

**United Nations Development Programme
Office of Audit and Investigations**



TERMS OF REFERENCE FOR HACT TRANSITIONAL AUDITS

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A. Background

This ToR is directed to the audit of the following 3 projects:

1. Moldova Energy and Biomass Project;
2. Supporting Moldova's National Climate Change Adaptation Planning Process Project;
3. Low Emission Capacity Building Programme.

A short description of each project is outlined below.

A.1. Moldova Energy and Biomass Project (MEBP)

The Moldova Energy and Biomass Project 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. It consists of 4 interrelated outputs: 1: Municipal biomass heating and fuel supply/technology markets established; 2: Foundations laid for establishment of efficient biomass-based household heating and heat supply markets established and private sector demand promoted; 3: Capacity for local growth of biomass markets at regional and local levels is built; and 4: The opportunities and benefits of biomass energy for Moldova are well known locally, and visibility of project results promoted.

End 2014, after 4 years of project implementation, based on highly satisfactory project performance, lessons learned and clearly identified gaps and additional needs to support further market consolidation, the project entered a second phase until end 2017 with additional funding of 9.41 million EUR allocated by the European Union in the framework of the Eastern Partnership Integration and Cooperation (EaPIC) programme.

The second phase will focus on development of local biomass market and general market consolidation of the biomass-related business through continued support to solid biofuel producers and support to local biomass boiler production and extension of Public Private Partnerships for establishing sustainable biomass based heating services. Support to installation of biomass heating systems will be further provided and extended to small and medium-sized towns, ATU Gagauzia and Taraclia district, and Transnistria region. To provide integrated energy saving and efficiency solutions to project sites, combined technology solar/biomass in public buildings will be developed and piloted.

The project is implemented under the National Implementation Mechanism (NIM). Thereunder selected activities will be implemented in line with the "Harmonized Approach to Cash Transfer" (HACT). HACT is a common operational framework of cash transfers to government and non-government institutions and is the UN system's response to strengthening national capacities for management and accountability, with a view to gradually shift to utilizing national systems in the context of Government's increasing interest towards expanding the role of public agencies in implementation of external assistance projects. More specifically it contributes to increasing national capacities to plan, manage, implement, monitor and account for results of programmes and policies as well as to enhance public financial management and procurement systems.

Hence some project activities, more specifically those under the Output 2, are managed through direct cash transfer modality and are implemented by Energy Efficiency Agency (EEA), through the Activity 2.1. Market solutions for high efficiency affordable rural biomass household heating identified and piloted" of MEBP's Project Document.

Accordingly to the Letter of Agreement between UNDP and Agency for Energy Efficiency, the activities implemented through HACT modality shall be implemented and managed by the Agency for Energy Efficiency as "Responsible Party" using the bank account of the Fund for Energy Efficiency as "Financial Party".

Before applying the modality, HACT micro-assessments of the EEA has 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 EEA is eligible and has adequate financial and procurement capacities to implement the proposed activities. 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.

A.2. Supporting Moldova's National Climate Change Adaptation Planning Process Project (NCCAP Project)

Supporting Moldova's National Climate Change Adaptation Planning Process Project (NCCAP Project) is a 4 year and 744,000 EUR project (2013-2017), funded by the Government of Austria and implemented by UNDP, aims to ensure that Moldova has a system and capacities in place for medium- to long term adaptation planning and budgeting with the overall aim to reduce vulnerability of the population and key sectors to the impacts of climate change.

The NCCAP project purpose is to support Moldova to put in place its National Adaptation Plan (NAP) process contributing to and building upon existing development planning strategies and processes and to implement priority adaptation actions.

The NCCAP project consists of 3 outputs as follows:

Output 1: Institutional and policy framework for medium- to long-term gender sensitive adaptation planning and budgeting in place;

Output 2: Institutional and technical capacities for iterative development of comprehensive NAP strengthened;

Output 3: Adaptation interventions in priority sectors implemented including demonstration projects at a local level to catalyze replication and upscaling.

