertainty related to the [insert the issue]. Our opinion is not qualified in respect of this matter.

Auditor's Name and Signature

Date of the auditor's report

Auditor's address

II. Sample Certification for Statement of Assets (Refer to ISA 700)

We have audited the accompanying statement of assets ("the statement") of the project number [insert project and project number(s)], [insert official title of project] as at [insert date].

Management is responsible for the preparation of the statement for <name/title> project and for such internal control as management determines is necessary to enable the preparation of the statement that is free from material misstatement, whether due to fraud or error.

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

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

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

Option 1: (Unmodified)

In our opinion, the attached statement of assets presents fairly, in all material respects, the balance of inventory of the project [insert official title of project] amounting to [insert amount in \$US] as at [insert date].in accordance with UNDP accounting policies [if needed add: set out in the note to the schedule].

Modified Opinions (Refer to ISA 705) Option 2: (Qualified opinion)

In our opinion, the attached statement of assets, except for the reasons indicated above in paragraphs (1), (2), (3), etc., [there should be a separate Basis for Qualified Opinion Paragraph where the basis for Qualified opinion is clearly explained] presents fairly in all material respects the balance of inventory of [insert amount in US\$] incurred by the project [insert official title of project] as at [insert date] in accordance with agreed upon accounting policies [if needed add: set out in the note to the schedule].

Option 3: (Adverse opinion)

In our opinion, based on the significance of the matter discussed in paragraph (1), (2), (3) etc. [there should be a separate Basis for Adverse Opinion Paragraph where the basis for adverse opinion is clearly explained] the statement of assets does not give a true and fair view of the expense of [insert amount in US\$] incurred by the project [insert official title of project] and audited by us as at [insert date].

Option 4: (Disclaimer of opinion)

Because of the significance of the matter described in paragraph (1),(2), (3), etc. [there should be a separate Basis

for Disclaimer of Opinion Paragraph where the basis for disclaimer of opinion is clearly explained] we were unable to obtain sufficient appropriate evidence to provide a basis for an audit opinion. Accordingly we are unable to express an opinion on the statement of assets of [insert amount in US\$] incurred by the project [insert official title of project] and audited by us as at [insert date].

Emphasis of Matter [if applicable] (Refer to ISA 706)

We draw attention to Note [insert number] to the statement of assets which describes the uncertainty related to the [insert the issue]. Our opinion is not qualified in respect of this matter.

Auditor's Name and Signature

Date of the auditor's report

Auditor's address

III. Sample Certification of Statement of Cash Position (Statement of Cash Position is required only if there is separate bank account for each of the projects and/or petty cash) (Refer to ISA 700)

We have audited the accompanying statement of cash ("the statement") of the project number [insert project and project number(s)], [insert official title of project] as at XXX.

Management of <project name/title> project is responsible for the preparation of the statement for project and for such internal control as management determines is necessary to enable the preparation of a schedule that is free from material misstatement, whether due to fraud or error.

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

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

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

Option 1: (Unmodified)

In our opinion, the attached Statement of cash position presents fairly, in all material respects, the cash and bank balance of the UNDP project [insert official title of project] amounting to [insert amount in \$US] as at [insert date] in accordance with the UNDP accounting policies [if needed add: set out in the note to the statement].

Modified Opinions (Refer to ISA 705) Option 2: (Qualified opinion)

In our opinion, the attached statement of cash, except for the reasons indicated above in paragraphs (1), (2), (3), etc., [there should be a separate Basis for Qualified Opinion Paragraph where the basis for Qualified opinion is clearly explained] presents fairly in all material respects the cash and bank balance amounting to [insert amount in US\$] as at [insert date] in accordance with the UNDP accounting policies [if needed add: set out in the note to the statement].

Option 3: (Adverse opinion)

In our opinion, based on the significance of the matter discussed in paragraph (1), (2), (3) etc. [there should be a separate Basis for Adverse Opinion Paragraph where the basis for adverse opinion is clearly explained] the statement of cash does not give a true and fair view of the cash and bank balance of [insert amount in US\$] audited by us as at [insert date].

Option 4: (Disclaimer of opinion)

Because of the significance of the matter described in paragraph (1),(2), (3), etc. [there should be a separate Basis for Disclaimer of Opinion Paragraph where the basis for disclaimer of opinion is clearly explained] we were unable to obtain sufficient appropriate evidence to provide a basis for an audit opinion. Accordingly we are unable to express an opinion on the statement of cash in the amount of [insert amount in US\$] audited by us as at [insert date].

Emphasis of Matter [if applicable] (Refer to ISA 706)

We draw attention to Note X to the statement of cash which describe the uncertainty related to [give explanation of the uncertainty]. Our opinion is not qualified in respect of this matter.

Auditor's Name and Signature

Date of the auditor's report

Auditor's address

Date of issuance: _____

AUDITOR'S NAME (Please print): _____

AUDITOR'S SIGNATURE: _____

STAMP AND SEAL OF AUDIT FIRM: _____

AUDIT FIRM ADDRESS: _____

AUDIT FIRM TEL. NO. _____

<p>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 UNDP financial statement (CDR) (Amount of qualification/Net Financial Impact). A definition of audit opinions is provided in Annex 4.</p>
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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 modified (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 modified (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 modified (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 expenses incurred and reported in the financial statements (**UNDP 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: INTERNATIONAL STANDARD FOR AUDIT (ISA) 450 AND 710

Guidance on Reporting Prior Year Modified opinion not corrected

Following the International Audit Standard (ISA) 450 and ISA 710 that came into effect on December 2010 there is a requirement regarding a previous year modified audit opinion³ This audit standard requires that auditors, when expressing an opinion on this year's statements, to take into account the possible effect of a prior year modified opinion that has not been properly corrected or resolved.

Consequently, a previous year modified opinion that has not been properly resolved may cause the auditors to issue a modified opinion in their current year audit report. If proper attention is not paid to this aspect, the risk could be a significant accumulation of unresolved modified opinions from previous years that would lead the UN BoA to issue a modified audit opinion on UNDP financial statements.

³ A "modified" audit opinion means either a qualified opinion, a disclaimer opinion or an adverse opinion.

ANNEX 6: PRIORITY OF AUDIT OBSERVATIONS AND RECOMMENDATIONS

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

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

Implementing Partner (IP) Signature of IP Official: _____ Name and title (print): _____ Date: _____	UNDP Country Office Signature of UNDP Official: _____ Name and title (print): _____ Date: _____	Government Auditors/Audit Firm Signature of Audit firm Official: _____ Name and title (print): _____ Date: _____ Stamp and Seal of audit firm: _____
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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 project/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 2013							
1	Project No.	Output 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)	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				
Project No.	Output No.	Value of Cash Position Statement as at 31 December 2010 (US\$)	Audit Opinion - Statement of Cash Position	Total amount of qualification - 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				
Project No.	Output No.	Value of Assets and equipment as at 31 December 2013 (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\$)

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

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

Name and position of Auditor: _____

Signature of Auditor: _____ Date: _____

Name and stamp of Audit Firm: _____

ANNEX 9: GUIDANCE OF FORMULATING AUDIT OBSERVATION

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 four (4) common elements:

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

Items 1 to 3 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."

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 auditees' 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 judgment.

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).