A.3. Low Emission Capacity Building Programme (LECB)

The Republic of Moldova is one of 11 phase 2 countries participating in a collaborative Low Emission Capacity Building Programme focused on capacity building for climate change over a five-year period, with a total budget of 642,000 USD. In the Republic of Moldova the overall programme will strengthen national capacities to do the following: 1) Develop/establish greenhouse gas inventory management systems; 2) Formulate Nationally Appropriate Mitigation Actions (NAMAs) and/or low-emission development strategies (LEDS) in the context of national development; and 3) Design MRV systems to support implementation and evaluation of NAMAs and LEDS.

The project consists of three outputs, each with specific activities and actions that are aligned with the EU-UNDP Low Emission Capacity Building Programme and the Republic of Moldova's low emission development, climate and disaster resilient priorities and needs.

The following are the expected outputs:

Output 1: Robust institutionalized inventory systems have been established at a national level

Output 2: NAMAs have been formulated within the context of national development priorities

Output 3: MRV systems have been created to support implementation and evaluation of NAMAs and LEDS.

Both NCCAP and LECB projects have 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 the Climate Change Office (CCO), acts as responsible party on behalf of the Ministry of Environment, and is providing procurement, finance, human resources, technical and other services necessary to produce the outputs of the project.

Before applying the modality, HACT micro-assessment of the CCO 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 the assessment is the confirmation of the fact that CCO is eligible and has adequate financial and procurement capacities to implement the proposed project. There were also identified some areas for capacity development and specifically the need to improve the overall implementation capacities, financial and procurement capacities. In this sense, a detailed assurance plan was set up, including assurance activities like periodic on-site reviews of financial records, quarterly monitoring of the implementation, progress of the Annual Work Plan as well as yearly audits.

B. Project Management

B.1. Project Management for the Moldova Energy and Biomass Project

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 Ministry of Economy is the government institution responsible for the implementation of the MEBP 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.

According to the Project Document and the approved Annual Work Plan, the project activities: 2.1 "Market solutions for high efficiency affordable rural biomass household heating identified and piloted" (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 the party responsible for the implementation of the project activities mentioned above (Responsible Party). The direct cash transfer implies that funds for implementation are transferred to the Responsible Party based on authorized requests from the Ministry of Economy.

The advances to the Responsible Party 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 Party.

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 2015 – 2017, a total amount of 403,200 Euros (four hundred and three thousands two hundred Euros) for the implementation of a subsidy mechanism meant to stimulate the market for high efficiency biomass heating systems suitable for rural areas.

For the implementation of the activities mentioned above, UNDP disbursed to the Responsible Party (EEA), in the period 1 January – 31 December 2015, a total amount of **6,477,000 MDL**.

The detailed description of the activities mentioned above, the implementation modalities and mechanisms are contained in the MEBP Project Document and Responsible Party Agreement, 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:

- Octavian Calmic, Minister of Economy, tel: (373 22) 250107
- Valeriu Triboi, Deputy Minister of Economy, tel (373 22) 250601
- Oleg Izvooreanu, 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

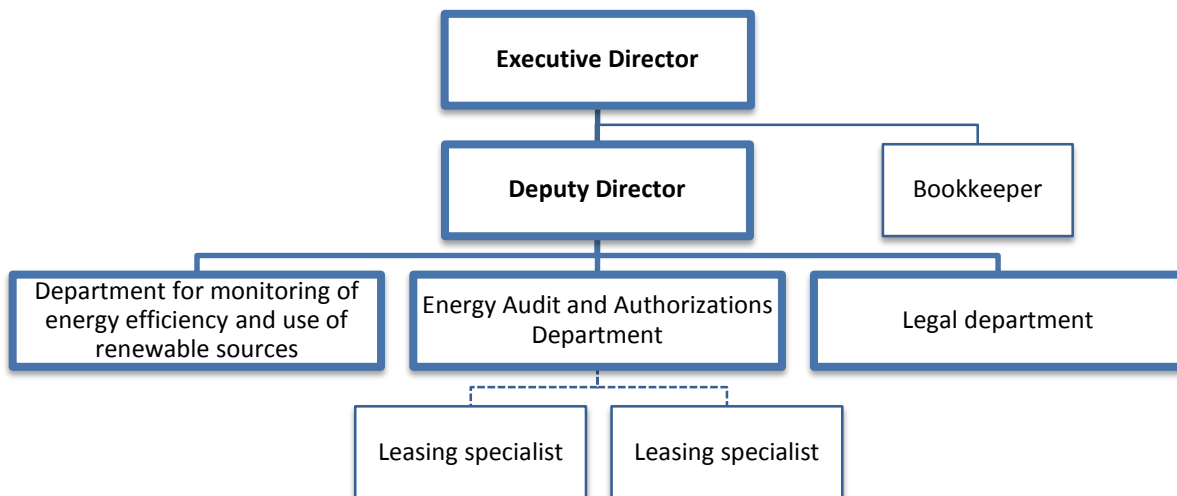
Leadership of the EEA:

- Mihai Stratan, Director, tel: (373 22) 310332, email: mihail.stratan@aee.md
- Denis Tumuruc, Deputy Director, tel: (373 22) 310332, email: denis.tumuruc@aee.md

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

- Eugenia Baciu, Chief Accountant, tel: (373 22) 310012 (ext. 2), email: bacieuugenia@mail.ru

Below is the EEA organization chart:



B.2. Project Management for “Supporting Moldova’s National Climate Change Adaptation Planning Process” (NCCAP) and “Low Emission Capacity Building Programme” (LECB) projects

The Ministry of Environment (MoEnv) is the central public authority with the mandate to work on climate change policy development and implementation; 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 Ministry of Environment is the government institution responsible for the implementation of both NCCAP and LECB projects. Both projects use the Direct Cash Transfer mechanism to transfer funds to the Responsible Party for the obligations and expenditures to be made by them in support of activities agreed by the Project Board in the Annual Work Plan. The direct cash transfer implies that funds for implementation are transferred to the Responsible Party based on authorized requests from the Ministry of Environment.

The advances to the Responsible Party 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 project activities is the responsibility of the Implementing Partner in collaboration with the Responsible Party.

For the implementation of the project activities, UNDP disbursed to the Responsible Party, CCO, in the period 1 January – 31 December 2015, the amounts as indicated below:

- Within NCCAP project – advances in the amount of **248,449.37 USD** (more specifically, MDL account: 3,430,776.76 MDL and USD account: 71,400 USD) and direct payments of **153,044.13 USD** (10,600.53 euros and 2,741,999.69 MDL)
- Within LECB project - advances in the amount of **190,418.97 USD** (MDL account: 3,676,009.95 MDL).

The detailed description of activities mentioned above, the implementation modalities and mechanisms are contained in the Project Documents, which will be provided to the auditors.

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

Physical address: 9 Cosmonautilor str., MD-2005, Chisinau

Web site: <http://mediu.gov.md/>

Leadership of the Ministry of Environment:

- Valeriu Munteanu, Minister of Environment, tel: (373 22) 204507, email: valeriu.munteanu@mediu.gov.md
- Victor Morgoci, Deputy Minister of Environment, tel: (37322) 204502, email: victor.morgoci@mediu.gov.md
- Andrian Delinschi, Deputy Minister of Environment, tel: (37322) 204504, email: andrian.delinschi@mediu.gov.md

Contact details of the Responsible Party – Climate Change Office

Physical address: 156A, Mitropolit Dosoftei Str., MD-2004, Chisinau

Tel/Fax numbers: (373 22) 232247

Web site: www.clima.md/

General email address: clima@mediu.gov.md

Leadership of the CCO:

- Vasile Scorpan, CCO Manager, tel: (373 22) 232247, email: v.scorpan@yahoo.com
- Ala Druta, NCCAP Project Manager, tel: (373 22) 310012 (ext.3), email: drutaala@yahoo.com
- Sergiu Ungureanu, LECB Project Manager, email: sergiuungureanu22@gmail.com

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

- Aliona Solomon, Administrative Assistant, tel: (373 22) 232247, email: alionasolomon77@yahoo.com

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 Country Office to hear their concerns/proposals/recommendations and 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 and Responsible Party for each project, to understand how cooperation within the projects is managed, and any issues of concern they may have;
- Further, upon completion of the draft audit report and management letter, the auditor should first hold a debriefing meeting with the Responsible Party, for each project, to discuss findings and recommendations for future improvements, as well as to seek their feedback thereon;
- The auditor will then meet with the UNDP country office and the Implementing Partner for each project to debrief them and discuss the draft audit 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 Party in connection with the implementation of the aforementioned outputs.

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, for the period 1 January - 31 December 2015;
- (ii) Statement of Cash position reported by the Responsible Party as of 31 December 2015 related to the implementation of project;
- (iii) Statement of assets and equipment reported by Responsible Party as of 31 December 2015 related to the implementation of the project, (with year-end inventory listing and a description of the inventory), which must be cumulative since project inception and thus include all assets available at 31 December 2015 and not only those purchased during 2015.

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 expenses appearing in the CDR and **must** be attached to the audit report. As described in more detail below, the CDR combines expenses from three disbursement sources for a calendar year. Refer to the section below on changes 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 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* 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. These 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.

- 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 (LOA). 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 Country Programme Action Plan (CPAP) with the respective clauses of the LOA for UNDP Support Services, the audit should also cover the UNDP expenses under CO support. The CO must include this information in the TOR/contract for the auditors.

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 the year-end expense 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. Project Documents
4. 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 project expense reflected in the CDR, 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.

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

Un-depreciated Fixed Assets – There could be cases where fixed assets that belong to or are used by the project are under UNDP's control (i.e. in situations where UNDP is providing support services to the

project and there is no signed Letter of Agreement, as an example). If there is an amount appearing on the CDR under this category, the auditors should investigate and determine that these assets are project related or not and, if project related, should perform the same audit procedures to validate the assets as those undertaken for the certification of the Statement of Assets and Equipment.

Inventory – Similar to the case of Un-depreciated Fixed Assets, there may be situations where certain items of inventory that were acquired for the project are temporarily under UNDP's control/custody. If there is an amount under this category, the auditors should determine the nature of the inventory and whether or not it is intended for the project. If it is determined that the inventory is project related, then the same audit procedures for the certification of the Statement of Assets and Equipment should be applied.

Prepayments – The auditors should validate any amount appearing under this category, i.e. determine what it represents and if it is in any way project related.

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 by the Responsible Party, as follows:

1. **Energy Efficiency Agency**, under the Moldova Energy and Biomass Project
2. **Climate Change Office**, within the Supporting Moldova's National Climate Change Adaptation Planning Process Project and Low Emission Capacity Building Project

The auditor will take into account at least the following:

- 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 2015.
- The scope of the audit is limited to the implementing partner expenses, 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.
- The auditor is required to verify the mathematical accuracy of the CDR by ensuring that the expenses 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 expenses, by disbursing source, in the CDR.
- The auditor is required to state in the audit report the amount of expenses excluded from the scope of the audit because they were made by UNDP as part of direct support services and the amount of total expenses excluded because they were made by a UN agency. This scope limitation is not a valid reason for the auditors to issue a qualified audit opinion on the CDR.
- 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 for the period 1 January to 31 December 2015 and will certify:
 1. The Statement of Expenses (**CDR**) for the period from 1 January to 31 December 2015;
 2. The Statement of Cash Position (cash and bank balances of the project) reported by the project as at 31 December 2015; and
 3. The Statement of Assets and Equipment held by the project as at 31 December 2015.
- The auditor is required to, as applicable, report in monetary value, the net financial impact of any

¹ International Standards on Auditing (ISA) published by the International Auditing and Assurance Standards Board of the International Federation of Accountants

² International Organization of Supreme Audit Institutions

modified audit opinion (modified opinions can be qualified, adverse, or disclaimer) on the Statement of Expenses (CDR) where applicable. This should also include prior year non resolved NFI.

- The auditor/audit firm is required to submit a draft audit report by 28/03/2016 and a final signed audit report with signed UNDP statements by 06/04/2016.

Note: Audit opinions must be one of the following: (a) unmodified, (b) qualified, (c) adverse, or (d) disclaimer. If the audit opinion is other than “unmodified”, 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 (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
- The audit standards that were applied (ISAs, or national standards that comply with one of the ISAs 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 of 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 CDR - for the period from 1 January to 31 December 2015 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.

(a) A Financial Audit to express an opinion on the project’s financial statements that includes:

- Expression of an opinion on whether the statement of expenses presents fairly the expense incurred by the project over a specified period in accordance with UNDP accounting policies and that the expenses incurred were: (i) in conformity with the approved project budgets; (ii) for the approved purposes of the project; (iii) in compliance with the relevant regulations and rules, policies and procedures of the Government or UNDP; and (iv) supported by properly approved vouchers and other supporting documents. The 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.
- Whether the result of the prior year’s audits resulting in modified audit opinions on the CDR had conclusive actions to properly address an audit qualification in the previous year audit and the related NFI. If there is a lack of conclusive actions, the auditors must take into account the possible effect of a prior year modified opinion that has not been properly corrected or resolved.

Note: 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.

- Expression of an opinion on the value and existence of the project's statement of assets and equipment as at a given date. This statement must include all assets and equipment available as at 31 December 2015, and not only those purchased in a given period. Where a 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 project as at a given date, i.e. 31 December 2015. The Audit Firm is required to express an opinion on the Statement of Cash Position where a dedicated bank account for the project has been established and/or the project holds petty cash. Where the project does not hold any cash, this should be disclosed in the audit report.

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

(b) An audit to assess and express an opinion on the project's internal controls and systems.

The deliverable will be an audit report similar to a long form management letter that covers the internal control weaknesses identified and the audit recommendations to address them.

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 audit of internal controls and systems will be conducted in accordance with the International Standards on Auditing (ISA).

The management letter should also include the following:

- 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 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 of 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 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 and further information is available on the INTOSAI site www.intosai.org (*Guidelines for Internal Control Standards*). The INTOSAI standards are intended for use by government managers as a framework to establish effective internal control structures.

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

- Review the expenses 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 and Accountability.
- 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 and Accountability; 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 authorized 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 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 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 on Auditing (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 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 expense 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 IT systems, and records maintenance.

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 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 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. CVs should include details on audits carried out by the applicable staff, including on-going assignments indicating capability and capacity to undertake the audit.

Minimum qualification requirements

Firm requirements

- Mandatory experience with International Organizations, similar Programmes / 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
- Listing in the Auditors' state register of the Ministry of Finance of the Republic of Moldova would be an asset

Audit Team composition:

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 and/or Romanian

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/or Russian

ANNEX 3: SAMPLE AUDIT REPORT

Independent Auditor's report to:

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

I. Sample Independent Auditor's Report on 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 Expenses ("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 and fair presentation 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 expenses 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 expenses, 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 expenses 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 Independent Auditor's Opinion on Statement of Assets and Equipment (Refer to ISA 700)

We have audited the accompanying statement of assets and equipment ("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 and equipment 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 and equipment, 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 and equipment 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 and equipment 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 and equipment 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 Independent Auditor's Report on 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 position ("the statement") of the project number [insert project and project number(s)], [insert official title of project] as at XXX.

Management of project <project name/title> 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 position, 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 position 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 position 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 position 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. _____

ANNEX 4: DEFINITION OF AUDIT OPINIONS

Unmodified (Clean) Opinion

An unmodified 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 audit opinion

A *qualified opinion* should be expressed when the auditor concludes that an unmodified 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 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 Opinion – a modified 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 position, 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.

Guidance on Reporting Prior Year Modified opinion not properly corrected or resolved

Following the International Standards on Auditing (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 of opinion or an adverse opinion.

ANNEX 6: Priority of Audit Observations and Recommendations

High	Prompt action is required to ensure that UNDP is not exposed to high risks, i.e. failure to take action could result in major negative consequences and issues.
Medium	Action is required to ensure that UNDP is not exposed to risks that are considered moderate. Failure to take action could contribute to negative consequences for UNDP.
Low	Action is desirable and should result in enhanced control or better value for money.

ANNEX 7 TEMPLATE FOR 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)				UNDP Country Office				Government Auditors/Audit Firm			
Signature of IP Official: _____				Signature of UNDP Official: _____				Signature of Audit firm Official: _____			
Name and title (print): _____				Name and title (print): _____				Name and title (print): _____			
Date: _____				Date: _____				Date: _____			
								Stamp and Seal of audit firm: _____			

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 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 auditors to report on the audit of the UNDP CDR

UNDP Combined Delivery Report (CDR) as at 31 December 2015							
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 of 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 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 2015 (US\$)	Audit Opinion - Statement of Cash Position	Total amount of qualification - Statement of Cash Position (US\$)

Table 3 – Template for 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 2015 (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 auditors to report on current year audit observations and recommendations

Project No.	Output 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 OBSERVATIONS AND RECOMMENDATIONS

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
- 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	Prompt action is required to ensure that UNDP is not exposed to high risks, i.e. failure to take action could result in major negative consequences and issues.
Medium	Action is required to ensure that UNDP is not exposed to risks that are considered moderate. Failure to take action could contribute to negative consequences for UNDP.
Low	Action is 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: GUIDANCE ON AUDIT MATERIALITY (ISA 320, 450)

ISA 320

ISA 320 deals with the auditor's responsibility to apply the concept of materiality in planning and performing an audit of financial statements.

Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that:

- Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements;
- Judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and
- Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

For purposes of the ISAs, performance materiality means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures.

When establishing the overall audit strategy, the auditor shall determine materiality for the financial statements as a whole. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

The auditor shall determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures.

The auditor shall revise materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.

If the auditor concludes that a lower materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) than that initially determined is appropriate, the auditor shall determine whether it is necessary to revise performance materiality, and whether the nature, timing and extent of the further audit procedures remain appropriate.

ISA 450

ISA 450 deals with the auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements.

Each individual misstatement is considered to evaluate its effect on the relevant classes of transactions, account balances or disclosures, including whether the materiality level for that particular class of transactions, account balance or disclosure, if any, has been exceeded.

The circumstances related to some misstatements may cause the auditor to evaluate them as material, individually or when considered together with other misstatements accumulated during the audit, even if they are lower than materiality for the financial statements as a whole. Circumstances that may affect the

evaluation include the extent to which the misstatement:

- Affects compliance with regulatory requirements;
- Relates to the incorrect selection or application of an accounting policy that has an immaterial effect on the current period's financial statements but is likely to have a material effect on future periods' financial statements;
- Is an omission of information not specifically required by the applicable financial reporting framework but which, in the judgment of the auditor, is important to the users' understanding of the financial position, financial performance of the entity.

The cumulative effect of immaterial uncorrected misstatements related to prior periods may have a material effect on the current period's financial statements. There are different acceptable approaches to the auditor's evaluation of such uncorrected misstatements on the current period's financial statements. Using the same evaluation approach provides consistency from period to period.